

## Introduction to Volume 1

Work on financial instruments was started in 1988 by the International Accounting Standards Board's (IASB) predecessor body, the International Accounting Standards Committee (IASC), and the subject has remained on the active international standard-setting agenda ever since.

The IASC issued International Accounting Standard (IAS) 32 *Financial Instruments: Disclosure and Presentation* in 1995 and IAS 39 *Financial Instruments: Recognition and Measurement* in 1999.

The IASB succeeded the IASC in 2001. The IASB made several amendments to IAS 32 and IAS 39 and in August 2005 it issued International Financial Reporting Standard (IFRS) 7 *Financial Instruments: Disclosures*.

In 2005 the IASB began working towards a long-term objective of improving and simplifying the reporting for financial instruments. That work accelerated in 2009 in response to the global financial crisis. On 24 July 2014 the work reached its culmination when the IASB issued the completed version of IFRS 9 *Financial Instruments*, replacing IAS 39.<sup>1</sup>

IFRS 9 will come into effect for annual periods beginning on or after 1 January 2018 with earlier application permitted. Consequently, until IFRS 9 becomes mandatory, different entities applying IFRS will use different IFRS requirements for financial instruments. In the meantime, entities applying IAS 39 (or early applying only part of IFRS 9) must, in accordance with paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, disclose the fact that the entity is yet to apply IFRS 9. They must also disclose known or reasonably estimable information relevant to assessing the possible impact that application of IFRS 9 will have on the entity's financial statements in the period of initial application. Consequently, such entities must also be familiar with the requirements set out in Volume 2 of this text.

IFRS 9 includes:

- (a) a model for classifying financial assets that is driven by an asset's contractual cash flow characteristics and the business model in which it is held;
- (b) a model for classifying financial liabilities including presentation in other comprehensive income, instead of in profit or loss, of gains (and losses) that are due to the deterioration (or improvement) in an entity's own credit risk on financial liabilities that an entity has elected to measure at fair value;<sup>2</sup>
- (c) a single, forward-looking 'expected loss' impairment model for financial assets not measured at fair value through profit or loss that requires entities to account for expected credit losses from when the financial assets are first recognised, and to recognise full lifetime expected losses when credit risk has increased significantly since initial recognition;<sup>3</sup> and

1 IAS 39 remains in place for fair value hedges of interest rate exposures on portfolios of financial assets or financial liabilities.

2 IFRS 9 permits early application of this aspect of the Standard (ie presentation of the effects of changes in own credit risk in other comprehensive income instead of in profit or loss for financial liabilities that an entity has elected to measure at fair value through profit or loss), before other changes in the accounting for financial instruments.

3 The new impairment model applies equally to off-balance-sheet exposures such as loan commitments and financial guarantee contracts.

- (d) a hedge accounting model that more closely aligns the accounting treatment with the entity's risk management activities and (in IFRS 7) provides enhanced disclosures about risk management activity.

Furthermore, because IFRS 9 was issued in stages, some entities might have elected to early apply only some parts of IFRS 9 by applying earlier versions. Moreover, an entity that chooses not to otherwise apply IFRS 9 early can nevertheless early apply, from IFRS 9, the presentation in other comprehensive income of gains (and losses) that are due to the deterioration (improvement) in an entity's own credit risk on financial liabilities that an entity chooses to measure at fair value.

To understand more fully the multiple permutations of IFRS requirements for financial instruments that exist at 1 January 2015, it is necessary to understand the stages in which IFRS 9 was developed and issued. The individual official pronouncements that culminated in the completed version of IFRS 9 that was issued on 24 July 2014 are set out in the following table:

Date issued	Description	URL for requirements (an eIFRS subscription is required to access the document)	URL for accompanying material (an eIFRS subscription is required to access the document)
November 2009	Classification and measurement of financial assets	<a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9st2009_129.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9st2009_129.pdf</a>	Amendments to other IFRSs and Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9guidance2009_175.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9guidance2009_175.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9bc_128.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9bc_128.pdf</a>
October 2010	Added classification and measurement of financial liabilities	<a href="http://eifrs.ifrs.org/eifrs/files/234/ifrs%209oct2010_134.pdf">http://eifrs.ifrs.org/eifrs/files/234/ifrs%209oct2010_134.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/234/IFRS%209%20IG_WEBSITE_128.pdf">http://eifrs.ifrs.org/eifrs/files/234/IFRS%209%20IG_WEBSITE_128.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/234/ifrs9bcocct2010_143.pdf">http://eifrs.ifrs.org/eifrs/files/234/ifrs9bcocct2010_143.pdf</a>
December 2011	Amendments to the mandatory effective date and transition disclosures	<a href="http://eifrs.ifrs.org/eifrs/files/235/amendifrs9andifrs72011_117.pdf">http://eifrs.ifrs.org/eifrs/files/235/amendifrs9andifrs72011_117.pdf</a>	

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Date issued	Description	URL for requirements (an eIFRS subscription is required to access the document)	URL for accompanying material (an eIFRS subscription is required to access the document)
November 2013	Added general hedge accounting	<a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_Standard_WEBSITE_107_187.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_Standard_WEBSITE_107_187.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_IG_WEBSITE_158_196.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_IG_WEBSITE_158_196.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_Basis_WEBSITE_111_182.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FI_Hedge%20Acting_Basis_WEBSITE_111_182.pdf</a> Project summary: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS%209_FI_Hedge%20Acting_Amdments_FBS_NOV%202013_WEBSITE_135_195.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS%209_FI_Hedge%20Acting_Amdments_FBS_NOV%202013_WEBSITE_135_195.pdf</a>
July 2014	Completed version of IFRS 9 adding impairment methodology and limited amendments to pre-existing IFRS 9 requirements	<a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Standard_WEBSITE_121.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Standard_WEBSITE_121.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_IG_WEBSITE_191.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_IG_WEBSITE_191.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Basis%20for%20Conclusions_WEBSITE_144.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Basis%20for%20Conclusions_WEBSITE_144.pdf</a> Project summary: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS%209_July%202014_Summary_July%202014_WEBSITE_176.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS%209_July%202014_Summary_July%202014_WEBSITE_176.pdf</a>

It should be noted that:

- (a) the requirements in IFRS 9 for 'own credit risk' can be applied in isolation (ie they can be early applied without applying any other part of IFRS 9). In other words, an entity that does not otherwise early apply IFRS 9 (ie it applies the requirements in Volume 1 of this text) can nevertheless elect to apply the own credit risk requirements from Volume 2 of this text to financial liabilities that it has designated as at fair value through profit or loss.
- (b) an entity that applies IFRS 9 (ie it applies the requirements in Volume 2 of this text) can nevertheless elect (an accounting policy choice) to continue applying the hedge accounting requirements in IAS 39 (as set out in Volume 1 of this text) for all hedge accounting relationships. This election applies even after the mandatory effective date of IFRS 9.
- (c) an entity that applied the 2009 or 2010 or 2013 version of IFRS 9 could (until it becomes mandatory to apply the completed version of IFRS 9 issued in July 2014) continue to apply that version of IFRS 9 as amended by other subsequent Standards that have become mandatory or that the entity has voluntarily early applied.

The only permutations presented in this edition are:

- (a) Volume 1: the consolidated text of Standards on financial instruments as required for the financial year beginning on 1 January 2015, assuming no early application (that is, applying IAS 39 and not early applying any part of IFRS 9); and
- (b) Volume 2: the consolidated text of Standards on financial instruments as issued at 1 January 2015, assuming early application (that is, with IFRS 9 as issued in July 2014 applied early).

However:

- (a) the Appendix to Volume 1 provides extracts from IFRS 7 and IFRS 9 that are relevant to those entities that elect to early apply *only* the own credit risk presentation requirements in IFRS 9; and
- (b) the version of IAS 39 included in Volume 2 is relevant only to the extent that entities choose to apply the IAS 39 requirements for fair value hedges of interest rate risk exposure on portfolios of financial assets or financial liabilities.

Consequently, the Standards included in this text are:

<b>Volume 1—no early application:</b> Official pronouncements applicable on 1 January 2015 with extensive cross-references and other annotations. Does not include IFRS requirements with an effective date after 1 January 2015.	<b>Volume 2—full early application:</b> Official pronouncements issued at 1 January 2015 with extensive cross-references and other annotations. Includes IFRS requirements with an effective date after 1 January 2015 but not the IFRS requirements they will replace.
<b>Classification, recognition and measurement</b>	
IAS 32 <i>Financial Instruments: Presentation</i>	IAS 32 <i>Financial Instruments: Presentation</i>
IFRIC 2 <i>Members' Shares in Co-operative Entities and Similar Instruments</i>	IFRIC 2 <i>Members' Shares in Co-operative Entities and Similar Instruments</i>
	IFRS 9 <i>Financial Instruments</i>
IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	IAS 39 <i>Financial Instruments: Recognition and Measurement</i> <sup>(a)</sup>
IFRIC 9 <i>Reassessment of Embedded Derivatives</i>	
IFRIC 10 <i>Interim Financial Reporting and Impairment</i>	
IFRIC 16 <i>Hedges of a Net Investment in a Foreign Operation</i>	IFRIC 16 <i>Hedges of a Net Investment in a Foreign Operation</i>
IFRIC 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i>	IFRIC 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i>

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<b>Disclosure</b>	
IFRS 7 <i>Financial Instruments: Disclosures</i>	IFRS 7 <i>Financial Instruments: Disclosures</i>
<b>Appendix—selected extracts regarding changes in the fair value of a financial liability attributable to changes in its credit risk</b>	
Paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.1.1–7.1.2, 7.2.14 and B5.7.5–B5.7.20 of IFRS 9 <i>Financial Instruments</i>	
Paragraphs 10–11 of IFRS 7 <i>Financial Instruments: Disclosures</i> (as amended by IFRS 9 (2010))	
<b>Glossary—selected extracts</b>	<b>Glossary—selected extracts</b>
(a) Applicable for fair value hedge accounting for interest rate risk exposure on portfolios of financial assets or financial liabilities.	

### IFRS

The IASB's Standards, known collectively as IFRS, are mandatory pronouncements and comprise:

- International Financial Reporting Standards;
- International Accounting Standards; and
- Interpretations developed by the IFRS Interpretations Committee (formerly known as the IFRIC) or its predecessor body, the Standing Interpretations Committee.

Standards are issued after extensive due process, and financial statements must not be described as complying with IFRS unless they comply with all the requirements of IFRS. A Standard often contains an appendix that sets out more detailed mandatory application guidance.

### Non-mandatory accompanying material

A distinction needs to be drawn between the Standard (mandatory) and the other (non-mandatory) material that is issued with it. The mandatory requirements of a Standard are also usually accompanied by other non-mandatory material, as follows:

- an Introduction that briefly describes the purposes and main features of the Standard;
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching the conclusions in the Standard;
- dissenting opinions (if any) by individual IASB members who did not agree with the issue of the Standard;
- Implementation Guidance; and

## Introduction

## (e) Illustrative Examples.

The rubric presented on the page following the contents page of each Standard sets out the authority of the information contained in, or accompanying, that Standard.

**Education overlay**

To help constituents to navigate a Standard and the accompanying material issued with it, in this text the IFRS Foundation education staff have inserted extensive cross-references between the documents. In addition, footnotes describe issues on which the IFRS Interpretations Committee decided not to develop an Interpretation.

In this publication the cross-references and the text of footnotes inserted by the IFRS Foundation education staff are presented **[like this]**. They do not form part of the Standard and have not been approved by the IASB.

Furthermore, the IFRS Interpretations Committee agenda decisions presented in the inserted footnotes with the prefix 'E' are published for information only and do not change existing IFRS requirements.

**More information**

The IASB website, [www.ifrs.org](http://www.ifrs.org), provides news, updates and other resources related to the IASB and the IFRS Foundation. The latest publications and subscription services can be ordered from the online IFRS Foundation's shop: <http://go.ifrs.org/shop>.

For more information about the IASB, or to obtain copies of its publications and details of the IFRS Foundation's subscription services, visit the website or write to:

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30 Cannon Street, London, EC4M 6XH, United Kingdom

Telephone: +44 (0)20 7332 2730

Fax: +44 (0)20 7332 2749

Email: [publications@ifrs.org](mailto:publications@ifrs.org)

Web: [www.ifrs.org](http://www.ifrs.org)

## International Accounting Standard 32

## Financial Instruments: Presentation

In April 2001 the International Accounting Standards Board (IASB) adopted IAS 32 *Financial Instruments: Disclosure and Presentation*, which had been issued by the International Accounting Standards Committee in 2000. IAS 32 *Financial Instruments: Disclosure and Presentation* had originally been issued in June 1995 and had been subsequently amended in 1998 and 2000.

The IASB issued a revised IAS 32 in December 2003 as part of its initial agenda of technical projects. This revised IAS 32 also incorporated the guidance contained in related Interpretations (SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions*, SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)* and SIC-17 *Equity—Costs of an Equity Transaction*). It also incorporated guidance previously proposed in draft SIC Interpretation D34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*.

In December 2005 the IASB amended IAS 32 by relocating all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*. Consequently, the title of IAS 32 changed to *Financial Instruments: Presentation*.

In February 2008 IAS 32 was changed to require some puttable financial instruments and obligations arising on liquidation to be classified as equity. In October 2009 the IASB amended IAS 32 to require some rights that are denominated in a foreign currency to be classified as equity. The application guidance in IAS 32 was amended in December 2011 to address some inconsistencies relating to the offsetting financial assets and financial liabilities criteria.

Other Standards have made minor consequential amendments to IAS 32. They include *Improvements to IFRSs* (issued May 2010), IFRS 10 *Consolidated Financial Statements* (issued May 2011), IFRS 11 *Joint Arrangements* (issued May 2011), IFRS 13 *Fair Value Measurement* (issued May 2011), *Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)* (issued June 2011), *Disclosures—Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)* (issued December 2011), *Annual Improvements to IFRSs 2009–2011 Cycle* (issued May 2012) and *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* (issued October 2012).

## Introduction to Volume 2

Work on financial instruments was started in 1988 by the International Accounting Standards Board's (IASB) predecessor body, the International Accounting Standards Committee (IASC), and the subject has remained on the active international standard-setting agenda ever since.

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- (a) a model for classifying financial assets that is driven by an asset's contractual cash flow characteristics and the business model in which it is held;
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- (c) a single, forward-looking 'expected loss' impairment model for financial assets not measured at fair value through profit or loss that requires entities to account for expected credit losses from when the financial assets are first recognised, and to recognise full lifetime expected losses when credit risk has increased significantly since initial recognition;<sup>3</sup> and
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2 IFRS 9 permits early application of this aspect of the Standard (ie presentation of the effects of changes in own credit risk in other comprehensive income instead of in profit or loss for financial liabilities that an entity has elected to measure at fair value through profit or loss), before other changes in the accounting for financial instruments.

3 The new impairment model applies equally to off-balance-sheet exposures such as loan commitments and financial guarantee contracts.

presentation in other comprehensive income of gains (and losses) that are due to the deterioration (or improvement) in an entity's own credit risk on financial liabilities that an entity chooses to measure at fair value.

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November 2009	Classification and measurement of financial assets	<a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9st2009_129.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9st2009_129.pdf</a>	Amendments to other IFRSs and Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9guidance2009_175.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9guidance2009_175.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/233/ifrs9bc_128.pdf">http://eifrs.ifrs.org/eifrs/files/233/ifrs9bc_128.pdf</a>
October 2010	Added classification and measurement of financial liabilities	<a href="http://eifrs.ifrs.org/eifrs/files/234/ifrs%2010oct2010_134.pdf">http://eifrs.ifrs.org/eifrs/files/234/ifrs%2010oct2010_134.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/234/IFRS%209%20IG_WEBSITE_128.pdf">http://eifrs.ifrs.org/eifrs/files/234/IFRS%209%20IG_WEBSITE_128.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/234/ifrs9_bc0ct2010_143.pdf">http://eifrs.ifrs.org/eifrs/files/234/ifrs9_bc0ct2010_143.pdf</a>
December 2011	Amendments to the mandatory effective date and transition disclosures	<a href="http://eifrs.ifrs.org/eifrs/files/235/amendifrs9andifrs72011_117.pdf">http://eifrs.ifrs.org/eifrs/files/235/amendifrs9andifrs72011_117.pdf</a>	
November 2013	Added general hedge accounting	<a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_Standard_WEBSITE_107_187.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_Standard_WEBSITE_107_187.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_IG_WEBSITE_158_196.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_IG_WEBSITE_158_196.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_Basis_WEBSITE_111_182.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS9_FL_Hedge%20Accting_Basis_WEBSITE_111_182.pdf</a> Project summary: <a href="http://eifrs.ifrs.org/eifrs/files/403/IFRS%209_FL_Hedge%20Accting_Amdmnts_FBS_NOV%202013_WEBSITE_135_195.pdf">http://eifrs.ifrs.org/eifrs/files/403/IFRS%209_FL_Hedge%20Accting_Amdmnts_FBS_NOV%202013_WEBSITE_135_195.pdf</a>

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July 2014	Completed version of IFRS 9 adding impairment methodology and limited amendments to pre-existing IFRS 9 requirements	<a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Standard_WEBSITE_121.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Standard_WEBSITE_121.pdf</a>	Implementation Guidance: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_IG_WEBSITE_191.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_IG_WEBSITE_191.pdf</a> Basis for Conclusions: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Basis%20for%20Conclusions_WEBSITE_144.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS9_July%202014_Basis%20for%20Conclusions_WEBSITE_144.pdf</a> Project summary: <a href="http://eifrs.ifrs.org/eifrs/files/71/IFRS%209_July%202014_Summary_WEBSITE_176.pdf">http://eifrs.ifrs.org/eifrs/files/71/IFRS%209_July%202014_Summary_WEBSITE_176.pdf</a>

It should be noted that:

- the requirements in IFRS 9 for 'own credit risk' can be applied in isolation (ie they can be early applied without applying any other part of IFRS 9). In other words, an entity that does not otherwise early apply IFRS 9 (ie it applies the requirements in Volume 1 of this text) can nevertheless elect to apply the own credit risk requirements from Volume 2 of this text to financial liabilities that it has designated as at fair value through profit or loss.
- an entity that applies IFRS 9 (ie it applies the requirements in Volume 2 of this text) can nevertheless elect (an accounting policy choice) to continue applying the hedge accounting requirements in IAS 39 (as set out in Volume 1 of this text) for all hedge accounting relationships. This election applies even after the mandatory effective date of IFRS 9.
- an entity that applied the 2009 or 2010 or 2013 version of IFRS 9 but did not thereafter early apply subsequent instalments of IFRS 9 could (until it becomes mandatory to apply the completed version of IFRS 9 issued in July 2014) continue to apply that version of IFRS 9 as amended by other subsequent Standards that have become mandatory or that the entity has voluntarily early applied.

The only permutations presented in this edition are:

- Volume 1: the consolidated text of the Standards on financial instruments as required for the financial year beginning on 1 January 2015, assuming no early application (that is, applying IAS 39 and not early applying any part of IFRS 9); and
- Volume 2: the consolidated text of the Standards on financial instruments as issued at 1 January 2015, assuming early application (that is, with IFRS 9 as issued in July 2014 applied early).

However:

- the Appendix to Volume 1 provides extracts from IFRS 7 and IFRS 9 that are relevant to those entities that elect to early apply *only* the own credit risk presentation requirements in IFRS 9; and

- (b) the version of IAS 39 included in Volume 2 is relevant only to the extent that entities choose to apply the IAS 39 requirements for fair value hedges of interest rate risk exposure on portfolios of financial assets or financial liabilities.

Consequently, the Standards included in this text are:

<b>Volume 1—no early application:</b> Official pronouncements applicable on 1 January 2015 with extensive cross-references and other annotations. Does not include IFRS requirements with an effective date after 1 January 2015.	<b>Volume 2—full early application:</b> Official pronouncements issued at 1 January 2015 with extensive cross-references and other annotations. Includes IFRS requirements with an effective date after 1 January 2015 but not the IFRS requirements they will replace.
<b>Classification, recognition and measurement</b>	
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IFRIC 16 <i>Hedges of a Net Investment in a Foreign Operation</i>	IFRIC 16 <i>Hedges of a Net Investment in a Foreign Operation</i>
IFRIC 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i>	IFRIC 19 <i>Extinguishing Financial Liabilities with Equity Instruments</i>
<b>Disclosure</b>	
IFRS 7 <i>Financial Instruments: Disclosures</i>	IFRS 7 <i>Financial Instruments: Disclosures</i>

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<b>Appendix—selected extracts regarding changes in the fair value of a financial liability attributable to changes in its credit risk</b>	
Paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.1.1–7.1.2, 7.2.14 and B5.7.5–B5.7.20 of IFRS 9 <i>Financial Instruments</i>	
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<b>Glossary—selected extracts</b>	<b>Glossary—selected extracts</b>
(a) Applicable for fair value hedge accounting for interest rate risk exposure on portfolios of financial assets or financial liabilities.	

## IFRS

The IASB's Standards, known collectively as IFRS, are mandatory pronouncements and comprise:

- International Financial Reporting Standards;
- International Accounting Standards; and
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Standards are issued after extensive due process, and financial statements must not be described as complying with IFRS unless they comply with all the requirements of IFRS. A Standard often contains an appendix that sets out more detailed mandatory application guidance.

### Non-mandatory accompanying material

A distinction needs to be drawn between the Standard (mandatory) and the other (non-mandatory) material that is issued with it. The mandatory requirements of a Standard are also usually accompanied by other non-mandatory material, as follows:

- an Introduction that briefly describes the purposes and main features of the Standard;
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching the conclusions in the Standard;
- dissenting opinions (if any) by individual IASB members who did not agree with the issue of the Standard;
- Implementation Guidance; and
- Illustrative Examples.

The rubric presented on the page following the contents page of each Standard sets out the authority of the information contained in, or accompanying, that Standard.

### Education overlay

To help constituents to navigate a Standard and the accompanying material issued with it, in this text the IFRS Foundation education staff have inserted extensive cross-references between the documents. In addition, footnotes describe issues on which the IFRS Interpretations Committee decided not to develop an Interpretation.

In this publication the cross-references and the text of footnotes inserted by the IFRS Foundation education staff are presented [like this]. They do not form part of the Standard and have not been approved by the IASB.

Furthermore, the IFRS Interpretations Committee agenda decisions presented in the inserted footnotes with the prefix 'E' are published for information only and do not change existing IFRS requirements.

### More information

The IASB website, [www.ifrs.org](http://www.ifrs.org), provides news, updates and other resources related to the IASB and the IFRS Foundation. The latest publications and subscription services can be ordered from the online IFRS Foundation's shop: <http://go.ifrs.org/shop>.

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## International Accounting Standard 32

# Financial Instruments: Presentation

In April 2001 the International Accounting Standards Board (IASB) adopted IAS 32 *Financial Instruments: Disclosure and Presentation*, which had been issued by the International Accounting Standards Committee in 2000. IAS 32 *Financial Instruments: Disclosure and Presentation* had originally been issued in June 1995 and had been subsequently amended in 1998 and 2000.

The IASB issued a revised IAS 32 in December 2003 as part of its initial agenda of technical projects. This revised IAS 32 also incorporated the guidance contained in related Interpretations (SIC-5 *Classification of Financial Instruments-Contingent Settlement Provisions*, SIC-16 *Share Capital-Reacquired Own Equity Instruments (Treasury Shares)* and SIC-17 *Equity-Costs of an Equity Transaction*). It also incorporated guidance previously proposed in draft SIC Interpretation D34 *Financial Instruments-Instruments or Rights Redeemable by the Holder*.

In December 2005 the IASB amended IAS 32 by relocating all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*. Consequently, the title of IAS 32 changed to *Financial Instruments: Presentation*.

In February 2008 IAS 32 was changed to require some puttable financial instruments and obligations arising on liquidation to be classified as equity. In October 2009 the IASB amended IAS 32 to require some rights that are denominated in a foreign currency to be classified as equity. The application guidance in IAS 32 was amended in December 2011 to address some inconsistencies relating to the offsetting financial assets and financial liabilities criteria.

Other Standards have made minor consequential amendments to IAS 32. They include *Improvements to IFRSs* (issued May 2010), IFRS 10 *Consolidated Financial Statements* (issued May 2011), IFRS 11 *Joint Arrangements* (issued May 2011), IFRS 13 *Fair Value Measurement* (issued May 2011), *Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)* (issued June 2011), *Disclosures-Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)* (issued December 2011), *Annual Improvements to IFRSs 2009-2011 Cycle* (issued May 2012), *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* (issued October 2012), IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)* (issued November 2013), IFRS 15 *Revenue from Contracts with Customers* (issued May 2014) and IFRS 9 *Financial Instruments* (issued July 2014).

set-off that becomes enforceable and affects the realisation 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 business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 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 IFRS 7.

[Refer: paragraph AG38B]

[Deleted]

51-95

### Effective date and transition

- 96 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.
- 96A *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 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 the 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.  
[Refer: Basis for Conclusions paragraph BC74]
- 96B *Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy.
- 96C 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.
- 97 This Standard shall be applied retrospectively.
- 97A 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.
- 97B IFRS 3 *Business Combinations* (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. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of IFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A-65E of IFRS 3 (as amended in 2010).

- 97C 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.

[Refer: Basis for Conclusions paragraph BC74]

- 97D Paragraph 4 was amended by *Improvements to IFRSs* issued in May 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of IFRS 7, paragraph 1 of IAS 28 and paragraph 1 of IAS 31 issued in May 2008. An entity is permitted to apply the amendment prospectively.
- 97E Paragraphs 11 and 16 were amended by *Classification of Rights Issues* issued in October 2009. An entity shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.
- 97F [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]
- 97G Paragraph 97B was amended by *Improvements to IFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.  
[Refer: IFRS 3 Basis for Conclusions paragraphs BC434A-BC434C]
- 97H [This paragraph refers to amendments that are not yet effective, and is therefore not included in this edition.]
- 97I IFRS 10 and IFRS 11 *Joint Arrangements*, issued in May 2011, amended paragraphs 4(a) and AG29. An entity shall apply those amendments when it applies IFRS 10 and IFRS 11.
- 97J IFRS 13, issued in May 2011, amended the definition of fair value in paragraph 11 and amended paragraphs 23 and AG31. An entity shall apply those amendments when it applies IFRS 13.

97K *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1), issued in June 2011, amended paragraph 40. An entity shall apply that amendment when it applies IAS 1 as amended in June 2011.

[Refer: IAS 1 Basis for Conclusions paragraphs BC105A and BC105B]

97L *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32), issued in December 2011, deleted paragraph AG38 and added paragraphs AG38A–AG38F. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. An entity shall apply those amendments retrospectively. Earlier application is permitted. If an entity applies those amendments from an earlier date, it shall disclose that fact and shall also make the disclosures required by *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) issued in December 2011.

[Refer: Basis for Conclusions paragraphs BC117–BC120]

97M *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), issued in December 2011, amended paragraph 43 by requiring an entity to disclose the information required in paragraphs 13B–13E of IFRS 7 for recognised financial assets that are within the scope of paragraph 13A of IFRS 7. An entity shall apply that amendment for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. An entity shall provide the disclosures required by this amendment retrospectively.

97N *Annual Improvements 2009–2011 Cycle*, issued in May 2012, amended paragraphs 35, 37 and 39 and added paragraph 35A. An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

97O *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, amended paragraph 4. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies that amendment earlier it shall also apply all amendments included in *Investment Entities* at the same time.

97P–97R [These paragraphs refer to amendments that are not yet effective, and are therefore not included in this edition.]

### Withdrawal of other pronouncements

- 98 This Standard supersedes IAS 32 *Financial Instruments: Disclosure and Presentation* revised in 2000.<sup>4</sup>
- 99 This Standard supersedes the following Interpretations:
- SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions*;
  - SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*; and
  - SIC-17 *Equity—Costs of an Equity Transaction*.

<sup>4</sup> In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

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

## Appendix Application Guidance IAS 32 *Financial Instruments: Presentation*

This appendix is an integral part of the Standard.

- AG1 This Application Guidance explains the application of particular aspects of the Standard.
- 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 IAS 39.

### Definitions (paragraphs 11–14)

[Refer also: Basis for Conclusions paragraph BC4]

#### Financial assets and financial liabilities

- AG3 Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised 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 cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.  
[Refer: paragraph 11 (definition of a financial asset parts (a) and (c))]
- AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:
- trade accounts receivable and payable;
  - notes receivable and payable;
  - loans receivable and payable; and
  - 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).  
[Refer: paragraph 11 (definition of a financial asset part (c)(i) and definition of a financial liability part (a)(i))]
- AG5 Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in 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.  
[Refer: paragraph 11 (definition of a financial asset part (c)(i) and definition of a financial liability part (a)(i))]

AG6 'Perpetual' debt instruments (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.<sup>5</sup> 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.

[Refer: paragraph 11 (definition of a financial asset part (c)(i) and definition of a financial liability part (a)(i))]

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

[Refer: paragraph 11 (definition of a financial asset part (c) and definition of a financial liability part (a))]

AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of IFRS 4.

[Refer: paragraphs 11 (definition of a financial asset part (c) and definition of a financial liability part (a)), 25 and AG28]

AG9 Under 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

<sup>5</sup> In this guidance, monetary amounts are denominated in 'currency units (CU)'.

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).

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

**[Refer: paragraph 11 (definition of a financial asset)]**

**AG11** Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

**[Refer: paragraph 11 (definition of a financial asset)]**

**AG12** 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.

**[Refer: paragraphs 11 and 13]**

### Equity instruments

**AG13** Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), 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 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), 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 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(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.

**[Refer also:**

**paragraphs 11 (definition of a financial instrument), 16 and 22**

**Illustrative Examples paragraph IE30]**

**AG14** 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 22A). Instead, any consideration paid for such a contract is deducted from equity.

**[Refer:**

**paragraph 16**

**Illustrative Examples paragraph IE15]**

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

**AG14A** One of the features of paragraphs 16A and 16C is that the financial instrument is in the class of instruments that is subordinate to all other classes.

**AG14B** 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.

**AG14C** 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.

**AG14D** If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

### Total expected cash flows attributable to the instrument over the life of the instrument (paragraph 16A(e))

**AG14E** The total expected cash flows of the instrument over the life of the instrument must be substantially based on the 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. Profit or loss and the change in the recognised net assets shall be measured in accordance with relevant IFRSs.

**Transactions entered into by an instrument holder other than as owner of the entity (paragraphs 16A and 16C)**

AG14F 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 may also 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 equity under paragraph 16A or paragraph 16C.

AG14G 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.

AG14H Another example is a profit or loss sharing arrangement that allocates 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 16A or paragraph 16C. However, profit or loss sharing arrangements that allocate 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 16A or paragraph 16C.

AG14I 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 16B and 16D)**

AG14J A condition for classifying as equity a financial instrument that otherwise meets the criteria in paragraph 16A or paragraph 16C is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the 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 16A or paragraph 16C from being classified as equity:

- (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.

**Derivative financial instruments**

AG15 Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.

[Refer:

paragraph 11

IAS 39 paragraph 9 (definition of a derivative)]

AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally<sup>6</sup> 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 favourable or unfavourable.

[Refer:

paragraph 11

IAS 39 paragraph 9 (definition of a derivative)]

AG17 A put or call option to exchange financial assets or financial liabilities (ie 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

<sup>6</sup> This is true of most, but not all derivatives, eg in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

Whether to permit hedge accounting using cash instruments	BC144
Whether to treat hedges of forecast transactions as fair value hedges	BC146
Hedges of firm commitments (paragraphs 93 and 94)	BC149
Basis adjustments (paragraphs 97–99)	BC155
Hedging using internal contracts	BC165
Eligible hedged items in particular situations (paragraphs AG99BA, AG99E, AG99F, AG110A and AG110B)	BC172B
Fair value hedge accounting for a portfolio hedge of interest rate risk	BC173
Novation of derivatives and continuation of hedge accounting	BC220A
<b>ELIMINATION OF SELECTED DIFFERENCES FROM US GAAP</b>	<b>BC221</b>
<b>SUMMARY OF CHANGES FROM THE EXPOSURE DRAFT</b>	<b>BC222</b>
<b>DISSENTING OPINIONS</b>	

## Basis for Conclusions on IAS 39 Financial Instruments: Recognition and Measurement

This Basis for Conclusions accompanies, but is not part of, IAS 39.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements (as revised in 2007).

References to the Framework are to IASC's Framework for the Preparation and Presentation of Financial Statements, adopted by the IASB in 2001. In September 2010 the IASB replaced the Framework with the Conceptual Framework for Financial Reporting.

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions on revising IAS 39 *Financial Instruments: Recognition and Measurement* in 2003. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of Proposed Amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. In August 2003 the Board published a further Exposure Draft of Proposed Amendments to IAS 39 on *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk*, with a comment deadline of 14 November 2003.

BC3 Because the Board's intention was not to reconsider the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39, this Basis for Conclusions does not discuss requirements in IAS 39 that the Board has not reconsidered.

### Background

BC4 The original version of IAS 39 became effective for financial statements covering financial years beginning on or after 1 January 2001. It reflected a mixed measurement model in which some financial assets and financial liabilities are measured at fair value and others at cost or amortised cost, depending in part on an entity's intention in holding an instrument.

BC5 The Board recognises that accounting for financial instruments is a difficult and controversial subject. The Board's predecessor body, the International Accounting Standards Committee (IASC) began its work on the issue some 15 years ago, in 1988. During the next eight years it published two Exposure Drafts, culminating in the issue of IAS 32 on disclosure and presentation in

1995. IASC decided that its initial proposals on recognition and measurement should not be progressed to a Standard, in view of:

- the critical response they had attracted;
- evolving practices in financial instruments; and
- the developing thinking by national standard-setters.

BC6 Accordingly, in 1997 IASC published, jointly with the Canadian Accounting Standards Board, a discussion paper that proposed a different approach, namely that all financial assets and financial liabilities should be measured at fair value. The responses to that paper indicated both widespread unease with some of its proposals and that more work needed to be done before a standard requiring a full fair value approach could be contemplated.

BC7 In the meantime, IASC concluded that a standard on the recognition and measurement of financial instruments was needed urgently. It noted that although financial instruments were widely held and used throughout the world, few countries apart from the United States had any recognition and measurement standards for them. In addition, IASC had agreed with the International Organization of Securities Commissions (IOSCO) that it would develop a set of 'core' International Accounting Standards that could be endorsed by IOSCO for the purpose of cross-border capital raising and listing in all global markets. Those core standards included one on the recognition and measurement of financial instruments. Accordingly, IASC developed the version of IAS 39 that was issued in 2000.

BC8 In December 2000 a Financial Instruments Joint Working Group of Standard Setters (JWG), comprising representatives or members of accounting standard-setters and professional organisations from a range of countries, published a Draft Standard and Basis for Conclusions entitled *Financial Instruments and Similar Items*. That Draft Standard proposed far-reaching changes to accounting for financial instruments and similar items, including the measurement of virtually all financial instruments at fair value. In the light of feedback on the JWG's proposals, it is evident that much more work is needed before a comprehensive fair value accounting model could be introduced.

BC9 In July 2001 the Board announced that it would undertake a project to improve the existing requirements on the accounting for financial instruments in IAS 32 and IAS 39. The improvements deal with practice issues identified by audit firms, national standard-setters, regulators and others, and issues identified in the IAS 39 implementation guidance process or by IASB staff.

BC10 In June 2002 the Board published an Exposure Draft of proposed amendments to IAS 32 and IAS 39 for a 116-day comment period. More than 170 comment letters were received.

BC11 Subsequently, the Board took steps to enable constituents to inform it better about the main issues arising out of the comment process, and to enable the Board to explain its views of the issues and its tentative conclusions. These consultations included:

- (a) discussions with the Standards Advisory Council on the main issues raised in the comment process.

- (b) nine round-table discussions with constituents during March 2003 conducted in Brussels and London. Over 100 organisations and individuals took part in those discussions.

- (c) discussions with the Board's liaison standard-setters of the issues raised in the round-table discussions.

- (d) meetings between members of the Board and its staff and various groups of constituents to explore further issues raised in comment letters and at the round-table discussions.

BC11A Some of the comment letters on the June 2002 Exposure Draft and participants in the round-tables raised a significant issue for which the June 2003 Exposure Draft had not proposed any changes. This was hedge accounting for a portfolio hedge of interest rate risk (sometimes referred to as 'macro hedging') and the related question of the treatment in hedge accounting of deposits with a demand feature (sometimes referred to as 'demand deposits' or 'demandable liabilities'). In particular, some were concerned that it was very difficult to achieve fair value hedge accounting for a macro hedge in accordance with previous versions of IAS 39.

BC11B In the light of these concerns, the Board decided to explore whether and how IAS 39 might be amended to enable fair value hedge accounting to be used more readily for a portfolio hedge of interest rate risk. This resulted in a further Exposure Draft of Proposed Amendments to IAS 39 that was published in August 2003 and on which more than 120 comment letters were received. The amendments proposed in the Exposure Draft were finalised in March 2004.

BC11C After those amendments were issued in March 2004 the Board received further comments from constituents calling for further amendments to the Standard. In particular, as a result of continuing discussions with constituents, the Board became aware that some, including prudential supervisors of banks, securities companies and insurers, were concerned that the fair value option might be used inappropriately. These constituents were concerned that:

- (a) entities might apply the fair value option to financial assets or financial liabilities whose fair value is not verifiable. If so, because the valuation of these financial assets and financial liabilities is subjective, entities might determine their fair value in a way that inappropriately affects profit or loss.

- (b) the use of the option might increase, rather than decrease, volatility in profit or loss, for example if an entity applied the option to only one part of a matched position.

- (c) if an entity applied the fair value option to financial liabilities, it might result in an entity recognising gains or losses in profit or loss associated with changes in its own creditworthiness.

In response to those concerns, the Board published in April 2004 an Exposure Draft of proposed restrictions to the fair value option. In March 2005 the Board held a series of roundtable meetings to discuss proposals with invited constituents. As a result of this process, the Board issued an amendment to IAS 39 in June 2005 relating to the fair value option.

BC11D In September 2007, following a request from the International Financial Reporting Interpretations Committee (IFRIC), the Board published *Exposures Qualifying for Hedge Accounting*, an exposure draft of proposed amendments to IAS 39. The Board's objective was to clarify its requirements on exposures qualifying for hedge accounting and to provide additional guidance by specifying eligible risks and portions of cash flows. The Board received 75 responses to the exposure draft. Many respondents raised concerns about the rule-based approach proposed in the exposure draft. Their responses indicated that there was little diversity in practice regarding the designation of hedged items. However, the responses demonstrated that diversity in practice existed, or was likely to occur, in the two situations set out in paragraph BC172C. After considering the responses, the Board decided to focus on those two situations. Rather than specifying eligible risks and portions as proposed in the exposure draft, the Board decided to address those situations by adding application guidance to illustrate how the principles underlying hedge accounting should be applied. The Board subsequently issued *Eligible Hedged Items* (Amendment to IAS 39) in July 2008. The rationale for the amendment is set out in paragraphs BC172B-BC172J.

BC11E In October 2008 the Board received requests to address differences between the reclassification requirements of IAS 39 and US GAAP (Statements of Financial Accounting Standards No. 115 *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115) and No. 65 *Accounting for Certain Mortgage Banking Activities* (SFAS 65) issued by the US Financial Accounting Standards Board). In response the Board issued *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7) in October 2008. The amendments to IAS 39 permit non-derivative financial assets held for trading and available-for-sale financial assets to be reclassified in particular situations. The rationale for the amendments is set out in paragraphs BC104A-BC104E.

BC11F Following the issue of *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7) in October 2008 constituents told the Board that there was uncertainty about the interaction between those amendments and IFRIC 9 regarding the assessment of embedded derivatives. In response the Board issued *Embedded Derivatives* (Amendments to IFRIC 9 and IAS 39) in March 2009. The amendment to IAS 39 clarifies the consequences if the fair value of the embedded derivative that would have to be separated cannot be measured separately.

BC12 The Board did not reconsider the fundamental approach to accounting for financial instruments contained in IAS 39.<sup>13</sup> Some of the complexity in existing requirements is inevitable in a mixed measurement model based in part on management's intentions for holding financial instruments and given the complexity of finance concepts and fair value estimation issues. The amendments reduce some of the complexity by clarifying the Standard, eliminating internal inconsistencies and incorporating additional guidance into the Standard.

<sup>13</sup> In 2011 the Board's project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13.

BC13 The amendments also eliminate or mitigate some differences between IAS 39 and US GAAP related to the measurement of financial instruments. Already, the measurement requirements in IAS 39 are, to a large extent, similar to equivalent requirements in US GAAP, in particular, those in FASB SFAS 114 *Accounting by Creditors for Impairment of a Loan*, SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities* and SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*.

BC14 The Board will continue its consideration of issues related to the accounting for financial instruments. However, it expects that the basic principles in the improved IAS 39 will be in place for a considerable period.

## Scope

### Loan commitments (paragraphs 2(h) and 4)

BC15 Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. In the IAS 39 implementation guidance process, the question was raised whether a bank's loan commitments are derivatives accounted for at fair value under IAS 39. This question arises because a commitment to make a loan at a specified rate of interest during a fixed period of time meets the definition of a derivative. In effect, it is a written option for the potential borrower to obtain a loan at a specified rate.

BC16 To simplify the accounting for holders and issuers of loan commitments, the Board decided to exclude particular loan commitments from the scope of IAS 39. The effect of the exclusion is that an entity will not recognise and measure changes in fair value of these loan commitments that result from changes in market interest rates or credit spreads. This is consistent with the measurement of the loan that results if the holder of the loan commitment exercises its right to obtain financing, because changes in market interest rates do not affect the measurement of an asset measured at amortised cost (assuming it is not designated in a category other than loans and receivables).

[Refer:  
paragraphs 2(h) and 4  
Introduction paragraph IN5]

BC17 However, the Board decided that an entity should be permitted to measure a loan commitment at fair value with changes in fair value recognised in profit or loss on the basis of designation at inception of the loan commitment as a financial liability through profit or loss. This may be appropriate, for example, if the entity manages risk exposures related to loan commitments on a fair value basis.

[Refer: paragraph 4(a)]

BC18 The Board further decided that a loan commitment should be excluded from the scope of IAS 39 only if it cannot be settled net. [Refer: paragraph 4(b)] If the value of a loan commitment can be settled net in cash or another financial instrument, including when the entity has a past practice of selling the resulting loan assets shortly after origination, it is difficult to justify its exclusion from the requirement in IAS 39 to measure at fair value similar instruments that meet the definition of a derivative. [Refer: paragraph 4(a)]

BC19 Some comments received on the Exposure Draft disagreed with the Board's proposal that an entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination should apply IAS 39 to all of its loan commitments. The Board considered this concern and agreed that the words in the Exposure Draft did not reflect the Board's intention. Thus, the Board clarified that if an entity has a past practice of selling the assets resulting from its loan commitments shortly after origination, it applies IAS 39 only to its loan commitments in the same class.

[Refer: paragraph 4(a)]

BC20 Finally, the Board decided that commitments to provide a loan at a below-market interest rate should be initially measured at fair value, and subsequently measured at the higher of (a) the amount that would be recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. It noted that without such a requirement, liabilities that result from such commitments might not be recognised in the balance sheet, because in many cases no cash consideration is received.

[Refer: paragraphs 43 and 47(d)]

Introduction paragraph IN5]

BC20A As discussed in paragraphs BC21–BC23E, the Board amended IAS 39 in 2005 to address financial guarantee contracts. In making those amendments, the Board moved the material on loan commitments from the scope section of the Standard to the section on subsequent measurement (paragraph 47(d)). The purpose of this change was to rationalise the presentation of this material without making substantive changes.

### Financial guarantee contracts (paragraphs 2(e), 9, 47(c), AG4 and AG4A)

BC21 In finalising IFRS 4 *Insurance Contracts* in early 2004, the Board reached the following conclusions:

- (a) Financial guarantee contracts can have various legal forms, such as that of a guarantee, some types of letter of credit, a credit default contract or an insurance contract. However, although this difference in legal form may in some cases reflect differences in substance, the accounting for these instruments should not depend on their legal form.
- (b) If a financial guarantee contract is not an insurance contract, as defined in IFRS 4, it should be within the scope of IAS 39. This was the case before the Board finalised IFRS 4.
- (c) As required before the Board finalised IFRS 4, if a financial guarantee contract was entered into or retained on transferring to another party financial assets or financial liabilities within the scope of IAS 39, the issuer should apply IAS 39 to that contract even if it is an insurance contract, as defined in IFRS 4.
- (d) Unless (c) applies, the following treatment is appropriate for a financial guarantee contract that meets the definition of an insurance contract:

(i) At inception, the issuer of a financial guarantee contract has a recognisable liability and should measure it at fair value. If a financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary.

(ii) Subsequently, the issuer should measure the contract at the higher of the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

BC22 Mindful of the need to develop a 'stable platform' of Standards for 2005, the Board finalised IFRS 4 in early 2004 without specifying the accounting for these contracts and then published an Exposure Draft *Financial Guarantee Contracts and Credit Insurance* in July 2004 to expose for public comment the conclusion set out in paragraph BC21(d). The Board set a comment deadline of 8 October 2004 and received more than 60 comment letters. Before reviewing the comment letters, the Board held a public education session at which it received briefings from representatives of the International Credit Insurance & Surety Association and of the Association of Financial Guaranty Insurers.

BC23 Some respondents to the Exposure Draft of July 2004 argued that there were important economic differences between credit insurance contracts and other forms of contract that met the proposed definition of a financial guarantee contract. However, both in developing the Exposure Draft and in subsequently discussing the comments received, the Board was unable to identify differences that would justify differences in accounting treatment.

BC23A Some respondents to the Exposure Draft of July 2004 noted that some credit insurance contracts contain features, such as cancellation and renewal rights and profit-sharing features, that the Board will not address until phase II of its project on insurance contracts. They argued that the Exposure Draft did not give enough guidance to enable them to account for these features. The Board concluded it could not address such features in the short term. The Board noted that when credit insurers issue credit insurance contracts, they typically recognise a liability measured as either the premium received or an estimate of the expected losses. However, the Board was concerned that some other issuers of financial guarantee contracts might argue that no recognisable liability existed at inception. To provide a temporary solution that balances these competing concerns, the Board decided the following:

- (a) If the issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 or IFRS 4 to such financial guarantee contracts.
- (b) In all other cases, the issuer of a financial guarantee contract should apply IAS 39.

BC23B The Board does not regard criteria such as those described in paragraph BC23A(a) as suitable for the long term, because they can lead to

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Guidance on implementing IAS 39 Financial Instruments: Recognition and Measurement

This guidance accompanies, but is not part of, IAS 39.

Section A Scope

A.1 Practice of settling net: forward contract to purchase a commodity

Entity XYZ enters into a fixed price forward contract to purchase one million kilograms of copper in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the copper at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of copper. Is the contract accounted for as a derivative?

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of copper, and it is to be settled at a future date. However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the copper 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, the contract is not accounted for as a derivative under IAS 39. Instead, it is accounted for as an executory contract.

[Refer: paragraphs 5, 6 and AG10]

A.2 Option to put a non-financial asset

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for CU150 million. The current value of the building is CU175<sup>79</sup> million. The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net (IAS 39 paragraph 5 and IAS 39.AG10).

The investor, however, cannot conclude that the option was entered into to meet the investor's expected purchase, sale or usage requirements because the investor does not have the ability to require delivery (IAS 39.7). In addition, the option may be settled net in cash. Therefore, the investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement can never satisfy the normal delivery requirement for the exemption from IAS 39 because the option writer does not have the ability to require delivery.

79 In this guidance, monetary amounts are denominated in 'currency units (CU)'.

However, if the contract were a forward contract rather than an option, and if the contract required physical delivery and the reporting entity had no past practice of settling net in cash or of taking delivery of the building 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, the contract would not be accounted for as a derivative.

## Section B Definitions

### B.1 Definition of a financial instrument: gold bullion

#### Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

[Link to IAS 32 paragraph 11 (definition of a financial instrument)]

### B.2 Definition of a derivative: examples of derivatives and underlyings

#### What are examples of common derivative contracts and the identified underlying?

IAS 39 defines a derivative as follows:

A derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

- its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');
- it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- it is settled at a future date.

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates

continued...

...continued

Type of contract	Main pricing-settlement variable (underlying variable)
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity of another entity)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity of another entity)

The above list provides examples of contracts that normally qualify as derivatives under IAS 39. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions of IAS 39 may apply, for example, if it is a weather derivative (see IAS 39.AG1), a contract to buy or sell a non-financial item such as commodity (see IAS 39.5 and IAS 39.AG10) or a contract settled in an entity's own shares (see IAS 32.21–IAS 32.24). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

[Refer also: paragraphs 9 and AG9–AG12A]

### B.3 Definition of a derivative: settlement at a future date, interest rate swap with net or gross settlement

For the purpose of determining whether an interest rate swap is a derivative financial instrument under IAS 39, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 per cent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis. The fixed and variable amounts are determined based on a CU100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 per cent and three-month LIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (LIBOR), there is no initial net investment, and settlements occur at future dates.

[Refer: paragraphs 9 and AG9–AG11]

#### B.4 Definition of a derivative: prepaid interest rate swap (fixed rate payment obligation prepaid at inception or subsequently)

**If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?**

Yes

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month LIBOR. The interest rate of the fixed part of the swap is 10 per cent per year. Entity S prepays its fixed obligation under the swap of CU50 million (CU100 million × 10 per cent × 5 years) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the CU100 million reset quarterly based on three-month LIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfils the 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors' provision of IAS 39. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

**Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?**

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IAS 39.

[Refer: paragraphs 9, AG9 and AG11]

#### B.5 Definition of a derivative: prepaid pay-variable, receive-fixed interest rate swap

**If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?**

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors' criterion of a derivative.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month LIBOR. The fixed interest payments under the swap are calculated as 10 per cent times the swap's notional amount, ie CU10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 per cent on CU100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive CU10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors' criterion of IAS 39. Therefore, the contract is not accounted for as a derivative under IAS 39. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

[Link to paragraphs 9 and AG11]

#### B.6 Definition of a derivative: offsetting loans<sup>E39</sup>

**Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of principal at inception of the two loans, since A and B have a netting agreement. Is this a derivative under IAS 39?**

**E39 [IFRIC Update—March 2014: IAS 39 *Financial Instruments: Recognition and Measurement*—accounting for term-structured repo transactions]** The Interpretations Committee received a request to clarify: (Issue 1) whether an entity (Entity A) should account for three transactions separately or aggregate and treat them as a single derivative; and (Issue 2) how to apply paragraph B.6 of Guidance on Implementing IAS 39 *Financial Instruments: Recognition and Measurement* ('IG B.6 of IAS 39') in addressing Issue 1. Some key features of the three transactions are as follows:

- Transaction 1 (bond purchase): Entity A purchases a bond (the bond) from another entity (Entity B).
- Transaction 2 (interest rate swap): Entity A enters into interest rate swap contract(s) with Entity B. Entity A pays a fixed rate of interest equal to the fixed coupon rate of the purchased bond in Transaction 1 and receives a variable rate of interest.
- Transaction 3 (repurchase agreement): Entity A enters into a repurchase agreement with Entity B, in which Entity A sells the same bond in Transaction 1 on the same day it purchases the bond and agrees to buy back the bond at the maturity date of the bond.

The Interpretations Committee noted that in order to determine whether Entity A should aggregate and account for the three transactions above as a single derivative, reference should be made to paragraphs B.6 and C.6 of Guidance on Implementing IAS 39 and paragraph AG39 of IAS 32 *Financial Instruments: Presentation*. The Interpretations Committee also discussed Issue 2, ie, how to apply paragraph IG B.6 of IAS 39 in addressing Issue 1. The Interpretations Committee noted that application of the guidance in paragraph IG B.6 of IAS 39 requires judgement. It also noted that the indicators in paragraph IG B.6 of IAS 39 may help an entity to determine the substance of the transaction, but that the presence or absence of any single specific indicator alone may not be conclusive. The Interpretations Committee noted that providing additional guidance would result in the Interpretations Committee attempting to specify the accounting for a specific transaction, and that this would not be appropriate. On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, neither an Interpretation nor an amendment to a Standard was necessary and consequently decided not to add this issue to its agenda.]

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- they are entered into at the same time and in contemplation of one another
- they have the same counterparty
- they relate to the same risk
- there is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in IAS 39.9 does not require net settlement.

[Refer: paragraphs 9 and AG11]

### B.7 Definition of a derivative: option not expected to be exercised

**The definition of a derivative in IAS 39.9 requires that the instrument 'is settled at a future date'. Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?**

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

[Refer: paragraph 9]

### B.8 Definition of a derivative: foreign currency contract based on sales volume

**Entity XYZ, whose functional currency is the US dollar, sells products in France denominated in euro. XYZ enters into a contract with an investment bank to convert euro to US dollars at a fixed exchange rate. The contract requires XYZ to remit euro based on its sales volume in France in exchange for US dollars at a fixed exchange rate of 6.00. Is that contract a derivative?**

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. IAS 39 does not exclude from its scope derivatives that are based on sales volume.

[Refer: paragraphs 9, AG9 and AG11]

**B.9 Definition of a derivative: prepaid forward**  
**An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?**

No. The forward contract fails the 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors' test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is CU50 per share; the one-year forward price of T is CU55 per share. XYZ is required to prepay the forward contract at inception with a CU50 million payment. The initial investment in the forward contract of CU50 million is less than the notional amount applied to the underlying, one million shares at the forward price of CU55 per share, ie CU55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T's shares could be purchased at inception for the same price of CU50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

[Link to paragraphs 9 and AG11]

### B.10 Definition of a derivative: initial net investment

**Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?**

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

[Link to paragraph 9]

### B.11 Definition of held for trading: portfolio with a recent actual pattern of short-term profit-taking

**The definition of a financial asset or financial liability held for trading states that 'a financial asset or financial liability is classified as held for trading if it is ... part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking'. What is a 'portfolio' for the purposes of applying this definition?**

Although the term 'portfolio' is not explicitly defined in IAS 39, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (IAS 39.9). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

[Refer also: paragraph AG15]

### B.12 Definition of held for trading: balancing a portfolio

**Entity A has an investment portfolio of debt and equity instruments. The documented portfolio management guidelines specify that the equity exposure of the portfolio should be limited to between 30 and 50 per cent of total portfolio value. The investment manager of the portfolio is authorised to balance the**

## Interest, dividends, losses and gains

IN15 IAS 32 incorporates the guidance previously in SIC-17 *Equity—Costs of an Equity Transaction*. Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of that transaction and are deducted from equity.

[Refer: paragraphs 35 and 37–39]

Basis for Conclusions paragraph BC33]

## Disclosure

IN16–  
IN19

[Deleted]

IN19A In August 2005 the Board revised disclosures about financial instruments and relocated them to IFRS 7 *Financial Instruments: Disclosures*.

## Withdrawal of other pronouncements

IN20 As a consequence of the revisions to this Standard, the Board withdrew the three Interpretations and one draft Interpretation of the former Standing Interpretations Committee noted in paragraph IN1.

[Refer: paragraphs 99 and 100]

## Potential impact of proposals in exposure drafts

IN21 [Deleted]

## Reasons for amending IAS 32 in February 2008

IN22 In February 2008 the IASB amended IAS 32 by requiring some financial instruments that meet the definition of a financial liability to be classified as equity. Entities should apply the amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

[Refer: paragraphs 96A–96C and 97C  
Basis for Conclusions paragraph BC74]

IN23 The amendment addresses the classification of some:

- (a) puttable financial instruments, and
- (b) 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.

[Refer: paragraphs 11 (definitions of a financial asset, a financial liability and a puttable instrument), 16–19, 22–23, AG13–AG14J and AG27–AG29A]

IN24 The objective was a short-term, limited scope amendment to improve the financial reporting of particular types of financial instruments that meet the definition of a financial liability but represent the residual interest in the net assets of the entity.

[Refer: Basis for Conclusions paragraphs BC50–BC74]

## International Accounting Standard 32 *Financial Instruments: Presentation*

### Objective

- 1 [Deleted]
- 2 The objective of this Standard is to establish principles for presenting financial instruments as liabilities or 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, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

- 3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in IFRS 9 *Financial Instruments*, and for disclosing information about them in IFRS 7 *Financial Instruments: Disclosures*.

### Scope

- 4 This Standard shall be applied by all entities to all types of financial instruments except:
  - (a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures*. However, in some cases, IFRS 10, IAS 27 or IAS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture using IFRS 9; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.
  - (b) employers' rights and obligations under employee benefit plans,<sup>E1</sup> to which IAS 19 *Employee Benefits* applies.
  - (c) [deleted]
  - (d) insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if IFRS 9 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to

<sup>E1</sup> [IFRIC Update—November 2005: *Employee long-service leave* The IFRIC considered whether a liability for long-service leave falls within IAS 19 or whether it is a financial liability within the scope of IAS 32. The IFRIC noted that IAS 19 indicates that employee benefit plans include a wide range of formal and informal arrangements. It is therefore clear that the exclusion of employee benefit plans from IAS 32 extends to all employee benefits covered by IAS 19. The IFRIC decided that, since the Standard was clear, it would not expect diversity in practice and would not add this item to its agenda.]

financial guarantee contracts if the issuer applies IFRS 9 in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.

(e) financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 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 IFRS 9).

(f) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies, except for

(i) contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,

(ii) paragraphs 33 and 34 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.

5– [Deleted]

7  
8 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. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through profit or loss in accordance with paragraph 2.5 of IFRS 9 *Financial Instruments*.

[Refer: paragraphs AG20–AG23]

9 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 8 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.

10 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 9(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.

### Definitions (see also paragraphs AG3–AG23)

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

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.

[Refer:

paragraphs AG7 and AG23

paragraphs 8–10 and AG20 for contracts that are accounted for as financial instruments even though they do not satisfy the definition of a financial instrument]

[Link to IFRS 9 Implementation Guidance question B.1 for an item that does not satisfy the definition of a financial instrument]

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

(a) **cash;**

[Refer: paragraph AG3]

(b) **an equity instrument of another entity;**

(c) **a contractual right:** [Refer: paragraphs 13 and AG12]

(i) **to receive cash or another financial asset from another entity; or**

[Refer: paragraphs AG3–AG12]

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or  
 [Refer: paragraphs AG7 and AG15–AG19]

(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 16A and 16B, 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 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

[Refer:

paragraphs 21, 22 and AG27(d)

Basis for Conclusions paragraphs BC4 and BC6–BC15]

[Link to paragraphs AG9–AG12 for examples of items that are not financial assets]

A financial liability is any liability that is:

(a) a contractual obligation [Refer: paragraphs 13 and AG12]:

(i) to deliver cash or another financial asset to another entity;<sup>E2</sup> or

[Refer: paragraphs 16(a)(i) and 17–20 for information on differentiating equity and liabilities]

paragraphs AG4–AG8, AG25 and AG26

Basis for Conclusions paragraphs BC7–BC9]

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

[Refer: paragraphs 16(a)(i) and 17–20 for information on differentiating equity and liabilities]

paragraphs AG7 and AG16–AG19]

(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

E2 [IFRIC Update—May 2008: Deposits on returnable containers] The IFRIC was asked to provide guidance on the accounting for the obligation to refund deposits on returnable containers. In some industries, entities that distribute their products in returnable containers collect a deposit for each container delivered and have an obligation to refund this deposit when containers are returned by the customer. The issue was whether the obligation should be accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The IFRIC noted that paragraph 11 of IAS 32 defines a financial instrument as 'any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.' Following delivery of the containers to its customers, the seller has an obligation only to refund the deposit for any returned containers. In circumstances in which the containers are derecognised as part of the sale transaction, the obligation is an exchange of cash (the deposit) for the containers (non-financial assets). Whether that exchange transaction occurs is at the option of the customer. Because the transaction involves the exchange of a non-financial item, it does not meet the definition of a financial instrument in accordance with IAS 32. In contrast, when the containers are not derecognised as part of the sale transaction, the customer's only asset is its right to the refund. In such circumstances, the obligation meets the definition of a financial instrument in accordance with IAS 32 and is therefore within the scope of IAS 39. In particular, paragraph 49 of IAS 39 [paragraph 49 of IAS 39 is now paragraph 47 of IFRS 13 *Fair Value Measurement*] states that 'the fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.' The IFRIC concluded that divergence in this area was unlikely to be significant and therefore decided not to add this issue to its agenda.]

instruments.<sup>E3</sup> For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. [Refer: Basis for Conclusions paragraphs BC4A–BC4K] Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, 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 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

[Refer:

paragraphs 16(b)(i), 21–24 and AG27 for information on differentiating equity and liabilities

Basis for Conclusions paragraphs BC10–BC15]

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 paragraphs 16A and 16B or paragraphs 16C and 16D.

[Refer:

Introduction paragraphs IN22–IN24

paragraphs AG14A–AG14J and AG29A

Basis for Conclusions paragraphs BC50–BC74]

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

[Refer:

paragraphs 15, 16, AG13 and AG14

Basis for Conclusions paragraph BC6]

<sup>E3</sup> [IFRIC Update—November 2006: Foreign currency instruments exchangeable into equity instruments of the parent entity of the issuer] At its meeting in April 2005 the IFRIC concluded that derivative contracts that may be settled by an entity by delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency are financial liabilities. At the same time, the IFRIC recommended that the issue should be referred to the Board. However, the Board, in September 2005, decided not to proceed with any amendments to IAS 32 in connection with convertible instruments issued by an entity in a currency other than the functional currency of the entity. Subsequently, the IFRIC was asked to consider a question relating to the issue by a subsidiary of financial instruments that provide holders with the rights to exchange the financial instruments into a fixed number of equity instruments of the parent at a fixed amount of currency. Variants considered were that the amount of currency is fixed if it is denominated in (i) the functional currency of the issuer of the exchangeable financial instruments or (ii) the functional currency of the issuer of the equity instruments. The question was whether the conversion options embedded in the exchangeable financial instruments should be classified as equity in the consolidated financial statements of the parent in accordance with IAS 32. The IFRIC noted that a group does not have a functional currency. It therefore discussed whether it should add a project to its agenda to address which functional currency should be the reference point in determining whether or not the embedded conversion options are equity instruments. The IFRIC believed that the question was sufficiently narrow that it was not expected to have widespread relevance in practice. The IFRIC, therefore, decided not to add the matter to its agenda.]

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13 Fair Value Measurement.)

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.

12 The following terms are defined in Appendix A of IFRS 9 or paragraph 9 of IAS 39 *Financial Instruments: Recognition and Measurement* and are used in this Standard with the meaning specified in IAS 39 and IFRS 9.

- amortised cost of a financial asset or financial liability [Refer: IFRS 9 Appendix A]
- derecognition [Refer: IFRS 9 Appendix A]
- derivative [Refer: IFRS 9 Appendix A]
- effective interest method [Refer: IFRS 9 Appendix A]
- financial guarantee contract [Refer: IFRS 9 Appendix A]
- financial liability at fair value through profit or loss [Refer: IFRS 9 Appendix A]
- firm commitment [Refer: IAS 39 paragraph 9]
- forecast transaction [Refer: IFRS 9 Appendix A and IAS 39 paragraph 9]
- hedge effectiveness [Refer: IAS 39 paragraph 9]
- hedged item [Refer: IAS 39 paragraph 9]
- hedging instrument [Refer: IAS 39 paragraph 9]
- held for trading [Refer: IFRS 9 Appendix A]
- regular way purchase or sale [Refer: IFRS 9 Appendix A]
- transaction costs. [Refer: IFRS 9 Appendix A]

13 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.

[Refer: paragraph AG12]

14 In this Standard, 'entity' includes individuals, partnerships, incorporated bodies, trusts and government agencies.