Exposure Draft of Proposed

AMENDMENTS TO

IAS 32
FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

IAS 39
FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Comments to be received by 14 October 2002

This Exposure Draft is published by the International Accounting Standards Board (IASB) for comment only. The recommendations in the draft may be modified in the light of the comments received before being issued in the form of amended International Accounting Standards.

Comments should be submitted in writing so as to be received by
14 October 2002.

All replies will be put on the public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Fax: +44 (0)20 7246 6411

ISBN 0 905625 99 4

Additional copies of this publication may be obtained from: IASCF Publications Department, 7th Floor, 166 Fleet Street, London EC4A 2DY, United Kingdom. Tel: +44 (0)20 7427 5927 Fax: +44 (0)20 7353 0562 Email: publications@iasb.org.uk Web: www.iasb.org.uk

Contents

Introduction

1. This Exposure Draft contains proposed amendments to the two International Accounting Standards on financial instruments:

    - IAS 32, Financial Instruments: Disclosure and Presentation
    - IAS 39, Financial Instruments: Recognition and Measurement.

Objective

2. The objective of the proposed amendments is to improve the existing requirements in IAS 32 and IAS 39. These amendments deal with issues identified by audit firms, national standard-setters, regulators, or others, and other issues identified in the IAS 39 implementation guidance process or by IASB staff.

3. The Board does not intend to reconsider at this time the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39. Some of the complexity in those Standards is inevitable in a mixed-attribute model based in part on intent and given the complexity of finance concepts and valuation issues. The Board expects that the proposed amendments will reduce some of the complexity by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards key elements of existing Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance.

4. The Board will continue its consideration of issues related to the accounting for financial instruments. It expects, however, that the basic principles in the improved IAS 32 and IAS 39, once finalised, will be in place for a considerable period.

Process

5. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to amend IAS 39. The Board also agreed to take the opportunity to revise IAS 32, as necessary, to remove duplications and inconsistencies.

6. The Board invited the IAS 39 Implementation Guidance Committee (IGC) to function as an Advisory Committee to the Board in identifying and reviewing issues that should be addressed in the project to improve IAS 32 and IAS 39. The IGC consists of senior experts in financial instruments with backgrounds as accounting standard-setters, auditors, bankers, and preparers from a range of countries as well as observers from the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO), and the European Commission.

Invitation to comment

7. The Board invites comments on the main changes proposed in the Exposure Draft and would particularly welcome answers to the questions set out in the 'Invitation to Comment' section at the front of each proposed revised Standard. As noted above, the Board is not considering changes to the basic principles in IAS 32 and IAS 39 at this time. Therefore, the Board is not requesting comments on matters relating to the basic principles for which no changes have been proposed. Comments should indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

8. Comments should be submitted in writing so as to be received no later than **14 October 2002**. Until revised Standards become effective, the requirements of the current version of the relevant Standards remain in force.

Presentation of the document

9. This Exposure Draft presents for each of the proposed revised Standards:

    - *An invitation to comment.* Questions have been limited to major issues, but the Board would also welcome comments on other changes proposed.

    - *A summary of main changes.* This section gives a summary of the Board's main proposals for changes to the Standard. Minor matters and editorial changes are not mentioned.

- *Revised text.* A marked-up copy of the full text of the Standard is presented.

- *A basis for conclusions.* This section presents the basis for the Board's conclusions on major issues. The Basis for Conclusions presents views considered by the Board, including some supported by a minority of Board members who, nonetheless, support the publication of the Exposure Draft for an individual Standard.

- *Alternative views*. The alternative views in Appendix D to the draft of IAS 39 reflect the views of Board members who voted against the publication of the Exposure Draft of that Standard. Those Board members concluded that the proposed revised text for that Standard, taken as a whole, should not be issued in its present form. The IASB does not allow partial dissents. Board members' views (including the views of Board members who supported the publication of the Exposure Draft of an individual Standard) may change as a result of comments received in the exposure process. Alternative views are not attributed to individual Board members.

10. Consequential amendments to other Standards and SIC Interpretations are presented at the end of the Exposure Draft.

Style

11. The Board decided that Standards revised in this project should be issued as revised International Accounting Standards (IASs). Therefore, most of the style changes the Board has agreed to make for new Standards—International Financial Reporting Standards (IFRSs)—have not been reflected in the revised text. These changes are set out in the Preface to International Financial Reporting Standards (issued in May 2002).

12. However, this document reflects the Board's decision to change certain terminology in existing Standards. Accordingly, the word 'shall' is used instead of 'should' and 'entity' is used instead of 'enterprise'. By replacing 'should' with 'shall', the Board does not intend to change the requirements in the Standards, but to clarify that it interprets 'should' as meaning 'shall'. By replacing 'enterprise' with 'entity', a more neutral term, the Board intends to reflect its objective that Standards are used by all profit-oriented entities preparing general purpose financial statements.

PROPOSED AMENDMENTS TO

IAS 32
FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

[Note: For the purpose of this Exposure Draft, the new text is shaded and underlined and the deleted text is shaded and struck through.]

Invitation to Comment (IAS 32)

The Board would particularly welcome answers to the questions set out below. Comments should indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1 - Probabilities of different manners of settlement (paragraphs 19, 22, and 22A)

Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified as a financial liability. In addition, the proposed amendments require a financial instrument that the issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).

Question 2 – Separation of liability and equity elements (paragraphs 28 and 29)

Do you agree that the options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative-fair-value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?

Question 3 – Classification of derivatives that relate to an entity's own shares (paragraphs 29C – 29G)

Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

Question 4 – Consolidation of the text in IAS 32 and IAS 39 into one comprehensive Standard

Do you believe it would be useful to integrate the text in IAS 32 and IAS 39 into one comprehensive Standard on the accounting for financial instruments? (Although the Board is not proposing such a change in this Exposure Draft, it may consider this possibility in finalising the revised Standards.)

Summary of Main Changes (IAS 32)

Scope

- The scope of IAS 32 generally is conformed to the scope of IAS 39.

Classification of compound instruments by the issuer

- The options in IAS 32 to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or by measuring the elements based on a relative-fair-value method are eliminated. Instead, any asset and liability elements are separated first and the residual is the equity element.

  The objective of the proposed amendment is to conform the requirements in IAS 32 relating to the separation of liability and equity elements with the definition of an equity instrument as a residual and the measurement requirements in IAS 39.

Classification of derivatives based on an entity's own shares

- Guidance about the classification of derivatives based on an entity's own shares is provided, as follows:

  - A derivative that is indexed to the price of an entity's own shares and requires net cash or net share settlement, or gives the counterparty a choice of net cash or net share settlement, is a derivative asset or derivative liability (not an equity instrument) and is accounted for as such under IAS 39.

  - A derivative that is indexed to the price of an entity's own shares and gives the entity a right to require net cash or net share settlement instead of gross physical settlement is a derivative asset or derivative liability (not an equity instrument) unless the entity has an established history of settling such contracts through a gross exchange of a fixed number of the entity's own shares for a fixed amount of cash or other financial assets.

  - Changes in the fair value of a derivative that is fully indexed to the price of an entity's own shares and will result in the receipt or delivery of a fixed number of an entity's own shares in exchange for a fixed amount of cash or other financial assets are not recognised in the financial statements.

  - When a derivative involves an obligation to pay cash in exchange for receiving an entity's own shares, there is a liability for the share redemption amount.

  The objective of the proposed amendment is to clarify the requirements affecting the classification of derivatives based on an entity's own shares and to promote the consistent application of those requirements.

Disclosure

- The exemption in IAS 32 from the requirement to disclose fair value of certain financial assets and financial liabilities is conformed to the exemption in IAS 39 from the requirement to measure at fair value certain unquoted financial assets and financial liabilities.

- Disclosure is required of:

  - the extent to which fair values are estimated using a valuation technique.

  - the extent to which valuations using valuation techniques are based on assumptions that are not supported by observable market prices.

  - the sensitivity of the estimated fair value to changes in those assumptions based on a range of reasonably possible alternative assumptions.

  - the change in fair values estimated using valuation techniques recognised in profit or loss during the reporting period.

  - the nature and extent of transfers of financial assets that do not qualify for derecognition.

- the risks inherent in any component that continues to be recognised after a transfer of financial assets that does not qualify for derecognition.
- the difference between the carrying amount and settlement amount of non-derivative financial liabilities that are carried at fair value.
- defaults in the payment of principal or interest and breaches of sinking fund or redemption provisions on loans payable, and any other breaches of loan agreements when those breaches can permit the lender to demand repayment.

- An issuer of a compound instrument with multiple embedded derivative features (such as an issued callable convertible bond) is required to disclose information about the existence of those features and the effective yield of that instrument.

- The existing disclosure requirements in IAS 39 are moved to IAS 32.

Incorporation of SIC Interpretations into IAS 32

- The key elements of the following SIC Interpretations are incorporated into IAS 32:
  - SIC-5, Classification of Financial Instruments – Contingent Settlement Provisions. However, no exception is made to the principle that a financial instrument that an entity could potentially be required to settle by delivering cash or other financial assets, depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder, should be classified as a financial liability.
  - SIC-16, Share Capital – Reacquired Own Equity Instruments (Treasury Shares).
  - SIC-17, Equity – Costs of an Equity Transaction.

- The key elements of the guidance in proposed final SIC Interpretation 34, Financial Instruments – Instruments or Rights Redeemable by the Holder, are incorporated into IAS 32:
  - An issued instrument that involves a right for the holder to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined based on an index or other item that has the potential to increase and decrease, is a liability.
  - An entity (such as an open-ended mutual fund or unit trust) may present a liability to repay a proportionate share of the net asset value of the entity as 'net asset value available to unitholders' on the face of the balance sheet and the change in the value of the liability as 'change in net asset value available to unit holders' on the face of the income statement.

Contents

International Accounting Standard IAS 32 (revised 200X)

Financial Instruments: Disclosure and Presentation

Continued../..

International Accounting Standard IAS 32

(revised 200X)

Financial Instruments: Disclosure and Presentation

[Draft] International Accounting Standard 32 *Financial Instruments: Disclosure and Presentation* (IAS 32) is set out in paragraphs 1-96. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. The scope and authority of IASs are explained in the *Preface to International Financial Reporting Standards*. IAS 32 is accompanied by application guidance and a Basis for Conclusions, as set out in Appendices A and B. IAS 32 should be read in the context of its objective and the *Framework for the Preparation and Presentation of Financial Statements*, which provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The dynamic nature of international financial markets has resulted in the widespread use of a variety of financial instruments ranging from traditional primary instruments, such as bonds, to various forms of derivative instruments, such as interest rate swaps. The objective of this Standard is to enhance financial statement users' understanding of the significance of ~~on-balance-sheet and off-balance-sheet~~ financial instruments to an ~~enterprise~~entity's financial position, performance, and cash flows.

~~The~~ This Standard prescribes ~~certain~~ requirements for presentation of ~~on-balance-sheet~~ financial instruments and identifies the information that should be disclosed about ~~both on-balance-sheet (recognised) and off-balance-sheet (unrecognised) financial instruments~~ them. The presentation ~~standards~~ paragraphs deal with the classification of financial instruments, ~~between~~ from the perspective of the issuer, into liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities should be offset. The disclosure ~~standards~~ paragraphs deal with information about factors that affect the amount, timing and certainty of an ~~enterprise~~entity's future cash flows relating

to financial instruments and the accounting policies applied to the instruments. ~~In addition, the~~ This Standard also deals with ~~encourages~~ disclosure of information about the nature and extent of an ~~enterprise~~entity's use of financial instruments, the business purposes ~~that~~ they serve, the risks associated with them, and management's policies for controlling those risks.

The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in IAS 39, Financial Instruments: Recognition and Measurement.

Scope

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

   (a) those interests in subsidiaries, associates, and joint ventures that are accounted for under ~~as defined in~~ IAS 27, ~~Consolidated Financial Statements and Accounting for Investments in Subsidiaries~~Consolidation and Separate Financial Statements; IAS 28, Accounting for Investments in Associates; and IAS 31, Financial Reporting of Interests in Joint Ventures. However, an entity shall apply this Standard to an interest in a subsidiary, associate, or joint venture that according to IAS 27, IAS 28, or IAS 31 is accounted for under IAS 39, Financial Instruments: Recognition and Measurement, such as one that is acquired and held exclusively with a view to its subsequent disposal within twelve months from its acquisition. In these cases, the disclosure requirements in IAS 27, IAS 28, and IAS 31 apply in addition to those in this Standard.

   ~~(b) interests in associates, as defined in IAS 28, Accounting for Investments in Associates;~~

   ~~(c) interests in joint ventures, as defined in IAS 31, Financial Reporting of Interests in Joint Ventures;~~

   (b)~~(d)~~ employers' rights and obligations under employee benefit plans, to which IAS 19, Employee Benefits, applies. ~~employers' and plans' obligations for post-employment benefits of all types, including employee benefit plans as described in IAS 19, Employee Benefits, and IAS 26, Accounting and Reporting by Retirement Benefit Plans;~~

   ~~(e) employers' obligations under employee stock option and stock purchase plans as described in IAS 19, Employee Benefits; and~~

   (c)~~(f)~~rights and obligations arising under insurance contracts. However, this Standard applies when a financial instrument takes the form of an insurance (or reinsurance) contract as described in paragraph 3, but principally involves the transfer of financial risks described in paragraph 43. In addition, this Standard applies to derivatives that are embedded in insurance contracts (see IAS 39).

   (d) contracts for contingent consideration in a business combination (see paragraphs 65-67 of IAS 22, Business Combinations).

   (e) contracts that require a payment based on climatic, geological or other physical variables, but this Standard applies to other types of derivatives that are embedded in such contracts (see IAS 39).

2. This Standard applies to recognised and unrecognised financial instruments. Recognised financial instruments include equity instruments issued by the entity and financial assets and financial liabilities that are within the scope of IAS 39. Unrecognised financial instruments include some financial instruments that, although outside the scope of IAS 39, are within the scope of this Standard (such as certain loan commitments). ~~Although this Standard does not apply to an enterprise's interests in subsidiaries, it does apply to all financial instruments included in the consolidated financial statements of a parent, regardless of whether those instruments are held or issued by the parent or by a subsidiary. Similarly, the Standard applies to financial instruments held or issued by a joint venture and included in the financial statements of a venturer either directly or through proportionate consolidation.~~

3. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and business interruption. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks (see paragraph 43), for example, some types of financial reinsurance and guaranteed investment contracts issued by insurance and other ~~enterprises~~entities. ~~Enterprises~~Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting and disclosing information about such obligations.

4. Other ~~International Accounting~~ Standards specific to ~~certain~~ particular types of financial instruments contain additional presentation and disclosure requirements. For example, IAS 17, Leases, and IAS 26, Accounting and Reporting by Retirement Benefit Plans, incorporate specific disclosure requirements relating to finance leases and retirement benefit plan investments, respectively. In addition, some requirements of other ~~International Accounting~~ Standards, particularly IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, ~~and IAS 39, Financial Instruments: Recognition and Measurement,~~ apply to financial instruments.

4A. This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or by some other financial instrument as if they were financial instruments, with the exception of contracts that were entered into and continue to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.

4B. Contracts to buy or sell a non-financial item, such as a contract to buy or sell a commodity for a fixed price at a future date, do not meet the definition of a financial instrument. Nevertheless, such a contract meets the definition of a derivative and is within the scope of this Standard if the entity has a practice of settling such contracts net in cash (either with the counterparty or by entering into offsetting contracts) or 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. Those practices indicate that the contract is not entered into for the purpose of making or taking delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.

Definitions

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

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

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

A financial asset is any asset that is:

(a) cash;

(b) a contractual right to receive cash or another financial asset from another ~~enterprise~~entity;

(c) a contractual right to exchange financial instruments with another ~~enterprise~~entity under conditions that are potentially favourable; or

(d) an equity instrument of another ~~enterprise~~entity.

A financial liability is any liability that is a contractual obligation:

(a) to deliver cash or another financial asset to another ~~enterprise~~entity; or

(b) to exchange financial instruments with another ~~enterprise~~entity under conditions that are potentially unfavourable.

~~An enterprise may have a contractual obligation that it can settle either by payment of financial assets or by payment in the form of its own equity securities. In such a case, if the number of equity securities required to settle the obligation varies with changes in their fair value so that the total fair value of the equity securities paid always equals the~~

~~***amount of the contractual obligation, the holder of the obligation is not exposed to gain or loss from fluctuations in the price of its equity securities. Such an obligation should be accounted for as a financial liability of the enterprise.***~~

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

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

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

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

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

7. For the purposes of the definitions in paragraph 5, the term ''~~enterprise~~entity'' includes individuals, partnerships, incorporated bodies, and government agencies.

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

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

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

11. 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 other assets, but it does not give rise to a present right to receive cash or other financial assets.

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

13. Liabilities or assets that are not contractual~~ in nature,~~ (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, Income Taxes.

14. Commitments to buy or sell non-financial items ~~Contractual rights and obligations that do not involve the transfer of a financial asset~~ do not~~ fall within the scope of~~ meet the definition of a financial instrument. For example, some contractual rights (obligations), such as those that arise under a commodity futures contract, can be settled only by the receipt (delivery) of non-financial assets. Similarly, contractual rights

(obligations) such as those that arise under an operating lease for use of a physical asset can be settled only by the receipt (delivery) of services. In both cases, the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver ,or exchange a financial asset. Although commitments to buy or sell non-financial items do not meet the definition of a financial instrument, some contracts that can be settled net are within the scope of this Standard (see paragraph 4A).

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

16. [deleted]~~An obligation of an enterprise to issue or deliver its own equity instruments, such as a share option or warrant, is itself an equity instrument, not a financial liability, since the enterprise is not obliged to deliver cash or another financial asset. Similarly, the cost incurred by an enterprise to purchase a right to re-acquire its own equity instruments from another party is a deduction from its equity, not a financial asset.~~

17. The minority interest that ~~may arise on an enterprise's balance sheet from~~is recognised when consolidating a subsidiary is not a financial liability or an equity instrument of the parent~~enterprise~~. In consolidated financial statements, an ~~enterprise~~entity presents the interests of other parties in the equity and income of its subsidiaries in accordance with IAS 27, ~~Consolidated Financial Statements and Accounting for Investments in Subsidiaries~~Consolidation and Separate Financial Statements. Accordingly, a financial instrument classified as an equity instrument by a subsidiary is eliminated on consolidation when held by

the parent, or presented by the parent in the equity section of the consolidated balance sheet as a minority interest separate from the equity of ~~its own shareholders~~the parent. A financial instrument classified as a financial liability by a subsidiary remains a liability in the parent's consolidated balance sheet unless eliminated on consolidation as an intragroup balance. The accounting treatment by the parent on consolidation does not affect the basis of presentation by the subsidiary in its financial statements.

Presentation

Liabilities and Equity

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

19. The substance of a financial instrument, rather than its legal form, governs its classification on the issuer's balance sheet. ~~While~~ Although substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. The classification of an instrument is made on the basis of an assessment of its substance and without regard to probabilities of the manners of settlement when ~~it~~ the instrument is first recognised. That classification continues at each subsequent reporting date until the financial instrument is derecognised (except as provided in paragraph 29F). ~~removed from the enterprise's balance sheet.~~

20. The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation ~~on~~ of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled. A restriction on the ability of the issuer to satisfy an obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the issuer's obligation or the holder's right under the instrument.

21. When a financial instrument does not give rise to a contractual obligation on the part of the issuer to deliver cash or another financial asset or to exchange another financial instrument under conditions that are potentially unfavourable, it is an equity instrument. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions out of equity, the issuer does not have a contractual obligation to make such distributions.

22. When a preferred share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A preferred share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. ~~For example, a preferred share that does not provide for mandatory redemption or redemption at the option of the holder may have a contractually provided accelerating dividend such that, within the foreseeable future, the dividend yield is scheduled to be so high that the issuer will be economically compelled to redeem the instrument. In these circumstances, classification as a financial liability is appropriate because the issuer has little, if any, discretion to avoid redeeming the instrument. Similarly, if a financial instrument labelled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument.~~

22A. An entity may issue a financial instrument (such as a bond or a share) that it could potentially be required to settle by delivering cash or other financial assets (or otherwise in such a way that the instrument would be classified as a financial liability, see paragraph 22C) depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument (such as a change in a stock market index, consumer price index, or interest rate, or the issuer's future revenues, net income, or debt-to-equity ratio). Such a financial instrument is a financial liability of the issuer because the issuer does not have an unconditional right to avoid settlement of the obligation in cash or other financial assets (or otherwise in such a way that the obligation would be classified as a financial liability).

22B. An entity may issue a financial instrument (a 'puttable instrument') that gives the holder the right to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined on the basis of an index or other item that has the potential to increase and decrease. For example, open-ended mutual funds, unit trusts, partnerships, and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the entity at any time for cash equal to their proportionate share of the net asset value of the entity. Even when the legal form of a puttable instrument gives the holder a right to the residual interest in the assets of an entity, the inclusion of an option for the holder to put that right back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability and is presented as such. Paragraphs 22-26A of IAS 39 address when an embedded derivative should be separated from a host contract and accounted for as a derivative.

22C. An entity may have a contractual obligation of a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments, but the entity must or can settle by delivery of its own equity instruments (the number of which depends on the amount of the obligation). Such an obligation is a financial liability of the entity.

22D. If the number of an entity's own shares or other own equity instruments required to settle an obligation varies with changes in their fair value so that the total fair value of the entity's own equity instruments to be delivered always equals the amount of the contractual obligation, the counterparty does not hold a residual interest in the entity. In addition, the entity may have to deliver more or fewer of its own equity instruments than would be the case at the date of entering into the contractual arrangement. Therefore, such an obligation is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments.

Classification of Compound Instruments by the Issuer

23. The issuer of a financial instrument that contains both a liability and an equity element ~~should~~shall classify the instrument's component parts separately in accordance with paragraph 18.

24. This Standard requires the separate presentation on an issuer's balance sheet of liability and equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and equity interests are created by a single financial instrument rather than two or more separate instruments. An issuer's financial position is more faithfully represented by separate presentation of liability and equity components contained in a single instrument~~ according to their nature~~.

25. ~~For purposes of balance sheet presentation, a~~An issuer recognises separately the component parts of a financial instrument that (a) creates a ~~primary~~ financial liability of the issuer and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the issuer. A bond or similar instrument convertible by the holder into a fixed number of common shares of the issuer is an example of such an instrument. From the perspective of the issuer, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or other financial assets) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert into a fixed number of common shares of the issuer). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase common shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the issuer presents the liability and equity elements separately on its balance sheet.

26. Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will

change from time to time. The issuer's obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument, or some other transaction.

27. A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument may give the holder the right to receive in settlement a non-financial asset (such as a commodity) ~~in settlement~~ and an option to exchange that right for a fixed number of shares of the issuer. The issuer recognises and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.

28. IAS 39 ~~This Standard does not~~ deals with the measurement of financial assets~~,~~ and financial liabilities. ~~and e~~Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound instrument is allocated to its equity and liability elements, ~~and does not therefore prescribe any particular method for assigning a carrying amount to liability and equity elements contained in a single instrument. Approaches that might be followed include:~~

~~(a) assigning to the less easily measurable~~ the equity component ~~(often an equity instrument),~~ is assigned the residual carrying amount after deducting from the instrument as a whole the amount separately determined for the liability component. The value of any embedded derivative features (such as a call option embedded in the compound instrument) other than the equity element (such as an equity conversion option) is included in the carrying amount of the liability component. ~~that is more easily measurable; and~~

~~(b) measuring the liability and equity components separately and, to the extent necessary, adjusting these amounts on a pro rata basis so that the sum of the components equals the amount of the instrument as a whole.~~

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

29. Under the ~~first~~ approach described in paragraph 28, the issuer of a bond convertible into common shares first determines the carrying amount of the ~~financial~~ liability component by ~~discounting the stream of future payments of interest and principal at the prevailing market rate~~measuring the fair value of ~~for~~ a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into common shares ~~may~~ is then ~~be~~ determined by deducting the carrying amount of the financial liability from the amount of the compound instrument as a whole. ~~Under the second approach, the issuer determines the value of the option directly either by reference to the fair value of a similar option, if one exists, or by using an option pricing model. The value determined for each component is then adjusted on a pro-rata basis to the extent necessary to ensure that the sum of the carrying amounts assigned to the components equals the amount of the consideration received for the convertible bond.~~

Transactions in an Entity's Own Equity Instruments

Treasury Shares

29A. If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss is recognised in the income statement on the purchase, sale, issue, or cancellation of an entity's own equity instruments. Consideration paid or received is recognised directly in equity.

29B. The amount of treasury shares held is disclosed separately either on the face of the balance sheet or in the notes under IAS 1, Presentation of Financial Statements. An entity provides disclosure in accordance with IAS 24, Related Party Disclosures, if the entity reacquires its own shares from related parties.

Derivatives Based on an Entity's Own Equity Instruments

29C. A derivative contract (such as an option, warrant, or forward) shall be classified as an equity instrument of the entity if, and only if, the contract will be settled by the exchange of a fixed number of an entity's

own equity instruments (other than derivatives) for a fixed monetary amount of cash or other financial assets. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of a derivative contract classified as equity are not recognised in the financial statements.

29D. A derivative contract is not classified as an equity instrument of the entity solely because it may result in the receipt or delivery of an entity's own equity instruments or because the value of the derivative contract is determined on the basis of the value of an entity's own equity instruments. A derivative contract (such as an option, forward, or total return swap) that requires settlement on a net basis in cash or other financial assets is a derivative asset or derivative liability even though its value may be determined on the basis of the value of the entity's own equity instruments. Similarly, a derivative contract that requires settlement on a net basis in an entity's own equity instruments is a derivative asset or a derivative liability. Such contracts are not classified as equity instruments because they will not result in the receipt or delivery of a fixed number of an entity's own equity instruments in exchange for a fixed amount of cash or other financial assets at the maturity date.

29E. If a derivative contract has more than one settlement alternative (such as net in cash, net in an entity's own equity instruments, or by exchanging an entity's own equity instruments for cash or other financial assets), the contract is a derivative asset or derivative liability unless the entity:

(a) has an unconditional right and ability to settle the contract by exchanging a fixed number of its own equity instruments (other than derivatives) for a fixed amount of cash or other financial assets;

(b) has an established practice of settling such contracts by exchanging a fixed number of its own equity instruments (other than derivatives) for a fixed amount of cash or other financial assets; and

(c) intends to settle the contract by exchanging a fixed number of its own equity instruments for a fixed amount of cash or other financial assets.

If these conditions are met, the contract is an equity instrument unless it may result in the entity delivering cash or other financial assets in exchange for receiving the entity's own equity instruments, in which case paragraph 29F applies. If the counterparty can require an entity to settle a derivative contract on a net basis in cash or in the entity's own equity instruments, the contract is a derivative asset or derivative liability unless the counterparty can require the entity to deliver cash or other financial assets in exchange for receiving the entity's own equity instruments, in which case paragraph 29F applies.

29F. When an entity enters into a derivative contract (such as a forward repurchase contract or written put option on the entity's own shares) that requires settlement by the delivery of cash or other financial assets in exchange for receiving the entity's own equity instruments, those equity instruments cease to meet the definition of equity instruments because the entity has an obligation to redeem them for cash or other financial assets. The obligation to deliver cash or other financial assets (for example, for the forward repurchase price, option exercise price, or other redemption amount) is a financial liability. When the financial liability is recognised initially under IAS 39, its cost (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39. If the derivative contract expires without delivery of cash or other financial assets, the carrying amount of the financial liability is reclassified to equity.

29G. A derivative contract whose fair value fluctuates in part or in full in response to changes in one or more underlying variables other than the value of an entity's own equity instruments (for example, a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or a credit rating) is not an equity instrument of the entity even though the entity may be required or have the right to settle the contract in its own equity instruments. Such a contract exposes the entity to potentially favourable or unfavourable changes in a variable other than the value of its own equity instruments. Therefore, it is a derivative asset or derivative liability.

Interest, Dividends, Losses, and Gains

30. Interest, dividends, losses, and gains relating to a financial instrument, or a component~~ part~~, classified as a financial liability ~~should~~shall be ~~reported~~ recognised in the income statement as expense or income. Distributions to holders of a financial instrument classified as an equity instrument ~~should~~shall be debited by the issuer directly to equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, net of any related income tax benefit.

31. The classification of a financial instrument as liability or equity~~in the balance sheet~~ determines whether interest, dividends, losses and gains relating to that instrument are classified as expenses or income and reported in the income statement. Thus, dividend payments on shares classified as liabilities are classified as expenses in the same way as interest on a bond and ~~reported~~ recognised in the income statement. Similarly, gains and losses associated with redemptions or refinancings of instruments classified as liabilities are reported in the income statement, whereas ~~while~~ redemptions or refinancings of instruments classified as equity ~~of the issuer~~ are reported as ~~movements~~ changes in equity. Changes in the fair value of a financial instrument classified as an equity instrument are not reported in the financial statements.

31A. An entity typically incurs various costs in issuing a financial instrument classified as equity or in acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting, and other professional advisers, printing costs, and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental external costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is not completed are recognised as an expense.

31B. Transaction costs that relate to the issue of a compound instrument that contains both a liability and an equity element are allocated to the components in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

31C. The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under IAS 1. The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under IAS 12, Income Taxes.

32. Dividends classified as an expense may be presented in the income statement either with interest on other liabilities or as a separate item. Disclosure of interest and dividends is subject to the requirements of IAS 1~~, Presentation of Financial Statements,~~ and IAS 30~~, Disclosures in the Financial Statements of Banks and Similar Financial Institutions and IAS 39, Financial Instruments: Recognition and Measurement~~. In some circumstances, because of significant differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately within the income statement. Disclosures of the ~~amounts of~~ tax effects are made in accordance with IAS 12~~, Income Taxes~~.

32A. Gains and losses related to changes in the carrying amount of a financial instrument classified as a financial liability are reported in the income statement as expense or income even when they relate to an instrument that includes a right to the residual interest in the assets of an entity for cash or another financial asset (see paragraph 22B). Under IAS 1 the issuer presents any gain or loss arising from remeasurement of such an instrument separately on the face of the income statement when it is relevant in explaining the entity's performance.

Offsetting of a Financial Asset and a Financial Liability

33. A financial asset and a financial liability ~~should~~shall be offset and the net amount reported in the balance sheet when, and only when, an ~~enterprise~~entity:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In the accounting for a transfer of a financial asset that does not qualify for derecognition, the transferred asset and the associated liability shall not be offset (see IAS 39, paragraphs 51-55).

34. This ~~standard~~ Standard requires the presentation of financial assets and financial liabilities on a net basis when ~~this~~ doing so reflects an ~~enterprise~~entity's expected future cash flows from settling two or more separate financial instruments. When an ~~enterprise~~entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the ~~enterprise~~entity.

35. Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from ceasing to recognise a financial asset or a financial liability. ~~While~~ Although offsetting does not give rise to recognition of a gain or ~~a~~ loss, ceasing to recognise a financial instrument not only results in the removal of the previously recognised item from the balance sheet but ~~may~~ also may result in recognition of a gain or ~~a~~ loss.

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

37. The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect significantly an ~~enterprise~~entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an ~~enterprise~~entity's future cash flows are not affected. When an ~~enterprise~~entity ~~does~~ intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting ~~since~~ because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

38. An ~~enterprise~~entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets, and other circumstances that may limit the ability to settle net or to settle simultaneously. When an ~~enterprise~~entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the ~~enterprise~~entity's credit risk exposure is disclosed in accordance with ~~the standard in~~ paragraph 66.

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

40. The conditions set out in paragraph 33 are generally not satisfied and offsetting is usually inappropriate when:

    (a) several different financial instruments are used to emulate the features of a single financial instrument (~~i.e.~~ a "synthetic instrument");

    (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;

(c) financial or other assets are pledged as collateral for non-recourse financial liabilities;

(d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or

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

41. An ~~enterprise~~entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a ''master netting arrangement'' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the 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 33 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an ~~enterprise~~entity's exposure to credit risk is disclosed in accordance with paragraph 66.

Disclosure

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

43. Transactions in financial instruments may result in an entity~~enterprise's~~ assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information ~~that~~ to assist~~s~~ users of financial statements in assessing the extent of risk related to ~~both recognised and unrecognised~~ financial instruments.

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

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

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

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

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

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

(c) *Liquidity risk* — Liquidity risk, also referred to as funding risk, is the risk that an ~~enterprise~~entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value.

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

Format and Location

44. Thise ~~standards~~ Standard does not prescribe either the format of the information required to be disclosed or its location within the financial statements. ~~With regard to recognised financial instruments, t~~To the extent that the required information is presented on the face of the ~~balance sheet~~financial statements, it is not necessary for it to be repeated in the notes to the financial statements. ~~With regard to unrecognised financial instruments, however, information in notes or supplementary schedules is the primary means of disclosure.~~ Disclosures may include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the instruments and their relative significance to the ~~enterprise~~entity.

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

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

~~Disclosure of~~ Risk Management Policies and Hedging Activities

~~43A.~~46A. An ~~enterprise~~entity ~~should~~shall describe its financial risk management objectives and policies, including its policy for hedging each major type of forecast~~ed~~ transaction for which hedge accounting is used.

46B. In addition to providing specific information about particular financial instrument balances and transactions, an entity provides a discussion of the extent to which financial instruments are used, the associated risks, and the business purposes served. A discussion of management’s policies for controlling the risks associated with financial instruments includes policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk, and requirements for collateral to mitigate credit risk. Such discussion provides a valuable additional perspective that is independent of the specific instruments held or outstanding at a particular time.

~~39.169(b).~~46C.An entity shall disclose the following separately for designated fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation ~~entity~~ (as defined in IAS 39):

(i) a description of the hedge;

(ii) a description of the financial instruments designated as hedging instruments ~~for the hedge~~ and their fair values at the balance sheet date;

(iii) the nature of the risks being hedged; and

(iv) for hedges of forecast~~ed~~ transactions, the periods in which the forecast~~ed~~ transactions are expected to occur, when they are expected to enter into the determination of ~~net~~ profit or loss, and a description of any forecast~~ed~~ transaction for which hedge accounting had previously been used but ~~that~~ which is no longer expected to occur.

~~39.169(c).~~46D.~~i~~If a gain or loss on derivative and non-derivative financial assets and financial liabilities designated as hedging instruments in cash flow hedges has been recognised directly in equity, through the statement of changes in equity, an entity shall disclose:

(i) the amount that was so recognised in equity during the ~~current~~ period; and

(ii) the amount that was removed from equity and reported in ~~net~~ profit or loss for the period. ~~; and~~

~~(iii) the amount that was removed from equity and added to the initial measurement of the acquisition cost or other carrying amount of the asset or liability in a hedged forecasted transaction during the current period (see paragraph 160).~~

Terms, Conditions, and Accounting Policies

47. For each class of financial asset, financial liability, and equity instrument~~, both recognised and unrecognised~~, an ~~enterprise~~entity ~~should~~shall disclose:

(a) information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and

(b) the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.

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

49. When financial instruments held or issued by an ~~enterprise~~entity, either individually or as a class, create a potentially significant exposure to the risks described in paragraph 43, terms and conditions that ~~may~~ warrant disclosure include:

(a) the principal, stated, face, or other similar amount which, for some derivative instruments, such as interest rate swaps, ~~may~~ might be the amount (referred to as the notional amount) on which future payments are based;

(b) the date of maturity, expiry, or execution;

(c) early settlement options held by either party to the instrument, including the period in which, or date at which, the options ~~may~~ can be exercised and the exercise price or range of prices;

(d) options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options ~~may~~ can be exercised and the conversion or exchange ratio(s);

(e) the amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including instalment repayments and any sinking fund or similar requirements;

(f) stated rate or amount of interest, dividend, or other periodic return on principal and the timing of payments;

(g) collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;

(h) in the case of an instrument for which cash flows are denominated in a currency other than the ~~enterprise~~entity's ~~reporting~~ presentation currency, the currency in which receipts or payments are required;

(i) in the case of an instrument that provides for an exchange, information described in items ~~(a) to (h)~~(a)-(h) for the instrument to be acquired in the exchange; and

(j) any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt-to-equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).

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

51. The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relation~~ships~~ between individual instruments that ~~may~~ can affect the amount, timing, or certainty of the future cash flows of an ~~enterprise~~entity. For example, it is important to disclose hedging relationships such as one that might exist when an ~~enterprise~~entity holds an investment in shares for which it has purchased a put option. ~~Similarly, it is important to disclose relationships between the components of ''synthetic instruments'' such as fixed rate debt created by borrowing at a floating rate and entering into a floating to fixed interest rate swap. In each case, an enterprise presents the individual financial assets and financial liabilities in its balance sheet according to their nature, either separately or in the class of financial asset or financial liability to which they belong.~~ The extent to which a risk exposure is altered by the relation~~ships~~ among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 49, but in some circumstances further disclosure is necessary.

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

(a) the criteria applied in determining when to recognise a financial asset or financial liability ~~on the balance sheet~~ and when to ~~cease to~~ derecognise it;

(b) the basis of measurement applied to financial assets and financial liabilities ~~both~~ on initial recognition and subsequently; and

(c) the basis on which income and expense arising from financial assets and financial liabilities ~~is~~ are recognised and measured.

52A. As part of the disclosure of an entity's accounting policies, an entity discloses for each category of financial assets whether 'regular way' purchases and sales of financial assets are accounted for at trade date or at settlement date (see IAS 39, paragraph 30).

53.-55. [deleted]

~~53. Types of transactions for which it may be necessary to disclose the relevant accounting policies include:~~

~~(a) transfers of financial assets when there is a continuing interest in, or involvement with, the assets by the transferor, such as securitisations of financial assets, repurchase agreements and reverse repurchase agreements;~~

~~(b) transfers of financial assets to a trust for the purpose of satisfying liabilities when they mature without the obligation of the transferor being discharged at the time of the transfer, such as an in-substance defeasance trust;~~

~~(c) acquisition or issuance of separate financial instruments as part of a series of transactions designed to synthesise the effect of acquiring or issuing a single instrument;~~

~~(d) acquisition or issuance of financial instruments as hedges of risk exposures; and~~

~~(e) acquisition or issuance of monetary financial instruments bearing a stated interest rate that differs from the prevailing market rate at the date of issue.~~

~~54. To provide adequate information for users of financial statements to understand the basis on which financial assets and financial liabilities have been measured, disclosures of accounting policies indicate not only whether cost, fair value or some other basis of measurement has been applied to a specific class of asset or liability but also the method of applying that basis. For example, for financial instruments carried on the cost basis, an enterprise may be required to disclose how it accounts for:~~

~~(a) costs of acquisition or issuance;~~

~~(b) premiums and discounts on monetary financial assets and financial liabilities;~~

~~(c) changes in the estimated amount of determinable future cash flows associated with a monetary financial instrument such as a bond indexed to a commodity price;~~

~~(d) changes in circumstances that result in significant uncertainty about the timely collection of all contractual amounts due from monetary financial assets;~~

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

~~(f) restructured financial liabilities.~~

~~For financial assets and financial liabilities carried at fair value, an enterprise indicates whether carrying amounts are determined from quoted market prices, independent appraisals, discounted cash flow~~

~~analysis or another appropriate method, and discloses any significant assumptions made in applying those methods.~~

~~55. An enterprise discloses the basis for reporting in the income statement realised and unrealised gains and losses, interest and other items of income and expense associated with financial assets and financial liabilities. This disclosure includes information about the basis on which income and expense arising from financial instruments held for hedging purposes are recognised. When an enterprise presents income and expense items on a net basis even though the corresponding financial assets and financial liabilities on the balance sheet have not been offset, the reason for that presentation is disclosed if the effect is significant.~~

Interest Rate Risk

56. For each class of financial assets and financial liabilit~~y~~ies, ~~both recognised and unrecognised,~~ an entity ~~enterprise should~~shall disclose information about its exposure to interest rate risk, including:

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

(b) effective interest rates, when applicable.

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

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

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

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

(a) exposed to fair value interest rate ~~price~~ risk, such as ~~monetary~~ financial assets and financial liabilities with a fixed interest rate;

(b) exposed to ~~interest rate~~ cash flow interest rate risk, such as ~~monetary~~ financial assets and financial liabilities with a floating interest rate that ~~is~~ resets as market rates change; and

(c) not directly exposed to interest rate risk, such as some investments in equity securities.

61. The effective interest rate (effective yield) of a ~~monetary~~ financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument (see IAS 39, paragraph 10). The present value calculation applies the interest rate to the stream of future cash receipts or payments from the reporting date to the next repricing (maturity) date and to the expected carrying amount (principal amount) at that date. The interest rate is a historical rate for a fixed rate instrument carried at amortised cost and a current market interest rate for a floating rate instrument or an instrument carried at fair value. The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the instrument for that period.

62. The requirement in paragraph 56(b) applies to bonds, notes, loans, and similar ~~monetary~~ financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement does not apply to financial instruments such as ~~non-monetary~~investments in equity securities and derivative instruments that do not bear a determinable effective interest rate. For example, ~~while~~even though instruments such as interest rate derivatives~~,~~ (including swaps, forward rate agreements, and options)~~,~~ are exposed to fair value~~price~~ or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not relevant. However, when providing effective interest rate information, an ~~enterprise~~entity discloses the effect on its interest rate risk exposure of hedging ~~or “conversion”~~ transactions such as interest rate swaps.

63. ~~An enterprise may retain an exposure to the interest rate risks associated with financial assets removed from its balance sheet as a result of a transaction such as a securitisation. Similarly, it~~An entity may become exposed to interest rate risks as a result of a transaction in which no financial asset or financial liability is recognised on its balance sheet, such as a commitment to lend funds at a fixed interest rate. In such circumstances, the ~~enterprise~~entity discloses information that ~~will~~ permits financial statement users to understand the nature and extent of its exposure. ~~In the case of a securitisation or similar transfer of financial assets, this information normally includes the nature of the assets transferred, their stated principal, interest rate and term to maturity, and the terms of the transaction giving rise to the retained exposure to interest rate risk. In the case of a commitment to lend funds, t~~The disclosure normally includes the stated principal, interest rate, and term to maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to risk.

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

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

(i) ~~within~~ not later than one year ~~of the balance sheet date~~;

(ii) later than ~~more than~~ one year and not later ~~less~~ than two ~~five~~ years ~~from the balance sheet date~~;

(iii) later than two years and not later than three years;

(iv) later than three years and not later than four years;

(v) later than four years and not later than five years; and

(v~~ii~~i) later than five years ~~or more from the balance sheet date~~.

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

(i) within one month of the balance sheet date;

(ii) more than one month and less than three months from the balance sheet date; and

(iii) more than three and less than twelve months from the balance sheet date.

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

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

65. In some circumstances, an ~~enterprise~~entity may be able to provide useful information about its exposure to interest rate risks by indicating the effect of a hypothetical change in ~~the prevailing level of~~ market interest rates on the fair value of its financial instruments and future earnings and cash flows. Such interest rate sensitivity information may be based on, for example, an assumed one percentage point (100 basis points) ~~1%~~ change in market interest rates occurring at the balance sheet date. The effects of a change in interest rates includes changes in interest income and expense relating to floating rate financial instruments and gains or losses resulting from changes in the fair values of fixed rate instruments. The reported interest rate sensitivity may be restricted to the direct effects of an interest rate change on interest-bearing financial instruments ~~on hand~~recognised at the balance sheet date ~~since~~ because the indirect effects of a rate change on financial markets and individual ~~enterprises~~entities cannot normally be predicted reliably. When disclosing interest rate sensitivity information, an ~~enterprise~~entity indicates the basis on which it has prepared the information, including any significant assumptions.

Credit Risk

66. For each class of financial assets and other credit exposures, ~~both recognised and unrecognised,~~ an ~~enterprise~~entity ~~should~~shall disclose information about its exposure to credit risk, including:

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

(b) significant concentrations of credit risk.

67. An ~~enterprise~~entity provides information relating to credit risk to permit users of its financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets ~~on hand~~recognised at the balance sheet date or require a cash outflow from other credit exposures. Such failures give rise to a financial loss recognised in an ~~enterprise~~entity's income statement. Paragraph 66 does not require an

~~enterprise~~entity to disclose an assessment of the probability of losses arising in the future.

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

(a) to provide users of financial statements with a consistent measure of the amount exposed to credit risk for financial assets and other credit exposures (such as a credit derivative or an issued guarantee to meet the obligations of a third party) ~~for both recognised and unrecognised financial assets~~; and

(b) to take into account the possibility that the maximum exposure to loss may differ from the carrying amount of ~~a recognised~~ financial assets recognised at the balance sheet date. ~~or the fair value of an unrecognised financial asset that is otherwise disclosed in the financial statements.~~

69. In the case of ~~recognised~~ financial assets exposed to credit risk, the carrying amount of the assets in the balance sheet, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the balance sheet date is normally the carrying amount ~~since~~ because it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the balance sheet is necessary. On the other hand, ~~as illustrated by the examples in paragraphs 70 and 71,~~ an ~~enterprise~~entity's maximum potential loss from some ~~recognised~~ financial ~~assets~~ instruments may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 66(a).

70. A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the balance sheet net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an ~~enterprise~~entity discloses the existence of the legal right of set-off when providing information in accordance

with paragraph 66. For example, when an ~~enterprise~~entity is due to receive the proceeds from realisation of a financial asset before settlement of a financial liability of equal or greater amount against which the ~~enterprise~~entity has a legal right of set-off, the ~~enterprise~~entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the ~~enterprise~~entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform financial statement users of the extent to which exposure to credit risk at a particular point in time has been reduced, the ~~enterprise~~entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the ~~enterprise~~entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.

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

(a) the credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realised; and

(b) the extent to which an ~~enterprise~~entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the balance sheet date because the exposure is affected by each transaction subject to the arrangement.

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

72. [deleted]~~When there is no credit risk associated with an unrecognised financial asset or the maximum exposure is equal to the principal, stated, face or other similar contractual amount of the instrument disclosed in accordance with paragraph 47 or the fair value disclosed in accordance with paragraph 77, no additional disclosure is required to comply with paragraph 66(a). However, with some unrecognised financial assets, the maximum loss that would be recognised upon default by the other party to the underlying instrument may differ substantially from the amounts disclosed in accordance with paragraphs 47 and 77. For example, an enterprise may have a right to mitigate the loss it would otherwise bear by setting off an unrecognised financial asset against an unrecognised financial liability. In such circumstances, paragraph 66(a) requires disclosure in addition to that provided in accordance with paragraphs 47 and 77.~~

73. An entity may be exposed to credit risk as a result of a transaction in which no financial asset is recognised on its balance sheet, such as for a financial guarantee or credit derivative contract. Guaranteeing an obligation of another party creates a liability and exposes the guarantor to credit risk that ~~would be~~ is taken into account in making the disclosures required by paragraph 66. ~~This situation may arise as a result of, for example, a securitisation transaction in which an enterprise remains exposed to credit risk associated with financial assets that have been removed from its balance sheet. If the enterprise is obligated under recourse provisions of the transaction to indemnify the purchaser of the assets for credit losses, it discloses the nature of the assets removed from its balance sheet, the amount and timing of the future cash flows contractually due from the assets, the terms of the recourse obligation and the maximum loss that could arise under that obligation.~~ (See also IAS 37, Provisions, Contingent Liabilities and Contingent Assets.)~~.~~

74. Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature of the business and financial position of the ~~business~~ entity and ~~they~~ result in a significant exposure to loss in the event of default by other parties. Identification of significant concentrations ~~is a matter for the exercise of~~ requires judgement by management taking into account the circumstances of the ~~enterprise~~entity and its debtors. IAS 14, Segment Reporting, provides ~~useful~~ guidance in identifying industry and geographical segments within which credit risk concentrations may arise.

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

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

Fair Value

77. For each class of financial assets and financial liabilities~~y, both recognised and unrecognised~~, an ~~enterprise~~entity ~~should~~shall disclose ~~information about~~the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the balance sheet (IAS 39 provides guidance for determining fair value) except as provided in paragraph 77A.

77A.~~When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability~~If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under IAS 39 because their fair value cannot be measured reliably, that fact ~~should~~shall be disclosed together with a description of the financial instruments, their carrying amount, an explanation of why fair value cannot be measured reliably, and, if possible, the range of estimates within which fair value is highly likely to lie. Furthermore, if financial assets whose fair value previously could not be reliably measured are

sold, that fact, the carrying amount of such financial assets at the time of sale, and the amount of gain or loss recognised shall be disclosed. ~~***information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.***~~

77B.An entity shall disclose:

(a) the methods and significant assumptions applied in determining fair values of financial assets and financial liabilities separately for significant classes of financial assets and financial liabilities (paragraph 46 provides guidance for determining classes of financial assets);

(b) the extent to which fair values of financial assets and financial liabilities are determined directly by reference to published price quotations in an active market or recent market transactions on arm's length terms or are estimated using a valuation technique (see IAS 39, paragraphs 98-100D);

(c) the extent to which fair values are determined in full or in part using a valuation technique based on assumptions that are not supported by observable market prices;

(d) if a fair value estimated using a valuation technique is sensitive to valuation assumptions that are not supported by observable market prices, a statement of this fact and the effect on the fair value of using a range of reasonably possible alternative assumptions; and

(e) the total amount of the change in fair value estimated using a valuation technique that was recognised in profit or loss during the reporting period.

78. Fair value information is widely used for business purposes in determining an ~~enterprise's~~ entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements ~~since~~because, in many circumstances, it reflects the judgement of the financial markets as to the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they

were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. When an ~~enterprise~~entity does not ~~carry~~ measure a financial asset or financial liability in its balance sheet at fair value, it provides fair value information through supplementary disclosures.

79. ~~The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods.~~ Disclosure of fair value information includes disclosure of the method ~~adopted~~ used in determining fair value and any significant assumptions made in its application. For example, an entity discloses information about prepayment rates, rates of estimated credit losses, and interest or discount rates.

80.-84. [deleted]

~~80. Underlying the definition of fair value is a presumption that an enterprise is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an enterprise would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, an enterprise takes its current circumstances into account in determining the fair values of its financial assets and financial liabilities. For example, the fair value of a financial asset that an enterprise has decided to sell for cash in the immediate future is determined by the amount that it expects to receive from such a sale. The amount of cash to be realised from an immediate sale will be affected by factors such as the current liquidity and depth of the market for the asset.~~

~~81. When a financial instrument is traded in an active and liquid market, its quoted market price provides the best evidence of fair value. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction may provide evidence of the current fair value provided that there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an enterprise has matching asset and~~

~~liability positions, it may appropriately use mid-market prices as a basis for establishing fair values.~~

~~82. When there is infrequent activity in a market, the market is not well established (for example, some "over the counter" markets) or small volumes are traded relative to the number of trading units of a financial instrument to be valued, quoted market prices may not be indicative of the fair value of the instrument. In these circumstances, as well as when a quoted market price is not available, estimation techniques may be used to determine fair value with sufficient reliability to satisfy the requirements of this Standard. Techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. In applying discounted cash flow analysis, an enterprise uses a discount rate equal to the prevailing market rate of interest for financial instruments having substantially the same terms and characteristics, including the creditworthiness of the debtor, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.~~

~~83. The fair value to an enterprise of a financial asset or financial liability, whether determined from market value or otherwise, is determined without deduction for the costs that would be incurred to exchange or settle the underlying financial instrument. The costs may be relatively insignificant for instruments traded in organised, liquid markets but may be substantial for other instruments. Transaction costs may include taxes and duties, fees and commissions paid to agents, advisers, brokers or dealers and levies by regulatory agencies or securities exchanges.~~

~~84. When an instrument is not traded in an organised financial market, it may not be appropriate for an enterprise to determine and disclose a single amount that represents an estimate of fair value. Instead, it may be more useful to disclose a range of amounts within which the fair value of a financial instrument is reasonably believed to lie.~~

85. ~~When~~ If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under IAS 39 because their fair values cannot be measured reliably, ~~disclosure of fair value~~ information about fair value is not required to be disclosed. Instead, ~~is~~ ~~omitted because it is not practicable to determine fair value with sufficient reliability,~~ information is provided to assist users of the financial statements in making their own judgements about the extent of possible differences between the carrying amount of such financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for not disclosing fair values ~~the omission~~ and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 47 may provide sufficient information ~~about the characteristics of the instrument~~. When it has a reasonable basis for doing so, management may indicate its opinion ~~as to~~ on the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value reliably.

86. For financial instruments such as short-term trade receivables and payables, no disclosure of fair value is required when the carrying amount approximates fair value. ~~The historical cost carrying amount of receivables and payables subject to normal trade credit terms usually approximates fair value. Similarly, the fair value of a deposit liability without a specified maturity is the amount payable on demand at the reporting date.~~

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

~~Financial Assets Carried at an Amount in Excess of Fair Value~~

~~91~~88.-93. [Deleted]

~~***88. When an enterprise carries one or more financial assets at an amount in excess of their fair value, the enterprise should disclose:***~~

~~***(a) the carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and***~~

~~***(b) the reasons for not reducing the carrying amount, including the nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.***~~

~~89. Management exercises judgement in determining the amount it expects to recover from a financial asset and whether to write down the carrying amount of the asset when it is in excess of fair value. The information required by paragraph 88 provides users of financial statements with a basis for understanding management's exercise of judgement and assessing the possibility that circumstances may change and lead to a reduction in the asset's carrying amount in the future. When appropriate, the information required by paragraph 88(a) is grouped in a manner that reflects management's reasons for not reducing the carrying amount.~~

~~90. An enterprise's accounting policies with respect to recognition of declines in value of financial assets, disclosed in accordance with paragraph 47, assist in explaining why a particular financial asset is carried at an amount in excess of fair value. In addition, the enterprise provides the reasons and evidence specific to the asset that provide management with the basis for concluding that the asset's carrying amount will be recovered. For example, the fair value of a fixed rate loan intended to be held to maturity may have declined below its carrying amount as a result of an increase in interest rates. In such circumstances, the lender may not have reduced the carrying amount because there is no evidence to suggest that the borrower is likely to default.~~

Other Disclosures

93A. ~~39.170.~~An entity shall disclose~~Financial statements should include all of~~ the following ~~additional disclosures~~ relating to its financial instruments:

~~***(a) if a gain or loss from remeasuring available-for-sale financial assets to fair value (other than assets relating to hedges) has been recognised directly in equity, through the statement of changes in equity, disclose:***~~

~~***(i) the amount that was so recognised in equity during the current period; and***~~

~~***(ii) the amount that was removed from equity and reported in net profit or loss for the period;***~~

~~***(b) if the presumption that fair value can be reliably measured for all financial assets that are available for sale or held for trading has been overcome (see paragraph 70) and the enterprise is, therefore, measuring any such financial assets at amortised cost, disclose that fact together with a description of the financial assets, their carrying amount, an explanation of why fair value cannot be reliably measured, and, if possible, the range of estimates within which fair value is highly likely to lie. Further, if financial assets whose fair value previously could not be measured reliably are sold, that fact, the carrying amount of such financial assets at the time of sale, and the amount of gain or loss recognised should be disclosed;***~~

(a)~~(c)disclose~~ significant items of income, expense, and gains and losses resulting from financial assets and financial liabilities, whether included in ~~net~~ profit or loss or as a separate component of equity. For this purpose, the following shall be disclosed:

(i) total interest income and total interest expense (both on a historical cost basis) for financial assets and financial liabilities that are not designated as held for trading~~should be disclosed separately~~;

(ii) ~~with respect to~~for available-for-sale financial assets ~~that are adjusted to fair value after initial acquisition~~, the amount of

any gain or loss recognised directly in equity during the period and the amount that was removed from equity and reported in profit or loss for the period; and

~~total gains and losses from derecognition of such financial assets included in net profit or loss for the period should be reported separately from total gains and losses from fair value adjustments of recognised assets and liabilities included in net profit or loss for the period (a similar split of 'realised' versus 'unrealised' gains and losses with respect to financial assets and liabilities held for trading is not required);~~

(iii) ~~the enterprise should disclose~~ the amount of interest income ~~that has been~~ accrued on impaired loans pursuant to IAS 39 paragraph ~~116~~115 ~~and that has not yet been received in cash~~;

(b) if the entity has sold or otherwise transferred a financial asset, but the transfer does not qualify for derecognition in full or in part (for example, because of a repurchase agreement, a put or call option, or a credit guarantee on the transferred asset or a portion of that asset):

(i) the nature of the assets transferred;

(ii) the nature of the continuing involvement in the assets transferred;

(iii) the extent of such transfers; and

(iv) information about the risks retained in any portion of a transferred asset that the transferor continues to recognise.

(c)~~(d)~~if the entity~~enterprise~~ has entered into a securitisation ~~or repurchase~~ agreement and has a continuing involvement in all or a portion of the securitised financial assets as of the balance sheet date, for each major asset type (for example, mortgage loans, credit card receivables, and car loans): ~~disclose, separately for such transactions occurring in the current financial reporting period and for remaining retained interests from transactions occurring in prior financial reporting periods:~~

(i) the nature of the assets transferred;

(ii) the ~~and~~ extent of such transactions, including ~~a description of any collateral and~~ quantitative information about the key assumptions used in calculating the fair values of new and retained interests; and

(iii) the total principal amount outstanding, any portion that has been derecognised, and the portion that continues to be recognised~~whether the financial assets have been derecognised~~;

(d)~~(e)~~if the ~~enterprise~~ entity has reclassified a financial asset as one required to be reported at cost or amortised cost rather than at fair value (see IAS 39, paragraph 92), ~~disclose~~ the reason for that reclassification;

(e)~~(f)~~~~disclose~~ the nature and amount of any impairment loss ~~or reversal of an impairment loss~~ recognised for a financial asset, separately for each significant class of financial asset (paragraph 46 ~~of IAS 32~~ provides guidance for determining classes of financial assets);

(f)~~(g)~~~~a borrower should disclose~~ the carrying amount of financial assets pledged as collateral for liabilities, the carrying amount of financial assets pledged as collateral for contingent liabilities, and (consistently with ~~IAS 32.~~paragraphs 47(a) and ~~IAS 32.~~49(g)) any significant terms and conditions relating to pledged assets; ~~and~~

(g)~~(h)~~when an entity has accepted collateral: ~~a lender should disclose:~~

(i) the fair value of collateral (both financial and non-financial assets) that it ~~has accepted and that it~~ is permitted to sell or repledge in the absence of default;

(ii) the fair value of collateral that it has sold ~~or repledged~~ and has an obligation to return; and

(iii) (consistently with ~~IAS 32.~~paragraphs 47(a) and ~~IAS 32.~~49(g)) any significant terms and conditions associated with its use of collateral;

(h) if the entity has designated non-derivative financial liabilities as held for trading, the difference between their carrying amount and the amount the entity would be contractually required to pay to the holders of the obligations at maturity;

(i) if the entity has issued an instrument that contains both a liability and an equity element (see paragraph 23) and the instrument has multiple embedded derivative features whose values are interdependent (such as a convertible debt instrument with an embedded call feature), the existence of those features and the effective yield on the liability element (excluding any embedded derivatives that are accounted for separately); and

(j) with respect to any defaults of principal, interest, sinking fund, or redemption provisions during the period on loans payable recognised as at the balance sheet date, and any other breaches during the period of loan agreements when those breaches can permit the lender to demand repayment (except for breaches that are remedied, or in response to which the terms of the loan are renegotiated, on or before the balance sheet date):

(i) details of those breaches;

(ii) the amount recognised as at the balance sheet date in respect of the loans payable on which the breaches occurred; and

(iii) with respect to amounts disclosed under (ii), whether the default has been remedied or the terms of the loans payable renegotiated before the date the financial statements were authorised for issue.

93B. For the purposes of disclosing information on breaches of loan agreements in accordance with paragraph 93A(j), loans payable include issued debt securities and financial liabilities other than short-term trade payables on normal credit terms. When such a breach occurred during the period, and the breach has not been remedied or the terms of the loan payable have not been renegotiated by the balance sheet date, the effect of the breach on the classification of the liability as current or non-current is determined under IAS 1.

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

~~(a) the total amount of the change in the fair value of financial assets and financial liabilities that has been recognised as income or expense for the period; and~~

~~(b) the average aggregate carrying amount during the year of recognised financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognised financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the balance sheet date are unrepresentative of amounts on hand during the year.~~

~~Transitional Provision~~

95. [deleted]***~~When comparative information for prior periods is not available when this International Accounting Standard is first adopted, such information need not be presented.~~***

Effective Date

96. This ~~International Accounting~~ Standard becomes operative for annual financial statements covering ~~periods~~ financial years beginning on or after [to be inserted after exposure] 2003. ~~1 January, 1996.~~ The Standard shall be applied retrospectively. The opening balance of retained earnings for the earliest prior period presented and the other comparative amounts shall be adjusted as if the Standard had always been in use unless restating the information would require undue cost or effort.

Appendix A

~~Examples of the~~ Application Guidance ~~of the Standard~~

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

A1. This Appendix explains and illustrates the application of ~~certain~~ particular aspects of the Standard ~~to various common financial instruments~~. The ~~detailed~~ examples are illustrative only and do not necessarily represent the only basis for applying the Standard in the specific circumstances discussed. Changing one or two of the facts assumed in the examples can lead to substantially different conclusions concerning the appropriate presentation or disclosure of a particular financial instrument. This Appendix does not discuss the application of all requirements of the Standard ~~in the examples provided~~. In all cases, the provisions of the Standard prevail.

A2. 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, Financial Instruments: Recognition and Measurement. ~~Certain recognition and measurement practices may be assumed for purposes of illustration but they are not required.~~

Definitions

Common Types of Financial Instruments, Financial Assets and Financial Liabilities

A3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and reported in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the

institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.

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

(a) trade accounts receivable and payable;

(b) notes receivable and payable;

(c) loans receivable and payable; and

(d) bonds receivable and payable.

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

A5. 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.

A6. Under IAS 17, Leases, a finance lease is accounted for as a sale with delayed payment terms. The lease contract is considered to be primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is considered to be primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is considered to be a financial instrument and an operating lease is considered not to be a financial instrument (except as regards individual payments currently due and payable).

Equity Instruments

A7. Examples of equity instruments include common shares, ~~certain~~ particular types of preferred shares, and warrants or written call options to subscribe for or purchase a fixed number of common shares in the issuing ~~enterprise~~entity in exchange for a fixed amount of cash or other financial assets. An entity's ~~enterprise's~~ obligation to issue its own equity instruments in exchange for financial assets of another party when the counterparty has a residual interest in the entity is not potentially unfavourable to the entity because ~~since~~ it results in an increase in equity and cannot result in a loss to the entity. ~~enterprise.~~ The possibility that existing holders of an equity interest in the ~~enterprise~~entity may find the fair value of their interest reduced as a result of the obligation does not make the obligation unfavourable to the ~~enterprise~~ entity~~itself~~.

A8. A~~n~~ purchased call option or other similar ~~instrument~~ contract acquired by an ~~enterprise~~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 other financial assets is not a financial asset of the ~~enterprise~~entity. Instead, any consideration paid for such a contract is deducted from equity. ~~The enterprise will not receive cash or any other financial asset through exercise of the option. Exercise of the option is not potentially favourable to the enterprise since it results in a reduction in equity and an outflow of assets. Any change in equity recorded by the enterprise from reacquiring and cancelling its own equity instruments represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity interest, rather than a gain or loss by the enterprise.~~

Derivative Financial Instruments

A9. Paragraph 10 of IAS 39 defines a derivative. On inception, derivative financial instruments give one party a contractual right to exchange financial assets with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets with another party under conditions that are potentially unfavourable. Some instruments embody both a right and an obligation to make an exchange.

~~Since~~ 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.

A10. A put or call option to exchange financial instruments gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forego potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would ~~still~~ constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial assets under potentially favourable conditions and the writer's obligation to exchange the financial assets under potentially unfavourable conditions are distinct from the underlying financial assets to be exchanged upon exercise of the option. The nature of the holder's right and the writer's obligation is not affected by the likelihood that the option will be exercised. An option to buy or sell an asset other than a financial asset (such as a commodity) does not give rise to a financial asset or financial liability ~~because it does not fit the requirements of the definitions for the receipt or delivery of financial assets or exchange of financial instruments~~. Nevertheless, some contracts to buy or sell non-financial items that can be settled net are within the scope of the Standard (see paragraph 4A).

A11. Another example of a derivative financial instrument is a forward contract to be settled in six months~~'~~ time in which one party (the purchaser) promises to deliver 1,000,000 cash in exchange for 1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver 1,000,000 face amount of fixed rate government bonds in exchange for 1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above 1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below

1,000,000, the effect will be the opposite. The purchaser has both a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). ~~The significant difference between a forward contract and an option contract is that b~~Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

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

Commodity Contracts and Commodity-linked Financial Instruments

A13. As indicated by paragraph 14 of the Standard, contracts that provide for settlement by receipt or delivery of a ~~physical asset~~ non-financial item only (for example, an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardised in form and traded on organised markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be ~~readily~~ bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the

obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net are within the scope of the Standard as if they were financial instruments (see paragraph 4A).

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

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

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

A17. Although the Standard was not developed to apply to commodity or other contracts that do not satisfy the definition of a financial instrument, ~~enterprises~~entities may regard it as ~~consider whether it is~~ appropriate to apply the relevant portions of the disclosure standards to such contracts. Some contracts to buy or sell non-financial items that can be settled net are within the scope of the Standard (see paragraph 4A).

Liabilities and Equity

A18. ~~It is relatively easy for issuers to classify certain types of financial instruments as liabilities or equity.~~ Examples of equity instruments include common (ordinary) shares and options that, if exercised, would require the writer of the option to issue a fixed number of common shares in exchange for receiving a fixed amount of cash or other financial assets. Common shares do not oblige the issuer to transfer assets to shareholders, except when the issuer formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following declaration of a dividend or when the ~~enterprise~~entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

"Perpetual" Debt Instruments ~~debt instruments~~

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

Preferred Shares

A20. Preferred (or preference) shares may be issued with various rights. In classifying a preferred share as a liability or equity, an ~~enterprise~~entity assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preferred share that provides for redemption on a specific date or at the option of the holder meets the definition of a financial liability if the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preferred share when contractually required to do so, whether due to a lack of funds~~ or~~, a statutory restriction, or insufficient profits or reserves, does not negate the obligation. An option of the issuer to redeem the shares does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. Redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.

A21. When preferred shares are non-redeemable, the appropriate classification is determined by the other rights that ~~may~~ attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preferred shares, whether~~,~~ cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preferred share as equity is not affected by (a) a history of making distributions; (b) an intent to make distributions in the future; (c) a possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares); (d) the amount of the issuer's reserves; (e) an issuer's expectation of a profit or loss for a period; or (f) an ability or inability of the issuer to control the amount of its profit or loss for the period.

Puttable Instruments

A21A. Paragraph 22B specifies that even when the legal form of a puttable instrument includes a right to the residual interest in the assets of an entity, the inclusion of an option for the holder to put that right back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability and is classified as such. A liability to repay unitholders' interests may be presented using a descriptor such as 'net asset value available to unitholders'. The change in a liability to repay unitholders may be presented using a descriptor such as 'change in net asset value available to unitholders'.

Compound Financial Instruments

A22. Paragraph 23~~ of the Standard~~ applies only to a limited group of compound instruments for the purpose of having the issuers present liability and equity ~~components~~ elements separately on their balance sheets. Paragraph 23 does not deal with compound instruments from the perspective of holders. IAS 39 deals with the separation of embedded derivatives from the perspective of holders of hybrid instruments that contain debt and equity features.

A23. A common form of compound financial instrument is a debt security with an embedded conversion option, such as a bond convertible into common shares of the issuer, and without any other embedded derivative features. Paragraph 23 ~~of the Standard~~ requires the issuer of such a financial instrument to present the liability ~~component~~element and the equity ~~component~~element separately on the balance sheet from their initial recognition.

(a) The issuer's obligation to make scheduled payments of interest and principal constitutes a financial liability ~~which~~ that exists as long as the instrument is not converted. On ~~inception~~initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market ~~at that time~~ to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

(b) The equity instrument is an embedded option to convert the liability into equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. The intrinsic value of an option or other derivative financial instrument is the excess, if any, of the fair value of the underlying financial instrument over the contractual price at which the underlying instrument is to be acquired, issued, sold or exchanged. The time value of a derivative instrument is its fair value less its intrinsic value. The time value is associated with the length of the remaining term to maturity or expiry of the derivative instrument. It reflects the income foregone by the holder of the derivative instrument from not holding the underlying instrument, the cost avoided by the holder of the derivative instrument from not having to finance the underlying instrument, and the value placed on the probability that the intrinsic value of the derivative instrument will increase ~~prior to its maturity or expiry due to~~before it matures or expires because of future volatility in the fair value of the underlying instrument. It is uncommon for the embedded option in a convertible bond or similar instrument to have any intrinsic value on ~~issuance~~issue.

A24. Paragraph 28 ~~of the Standard~~ describes how the ~~components~~ elements of a compound financial instrument are separated by the issuer ~~may be valued~~ on initial recognition. The following example illustrates ~~in greater detail~~ how such valuations may be made.

An ~~enterprise~~entity issues 2,000 convertible bonds at the start of ~~Y~~year 1. The bonds have a three-year term, and are issued at par with a face value of 1,000 per bond, giving total proceeds of 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent~~%~~. Each bond is convertible at any time up to maturity into 250 common shares.

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

~~*Residual valuation of equity component*~~

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

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

~~*Option pricing model valuation of equity component*~~

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

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

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

~~This amount relates to the potential for favourable (and unfavourable) changes in the price of the asset underlying the option, in this case the common shares of the enterprise issuing the convertible bonds. The volatility of the returns on the underlying asset are estimated by the standard deviation of the returns. The higher the standard deviation, the greater the fair value of the option. In this example, the standard deviation of the annual returns on the shares is assumed to be 30%. The time to expiry of the conversion rights is three years.~~

~~The standard deviation of proportionate changes in fair value of the shares multiplied by the square root of the time to expiry of the option is thus determined as:~~

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

~~(ii) Ratio of the fair value of the asset underlying the option to the present value of the option exercise price.~~

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

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

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

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

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

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

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

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

A24A. The following example illustrates the application of paragraph 28 to the separation of the liability and equity elements of a compound instrument with multiple embedded derivative features. Assume that the proceeds received on the issue of a callable convertible bond are 60. The value of a similar bond without any call or equity conversion option is 57. Based on an option-pricing model, it is determined that the value to the issuer of the embedded call feature in a similar bond without an equity conversion option is 2 and that the value to the counterparty of the equity conversion option in a similar bond without an embedded call feature is 12. In this case, the value allocated to the liability element under paragraph 28 is 55 (57-2) and the value allocated to the equity element is 5 (60-55). This allocation ensures that the joint value between the liability and equity elements attributable to interdependence between the embedded call and equity conversion features of 7 (12-5) is included in the liability element.

Offsetting ~~of~~ a Financial Asset and a Financial Liability

A25. The Standard does not provide special treatment for so–called ‘‘synthetic instruments’’, which are groupings of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt. Each of the individual financial instruments that together constitute a ‘‘synthetic instrument’’ ~~separate components of a ‘‘synthetic instrument’’~~ represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each ~~component~~ financial instrument is exposed to risks that may differ from the risks to which other ~~components~~ financial instruments are exposed. Accordingly, when one financial instrument in ~~component of~~ a ‘‘synthetic instrument’’ is an asset and another is a liability, they are not offset and presented on an ~~enterprise~~entity’s balance sheet on a net basis unless they meet the criteria for offsetting in paragraph 33 ~~of the Standard~~. ~~Such is often not the case.~~ Disclosures are provided about the significant terms and conditions of each financial instrument ~~constituting a component of a ‘‘synthetic instrument’’ without regard to the existence of the ‘‘synthetic instrument’’~~, although an ~~enterprise~~entity may indicate in addition the nature of the relationship between the ~~components~~ individual instruments (see paragraph 51 ~~of the Standard~~).

~~Disclosure~~

~~A26. Paragraph 53 of the Standard lists examples of broad categories of matters that, when significant, an enterprise addresses in its disclosure of accounting policies. In each case, an enterprise has a choice from among two or more different accounting treatments. The following discussion elaborates on the examples in paragraph 53 and provides further examples of circumstances in which an enterprise discloses its accounting policies.~~

~~(a) An enterprise may acquire or issue a financial instrument under which the obligations of each party are partially or completely unperformed (sometimes referred to as an unexecuted or executory contract). Such a financial instrument may involve a future exchange and performance may be conditional on a future event. For example, neither the right nor the obligation to make an exchange under a forward contract results in any transaction in the underlying financial instrument until the maturity of the contract but the right and obligation constitute a financial asset and a financial liability, respectively. Similarly, a financial guarantee does not require the guarantor to assume any obligation to the holder of the guaranteed debt until an event of default has occurred. The guarantee is, however, a financial liability of the guarantor because it is a contractual obligation to exchange one financial instrument (usually cash) for another (a receivable from the defaulted debtor) under conditions that are potentially unfavourable.~~

~~(b) An enterprise may undertake a transaction that, in form, constitutes a direct acquisition or disposition of a financial instrument but does not~~

~~involve the transfer of the economic interest in it. Such is the case with some types of repurchase and reverse repurchase agreements. Conversely, an enterprise may acquire or transfer to another party an economic interest in a financial instrument through a transaction that, in form, does not involve an acquisition or disposition of legal title. For example, in a non-recourse borrowing, an enterprise may pledge accounts receivable as collateral and agree to use receipts from the pledged accounts solely to service the loan.~~

~~(c) An enterprise may undertake a partial or incomplete transfer of a financial asset. For example, in a securitisation, an enterprise acquires or transfers to another party some, but not all, of the future economic benefits associated with a financial instrument.~~

~~(d) An enterprise may be required, or intend, to link two or more individual financial instruments to provide specific assets to satisfy specific obligations. Such arrangements include, for example, "in substance" defeasance trusts in which financial assets are set aside for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation, non-recourse secured financing and sinking fund arrangements.~~

~~(e) An enterprise may use various risk management techniques to minimise exposures to financial risks. Such techniques include, for example, hedging, interest rate conversion from floating rate to fixed rate or fixed rate to floating rate, risk diversification, risk pooling, guarantees and various types of insurance (including sureties and "hold harmless" agreements). These techniques generally reduce the exposure to loss from only one of several different financial risks associated with a financial instrument and involve the assumption of additional but only partially offsetting risk exposures.~~

~~(f) An enterprise may link two or more separate financial instruments together notionally in a "synthetic" instrument or for some purposes other than those described in items (d) and (e) above.~~

~~(g) An enterprise may acquire or issue a financial instrument in a transaction in which the amount of the consideration exchanged for the instrument is uncertain. Such transactions may involve non-cash consideration or an exchange of several items.~~

~~(h) An enterprise may acquire or issue a bond, promissory note or other monetary instrument with a stated amount or rate of interest that~~

~~differs from the prevailing market interest rate applicable to the instrument. Such financial instruments include zero coupon bonds and loans made on apparently favourable terms but involving non-cash consideration, for example, low interest rate loans to employees.~~

~~A27. Paragraph 54 of the Standard lists several issues that an enterprise addresses in its disclosure of accounting policies when the issues are significant to the application of the cost basis of measurement. In the case of uncertainty about the collectibility of amounts realisable from a monetary financial asset or a decline in the fair value of a financial asset below its carrying amount due to other causes, an enterprise indicates its policies for determining:~~

~~(a) when to reduce the carrying amount of the asset;~~

~~(b) the amount to which it reduces the carrying amount;~~

~~(c) how to recognise any income from the asset; and~~

~~(d) whether the reduction in carrying amount may be reversed in the future if circumstances change.~~

Examples Illustrating the Accounting for Derivatives Based on an Entity's Own Equity Instruments

A26. The following examples illustrate the application of paragraphs 29C-29G and IAS 39 to the accounting for derivatives based on an entity's own equity instruments.

Illustrative example 1: Forward to buy shares

A27. This example illustrates the journal entries for forward purchase contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of multiple settlement alternatives (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (ie the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	1 February 2002
Maturity date	31 January 2003

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	110
Market price per share on 31 January 2003	106
Fixed forward price to be paid on 31 January 2003	104
Present value of forward price on 1 February 2002	100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 2002	0
Fair value of forward on 31 December 2002	6,300
Fair value of forward on 31 January 2003	2,000

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

A28. In this subsection, the forward purchase contract on the entity's own shares will be settled net in cash, ie there is no receipt or delivery of the entity's own shares upon settlement of the forward contract.

1 February 2002

On 1 February 2002, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding common shares as of 31 January 2003 in exchange for a payment of 104,000 in cash (ie 104 per share) on 31 January 2003. The contract will be net cash settled.

The price per share when the contract is agreed on 1 February 2002 is 100. The initial fair value of the forward contract on 1 February 2002 is zero.

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

31 December 2002

On 31 December 2002, the market price per share has increased to 110 and, as a result, the fair value of the forward contract has increased to 6,300.

Dr.	Forward asset	6,300	
Cr.	Gain		6,300

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

31 January 2003

On 31 January 2003, the market price per share has decreased to 106. The fair value of the forward contract is 2,000 ([106 x 1,000] – 104,000).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver 104,000 to Entity B and Entity B has an obligation to deliver 106,000 [106 x 1,000] to Entity A, so Entity B pays the net amount of 2,000 to Entity A.

Dr.	Loss	4,300	
Cr.	Forward asset		4,300

To record the decrease in the fair value of the forward contract (ie 4,300 = 6,300 – 2,000).

Dr.	Cash	2,000	
Cr.	Forward asset		2,000

To record the settlement of the forward contract.

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

A29. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. The journal entries are the same as those shown in (a) above, except for recording the settlement of the forward contract, as follows:

31 January 2003

The contract is settled net in shares. Entity A has an obligation to deliver 104,000 worth of its shares to Entity B and Entity B has an obligation to deliver 106,000 worth of shares to Entity A, so Entity B delivers 2,000 worth of shares to Entity A.

Dr.	Equity	2,000	
Cr.	Forward asset		2,000

To record the settlement of the forward contract.

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

A30. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a specified number of Entity A's shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at 104. Accordingly, Entity A has an obligation to pay 104,000 in cash to Entity B (104 x 1,000) and Entity B has an obligation to deliver 1,000 of Entity A's outstanding shares to Entity A in one year.

1 February 2002

Dr.	Equity	100,000	
Cr.	Liability		100,000

To record the obligation to deliver 104,000 in one year at its present value of 100,000 discounted using an appropriate interest rate (see IAS 39, paragraph 67).

31 December 2002

Dr.	Interest expense	3,660	
Cr.	Liability		3,660

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

31 January 2003

Dr.	Interest expense	340	
Cr.	Liability		340

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

Entity A delivers 104,000 in cash to Entity B and Entity B delivers 1,000 shares of Entity A to Entity A.

Dr.	Liability	104,000	
Cr.	Cash		104,000

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

(d) Multiple settlement alternatives

A31. The existence of multiple settlement alternatives (such as net in cash, net in shares, or an exchange of cash and shares) does not affect the treatment of a forward repurchase contract as an asset or liability, as described in (a)-(c) above. The accounting treatment is determined on the basis of the party that controls the settlement alternatives. If the counterparty has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a liability for the obligation to deliver cash, as illustrated in (c) above. If the issuing entity has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a derivative asset or derivative liability, as illustrated in (a) and (b) above, unless it has an established practice of settling through the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it recognises a liability for the share redemption amount.

Illustrative example 2: Forward to sell shares

A32. This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by receiving cash in exchange for shares. It also discusses the effect of multiple settlement alternatives (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (ie the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	1 February 2002
Maturity date	31 January 2003

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	110
Market price per share on 31 January 2003	106
Fixed forward price to be received on 31 January 2003	104
Present value of forward price on 1 February 2002	100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 2002	0
Fair value of forward on 31 December 2002	6,300
Fair value of forward on 31 January 2003	2,000

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

A33. On 1 February 2002, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding common shares as of 31 January 2003 in exchange for 104,000 in cash (ie 104 per share) on 31 January 2003. The contract will be net cash settled.

1 February 2002

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

31 December 2002

Dr.	Loss	6,300	
Cr.	Forward liability		6,300

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

31 January 2003

Dr.	Forward liability	4,300	
Cr.	Gain		4,300

To record the increase in the fair value of the forward contract (ie 4,300 = 6,300 – 2,000).

The contract is settled net in cash. Entity B has an obligation to deliver 104,000 to Entity A and Entity A has an obligation to deliver 106,000 [106 x 1,000] to Entity B, so Entity A pays the net amount of 2,000 to Entity B.

Dr.	Forward liability	2,000	
Cr.	Cash		2,000

To record the settlement of the forward contract.

(b) Shares vs shares (‘net share settlement’)

A34. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. The journal entries are the same as those shown in (a), except:

31 January 2003

The contract is settled net in shares. Entity A has a right to receive 104,000 worth of its shares and an obligation to deliver 106,000 worth of its shares to Entity A, so Entity A delivers a net amount of 2,000 worth of its shares to Entity B.

Dr.	Forward liability	2,000	
Cr.	Equity		2,000

To record the settlement of the forward contract. The issue of the entity’s own shares is treated as an equity transaction.

(c) Shares vs cash (‘gross physical settlement’)

A35. Assume the same facts as in (a), except that settlement will be made by receiving a fixed amount of cash and delivering a specified number of the entity’s own shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at 104. Accordingly, Entity A has a right to receive 104,000 in cash (104 x 1,000) and an obligation to deliver 1,000 of the entity’s own shares in one year.

1 February 2002

No entry is made on 1 February. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a specified number of the entity’s own shares in exchange for a fixed amount of cash or other financial assets meets the definition of an equity instrument because it cannot be settled other than through the delivery of shares in exchange for cash.

31 December 2002

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

31 January 2003

On 31 January 2003, Entity A receives 104,000 in cash and delivers 1,000 shares.

Dr. Cash	104,000	
Cr. Equity		104,000

To record the settlement of the forward contract.

(d) Multiple settlement alternatives

A36.The existence of multiple settlement alternatives generally does not affect the treatment of a forward sale contract as a derivative asset/liability or equity instrument. If the counterparty has the right, among the different settlement alternatives, to require net cash or net share settlement, the issuer recognises a derivative asset or liability, as illustrated in (a) and (b) above. If the issuing entity has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares through physical delivery of shares, the issuer recognises a derivative asset or liability, as illustrated in (a) or (b), unless it has an established practice of settling through the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it classifies the forward sale contract as an equity instrument of the entity, as illustrated in (c) above.

Illustrative example 3: Purchased call on shares

A37.This example illustrates the journal entries for a purchased call option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for the entity's own shares. It also discusses the effect of multiple settlement alternatives (see (d) below).

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, ie it can be exercised only at maturity)
Exercise right holder	reporting entity (Entity A)

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	104
Market price per share on 31 January 2003	104

Fixed exercise price to be paid on 31 January 2003	102
Number of shares under option contract	1,000

Fair value of option on 1 February 2002	5,000
Fair value of option on 31 December 2002	3,000
Fair value of option on 31 January 2003	2,000

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

1 February 2002

A38.On 1 February 2002, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver and Entity A the right to receive the fair value of 1,000 of Entity A's own common shares as of 31 January 2003 in exchange for 102,000 in cash (ie 102 per share) on 31 January 2003, if Entity A exercises that right. The contract will be net cash settled. If Entity A does not exercise its right, no payment will be made.

The price per share when the contract is agreed on 1 February 2002 is 100. The initial fair value of the option contract on 1 February 2002 is

5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of 102 exceeds the market price per share of 100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option right is out of the money.

Dr. Call option right	5,000	
Cr. Cash		5,000

To recognise the purchased call option.

31 December 2002

On 31 December 2002, the market price per share has increased to 104. The fair value of the call option has decreased to 3,000, of which 2,000 is intrinsic value ([104 – 102] x 1,000), and 1,000 is the remaining time value.

Dr. Loss	2,000	
Cr. Call option right		2,000

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

31 January 2003

On 31 January 2003, the market price per share is still 104. The fair value of the call option has decreased to 2,000, which is all intrinsic value ([104 – 102] x 1,000) because no time value remains.

Dr. Loss	1,000	
Cr. Call option right		1,000

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

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver 104,000 [104 x 1,000] to Entity A in exchange for 102,000 [102 x 1,000] from Entity A, so Entity A receives a net amount of 2,000.

Dr. Cash	2,000	
Cr. Call option right		2,000

To record the settlement of the option contract.

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

A39. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. The journal entries are the same as those shown in (a) except for recording the settlement of the option contract as follows:

31 January 2003

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver 104,000 [104 x 1,000] worth of Entity A's shares to Entity A in exchange for 102,000 [102 x 1,000] worth of Entity A's shares, so Entity B delivers the net amount of 2,000 worth of shares to Entity A, ie 19.2 shares (2,000 / 104).

Dr. Equity	2,000	
Cr. Call option right		2,000

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

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

A40. Assume the same facts as in (a) except that settlement will be made by receiving a specified number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at 102. Accordingly, Entity A has a right to receive 1,000 of Entity A's own outstanding shares in exchange for 102,000 (102 x 1,000) in cash, if Entity A exercises its option.

1 February 2002

Dr. Equity	5,000	
Cr. Cash		5,000

To record the cash paid in exchange for the right to receive the entity's own shares in one year for a fixed price. The premium paid is recorded against equity.

31 December 2002

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

31 January 2003

Entity A exercises the call option and the contract is settled gross. Entity B has an obligation to deliver 1,000 of Entity A's shares in exchange for 102,000 in cash.

Dr. Equity	102,000	
Cr. Cash		102,000

To record the settlement of the option contract.

(d) Multiple settlement alternatives

A41. The existence of multiple settlement alternatives does not affect the treatment of a purchased call option right as described in (a)-(c) above. The accounting treatment is determined on the basis of the party that controls the settlement alternatives. If the counterparty has the right, among the different settlement alternatives, to require net share or net cash settlement, the issuer recognises a derivative asset, as illustrated in (a) and (b) above. If the issuing entity has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a derivative asset, as illustrated in (a) and (b) above, unless it has an established practice of the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it classifies the written call as an equity instrument, as illustrated in (c) above.

Illustrative example 4: Written call on shares

A42. This example illustrates the journal entries for a written call option obligation on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of multiple settlement alternatives (see (d) below).

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, ie it can be exercised only at maturity)
Exercise right holder	counterparty (Entity B)

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	104
Market price per share on 31 January 2003	104

Fixed exercise price to be received on 31 January 2003	102
Number of shares under option contract	1,000

Fair value of option on 1 February 2002	5,000
Fair value of option on 31 December 2002	3,000
Fair value of option on 31 January 2003	2,000

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

1 February 2002

A43. Assume the same facts as in illustrative example 3(a) above except that Entity A has written a call option on the entity's own shares instead of having purchased a call option on the entity's own shares. Accordingly, on 1 February 2002 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own common shares as of 31 January 2003 in exchange for 102,000 in cash (ie 102 per share) on 31 January 2003, if Entity B exercises that right. The contract will be net cash settled. If Entity B does not exercise its right, no payment will be made.

Dr. Cash	5,000	
Cr. Call option obligation		5,000

To recognise the written call option.

31 December 2002

Dr. Call option obligation	2,000	
Cr. Gain		2,000

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

31 January 2003

Dr. Call option obligation	1,000	
Cr. Gain		1,000

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

On the same day, Entity B exercises the call option and the contract is settled net in cash. Entity A has an obligation to deliver 104,000 [104 x 1,000] to Entity B in exchange for 102,000 [102 x 1,000] from Entity B, so Entity A pays a net amount of 2,000.

Dr. Call option obligation	2,000	
Cr. Cash		2,000

To record the settlement of the option contract.

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

A44. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. The journal entries are the same as those shown in (a), except for recording the settlement of the option contract, as follows:

31 January 2003

Entity B exercises the call option and the contract is settled net in shares. Entity A has an obligation to deliver 104,000 [104 x 1,000] worth of Entity A's shares to Entity B in exchange for 102,000 [102 x 1,000] worth of Entity A's shares, so Entity A delivers the net amount of 2,000 worth of shares to Entity B, ie 19.2 shares (2,000 / 104).

Dr. Call option obligation	2,000	
Cr. Equity		2,000

To record the settlement of the option contract. The settlement is accounted for as an equity transaction.

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

A45. Assume the same facts as in (a) except that settlement will be made by delivering a specified number of shares and receiving a fixed amount of cash, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at 102. Accordingly, Entity B has a right to receive 1,000 of Entity A's own outstanding shares in exchange for 102,000 (102 x 1,000) in cash, if Entity B exercises its option.

1 February 2002

Dr. Cash	5,000	
Cr. Equity		5,000

To record the cash received in exchange for the obligation to deliver a specified number of the entity's own shares in one year for a fixed price. The premium received is recorded in equity. Upon exercise, the call would result in the issue of a specified number of shares in exchange for a fixed amount of cash.

31 December 2002

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

31 January 2003

Entity B exercises the call option and the contract is settled gross. Entity A has an obligation to deliver 1,000 shares in exchange for 102,000 in cash.

Dr.	Cash	102,000	
Cr.	Equity		102,000

To record the settlement of the option contract.

(d) Multiple settlement alternatives

A46.The existence of multiple settlement alternatives does not affect the treatment of a written call option contract as described in (a)-(c) above. The accounting treatment is determined on the basis of the party that controls the settlement alternatives. If the issuing entity has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a derivative liability, as illustrated in (a) and (b) above, unless it has an established practice of the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it classifies the written call as an equity instrument, as illustrated in (c) above. If the counterparty has the right, among the different settlement alternatives, to require net share or net cash settlement, the issuer recognises a derivative liability, as illustrated in (a) and (b) above.

Illustrative example 5: Purchased put on shares

A47.This example illustrates the journal entries for a purchased put option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of multiple settlement alternatives (see (d) below).

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, ie it can be exercised only at maturity)
Exercise right holder	reporting entity (Entity A)

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	95
Market price per share on 31 January 2003	95
Fixed exercise price to be received on 31 January 2003	98
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	5,000
Fair value of option on 31 December 2002	4,000
Fair value of option on 31 January 2003	3,000

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

1 February 2002

A48.On 1 February 2002, Entity A enters into a contract with Entity B that gives Entity A the right to sell and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding common shares as of 31 January 2003 at a strike price of 98,000 (ie 98 per share) on 31 January 2003, if Entity A exercises that right. The contract will be net cash settled. If Entity A does not exercise its right, no payment will be made.

The price per share when the contract is agreed on 1 February 2002 is 100. The initial fair value of the option contract on 1 February 2002 is 5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of 98 is less than the market price per share of 100 and it would therefore not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

Dr.	Put option right	5,000	
Cr.	Cash		5,000

To recognise the purchased put option.

31 December 2002

On 31 December 2002 the market price per share has decreased to 95. The fair value of the put option has decreased to 4,000 of which 3,000 is intrinsic value ([98 – 95] x 1,000) and 1,000 is the remaining time value.

Dr.	Loss	1,000	
Cr.	Put option right		1,000

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

31 January 2003

On 31 January 2003 the market price per share is still 95. The fair value of the put option has decreased to 3,000, which is all intrinsic value ([98 – 95] x 1,000) because no time value remains.

Dr.	Loss	1,000	
Cr.	Put option right		1,000

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

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver 98,000 to Entity A and Entity A has an obligation to deliver 95,000 [95 x 1,000] to Entity B, so Entity B pays the net amount of 3,000 to Entity A.

Dr.	Cash	3,000	
Cr.	Put option right		3,000

To record the settlement of the option contract.

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

A49. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. The journal entries are the same as shown in (a), except:

31 January 2003

Entity A exercises the put option and the contract is settled net in shares. In effect, Entity B has an obligation to deliver 98,000 worth of Entity A's shares to Entity A and Entity A has an obligation to deliver 95,000 worth of Entity A's shares [95 x 1,000] to Entity B, so Entity B delivers the net amount of 3,000 worth of shares to Entity A, ie 31.6 shares (3,000 / 95).

Dr.	Equity	3,000	
Cr.	Put option right		3,000

To record the settlement of the option contract.

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

A50. Assume the same facts as in (a) except that settlement will be made by receiving a fixed amount of cash and delivering a specified number of Entity A's shares, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at 98. Accordingly, Entity B has an obligation to pay 98,000 in cash to Entity A (98 x 1,000) in exchange for 1,000 of Entity A's outstanding shares, if Entity A exercises its option.

1 February 2002

Dr.	Equity	5,000	
Cr.	Cash		5,000

To record the cash received in exchange for the right to deliver the entity's own shares in one year for a fixed price. The premium paid is *recorded directly in equity. Upon exercise, it would result in the issue of a specified number of shares in exchange for a fixed price.*

31 December 2002

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

31 January 2003

Entity A exercises the put option and the contract is settled gross. Entity B has an obligation to deliver 98,000 in cash to Entity A in exchange for 1,000 shares.

Dr. Cash	98,000	
Cr. Equity		98,000

To record the settlement of the option contract.

(d) Multiple settlement alternatives

A51. The existence of multiple settlement alternatives does not affect the treatment of a purchased put option contract as described in (a)-(c) above. The accounting treatment is determined on the basis of the party that controls the settlement alternatives. If the counterparty has the right, among the different settlement alternatives, to require net share or net cash settlement, the issuer recognises a derivative asset, as illustrated in (a) and (b) above. If the issuing entity has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a derivative asset, as illustrated in (a) and (b) above, unless it has an established practice of the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it classifies the purchased put as an equity instrument, as illustrated in (c) above.

Illustrative example 6: Written put on shares

A52. This example illustrates the journal entries for a written put option obligation on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of multiple settlement alternatives (see (d) below).

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, ie it can be exercised only at maturity)
Exercise right holder	counterparty (Entity B)

Market price per share on 1 February 2002	100
Market price per share on 31 December 2002	95
Market price per share on 31 January 2003	95
Fixed exercise price to be paid on 31 January 2003	98
Present value of exercise price on 1 February 2002	95
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	5,000
Fair value of option on 31 December 2002	4,000
Fair value of option on 31 January 2003	3,000

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

1 February 2002

A53. Assume the same facts as in illustrative example 5(a) above except that Entity A has written a put option on the entity's own shares instead of having purchased a put option on the entity's own shares. Accordingly, on 1 February 2002 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding common shares as of 31 January 2003 in exchange for 98,000 in cash (ie 98 per share) on 31 January 2003, if Entity B exercises that right. The contract will be net cash settled. If Entity B does not exercise its right, no payment will be made.

Dr. Cash	5,000	
Cr. Put option liability		5,000

To recognise the written put option.

31 December 2002

Dr. Put option liability	1,000	
Cr. Gain		1,000

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

31 January 2003

Dr. Put option liability	1,000	
Cr. Gain		1,000

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

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver 98,000 to Entity B and Entity B has an obligation to deliver 95,000 [95 x 1,000] to Entity A, so Entity A pays the net amount of 3,000 to Entity B.

Dr. Put option liability	3,000	
Cr. Cash		3,000

To record the settlement of the option contract.

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

A54. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Then, the journal entries are the same as those in (a), except:

31 January 2003

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver 98,000 worth of shares to Entity B and Entity B has an obligation to deliver 95,000 worth of Entity A's shares [95 x 1,000] to Entity A, so Entity A delivers the net amount of 3,000 worth of Entity A's shares to Entity B, ie 31.6 shares (3,000 / 95).

Dr. Put option liability	3,000	
Cr. Equity		3,000

To record the settlement of the option contract. The issue of the entity's own shares is accounted for as an equity transaction.

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

A55. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a specified number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at 98. Accordingly, Entity A has an obligation to pay 98,000 in cash to Entity B (98 x 1,000) in exchange for 1,000 of Entity A's outstanding shares, if Entity B exercises its option.

1 February 2002

Dr. Cash	5,000	
Dr. Equity	90,000	
Cr. Liability		95,000

To record the present value of the obligation to deliver 98,000 in one year, ie 95,000, as a liability. The option premium received of 5,000 is recorded in equity.

31 December 2002

Dr. Interest expense	2,750	
Cr. Liability		2,750

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

31 January 2003

Dr.	Interest expense	250	
Cr.	Liability		250

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

On the same day, Entity B exercises the put option and the contract is settled gross. Entity A has an obligation to deliver 98,000 in cash to Entity B in exchange for 95,000 worth of shares [95 x 1,000].

Dr.	Liability	98,000	
Cr.	Cash		98,000

To record the settlement of the option contract.

(d) Multiple settlement alternatives

A56. The existence of multiple settlement alternatives generally does not affect the treatment of a written put option contract as described in (a)-(c) above. The accounting treatment is determined on the basis of the party that controls the settlement alternatives. If the counterparty has the right, among the different settlement alternatives, to require the exchange of a fixed amount of cash for a fixed number of the entity's own shares, the issuer recognises a liability for the obligation to deliver cash, as illustrated in (c) above. If the issuing entity has the right, among the different settlement alternatives, to require net share or net cash settlement, the issuer recognises a derivative liability, as illustrated in (a) and (b) above, unless it has an established practice of the exchange of a fixed amount of cash for a fixed number of the entity's own shares, in which case it recognises a liability for the share redemption amount.

Appendix B

Basis for Conclusions (Revisions 200X)

B1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.

B2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to amend IAS 39, Financial Instruments: Recognition and Measurement. The Board also agreed to revise IAS 32, Financial Instruments: Disclosure and Presentation, as necessary, to remove duplications and inconsistencies and make other improvements.

B3. As the intention of the project to improve IAS 32 is 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 32 that the Board has not reconsidered.

Presentation

Liabilities and Equity

Contingent Settlement Provisions (paragraph 22A)

B4. The proposed amendments incorporate the conclusion in SIC-5, Classification of Financial Instruments – Contingent Settlement Provisions, that a financial instrument for which the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder (ie a contingent settlement provision), should be classified as a financial liability by the issuer.

B5. The proposed amendments do not include the exception provided in SIC-5, paragraph 6, for circumstances in which the possibility of the issuer being required to settle in cash or another financial asset is remote at the time the financial instrument is issued. It is not consistent with the definitions of a financial liability and an equity instrument to classify an obligation to deliver cash or other financial assets as a liability only when settlement in cash is probable. There is a contractual obligation to transfer economic benefits as a result of past events because the issuer is unable to avoid a settlement in cash or other financial assets unless an event occurs or does not occur in the future.

Puttable Instruments (paragraphs 22B, 32A and A21A)

B6. In September 2001 the Standing Interpretations Committee (SIC) issued for public comment Draft Interpretation SIC-D34, Financial Instruments or Rights Redeemable by the Holder. Such financial instruments are commonly issued by mutual funds, unit trusts, and similar entities with the redemption amount being equal to a proportionate share in the net asset value of the entity. In December 2001 the Board considered a proposed final Interpretation and decided that this issue, instead of being the subject of an Interpretation, should be addressed in the proposed amendments to IAS 32. The proposed amendments incorporate the key elements of that Draft Interpretation.

B7. Accordingly, an issuer of an instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset should classify the entire instrument as a liability. Even when the legal form of a financial instrument includes a right to the residual interest in the assets of an entity available to holders of such instruments, the inclusion of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the instrument meets the definition of a financial liability. The classification as a liability is independent of when the right is exercisable, how the amount payable/receivable upon exercise of the right is determined, and whether the puttable instrument has a fixed maturity.

B8. The Board concluded that the classification of a puttable instrument as a liability does not preclude the use of descriptors such as 'net asset value available to unitholders' and 'change in net asset value available to unitholders' on the face of the financial statements of an entity that has no equity capital (such as certain mutual funds and unit trusts).

Obligations to Deliver Equity Indexed to a Non-Equity Variable (paragraphs 22C and 22D)

B9. The Board proposes that the requirement in IAS 39, paragraph 11, regarding the accounting for contractual obligations of a fixed amount or an amount that varies based on changes in a variable other than the market price of an entity's own equity as financial liabilities, should be eliminated because it is in IAS 32, paragraph 5. The requirement deals with presentation rather than recognition or measurement, which are the topics of IAS 39. The requirement in paragraph 5 of IAS 32 related to obligations to deliver equity indexed to a non-equity variable has been moved to paragraph 22C because it deals with the classification of a financial instrument.

B10. The Board further proposes that the wording be amended to clarify that an obligation that must or can be settled in an entity's own equity instruments is a financial liability in any cases in which the obligation exposes the entity to favourable or unfavourable changes in a variable other than the market price of its own equity instruments.

Classification of Compound Instruments by the Issuer

Allocation of the Initial Carrying Amount to the Liability and Equity Elements (paragraphs 28 and 29 and A23-A24A)

B11. Under IAS 32, paragraph 23, an issuer of a financial instrument that contains both a liability and an equity element should classify the instrument's elements separately. A bond convertible by the holder into a fixed number of common shares of the issuer is an example of such an instrument (paragraph 25). In separating the liability and equity elements of a compound instrument, IAS 32 does not prescribe a particular method for assigning an initial carrying amount to those elements. Paragraph 28 suggests that approaches that might be considered include:

- assigning to the less easily measurable component (often the equity element), the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily determinable (a 'with-and-without' method); and

- measuring the liability and equity components separately and, to the extent necessary, adjusting these amounts on a pro rata basis so that the sum of the components equals the amount of the instrument as a whole (a 'relative fair value' method).

B12. IAS 32, paragraph 28, justifies the choice by noting that IAS 32 does not deal with the measurement of financial assets, financial liabilities, and equity instruments.

B13. Following the issue of IAS 39, international standards contain requirements for the measurement of financial assets and financial liabilities. Therefore, the view that IAS 32 should not prescribe a particular method for bifurcating compound instruments because of the absence of measurement requirements for financial instruments is no longer valid. IAS 39, paragraph 66, requires a financial liability to be measured on initial recognition at the fair value of the consideration received. Therefore, a relative fair value method would result in an initial measurement of the liability element that is not in compliance with IAS 39, paragraph 66.

B14. After initial recognition, a financial liability that is classified as held for trading is measured at fair value under IAS 39, and other financial liabilities are measured at amortised cost. If the liability element of a compound instrument is classified as held for trading, an entity could recognise an immediate gain or loss after initial recognition if it applies a relative fair value method. This is contrary to IAS 32, paragraph 28, which states that no gain or loss arises from recognising separately the components of the instrument.

B15. Under the IASB Framework, IAS 32 and IAS 39, an equity instrument is defined as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. The Framework further states that the amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities (paragraph 67).

B16. The Board decided to propose that the options in IAS 32 to measure on initial recognition the liability element of a compound instrument as a residual amount after separating the equity element or based on a relative fair value method should be eliminated. Instead the liability element should be measured first (including the value of any embedded non-

equity derivative features, such as an embedded call feature), and the residual amount assigned to the equity element.

B17. The objective of the proposed change is to make the requirements about the issuer's separation of the liability and equity elements of a single compound instrument consistent with the requirements about the initial measurement of a financial liability in IAS 39 and the definitions in IAS 32, IAS 39 and the IASB Framework of an equity instrument as a residual interest.

B18. The proposed approach eliminates the need to estimate inputs to, and apply, complex option pricing models to measure the equity element of some compound instruments. The Board also noted that the absence of a prescribed approach leads to a lack of comparability among entities applying IAS 32 and that it is therefore desirable to specify a single approach.

B19. The Board noted that a requirement to use the with-and-without method, under which the liability element is determined first, is consistent with the proposals of the Joint Working Group of Standard Setters in its Draft Standard and Basis for Conclusions, Financial Instruments and Similar Instruments, published in December 2000 (see Draft Standard, paragraphs 74 and 75, and Application Supplement, paragraph 318).

Transactions in Own Equity Instruments

Treasury Shares (paragraphs 29A and 29B)

B20. The proposed amendments incorporate, without reconsideration, the key elements of the guidance in SIC-16, Share Capital – Reacquired Own Equity Instruments (Treasury Shares). The acquisition and subsequent resale by an entity of its own equity instruments represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument, rather than a gain or loss to the entity.

Derivatives Based on an Entity's Own Equity Instruments (paragraphs 29C-29G)

B21. Existing guidance in IAS 32 addresses piecemeal the accounting for derivatives that are indexed to or potentially settled in an entity's own equity instruments. IAS 32 provides guidance on how to account for call options (including warrants) on an entity's own equity instruments written by the entity and call options on an entity's own equity instruments purchased by the entity, when those derivatives will be settled by receipt or delivery of its own equity instruments. Such derivatives are accounted for directly in equity (see IAS 32, paragraphs A7 and A8). IAS 32 does not address specifically the classification as equity or assets/liabilities of other derivatives on an entity's own equity instruments (such as put options on its own equity instruments purchased or written by the entity or total return swaps on an entity's own equity instruments). It also does not provide guidance on whether the manner of settlement (such as net in cash, net in shares, or through physical delivery of shares in exchange for cash) or the existence of multiple settlement alternatives within the control of either the entity or the counterparty affects the classification as assets/liabilities or equity of derivatives indexed to the value of an entity's own equity instruments.

B22. The Board decided to propose that IAS 32 should include guidance that addresses these issues. The objective of the proposed changes is to clarify the accounting treatment of derivatives on an entity's own equity instruments whose value changes in response to changes in the market price of the entity's own equity instruments. The proposed changes are based on the principle that only those derivative contracts that result in an exchange of a fixed amount of cash or other financial assets for a fixed number of an entity's own equity instruments (other than derivatives) should be accounted for directly in equity. For such derivatives, changes in fair value would not be recognised. All other derivatives that are indexed to the price of an entity's own equity instruments should be accounted for as derivative assets or derivative liabilities because they do not evidence a residual interest in the entity.

B23. The Board considered an alternative approach based on the notion that only derivatives whose value to the counterparty moves in the same direction as a (non-derivative) equity instrument of the entity and require the exchange of a fixed amount of cash for a fixed number of the entity's own shares should be classified as equity instruments. That approach would result in fair value measurement for derivatives that involve an obligation to deliver cash or other financial assets in exchange for receiving the entity's own shares (such as purchased call options, written put options, and forward repurchase contracts on the entity's own shares that provide for the exchange of a fixed amount of cash for a fixed number of the entity's own shares). The Board concluded that it would be beyond the scope of the project to propose such a fundamental change to the accounting for derivatives on an entity's own shares. The Board will continue in a future project its consideration of issues related to the definitions of a liability and equity.

B24. The proposed amendments require that net-settled derivatives on the entity's own shares (ie derivatives for which the change in fair value will be settled net in cash or net in shares) be treated as derivative assets or derivative liabilities. Such derivatives will not result in the receipt or delivery of a fixed number of equity instruments on their maturity date. The number of equity instruments specified in such contracts is a notional amount that determines their value, but is not the number of equity instruments that may actually be exchanged. Accordingly, the entity is exposed to changes in an underlying variable in a manner more similar to net-settled derivatives than equity instruments. The Board concluded that it would be inappropriate to account for such derivatives directly in equity.

B25. When there are multiple settlement alternatives (such as net in cash, net in shares, or cash vs shares), classification of the instrument depends on whether it is the entity (the issuer of equity) or the counterparty that has control over the manner of settlement. If the counterparty has control, net settlement should be presumed unless the contract involves an obligation to redeem an entity's own equity instruments in exchange for cash or other financial assets, in which case the obligation to redeem the entity's own shares for cash meets the definition of a liability. If the entity controls the manner of settlement, net settlement should be presumed unless the entity has an established practice of exchanging a fixed amount of cash for a fixed number of the entity's own shares. The inclusion of a non-substantive cash vs share settlement option in a derivative contract should not fundamentally alter the accounting for that derivative.

B26. If a derivative on the entity's own equity instruments involves an obligation to redeem equity instruments for cash (such as a forward repurchase contract or written put option), the Board concluded that there is a liability for the share redemption amount. The accounting should not differ depending on whether the obligation to redeem a share for a fixed amount of cash is embedded in the share itself or is transacted as a separate forward repurchase contract. On the entity entering into the derivative transaction, the obligation to deliver cash is presented as a liability by reclassifying the fair value (present value) of that obligation out of equity. The forward repurchase contract establishes a maturity date on the shares that are subject to the forward contract and those shares therefore cease to be equity instruments when the entity enters into the forward contract to buy them back. The recognition of a liability for the share redemption amount achieves consistency with the treatment of shares that provide for mandatory redemption by the issuer in IAS 32, paragraph 22. Without a requirement to recognise a liability for the share redemption amount, entities with identical obligations to deliver cash in exchange for equity instruments could report different financial information depending on whether the redemption clause is embedded in an equity instrument or is a free-standing derivative contract.

B27. The following table provides an overview of the application of the proposed principle:

Table: Overview of the proposed accounting for derivatives indexed only to the value of the entity's own shares

Derivative contract	**Settlement method**				
	Gross physical settlement	***Net settlement (net cash or net shares)***	***Issuer choice (past practice of gross physical settlement)***	***Issuer choice (no past practice of gross physical settlement)***	***Counterparty choice***
Forward to buy	L	D	L	D	L
Forward to sell	E	D	E	D	D
Purchased call	E	D	E	D	D
Written call	E	D	E	D	D
Purchased put	E	D	E	D	D
Written put	L	D	L	D	L
Total return swap	-	D	-	-	-

D = Derivative asset/liability (net amount);
E = Equity;
L = Liability for the share redemption amount (gross amount).

Gross physical settlement means the exchange of a fixed amount of cash for a fixed number of the entity's own shares.

Net settlement means the exchange of either (a) a fixed amount of cash for a variable amount of cash equal to the fair value of a fixed number of the entity's own shares or (b) a variable number of the entity's own shares that have a value equal to a fixed amount of cash for a fixed number of the entity's own shares.

Issuer choice means that the reporting entity (the issuer of the shares) can require, among the different settlement alternatives, gross physical settlement.

Counterparty choice means that the counterparty to the derivative can require, among the different settlement alternatives, net settlement.

B28.The Board proposes that the requirement in IAS 39, paragraph 12, regarding the accounting for derivatives whose value changes in response to something other than the market price of the entity's own equity instruments, but which the entity can choose to settle or is required to settle in its own equity instruments, be moved to IAS 32. That requirement deals with presentation rather than recognition or measurement, which are the topics of IAS 39.

Interest, Dividends, Losses and Gains

Costs of an Equity Transaction (paragraphs 30 and 31A–31C)

B29.The proposed amendments incorporate the guidance 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 the transaction to which they relate. Linking the equity transaction and costs of the transaction reflects the total cost of the transaction in equity.

Disclosure

Terms, Conditions and Accounting Policies (paragraphs 47-55)

B30.Because IAS 39 contains requirements about the accounting policies to be used in recognising and measuring financial assets and financial liabilities, the Board is proposing to eliminate the guidance in IAS 32 on disclosures about an entity's accounting policies.

Fair Value (paragraphs 77-87)

B31.The proposed amendments make the exemption from the requirement to provide disclosures about fair value in IAS 32, paragraph 77, consistent with the exemption from the requirement to measure particular financial assets and financial liabilities at fair value under IAS 39, paragraph 69. Accordingly, disclosure of fair value is not required for investments in unquoted equity instruments and derivatives linked to such equity instruments if their fair value cannot be measured reliably. For all other financial assets and financial liabilities, it is reasonable to expect that fair value can be determined with sufficient reliability within constraints of timeliness and cost, so there should be no exception from the requirement to disclose fair value information for such financial assets and financial liabilities.

B32.The disclosure requirement in IAS 39, paragraph 170(b), about instances in which the presumption that fair value can be measured reliably has been overcome, has been moved to IAS 32, paragraph 77A. The disclosure requirement in IAS 39, paragraph 167(a), about the methods and significant assumptions applied in estimating fair values of financial assets and financial liabilities, has been moved to IAS 32, paragraph 77B(a). The fair value estimation guidance in IAS 32, paragraphs 80-84, has been eliminated because it overlaps with similar guidance in IAS 39. To provide users of financial statements with a sense of the potential variability of fair value estimates, the Board decided that information about the use of valuation techniques should be disclosed, such as the sensitivities of fair value estimates to key valuation assumptions.

Financial Assets Carried at an Amount in Excess of Fair Value (paragraphs 88-90)

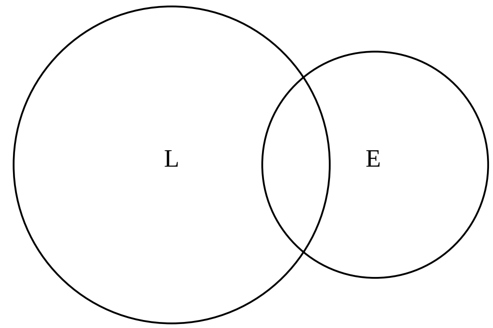
B33.The Board proposes that the disclosure requirements in IAS 32, paragraphs 88-90, regarding financial assets carried at an amount in excess of fair value, including the reasons for not reducing the carrying amount, should be eliminated. IAS 39 requires financial assets classified as either held-to-maturity investments or originated loans and receivables to be carried at amortised cost, which may exceed fair value. Because IAS 39 contains requirements governing the measurement of financial assets and IAS 32 requires fair value information to be provided in a way that permits comparisons with the financial assets' carrying amounts, the requirement to disclose separate information about financial assets carried at an amount in excess of fair value is redundant.

Other Disclosures

Multiple Embedded Derivative Features (paragraphs 93A(i) and A24A)

B34.The Board notes that the separation of the liability and equity elements of a compound instrument is more complicated for compound instruments with multiple embedded derivative features whose values are interdependent (for example, a convertible debt instrument that gives the issuer a right to call the instrument back from the holder or the holder a right to put the instrument back to the issuer) than for those without such features. If the embedded equity and non-equity derivative features are interdependent, the sum of the separately determined values of the liability and equity elements will not equal the value of the compound instrument as a whole.

B35.For example, the values of an embedded call option feature and an equity conversion option feature in a callable convertible debt instrument depend in part on each other in cases where the holder's equity conversion option is extinguished when the issuer exercises the call option or vice versa. The following diagram illustrates the joint value arising from the interaction between a call option and an equity conversion option in a callable convertible bond. Circle L represents the value of the liability element, ie the value of the straight debt and the embedded call option on the straight debt, and Circle E represents the value of the equity element, ie the equity conversion option on the straight debt. The total area covered by the two circles represents the value of the callable convertible bond. The difference between the value of the callable convertible bond as a whole and the sum of the separately determined values for the liability and equity elements is the joint value attributable to the interdependence between the call option feature and the equity conversion feature. It is represented by the intersection between the two circles.



B36.Under the proposed approach set out in paragraph B13, the joint value attributable to the interdependence between multiple embedded derivative features is included in the liability element. Guidance is included in Appendix A to the Standard to illustrate this.

B37.Even though the proposed approach is consistent with the accounting definition of equity as a residual interest, the Board recognises that the allocation of the joint value to either the liability or equity element is arbitrary because it is, by its nature, joint. Therefore, the Board has concluded that disclosure of the existence of issued compound instruments with multiple embedded derivative features that have interdependent values and the reported effective yield on the liability element is important. Such disclosure highlights the impact of multiple embedded derivative features on the amounts reported as liabilities and equity and interest expense for the issuer of a compound instrument.

Other Disclosures

B38. The Exposure Draft includes disclosure requirements about the nature and extent of transfers of financial assets that do not qualify for derecognition in full or in part. Also, it proposes disclosure of information about the risks retained in any portion of the transferred asset that the transferor continues to recognise (see paragraph 93A(b)(iv)). Such disclosure may be relevant, for example, if an entity sells a portfolio of receivables and provides a limited credit guarantee up to an amount that is expected to cover all likely credit losses. In that example, the risk density of the portion of the transferred receivables in which the transferor has a continuing involvement may be much higher than that of the portion that it has derecognised.

B39. The Exposure Draft also includes expanded disclosure requirements about securitised financial assets in which the transferor has a continuing involvement, including information about the total principal amount outstanding, any amount that has been derecognised, and the amount that continues to be recognised (see paragraph 93A(c)).

B40. The proposed amendments to IAS 39 include the ability for entities to designate a non-derivative financial liability as held for trading measured at fair value. In those cases, the Board is proposing that information about the difference between the carrying amount and the amount the entity would contractually be required to pay to the holders of the obligations at maturity should be disclosed (see paragraph 93A(h)). The fair value may differ significantly from the settlement amount, in particular for financial liabilities with a long duration where an entity has experienced a significant deterioration in creditworthiness since the issue of those liabilities.

B41. Paragraph 93A(j) proposes disclosures of defaults in the payment of principal and interest, breaches of sinking fund or redemption provisions on loans payable, and any other breaches when those breaches can permit the lender to demand repayment of loans payable. Such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.

B42. The disclosure requirements in IAS 39, paragraphs 166-170, have been moved to IAS 32 and, where appropriate, amended to reflect the proposed

revisions to IAS 32 and IAS 39. The purpose of moving to IAS 32 the disclosure requirements provided in IAS 39 is to collect all disclosure requirements in one Standard.

PROPOSED AMENDMENTS TO

IAS 39
FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

[Note: For the purpose of this Exposure Draft, the new text is shaded and underlined and the deleted text is shaded and struck through.]

Invitation to Comment (IAS 39)

The Board would particularly welcome answers to the questions set out below. Comments should indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Question 1 – Scope: loan commitments (paragraph 1(i))

Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?

Question 2 – Derecognition: continuing involvement approach (paragraphs 35-57)

Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not, what approach would you propose?

Question 3 – Derecognition: pass-through arrangements (paragraph 41)

Do you agree that assets transferred under pass-through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?

Question 4 – Measurement: fair value designation (paragraph 10)

Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?

Question 5 – Fair value measurement considerations (paragraphs 95-100D)

Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95–100D of the Exposure Draft? Additional

guidance is included in paragraphs A32–A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?

Question 6 – Collective evaluation of impairment (paragraphs 112 and 113A–113D)

Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113A-113D?

Question 7 – Impairment of investments in available-for-sale financial assets (paragraphs 117–119)

Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?

Question 8 – Hedges of firm commitments (paragraphs 137 and 140)

Do you agree that a hedge of an unrecognised firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?

Question 9 – 'Basis adjustments' (paragraph 160)

Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognised directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?

Question 10 – Prior derecognition transactions (paragraph 171B)

Do you agree that a financial asset that was derecognised under the previous derecognition requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grandfathered)? Alternatively, should prior derecognition transactions be grandfathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

Summary of Main Changes (IAS 39)

The Exposure Draft proposes the following changes to IAS 39, Financial Instruments: Recognition and Measurement:

Scope

- A specific scope exclusion is added for loan commitments that are not designated as held for trading and cannot be settled net.

  The objective of the proposed amendment is to simplify the accounting for entities that grant or hold loan commitments that will result in the origination of a loan asset and, in the absence of a specific scope exclusion, would be accounted for as derivatives under IAS 39.

- Financial guarantee contracts are initially recognised and measured in accordance with IAS 39. Subsequently, the issuer of such a contract measures it at the amount the entity would rationally pay to settle the obligation at the balance sheet date or transfer it to a third party (see IAS 37, Provisions, Contingent Liabilities and Contingent Assets).

  The objective of the proposed amendment is to ensure that issued financial guarantee contracts that provide for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due are recognised as liabilities.

- Contracts to buy or sell non-financial items are accounted for as derivatives if 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.

  The objective of the proposed amendment is to ensure that derivative-type contracts on non-financial items are accounted for as derivatives when they are used for trading purposes. It is not intended to change the accounting for entities that profit from delivery of goods rather than speculating on price changes.

Derecognition of a financial asset

- The derecognition provisions in IAS 39 are clarified by establishing as the guiding principle a continuing involvement approach that disallows derecognition to the extent to which the transferor has continuing involvement in an asset or a portion of an asset it has transferred.

  - A transferor has a continuing involvement when:

    (i) it could, or could be required to, reacquire control of the transferred asset (for example, if the financial asset can be called back by the transferor, the transfer does not qualify for derecognition to the extent of the asset that is subject to the call option); or

    (ii) compensation based on the performance of the transferred asset will be paid (for example, if the transferor provides a guarantee, derecognition is precluded up to the amount of the guarantee).

  - No exceptions are made to the general principle. The following existing provisions in IAS 39 are eliminated:

    (i) the notion that the transferor must not retain substantially all of the risk and returns of particular assets for any portion of those assets to qualify for derecognition; and

    (ii) the transferee 'right to sell or repledge' condition for derecognition.

  - Guidance is provided on pass-through arrangements. When the transferor continues to collect cash flows from the transferred asset, additional conditions must be met for a transfer to qualify for derecognition, including:

    (i) the transferor has no obligation to pay cash flows to the transferee unless it collects equivalent cash flows from the transferred asset;

    (ii) the transferor cannot use the transferred asset for its benefit; and

    (iii) the transferor is obligated to remit on a timely basis to the transferee any cash flows it collects on behalf of the transferee.

  - Guidance is provided on the accounting for collateral, including:

    (i) if the transferee has the ability to sell or repledge collateral received, the transferor reclassifies the collateral in its balance sheet (for example, as securities pledged);

    (ii) if the transferee sells the collateral received, the transferee records a liability for the obligation to return the collateral; and

    (iii) if the transferor defaults and is no longer entitled to the transferred asset, the transferor derecognises the asset and the transferee recognises the asset.

The objective of the proposed amendments is to facilitate the implementation and application of IAS 39 by clarifying the guidance and eliminating internal inconsistencies. The results of applying the proposed amendments are generally consistent with the guidance that already exists in IAS 39 and the interpretations of the IAS 39 Implementation Guidance Committee dealing with derecognition. However, under the proposed amendments the assessment of derecognition is based on the continuing involvement of the transferor with the financial asset being transferred. It is not necessary to consider risk retained and to use that as the basis for assessing whether derecognition is appropriate.

Measurement

- An entity is permitted to measure any financial asset or financial liability at fair value, with changes in fair value recognised in profit or loss, by designating it at initial recognition as held for trading. In presenting and disclosing information, an entity uses an appropriate label for such instruments other than 'trading' (such as 'financial instruments at fair value (through net income)'). To impose discipline on this approach, an entity is precluded from reclassifying financial instruments into (or out of) the category while they are held.

  The objective of the proposed amendment is to simplify the application of IAS 39 (for example, for hybrid instruments and for entities with matched asset/liability positions) and to enable consistent measurement of financial assets and financial liabilities. The proposed designation would be at the entity's option. The proposal does not require greater use of fair values.

- The option to recognise gains and losses on available-for-sale financial assets in profit or loss is eliminated (because it is no longer necessary in light of the proposed amendment above). Under the proposed amendment above, an entity is permitted by designation to measure any financial instrument at fair value with gains and losses reported in net income.

- An entity is permitted to designate an asset that would otherwise be classified as a loan or receivable originated by the entity as an available-for-sale financial asset.

- Additional guidance is provided about how to determine fair values using valuation techniques:

  - The objective is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

  - A valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is

consistent with accepted economic methodologies for pricing financial instruments.

  - In applying valuation techniques, an entity uses estimates and assumptions that are consistent with available information about the estimates and assumptions market participants would use in setting a price for the financial instrument.

Impairment of financial assets

- Guidance is provided about how to evaluate impairment that is inherent in a group of loans, receivables, or held-to-maturity investments, but cannot yet be identified with any individual financial asset in the group, as follows:

  - An asset that is individually identified as impaired should not be included in a group of assets that are collectively assessed for impairment.

  - An asset that has been individually assessed for impairment and found not to be individually impaired should be included in a collective assessment of impairment. The occurrence of an event or a combination of events should not be a precondition for including an asset in a group of assets that are collectively evaluated for impairment.

  - Assets should be grouped by similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms.

  - Contractual cash flows and historical loss experience should provide the basis for estimating expected cash flow. Historical loss rates should be adjusted on the basis of relevant observable data that reflect current economic conditions.

  - The methodology for measuring impairment should ensure that an impairment loss is not recognised immediately on initial recognition. Therefore, for the purposes of measuring impairment in groups of assets, estimated cash flows (contractual principal and interest payments adjusted for estimated credit losses) should be discounted using an original effective interest rate that equates the present value of the originally estimated cash flows with the initial net carrying amount of those assets.

The objective of the proposed amendment is to ensure that impairment losses that exist in a group of assets are recognised in the financial statements even though they cannot yet be identified with any individual assets.

- Guidance is provided on what constitutes objective evidence of impairment for investments in equity instruments.

- Impairment losses recognised on investments in debt or equity instruments that are classified as available for sale cannot be reversed.

Hedge accounting

- Hedges of firm commitments are treated as fair value hedges rather than cash flow hedges.

- When a hedged forecast transaction actually occurs and results in an asset or liability, the gain or loss deferred in equity does not adjust the initial carrying amount of the asset or liability ('basis adjustment'), but remains in equity and is reported in profit or loss in a manner that is consistent with the reporting of gains and losses on the asset or liability.

Disclosure

- All disclosure requirements in IAS 39 are moved to IAS 32, Financial Instruments: Disclosure and Presentation.

Contents

International Accounting Standard IAS 39 (revised ~~2000~~200X)

Financial Instruments: Recognition and Measurement

Continued../..

Continued../..

Continued../..

International Accounting Standard IAS 39
(revised ~~2000~~200X)

Financial Instruments: Recognition and Measurement

[Draft] International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39) is set out in paragraphs 1-171C and Appendix A. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. The scope and authority of IASs are explained in the *Preface to International Financial Reporting Standards*. IAS 39 is accompanied by illustrative examples, a Basis for Conclusions, and alternative views as set out in Appendices B, C and D. IAS 39 should be read in the context of its objective and the *Framework for the Preparation and Presentation of Financial Statements*, which provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The objective of this Standard is to establish principles for recognising~~,~~ and measuring~~, and disclosing information about~~ financial assets, financial liabilities, and contracts to buy or sell a non-financial item that can be settled net in cash or by some other financial instrument. ~~instruments in the financial statements of business enterprises.~~ Principles for presenting and disclosing information about financial instruments are in IAS 32, Financial Instruments: Disclosure and Presentation.

Scope

1. This Standard ~~should~~shall be applied by all ~~enterprises~~entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates, and joint ventures that are accounted for under IAS 27,~~ Consolidated Financial Statements and Accounting for Investments in Subsidiaries~~ Consolidation and Separate Financial Statements; IAS 28, Accounting for Investments in Associates; and IAS 31, Financial Reporting of Interests in Joint Ventures. However, an ~~enterprise~~entity shall ~~applies~~ apply this Standard ~~in its consolidated financial statements~~ to account for an interest in a subsidiary, associate, or joint venture that according to IAS 27, IAS 28, or IAS 31 is accounted for under this Standard, such as one that ~~(a)~~ is acquired and held exclusively with a view to its subsequent disposal within twelve months from its acquisition. ~~the near future; or (b) operates under severe long-term restrictions that significantly impair its ability to transfer funds to the enterprise. In these cases, the disclosure requirements in IAS 27, IAS 28, and IAS 31 apply in addition to those in this Standard;~~

(b) rights and obligations under leases~~,~~ to which IAS 17, Leases, applies; however, (i) lease receivables recognised ~~on~~by a lessor ~~’s balance sheet~~ are subject to the derecognition provisions of this Standard (see paragraphs 35-57~~65 and 170(d)~~) and (ii) this Standard ~~does~~ appl~~y~~ies to derivatives that are embedded in leases (see paragraphs 22-26A).~~;~~

(c) employers’ ~~assets and liabilities~~rights and obligations under employee benefit plans, to which IAS 19, Employee Benefits, applies.~~;~~

(d) rights and obligations under insurance contracts. However, this Standard applies when a financial instrument takes the form of an insurance (or reinsurance) contract as ~~defined~~ described in paragraph 3 of IAS 32, Financial Instruments: Disclosure and Presentation, but principally involves the transfer of financial risks described in paragraph 43 of that Standard. In addition, this Standard ~~does apply~~applies to derivatives that are embedded in insurance contracts (see paragraphs 22-26A).~~;~~

(e) equity instruments issued by the ~~reporting enterprise~~entity including options, warrants, and other financial instruments that are classified as shareholders’ equity of the ~~reporting enterprise~~entity (see IAS 32). ~~however~~However, the holder of such instruments is required to apply this Standard to those instruments.~~);~~

(f) with respect to measurement after initial recognition, financial guarantee contracts~~,~~ (including letters of credit and credit derivative default products)~~,~~ that provide for specified payments to be made to reimburse the holder for a loss it incurs because a specified ~~if the~~ debtor fails to make payment when due under either the original or modified terms of a debt instrument. ~~(~~An issuer of such a financial guarantee contract shall apply IAS 37, Provisions, Contingent Liabilities and Contingent Assets, paragraphs 36-39, in ~~provides guidance for recognising and~~ measuring ~~financial guarantees, warranty obligations, and other similar instruments~~ the contract after initial recognition~~)~~. In contrast, financial guarantee contracts are subject to this Standard if they provide for payments to be made in response to changes in a specified interest rate, security price, commodity price, credit rating, foreign exchange rate, index of prices or rates, or other variable (sometimes called the ‘underlying’). For example, a financial guarantee contract that provides for payments to be made if the credit rating of a debtor falls below a particular level is within the scope of this Standard. ~~Also~~In addition, this Standard ~~does~~ requires recognition of financial guarantees incurred or retained as a result of the derecognition ~~standards set out~~ requirements in paragraphs 35-~~65~~57.~~;~~

(g) contracts for contingent consideration in a business combination (see paragraphs 65~~-76~~ 67 of IAS 22~~ (Revised 1998)~~, Business Combinations).~~;~~

(h) contracts that require a payment based on climatic, geological, or other physical variables (see paragraph 2), but this Standard ~~does~~ appl~~y~~ies to other types of derivatives that are embedded in such contracts (for example, if an interest rate swap is contingent on a climatic variable such as heating degree days, the interest rate swap element is an embedded derivative that is within the scope of this Standard, see paragraphs 22-26A).

(i) loan commitments that cannot be settled net in cash or by some other financial instrument except for such loan commitments that the entity elects to designate as held for trading under this Standard. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination

shall apply this Standard to all of its loan commitments. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for instance, a mortgage construction loan that is paid out in instalments in line with the progress of construction). An issuer of loan commitments shall apply IAS 37 to loan commitments that are not within the scope of this Standard.

2. Contracts that require a payment based on climatic, geological, or other physical variables are commonly used as insurance policies. (Those based on climatic variables are sometimes referred to as weather derivatives.) In such cases, the payment made is based on ~~an~~ the amount of loss to the ~~enterprise~~insured entity. Rights and obligations under insurance contracts that do not principally involve the transfer of financial risks are excluded from the scope of this Standard by paragraph 1(d). ~~The Board recognises that t~~The payout under some ~~of these~~ contracts that require a payment based on climatic, geological, or other physical variables is unrelated to the amount of an ~~enterprise~~ insured entity's loss. Such contracts are excluded from the scope of this Standard by paragraph 1(h). ~~While the Board considered leaving such derivatives within the scope of the Standard, it concluded that further study is needed to develop operational definitions that distinguish between 'insurance-type' and 'derivative type' contracts.~~

3. This Standard does not change the requirements relating to~~:~~

~~(a) accounting by a parent for investments in subsidiaries in the parent's separate financial statements as set out in paragraphs 29-31 of IAS 27;~~

~~(b) accounting by an investor for investments in associates in the investor's separate financial statements as set out in paragraphs 12-15 of IAS 28;~~

~~(c) accounting by a joint venturer for investments in joint ventures in the venturer's or investor's separate financial statements as set out in paragraphs 35 and 42 of IAS 31; or~~

~~(d)~~ employee benefit plans that comply with IAS 26, Accounting and Reporting by Retirement Benefit Plans, and royalty agreements based on the volume of sales or service revenues that are accounted for under IAS 18, Revenue.

4. Sometimes, an ~~enterprise~~entity makes what it views as a 'strategic investment' in equity securities issued by another ~~enterprise~~entity, with the intent of establishing or maintaining a long-term operating relation~~ship~~ with the ~~enterprise~~entity in which the investment is made. The investor ~~enterprise~~entity uses IAS 28, Accounting for Investments in Associates, to determine whether the equity method of accounting is appropriate for such an investment ~~because the investor has significant influence over the associate~~. Similarly, the investor ~~enterprise~~entity uses IAS 31, Financial Reporting of Interests in Joint Ventures, to determine whether proportionate consolidation or the equity method is appropriate for such an investment. If neither the equity method nor proportionate consolidation is appropriate, the ~~enterprise~~entity ~~will apply~~applies this Standard to that strategic investment.

5. This Standard applies to the financial assets and financial liabilities of insurance ~~companies~~ entities other than rights and obligations arising under insurance contracts~~, which~~ that are excluded by paragraph 1(d). ~~A separate IASC project on accounting for insurance contracts is currently under way, and it will address rights and obligations arising under insurance contracts. See paragraphs 22-26 for guidance on financial instruments that are embedded in insurance contracts.~~

6. This Standard ~~should~~shall be applied to ~~commodity-based~~those contracts ~~that give either party the right~~ to buy or sell a non-financial item that can be settled net in cash or by some other financial instrument as if they were financial instruments, with the exception of ~~commodity~~ contracts that ~~(a)~~ were entered into and continue to be for the purpose of receipt or delivery of a non-financial item in accordance with ~~meet~~ the ~~enterprise~~entity's expected purchase, sale, or usage requirements~~, (b) were designated for that purpose at their inception, and (c) are expected to be settled by delivery~~.

7. Contracts to buy or sell a non-financial item, such as a contract to buy or sell a commodity for a fixed price at a future date, do not meet the definition of a financial instrument (see IAS 32). Nevertheless, such a contract meets the definition of a derivative and is within the scope of this Standard if the entity has a practice of settling such contracts net in cash (either with the counterparty or by entering into offsetting contracts) or 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. Those practices indicate that the contract is not entered into for the purpose of making or taking delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements. ~~If an enterprise follows a pattern of entering into offsetting contracts that effectively accomplish settlement on a net basis, those contracts are not entered into to meet the enterprise's expected purchase, sale, or usage requirements.~~

Definitions

~~From IAS 32~~

~~***8. The following terms are used in this Standard with the meanings specified in IAS 32:***~~

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

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

~~***(a) cash;***~~

~~***(b) a contractual right to receive cash or another financial asset from another enterprise;***~~

~~***(c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable; or***~~

~~***(d) an equity instrument of another enterprise.***~~

~~***A financial liability is any liability that is a contractual obligation:***~~

~~***(a) to deliver cash or another financial asset to another enterprise; or***~~

~~***(b) to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.***~~

~~***An equity instrument is any contract that evidences a residual interest in the assets of an enterprise after deducting all of its liabilities (see paragraph 11).***~~

~~***Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.***~~

8. The terms defined in IAS 32 are used in this Standard with the meanings specified in IAS 32 (see IAS 32, paragraph 5). IAS 32 defines a financial instrument, financial asset, financial liability, equity instrument, fair value and market value, and provides guidance on applying those definitions.

9. [deleted]~~For purposes of the foregoing definitions, IAS 32 states that the term 'enterprise' includes individuals, partnerships, incorporated bodies, and government agencies.~~

~~Additional Definitions~~

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

Definition of a Derivative

A derivative is a financial instrument or other contract within the scope of this Standard (see paragraph 6) with all three of the following characteristics:

(a) ~~whose~~ its value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or ~~similar~~ other variable (sometimes called the 'underlying');

(b) ~~that~~ it requires no initial net investment or ~~little~~ an initial net investment that is smaller than would be required for ~~relative to~~ other types of contracts that would be expected to have a similar response to changes in market ~~conditions~~factors; and

(c) ~~that~~ it is settled at a future date.

Definitions of Four Categories of Financial ~~Assets~~Instruments

A financial asset or financial liability held for trading is one that upon initial recognition is ~~was~~ designated by the entity as held for trading~~acquired or incurred principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin~~. A financial instrument ~~asset should~~shall be classified as held for trading if~~, regardless of why~~ it (a)~~was~~ is acquired or incurred principally for the purpose of selling or repurchasing~~,~~ it in the near term, (b) 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, or ~~(see paragraph 21).~~ (c) is a ~~D~~derivative ~~financial assets and derivative financial liabilities are always deemed held for trading unless they are~~ (except for a derivative that is a designated and effective hedging instrument)~~s~~. ~~(See paragraph 18 for an example of a liability held for trading.)~~ Any financial instrument may be designated as held for trading when it is initially recognised.

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that an ~~enterprise~~entity has the positive intent and ability to hold to maturity (see paragraphs ~~80-92~~79-89) other than those that the entity upon initial recognition elects to designate as held for trading or available for sale, or that meet the definition of loans and receivables originated by the ~~enterprise~~entity.

Loans and receivables originated by the ~~enterprise~~entity are financial assets with fixed or determinable payments that are not quoted in an active market and are created by the ~~enterprise~~entity by providing money, goods, or services directly to a debtor, other than (i) those that are originated with the ~~intent to be sold~~ intention of sale immediately or in the short term, which ~~should~~shall be classified as held for trading, and (ii) those that the entity on initial recognition elects to designate as held for trading or available for sale. ~~Loans and receivables originated by the enterprise are not included in held-to-maturity investments but, rather, are classified separately under this Standard (see paragraphs 19-20).~~

Available-for-sale financial assets are those financial assets that are not classified as (a) loans and receivables originated by the ~~enterprise~~entity, (b) held-to-maturity investments, or (c) ~~financial assets~~ held for trading~~(see paragraph 21)~~.

Definitions Relating to Recognition and Measurement

Amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability ~~was~~ is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any write-down (directly or through the use of an allowance account) for impairment or uncollectability.

The effective interest method is a method of calculating ~~amortisation~~ amortised cost and interest income or interest expense using the effective interest rate of a financial asset or financial liability. For an individual financial asset or financial liability, ~~T~~the effective interest rate is the rate that exactly discounts the ~~expected~~ contractual stream of future cash payments or receipts through maturity or the next market-based repricing date to the ~~current~~ net carrying amount of the financial asset or financial liability at initial recognition or the most recent market-based repricing date after initial recognition, as applicable. That computation ~~should~~ includes all fees and points paid or received between parties to the contract. The determination of the effective interest rate is based on the estimated stream of cash receipts rather than the contractual stream of cash receipts for the purposes of (i) recognising interest income for a group of assets that are subject to prepayment risk, provided it is possible to make a reasonable estimate of the timing and amounts of prepayments in the group, and (ii) measuring impairment in groups of assets that are collectively evaluated for impairment (see paragraph 112). The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the financial asset or financial liability for that period. (See IAS 18, Revenue, paragraph 31, and IAS 32, paragraph 61.)

Transaction costs are incremental external costs that are directly attributable to the acquisition or disposal of a financial asset or financial liability (see paragraph 17).

A firm commitment is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

~~Control of an asset is the power to obtain the future economic benefits that flow from the asset.~~

Derecognise means to remove a previously recognised financial asset or financial liability, or a portion of a financial asset or financial liability, from an ~~enterprise~~entity's balance sheet.

Definitions Relating to Hedge Accounting

~~Hedging, for accounting purposes, means designating one or more hedging instruments so that their change in fair value is an offset, in whole or in part, to the change in fair value or cash flows of a hedged item.~~

A hedged item is an asset, liability, firm commitment, ~~or~~ forecast~~ed~~ future transaction, or net investment in a foreign operation that (a) exposes the ~~enterprise~~entity to risk of changes in fair value or ~~changes in~~ future cash flows and ~~that~~ (b) ~~for hedge accounting purposes,~~ is designated as being hedged (paragraphs 127-135A elaborate on the definition of hedged items).

A hedging instrument~~, for hedge accounting purposes,~~ is a designated derivative or (in limited circumstances) a ~~nother~~non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (paragraphs 122-126C elaborate on the definition of a hedging instrument). Under this Standard, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument for hedge accounting purposes only if it hedges the risk of changes in foreign currency exchange rates.

Hedge effectiveness is the degree to which offsetting changes in fair value or cash flows attributable to a hedged risk are achieved by the hedging instrument (see paragraphs 146-152).

Other Definitions

Securitisation is the process by which financial assets are transformed into securities.

A repurchase agreement is an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial asset at a future date for an amount equal to the cash or other consideration exchanged plus interest.

Elaboration on the Definitions

~~Equity Instrument~~

~~11. An enterprise may have a contractual obligation that it can settle either by payment of financial assets or by payment in the form of its own equity securities. In such a case, if the number of equity securities~~

~~***required to settle the obligation varies with changes in their fair value so that the total fair value of the equity securities paid always equals the amount of the contractual obligation, the holder of the obligation is not exposed to gain or loss from fluctuations in the price of the equity securities. Such an obligation should be accounted for as a financial liability of the enterprise and, therefore, is not excluded from the scope of this Standard by paragraph 1(e).***~~

11.-12. [deleted]~~An enterprise may have a forward, option, or other derivative instrument whose value changes in response to something other than the market price of the enterprise's own equity securities but that the enterprise can choose to settle or is required to settle in its own equity securities. In such case, the enterprise accounts for the instrument as a derivative instrument, not as an equity instrument, because the value of such an instrument is unrelated to the changes in the equity of the enterprise.~~

Derivatives

13. Typical examples of derivatives are futures and forward, swap, and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume, or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of 1,000 if six-month LIBOR increases by 100 basis points. Such a contract is a derivative even though ~~In this example,~~ a notional amount is not specified.

14. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (for example, a forward contract to purchase a fixed-rate debt instrument). An entity may have a contract ~~Commitments~~ to buy or sell non-financial items that can be settled net in cash or by some other financial instrument and meets the definition of a derivative (for example, a contract to buy or sell a commodity at a fixed price at a future date). ~~assets and liabilities that are intended to be settled~~ Such a contract is within the scope of this Standard

unless it was entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. ~~by the reporting enterprise by making or taking delivery in the normal course of business, and for which there is no practice of settling net (either with the counterparty or by entering into offsetting contracts), are not accounted for as derivatives but rather as executory contracts. Settling net means making a cash payment based on the change in fair value.~~

15. One of the defining ~~conditions~~ characteristics of a derivative is that it has ~~requires little~~an initial net investment that is smaller than would be required for ~~relative to~~ other types of contracts that would be expected to have a similar response to changes in market ~~conditions~~ factors. An option contract meets that definition because the premium is ~~significantly~~ less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.

16. If an ~~enterprise~~entity contracts to buy a financial asset on terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned (sometimes called a 'regular way' contract~~[2]~~), the fixed price commitment between trade date and settlement date is a forward contract that meets the definition of a derivative. This Standard provides for special accounting for such regular way contracts (see paragraphs 30-33~~34~~).

Transaction Costs

17. Transaction costs include fees and commissions paid to agents, advisers, brokers, and dealers; levies by regulatory agencies and securities exchanges; and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs, or allocations of internal administrative or holding costs.

Financial Assets and Financial Liabilities ~~y~~ Held for Trading

17A. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin. However, designation of a financial instrument as held for trading is not precluded simply because the entity does not intend to sell or repurchase it in the near term. Under this Standard, an entity may designate any financial instrument irrevocably on initial recognition as held for trading.

18. Financial ~~L~~liabilities held for trading include (a) derivative liabilities that are not accounted for as hedging instruments, ~~and~~ (b) ~~the~~ obligations to deliver securities or other financial assets borrowed by a short seller (ie an ~~enterprise~~entity that sells ~~securities~~ financial assets ~~that~~ it has borrowed and does not yet own), (c) financial liabilities that are incurred with an intention to repurchase them in the near term (for example, a quoted debt security that the issuer may buy back in the near term depending on changes in its fair value), (d) financial liabilities that are 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, and (e) other financial liabilities that are designated as held for trading. The fact that a liability is used to fund trading activities does not in itself make that liability one held for trading. However, it may be designated as such.

18A. In presenting and disclosing information about financial instruments, an entity describes those financial instruments in a manner consistent with the nature of the instruments. If an entity has elected to designate as held for trading financial instruments other than those that are acquired or incurred principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, it uses a label such as 'financial instruments at fair value (through net income)' in presenting and disclosing information about those financial instruments rather than 'financial instruments held for trading'.

Loans and Receivables Originated by the ~~Enterprise~~Entity

19. A loan acquired by an ~~enterprise~~entity as a participation in a loan from another lender is ~~considered to be~~regarded as originated by the ~~enterprise~~entity provided it is funded by the ~~enterprise~~entity on the date that the loan is originated by the other lender. However, the acquisition of an interest in a pool of loans or receivables, for example in connection with a securitisation, is a purchase, not an origination, because the ~~enterprise~~entity did not provide money, goods, or services directly to the

underlying debtors ~~n~~or acquire its interest through a participation with another lender on the date the underlying loans or receivables were originated. ~~Also~~In addition, a transaction that is, in substance, a purchase of a loan that was previously originated ~~—~~(for example, a loan to an unconsolidated special purpose entity that ~~is~~was made to provide funding for ~~its~~ purchases of loans originated by others) ~~—~~is not a loan originated by the ~~enterprise~~entity. A loan acquired by an ~~enterprise~~entity~~–~~ in a business combination is ~~considered to be~~regarded as originated by the acquiring ~~enterprise~~entity provided that it was similarly classified by the acquired ~~enterprise~~entity. The loan is measured at acquisition under IAS 22, Business Combinations. A loan acquired through a syndication is an originated loan because each lender shares in the origination of the loan and provides money direct~~ly~~ to the debtor.

20. Any financial asset with fixed or determinable payments (including originated loan assets, trade receivables, investments in debt securities that are acquired at original issue, and deposits held in banks) potentially could meet the definition of loans and receivables originated by the entity. However, a financial asset that is quoted in an active market (such as a quoted debt security, see paragraph 99) does not qualify for classification as a loan or receivable originated by the entity. In addition, financial assets ~~Loans or receivables~~ that are purchased by an ~~enterprise~~entity after origination~~, rather than originated,~~ are not ~~are~~ classified as loans or receivables originated by the entity. ~~held to maturity, available for sale, or held for trading, as appropriate.~~ Financial assets that do not meet the definition of loans and receivables originated by the entity may be classified as held-to-maturity investments if they meet the conditions for that classification (see paragraphs 79-89). An entity may on initial recognition of a financial asset that would otherwise be classified as an originated loan or receivable elect to designate it as either held for trading or available for sale.

~~Available-for-Sale Financial Assets~~

21. [deleted] ~~A financial asset is classified as available for sale if it does not properly belong in one of the three other categories of financial assets – held for trading, held to maturity, and loans and receivables originated by the enterprise. A financial asset is classified as held for trading, rather than available for sale, if it is part of a portfolio of similar assets for~~

~~which there is a pattern of trading for the purpose of generating a profit from short-term fluctuations in price or dealer's margin.~~

Embedded Derivatives

22. An embedded derivative is a component of ~~Sometimes, a derivative may be a component of~~ a hybrid (combined) ~~financial~~ instrument that also includes ~~both the derivative and~~ a non-derivative host contract – with the effect that some of the cash flows of the combined instrument vary in a ~~similar~~ way similar to a stand-alone derivative. ~~Such derivatives are sometimes known as 'embedded derivatives'.~~ An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified based on a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument. This Standard does not address whether an embedded derivative shall be presented separately on the face of the financial statements.

23. An embedded derivative ~~should~~shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if, all of the following conditions are met:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value reported in ~~net~~ profit or loss (ie a derivative that is embedded in a financial instrument that is classified as held for trading would not be separated).

If an embedded derivative is separated, the host contract ~~itself~~ ~~should~~shall be accounted for ~~(a)~~ under this Standard if it is~~, itself,~~ a financial instrument and ~~(b)~~ in accordance with other appropriate ~~International Accounting~~ Standards if it is not a financial instrument.

24.-25. [deleted] (see Appendix A)

~~24. The economic characteristics and risks of an embedded derivative are not considered to be closely related to the host contract (paragraph 23(a)) in the following examples. In these circumstances, assuming the conditions in paragraphs 23(b) and 23(c) are also met, an enterprise accounts for the embedded derivative separately from the host contract under this Standard:~~

~~(a) a put option on an equity instrument held by an enterprise is not closely related to the host equity instrument;~~

~~(b) a call option embedded in an equity instrument held by an enterprise is not closely related to the host equity instrument from the perspective of the holder (from the issuer's perspective, the call option is an equity instrument of the issuer if the issuer is required to or has the right to require settlement in shares, in which case it is excluded from the scope of this Standard);~~

~~(c) an option or automatic provision to extend the term (maturity date) of debt is not closely related to the host debt contract held by an enterprise unless there is a concurrent adjustment to the market rate of interest at the time of the extension;~~

~~(d) equity-indexed interest or principal payments – by which the amount of interest or principal is indexed to the value of equity shares – are not closely related to the host debt instrument or insurance contract because the risks inherent in the host and the embedded derivative are dissimilar;~~

~~(e) commodity-indexed interest or principal payments – by which the amount of interest or principal is indexed to the price of a commodity – are not closely related to the host debt instrument or insurance contract because the risks inherent in the host and the embedded derivative are dissimilar;~~

~~(f) an equity conversion feature embedded in a debt instrument is not closely related to the host debt instrument;~~

~~(g) a call or put option on debt that is issued at a significant discount or premium is not closely related to the debt except for debt (such as a zero coupon bond) that is callable or puttable at its accreted amount; and~~

~~(h) arrangements known as credit derivatives that are embedded in a host debt instrument and that allow one party (the 'beneficiary') to transfer the credit risk of an asset, which it may or may not actually own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with a reference asset without directly purchasing it.~~

~~25. On the other hand, the economic characteristics and risks of an embedded derivative are considered to be closely related to the economic characteristics and risks of the host contract in the following examples. In these circumstances, an enterprise does not account for the embedded derivative separately from the host contract under this Standard:~~

~~(a) the embedded derivative is linked to an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on the host debt contract (that is, this Standard does not permit floating rate debt to be treated as fixed rate debt with an embedded derivative);~~

~~(b) an embedded floor or cap on interest rates is considered to be closely related to the interest rate on a debt instrument if the cap is at or above the market rate of interest or if the floor is at or below the market rate of interest when the instrument is issued, and the cap or floor is not leveraged in relation to the host instrument;~~

~~(c) the embedded derivative is a stream of principal or interest payments that are denominated in a foreign currency. Such a derivative is not separated from the host contract because IAS 21, The Effects of Changes in Foreign Exchange Rates, requires that foreign currency translation gains and losses on the entire host monetary item be recognised in net profit or loss;~~

~~(d) the host contract is not a financial instrument and it requires payments denominated in (i) the currency of the primary economic environment in which any substantial party to that contract operates or (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in international commerce (for example, the U.S. dollar for crude oil transactions). That is, such contract is not regarded as a host contract with an embedded foreign currency derivative;~~

~~(e) the embedded derivative is a prepayment option with an exercise price that would not result in a significant gain or loss;~~

~~(f) the embedded derivative is a prepayment option that is embedded in an interest-only or principal-only strip that (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative and that (ii) does not contain any terms not present in the original host debt contract;~~

~~(g) with regard to a host contract that is a lease, the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the enterprise's own economic environment), (ii) contingent rentals based on related sales, and (iii) contingent rentals based on variable interest rates; or~~

~~(h) the embedded derivative is an interest rate or interest rate index that does not alter the net interest payments that otherwise would be paid on the host contract in such a way that the holder would not recover substantially all of its recorded investment or (in the case of a derivative that is a liability) the issuer would pay a rate more than twice the market rate at inception.~~

26. If an ~~enterprise~~entity is required by this Standard to separate an embedded derivative from its host contract, but is unable to ~~separately~~ measure the embedded derivative separately either at acquisition or at a subsequent financial reporting date, it ~~should~~shall treat the entire combined contract as a financial instrument held for trading.

26A. If an entity is unable to determine reliably the fair value of an embedded derivative based on its terms and conditions (for example, because the embedded derivative is based on an unquoted equity instrument), the fair value of the embedded derivative is the difference between the fair value of the hybrid instrument and the fair value of the host contract, if those can be determined under this Standard. If the entity is unable to determine the fair value of the embedded derivative using this method, paragraph 26 applies and the combined instrument is treated as a financial instrument held for trading.

Recognition

Initial Recognition

27. An ~~enterprise~~entity ~~should~~shall recognise a financial asset or financial liability on its balance sheet when, and only when, ~~it~~the entity becomes a party to the contractual provisions of the instrument. (See paragraph 30 with respect to 'regular way' purchases of financial assets.)

28. As a consequence of the principle in the preceding paragraph, an ~~enterprise~~entity recognises all of its contractual rights ~~or~~ and obligations under derivatives in its balance sheet as assets ~~or~~ and liabilities, respectively. If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset (see paragraph 56).

29. The following are ~~some~~ examples of applying the principle in paragraph 27:

(a) unconditional receivables and payables are recognised as assets or liabilities when the ~~enterprise~~entity becomes a party to the contract and, as a consequence, has a legal right to receive, or a legal obligation to pay, cash;

(b) assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services generally are not recognised ~~under present accounting practice~~ until at least one of the parties has performed under the agreement ~~such that it either is entitled to receive an asset or is obligated to disburse an asset~~. For example, an ~~enterprise~~entity that receives a firm order generally does not recognise an asset (and the ~~enterprise~~entity that places the order does not recognise a liability) at the time of the commitment but, rather, delays recognition until the ordered goods or services have been shipped, delivered, or rendered. However, this is not the accounting for a firm commitment to buy or sell non-financial items that is within the scope of this Standard under paragraph 6 because the contract can be settled net. Any net fair value of such a commitment is recognised as an asset or liability on the commitment date (see (c) below). In addition, if a previously unrecognised firm commitment is designated as a hedged item, any change in the net fair value attributable to the hedged risk is recognised as an asset or liability subsequent to the inception of the hedge (see paragraph 140);

(c) ~~in contrast to (b) above, however,~~ a forward contract that is within the scope of this Standard (see paragraphs 1 and 6) ~~a commitment to purchase or sell a specified financial instrument or commodity subject to this Standard on a future date at a specified price~~ is recognised as an asset or a liability on the commitment date, rather than ~~waiting until~~ on the ~~closing~~ date on which ~~the exchange~~ settlement ~~actually~~ takes place. When an ~~enterprise~~entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. ~~, and o~~Only any net fair value of the right and obligation is recognised as an asset or liability. ~~However, each party is exposed to the price risk that is the subject of the contract from that date. Such a forward contract satisfies the recognition principle of paragraph 27, from the perspectives of both the buyer and the seller, at the time the enterprises become parties to the contract, even though it may have a zero net value at that date. The fair value of the contract may become a net asset or liability in the future depending on, among other things, the time value of money and the value of the underlying instrument or commodity that is the subject of the forward~~;

(d) ~~financial~~ option contracts that are within the scope of this Standard (see paragraphs 1 and 6) are recognised as assets or liabilities when the holder or writer becomes a party to the contract; and

(e) planned future transactions, no matter how likely, are not assets and liabilities of an ~~enterprise~~entity ~~since~~ because the ~~enterprise~~entity~~, as of the financial reporting date,~~ has not become a party to a contract ~~requiring future receipt or delivery of assets arising out of the future transactions~~.

~~Trade Date vs. Settlement Date~~

30.-34. [deleted] (see paragraph 57A and Appendix A)

~~***30. A 'regular way' purchase or sale of financial assets should be recognised using either trade date accounting or settlement date***~~

~~***accounting as described in paragraphs 32 and 33. The method used should be applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets defined in paragraph 10.***~~

~~31. A contract for the purchase or sale of financial assets that requires delivery of the assets within the time frame generally established by regulation or convention in the marketplace concerned (sometimes called a 'regular way' contract) is a financial instrument as described in this Standard. The fixed price commitment between trade date and settlement date meets the definition of a derivative – it is a forward contract. However, because of the short duration of the commitment, such a contract is not recognised as a derivative financial instrument under this Standard.~~

~~32. The trade date is the date that an enterprise commits to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date and (b) derecognition of an asset that is sold and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.~~

~~33. The settlement date is the date that an asset is delivered to or by an enterprise. Settlement date accounting refers to (a) the recognition of an asset on the day it is transferred to an enterprise and (b) the derecognition of an asset on the day that it is transferred by the enterprise. When settlement date accounting is applied, under paragraph 106 an enterprise will account for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it will account for the acquired asset under this Standard. That is, the value change is not recognised for assets carried at cost or amortised cost; it is recognised in net profit or loss for assets classified as trading; and it is recognised in net profit or loss or in equity (as appropriate under paragraph 103) for assets classified as available for sale.~~

~~34. The following example illustrates the application of paragraphs 30-33 and later parts of this Standard that specify measurement and recognition of changes in fair values for various types of financial assets. On 29~~

~~December 20x1, an enterprise commits to purchase a financial asset for 1,000 (including transaction costs), which is its fair value on commitment (trade) date. On 31 December 20x1 (financial year end) and on 4 January 20x2 (settlement date) the fair value of the asset is 1,002 and 1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below:~~

~~**SETTLEMENT DATE ACCOUNTING**~~			
~~**Balances**~~	~~**Held-to-Maturity Investments – Carried at Amortised Cost**~~	~~**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**~~	~~**Assets Held for Trading and Available-for-Sale Assets – Remeasured to Fair Value with Changes in Profit or Loss**~~
~~**29 December 20x1**~~			
~~Financial asset~~	~~–~~	~~–~~	~~–~~
~~Liability~~	~~–~~	~~–~~	~~–~~
~~**31 December 20x1**~~			
~~Receivable~~	~~–~~	~~2~~	~~2~~
~~Financial asset~~	~~–~~	~~–~~	~~–~~
~~Liability~~	~~–~~	~~–~~	~~–~~
~~Equity (fair value adjustment)~~	~~–~~	~~(2)~~	~~–~~
~~Retained earnings (through net profit or loss)~~	~~–~~	~~–~~	~~(2)~~
~~**4 January 20x2**~~			
~~Receivable~~	~~–~~	~~–~~	~~–~~
~~Financial asset~~	~~1,000~~	~~1,003~~	~~1,003~~
~~Liability~~	~~–~~	~~–~~	~~–~~
~~Equity (fair value adjustment)~~	~~–~~	~~(3)~~	~~–~~
~~Retained earnings (through net profit or loss)~~	~~–~~	~~–~~	~~(3)~~

~~**TRADE DATE ACCOUNTING**~~			
~~**Balances**~~	~~**Held-to-Maturity Investments – Carried at Amortised Cost**~~	~~**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**~~	~~**Assets Held for Trading and Available-for-Sale Assets – Remeasured to Fair Value with Changes in Profit or Loss**~~
~~**29 December 20x1**~~			
~~Financial asset~~	~~1,000~~	~~1,000~~	~~1,000~~
~~Liability~~	~~(1,000)~~	~~(1,000)~~	~~(1,000)~~
~~**31 December 20x1**~~			
~~Receivable~~	~~–~~	~~–~~	~~–~~
~~Financial asset~~	~~1,000~~	~~1,002~~	~~1,002~~
~~Liability~~	~~(1,000)~~	~~(1,000)~~	~~(1,000)~~
~~Equity (fair value adjustment)~~	~~–~~	~~(2)~~	~~–~~
~~Retained earnings (through net profit or loss)~~	~~–~~	~~–~~	~~(2)~~
~~**4 January 20x2**~~			
~~Receivable~~	~~–~~	~~–~~	~~–~~
~~Financial asset~~	~~1,000~~	~~1,003~~	~~1,003~~
~~Liability~~	~~–~~	~~–~~	~~–~~
~~Equity (fair value adjustment)~~	~~–~~	~~(3)~~	~~–~~
~~Retained earnings (through net profit or loss)~~	~~–~~	~~–~~	~~(3)~~

Derecognition of a Financial Asset

~~**Derecognition of a Financial Asset**~~

35. An ~~enterprise~~ entity ~~should~~shall derecognise a financial asset or a portion of a financial asset when, and only when:

(a) ~~, the enterprise loses control of the~~ the entity's contractual rights to the cash flows that ~~comprise~~ constitute the financial asset (or a portion of the financial asset)~~. An enterprise loses such control if it realises the rights to benefits specified in the contract, the rights~~ expire or are forfeited; ~~,~~ or

(b) ~~the~~ the entity transfers the contractual rights to the cash flows that constitute the financial asset (or a portion of the financial asset) and the entity has no continuing involvement in all or a portion of those rights (see paragraph 37)~~enterprise surrenders those rights~~.

If one of these conditions is met for the asset in its entirety, all of the financial asset is derecognised. If one of these conditions is met for only a portion of the asset, that portion is derecognised and the other portion continues to be recognised.

36. A financial asset that is the subject of a transfer can be a single financial asset, a group of financial assets, or a subdivided portion thereof. A subdivided portion of a financial asset or group of financial assets consists of the rights to and related benefits and risks of a determinable portion of the underlying cash flows of a financial asset or group of financial assets. For the purposes of applying this Standard, a transfer of a financial asset refers to the transfer of the contractual rights to all or a portion of the cash flows of a single financial asset or a group of financial assets either directly under a contractual agreement or in the form of a security.

37. A transferor has no continuing involvement in the contractual rights to cash flows that constitute a transferred asset or a portion thereof to the extent that both of the following conditions are met for all or a portion of the transfer:

(a) the transferor either:

(i) relinquishes its contractual rights to the cash flows; or

(ii) enters into a 'pass-through' arrangement that meets the conditions in paragraph 41; and

(b) there are no contractual provisions related to the transfer that either:

(i) may result in the transferor (including a consolidated entity) reacquiring control of its previous contractual rights (for example, through a repurchase agreement, a call option held by the transferor, or a put option written by the transferor); or

(ii) gives the transferor (including a consolidated entity) an obligation to pay subsequent decreases, or a right to receive subsequent increases, in the value of its previous contractual rights (for example, through a credit guarantee, a total return swap, or a cash-settled put or call option).

A continuing involvement in a transferred financial asset may result from contractual provisions incorporated in the transfer agreement itself or a separate agreement with the transferee or a third party entered into in connection with the transfer. Normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith, and fair dealings that could invalidate a transfer as a result of legal action do not constitute a continuing involvement in a transferred financial asset. The retention of the right to service a transferred financial asset does not in itself constitute continuing involvement in that asset.

38. If there are contractual provisions related to the transfer of a financial asset that may result in the transferor reacquiring control of all or a portion of the contractual cash flows that constitute the transferred asset, the transfer does not qualify for derecognition to the extent of the transferred asset that could be reacquired. An entity can regain control of its contractual rights to cash flows that constitute a transferred financial asset to the extent that the cash flows that underlie the financial asset are subject to a contractual agreement that requires or permits the entity to repurchase them (for example, through a forward repurchase agreement

or call option held by the transferor). An entity may be required to regain control of the rights to cash flows that constitute a financial asset to the extent that it can be required to repurchase the rights to cash flows (for example, through a put option held by the transferee). In those cases, the transfer does not qualify for derecognition to the extent of the transferred asset that could be reacquired.

39. A transfer does not qualify for derecognition to the extent that there are contractual provisions related to the transfer that require payments to be made by or to the transferor based on subsequent changes in the value of the transferred asset. For example, a transferor may provide a credit guarantee on the transferred asset and the transferee may agree to pay increases in value of the transferred asset back to the transferor. In those cases, the transfer does not qualify for derecognition to the extent of the transferor's continuing involvement in the gains or losses of the transferred asset (the maximum amount of the consideration received that could be required to be repaid or the amount of the asset on which increases in value are returned to the transferor, whichever is greater).

40. A transfer of a portion of a financial asset qualifies for derecognition if the transferor has no continuing involvement in that portion even if a separate portion of the same financial asset is retained by the transferor and it contains all or substantially all of the risk of the financial asset.

41. If an entity transfers its contractual rights to all or a portion of the cash flows that constitute a financial asset and continues to collect cash flows from the transferred asset (a 'pass-through arrangement'), the transfer qualifies for derecognition to the extent that the transfer of all or a portion of the asset meets all of the following conditions and the transferor does not otherwise have a continuing involvement (see paragraph 37(b):

(a) The transferor does not have an obligation to pay amounts to the transferee unless it collects equivalent amounts from the transferred asset or portion thereof that qualifies for derecognition (ie the transferee is entitled only to the cash flows of the underlying financial asset or the portion thereof that qualifies for derecognition).

(b) The transferor is prohibited by the terms of the transfer contract or documents from selling or pledging the transferred asset or otherwise using that asset for its benefit.

(c) The transferor has an obligation to remit any cash flows it collects on behalf of the transferee without material delay. The transferor is not entitled to reinvest such cash flows for its own benefit.

42. If all or a portion of the contractual rights to cash flows of a financial asset is transferred, custody of the underlying asset may remain with the transferor. This situation may occur, for example, if the transferor is a special purpose entity or trust, and issues beneficial interests in the underlying financial assets that it owns to investors and provides the servicing of those financial assets. In that case, the assets qualify for derecognition to the extent that the conditions in paragraph 41 are met.

Servicing Assets and Servicing Liabilities

43. If an entity transfers all or a portion of a financial asset and retains the right to service the financial asset for a fee, it shall recognise either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognised at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognised for the servicing right at an amount determined on the basis of an allocation of the consideration received in accordance with paragraph 47.

~~36. If a financial asset is transferred to another enterprise but the transfer does not satisfy the conditions for derecognition in paragraph 35, the transferor accounts for the transaction as a collateralised borrowing. In that case, the transferor's right to reacquire the asset is not a derivative.~~

~~37. Determining whether an enterprise has lost control of a financial asset depends both on the enterprise's position and that of the transferee. Consequently, if the position of either enterprise indicates that the transferor has retained control, the transferor should not remove the asset from its balance sheet.~~

~~38. A transferor has not lost control of a transferred financial asset and, therefore, the asset is not derecognised if, for example:~~

~~(a) the transferor has the right to reacquire the transferred asset unless either (i) the asset is readily obtainable in the market or (ii) the reacquisition price is fair value at the time of reacquisition;~~

~~(b) the transferor is both entitled and obligated to repurchase or redeem the transferred asset on terms that effectively provide the transferee with a lender's return on the assets received in exchange for the transferred asset. A lender's return is one that is not materially different from that which could be obtained on a loan to the transferor that is fully secured by the transferred asset; or~~

~~(c) the asset transferred is not readily obtainable in the market and the transferor has retained substantially all of the risks and returns of ownership through a total return swap with the transferee or has retained substantially all of the risks of ownership through an unconditional put option on the transferred asset held by the transferee (a total return swap provides the market returns and credit risks to one of the parties in return for an interest index to the other party, such as a LIBOR payment).~~

~~39. Under paragraph 38(a), a transferred asset is not derecognised if the transferor has the right to repurchase the asset at a fixed price and the asset is not readily obtainable in the market, because the fixed price is not necessarily fair value at the time of reacquisition. For instance, a transfer of a group of mortgage loans that gives the transferor the right to reacquire those same loans at a fixed price would not result in derecognition.~~

~~40. A transferor may be both entitled and obligated to repurchase or redeem an asset by (a) a forward purchase contract, (b) a call option held and a put option written with approximately the same strike price, or (c) in other ways. However, neither the forward purchase contract in (a) nor the combination of options in (b) is sufficient, by itself, to maintain control over a transferred asset if the repurchase price is fair value at the time of repurchase.~~

~~41. A transferor generally has lost control of a transferred financial asset only if the transferee has the ability to obtain the benefits of the transferred asset. That ability is demonstrated, for example, if the transferee:~~

~~(a) is free either to sell or to pledge approximately the full fair value of the transferred asset; or~~

~~(b) is a special purpose entity whose permissible activities are limited, and either the special purpose entity itself or the holders of beneficial interests in that entity have the ability to obtain substantially all of the benefits of the transferred asset.~~

~~That ability may be demonstrated in other ways.~~

~~42. Neither paragraph 38 nor paragraph 41 is viewed in isolation. For example, a bank transfers a loan to another bank, but to preserve the relationship of the transferor bank with its customer, the acquiring bank is not allowed to sell or pledge the loan. Although the inability to sell or pledge would suggest that the transferee has not obtained control, in this instance the transfer is a sale provided that the transferor does not have the right or ability to reacquire the transferred asset.~~

Derecognition of a Financial Asset in its Entirety

~~**Asset Derecognition Coupled with a New Financial Asset or Liability**~~

~~51.~~44. If an ~~enterprise~~entity transfers ~~control of~~ an entire financial asset and the transfer qualifies for derecognition in its entirety but, in doing so, ~~creates~~ obtains a new financial asset or assumes a new financial liability, or a servicing liability, the ~~enterprise~~entity ~~should~~shall recognise the new financial asset ~~or~~, financial liability, or servicing liability at fair value. ~~and should recognise a gain or loss on the transaction based on the difference between:~~

~~(a) the proceeds; and~~

~~(b) the carrying amount of the financial asset sold plus the fair value of any new financial liability assumed, minus the fair value of any new financial asset acquired, and plus or minus any adjustment that had previously been reported in equity to reflect the fair value of that asset.~~

~~52.~~45. Examples of the circumstances described in paragraph ~~51~~ 44 are:

(a) selling a portfolio of debt securities and obtaining cash and equity securities as consideration for the fair value of the debt securities; ~~receivables while assuming an obligation to compensate the purchaser of the receivables if collections are below a specified level;~~ and

(b) selling or securitising a portfolio of receivables while retaining the right to service the receivables for a fee, and the fee to be received is not expected to compensate the entity adequately for performing the ~~less than the costs of~~ servicing, thereby resulting in a liability for the servicing obligation. Although a servicing liability is not a financial liability, it is treated as if it were in recognising any new financial asset or financial liability created as a result of a transfer of an entire financial asset (see paragraph 43).

~~53. The following example illustrates application of paragraph 51. A transfers certain receivables to B for a single, fixed cash payment. A is not obligated to make future payments of interest on the cash it has received from B. However, A guarantees B against default loss on the receivables up to a specified amount. Actual losses in excess of the amount guaranteed will be borne by B. As a result of the transaction, A has lost control over the receivables and B has obtained control. B now has the contractual right to receive cash inherent in the receivables as well as a guarantee from A. Under paragraph 51:~~

~~(a) B recognises the receivables on its balance sheet, and A removes the receivables from its balance sheet because they were sold to B; and~~

~~(b) the guarantee is treated as a separate financial instrument, created as a result of the transfer, to be recognised as a financial liability by A and a financial asset by B. For practical purposes, B might include the guarantee asset with the receivables.~~

~~54. In the rare circumstance that the fair value of the new financial asset or new financial liability cannot be measured reliably, then:~~

~~(a) if a new financial asset is created but cannot be measured reliably, its initial carrying amount should be zero, and a gain or loss should be recognised equal to the difference between (i) the proceeds and (ii) the previous carrying amount of the derecognised financial asset plus or minus any prior adjustment that had been reported in equity to reflect the fair value of that asset; and~~

~~(b) if a new financial liability is assumed but cannot be measured reliably, its initial carrying amount should be such that no gain is recognised on the transaction and, if IAS 37, Provisions, Contingent Liabilities and Contingent Assets, requires recognition of a provision, a loss should be recognised.~~

~~Paragraphs 95-102 provide guidance as to when fair value is reliably measurable.~~

~~55. To illustrate paragraph 54(b), the excess of the proceeds over the carrying amount is not recognised in net profit or loss. Instead it is recorded as a liability in the balance sheet.~~

~~56. If a guarantee is recognised as a liability under this Standard, it continues to be recognised as a liability of the guarantor, measured at its fair value (or at the greater of its original recorded amount and any provision required by IAS 37, if fair value cannot be reliably measured), until it expires. If the guarantee involves a large population of items, the guarantee should be measured by weighting all possible outcomes by their associated probabilities.~~

~~43.~~46. On derecognition of a financial asset in its entirety, the difference between (a) the carrying amount of ~~an~~ the asset ~~(or portion of an asset)~~ transferred to another party and (b) the sum of (i) the consideration ~~proceeds~~ received ~~or receivable~~ and (ii) any cumulative gain or loss on ~~prior adjustment to reflect the fair value of that~~the asset that had been ~~reported~~ recognised directly in equity (see paragraph 103(b))~~should~~shall be included in ~~net~~ profit or loss for the period.

~~44.-46. [Deleted]~~

Derecognition of ~~Part~~ a Portion of a Financial Asset

47. If an ~~enterprise~~entity, as a result of a transfer, derecognises ~~transfers~~ a ~~part~~ portion of a financial asset ~~to others~~ while ~~retaining~~it continues to recognise ~~a part~~the other portion, the previous carrying amount of the financial asset ~~should~~shall be allocated between the ~~part~~ portion that

continues to be recognised~~retained~~ and the ~~part~~ portion that is derecognised ~~sold~~ based on the~~ir~~ relative fair values of those portions on the date of ~~sale~~the transfer. For this purpose, a retained servicing asset shall be treated as a portion that continues to be recognised. The difference between (a) the carrying amount allocated to the portion derecognised and (b) the sum of (i) the consideration received for the portion derecognised and (ii) any cumulative gain or loss allocated to it that had been recognised directly in equity (see paragraph 103(b)) shall be included in profit or loss for the period. ~~A gain or loss should be recognised based on the proceeds for the portion sold. In the rare circumstance that the fair value of the part of the asset that is retained cannot be measured reliably, then that asset should be recorded at zero. The entire carrying amount of the financial asset should be attributed to the portion sold, and a gain or loss should be recognised equal to the difference between (a) the proceeds and (b) the previous carrying amount of the financial asset plus or minus any prior adjustment that had been reported in equity to reflect the fair value of that asset (a 'cost recovery' approach).~~

48. Examples of the circumstances described in paragraph 47 are:

(a) separating the principal and interest cash flows of a bond and selling some of them to another party while retaining the rest; and

(b) selling or securitising a portfolio of receivables while retaining the right to service the receivables ~~profitably~~ for a fee that is expected to be more than adequate compensation for the servicing, resulting in an asset for the servicing right ~~(see paragraph 50)~~. Although a servicing asset is not a financial asset, it is treated as if it were in allocating the previous carrying amount based on relative fair values (see paragraph 43).

49. A transferor may retain the right to a portion of the interest payments on transferred financial assets as compensation for servicing those assets. The portion of the interest payments that the transferor would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The portion of the interest payments that the transferor would not lose is an interest-only strip receivable. For example, if the transferor would not lose any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 47, the fair

values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivables between the portion of the assets that is derecognised and the portion that continues to be recognised. If there is no servicing fee specified or the fee to be received is not expected to compensate the transferor adequately for performing the servicing, a liability for the servicing obligation is recognised at fair value.

50. In estimating the fair values of the portion retained and portion transferred for the purposes of determining the carrying amount of the portion retained and any gain or loss on the portion transferred, the fair value measurement requirements in paragraphs 98-100D apply.

51. If an entity retains a residual interest in a transferred financial asset and has a history of selling similar residual interests or other market transactions exist for similar residual interests, recent prices of actual transactions provide the best estimate of the fair value of the retained residual interest. When there are no price quotes or recent market transactions to support the fair value of a retained residual interest, the best estimate of the fair value of the retained residual interest is the difference between the fair value of the underlying financial asset as a whole and the consideration received from the transferee for the portion transferred.

~~49. To illustrate application of paragraph 47, assume receivables with a carrying amount of 100 are sold for 90. The selling enterprise retains the right to service those receivables for a fee that is expected to exceed the cost of servicing, but the fair value of the servicing right cannot be measured reliably. In that case, a loss of 10 would be recognised and the servicing right would be recorded at zero.~~

~~50. This example illustrates how a transferor accounts for a sale or securitisation in which servicing is retained. An enterprise originates 1,000 of loans that yield 10 per cent interest for their estimated lives of 9 years. The enterprise sells the 1,000 principal plus the right to receive interest income of 8 per cent to another enterprise for 1,000. The transferor will continue to service the loans, and the contract stipulates that its compensation for performing the servicing is the right to receive half of the interest income not sold (that is, 100 of the 200 basis points). The remaining half of the interest income not sold is considered an~~

~~interest-only strip receivable. At the date of the transfer, the fair value of the loans, including servicing, is 1,100, of which the fair value of the servicing asset is 40 and the fair value of the interest-only strip receivable is 60. Allocation of the 1,000 carrying amount of the loan is computed as follows:~~

	~~Fair Value~~	~~Percentage of Total Fair Value~~	~~Allocated Carrying Amount~~
~~Loans sold~~	~~1,000~~	~~91.0%~~	~~910~~
~~Servicing asset~~	~~40~~	~~3.6~~	~~36~~
~~Interest-only strip receivable~~	~~60~~	~~5.4~~	~~54~~
~~Total~~	~~1,100~~	~~100.0%~~	~~1,000~~

~~The transferor will recognise a gain of 90 on the sale of the loan – the difference between the net proceeds of 1,000 and the allocated carrying amount of 910. Its balance sheet will also report a servicing asset of 36 and an interest-only strip receivable of 54. The servicing asset is an intangible asset subject to the provisions of IAS 38, Intangible Assets.~~

Accounting for Transfers that Do Not Qualify for Derecognition

52. If all or a portion of a financial asset is transferred to another entity but the transfer does not satisfy the conditions for derecognition or only a portion qualifies for derecognition, the transferor shall account for the transaction as a collateralised borrowing by recognising a financial liability for the portion of the transferred asset that does not qualify for derecognition.

53. The transferor shall account for the transferred asset and the associated borrowing that arises when a transfer does not qualify for derecognition on a basis that is consistent with, and reflects, the transferor's rights and obligations related to the transfer. When the transferor has only a limited exposure to changes in the fair value of the asset, changes in the fair value of the asset to which the transferor is not exposed shall not be recognised. The transferred asset and the associated borrowing shall not be offset (see IAS 32, Financial Instruments: Disclosure and Presentation, paragraph 33).

54. The transferor accounts for the transferred asset and the related borrowing on a basis that ensures that the net carrying amount of the transferred asset and the related borrowing reflects the transferor's rights and obligations related to the transfer. Accordingly, when the transferred asset is measured at fair value and the transferor has only a one-sided exposure to changes in the fair value of the transferred asset because of a retained call option or written put option, the recognition of changes in the fair value of the asset is limited by the option exercise price.

55. If a transfer of a financial asset or portion thereof does not qualify for derecognition because of the transferor's contractual rights or obligations related to the transfer (see paragraph 37), those rights and obligations are not accounted for separately as derivatives if recognising both the derivative and either the transferred asset or the liability arising from the transfer would result in recognising the same rights or obligations twice. For instance, a call option retained by the transferor prevents a transfer of financial assets from being accounted for as a sale to the extent of the amount of the transferred asset that the transferor can repurchase upon exercise of the call option. In that case, the call option is not separately recognised as a derivative asset.

56. If a transferor provides non-cash collateral (such as securities) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted:

(a) If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset separately in its balance sheet (for example, as a loaned asset, pledged securities, or repurchase receivable) from other assets.

(b) If the transferee sells collateral pledged to it, it shall recognise the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.

(c) If the transferor defaults under the terms of the contract and is no longer entitled to redeem the pledged asset, it shall derecognise the pledged asset, and the transferee shall recognise the collateral

as its asset initially measured at fair value or, if it has already sold the collateral, derecognise its obligation to return the collateral.

(d) Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognise the collateral as an asset.

57. If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may account for its receivable as a loan or receivable originated by the entity. In other cases, the transferee classifies its receivable as held for trading, available for sale, or held to maturity, as appropriate.

Regular Way Purchase or Sale of a Financial Asset~~Trade Date vs. Settlement Date~~

~~30.~~57A. A 'regular way' purchase or sale of financial assets ~~should~~shall be recognised and derecognised, as applicable, using either trade date accounting or settlement date accounting (see Appendix A).~~as described in paragraphs 32 and 33. The method used should be applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets defined in paragraph 10.~~

Derecognition of a Financial Liability

~~57.~~58. An ~~enterprise~~entity ~~should~~shall remove a financial liability (or a ~~part~~ portion of a financial liability) from its balance sheet when, and only when, it is extinguished – ~~that is,~~ie when the obligation specified in the contract is discharged~~,~~ or cancelled, or expires.

~~58.~~59. ~~The condition in paragraph 57 is met~~A financial liability is extinguished when either:

(a) the debtor discharges the liability by paying the creditor, normally with cash, other financial assets, goods, or services; or

(b) the debtor is legally released from primary responsibility for the liability (or ~~part~~ portion thereof) either by process of law or by the creditor (the fact that the debtor may have given a guarantee does not necessarily mean that this condition is not met).

60. If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.

~~59.~~61. Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.

62. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognise the debt obligation unless the condition in paragraph 59(b) is met. If the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.

~~60.~~63. ~~While~~ Although legal release, whether judicially or by the creditor, ~~will~~ results in derecognition of a liability, the ~~enterprise~~entity may ~~have to~~ recognise a new liability if the derecognition criteria in paragraphs~~s~~ 35-~~57~~ are not met for the ~~non-cash~~ financial assets ~~that were~~ transferred. If those criteria are not met, the transferred assets are not ~~removed from the transferor's balance sheet~~derecognised, and the transferor recognises a new liability relating to the transferred assets that may be equal to the derecognised liability.

~~61.~~64. An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for ~~is~~ as an extinguishment of the ~~old debt~~original financial liability ~~that should result in derecognition of that debt~~ and the recognition of a new ~~debt instrument~~financial liability. Similarly, a substantial modification of the terms of an existing ~~debt instrument~~financial liability (whether or not ~~due~~attributable to the financial difficulty of

the debtor) ~~should~~shall be accounted for as an extinguishment of the ~~old debt~~original financial liability and the recognition of a new financial liability.

~~62.~~65. For the purpose of paragraph ~~61~~64, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original ~~debt instrument~~financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred ~~are an~~ adjust ~~ment to~~ the carrying amount of the liability and are amortised over the remaining term of the modified ~~loan~~liability.

~~63.~~65A. The difference between the carrying amount of a liability (or ~~part~~ portion of a liability) extinguished or transferred to another party~~, including related unamortised costs,~~ and the amount paid ~~for it~~ ~~should~~shall be included in ~~net~~ profit or loss for the period.

~~64.~~65B. In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee ~~n~~ obligation to pay if the party assuming primary responsibility defaults. In this circumstance the debtor:

(a) recognises a new financial liability based on the fair value of its obligation for the guarantee; and

(b) recognises a gain or loss based on the difference between (i) any proceeds and (ii) the carrying amount of the original financial liability ~~(including any related unamortised costs) minus~~less the fair value of the new financial liability.

~~Derecognition of Part of a Financial Liability or Coupled with a New Financial Asset or Liability~~

~~65.~~65C. If an ~~enterprise~~entity ~~transfers~~ repurchases a ~~part~~ portion of a financial liability ~~to others while retaining a part, or if an enterprise transfers an entire financial liability and in so doing creates a new financial asset or assumes a new financial liability~~, the ~~enterprise~~entity ~~should~~shall allocate the previous carrying amount of the financial liability between the portion that continues to be recognised and the portion that is derecognised based on the relative fair values of those portions on the date of the repurchase. The difference between (a) the carrying amount allocated to the portion derecognised and (b) the consideration paid for the portion derecognised shall be included in profit or loss for the period. ~~account for the transaction in the manner set out in paragraphs 47-56.~~

Measurement

Initial Measurement of Financial Assets and Financial Liabilities

66. When a financial asset or financial liability is recognised initially, an ~~enterprise~~entity ~~should~~shall measure it at its cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability)~~ for it~~. Transaction costs that are directly attributable to the acquisition or issue are included in the initial measurement of ~~all~~ the financial asset~~s~~ ~~and~~or financial liability. ~~liabilities.~~

67. The fair value of the consideration given or received for a financial instrument ~~normally~~ is normally determinable by reference to the transaction price or other market prices. If such market prices are not ~~reliably determinable,~~ available, or part of the consideration is for something other than the financial instrument, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted~~, if the effect of doing so would be material,~~ using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate, and other factors) of an issuer with a similar credit rating (see IAS 18, Revenue, paragraph 11). For example, the fair value of an originated long-term loan or receivable that carries no interest is the present value of all future cash receipts discounted using applicable market interest rates at origination (any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset). ~~As an exception to paragraph 66, paragraph 160 requires that certain hedging gains and losses be included as part of the initial measurement of the cost of the related hedged asset.~~

Subsequent Measurement of Financial Assets

68. For the purpose of measuring a financial asset subsequent to initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 10:

(a) loans and receivables originated by the ~~enterprise~~entity ~~and not held for trading~~;

(b) held-to-maturity investments;

(c) available-for-sale financial assets; and

(d) financial assets held for trading.

69. After initial recognition, an ~~enterprise~~entity ~~should~~shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs ~~that~~ it may incur on sale or other disposal, except for the following ~~categories of~~ financial assets~~, which should be measured under paragraph 73~~:

(a) loans and receivables originated by the ~~enterprise~~entity as defined in paragraph 10~~and not held for trading~~, which shall be measured at amortised cost using the effective interest method;

(b) held-to-maturity investments as defined in paragraph 10, which shall be measured at amortised cost using the effective interest method; and

(c) investments in equity instruments ~~any financial asset~~ that does not have a quoted market price in an active market and whose fair value cannot be reliably measured (see paragraph ~~70~~101) and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost.

Financial assets that are designated as hedged items are subject to measurement under the hedge accounting ~~provisions~~ requirements in paragraphs 121-165~~ of this Standard~~. All financial assets other than those measured at fair value with changes in fair value recognised in profit or loss are subject to review for impairment in accordance with paragraphs 109-119.

70.-71. [deleted]

~~***70. There is a presumption that fair value can be reliably determined for most financial assets classified as available for sale or held for trading. However, that presumption can be overcome for an investment in an equity instrument (including an investment that is in substance an equity instrument – see paragraph 71) that does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly inappropriate or***~~

~~unworkable. The presumption can also be overcome for a derivative that is linked to and that must be settled by delivery of such an unquoted equity instrument. See paragraphs 95-102 for guidance on estimating fair value.~~

~~71. An example of an investment that is in substance an equity instrument is special participation rights without a specified maturity whose return is linked to an enterprise's performance.~~

72. If a financial asset is ~~required to be~~ measured at fair value and its fair value is below zero, it is accounted for as a financial liability ~~as set out~~ in accordance with paragraph ~~93~~89A.

~~77.~~72A. The following example illustrates ~~how~~ the accounting for transaction costs ~~relate to~~ on the initial and subsequent measurement of a financial asset held for trading. An asset is acquired for 100 plus a purchase commission of 2. Initially ~~it~~ the asset is ~~recorded~~ recognised at 102. At the next financial reporting date, the quoted market price of the asset ~~remains at~~ is 100. If the asset were sold, a commission of 3 would be paid. In that case, the asset is measured at 100 (without regard to the possible commission on sale) and a loss of 2 is recognised in ~~net~~ profit or loss for the period.

73.-74. [deleted]

~~73. Those financial assets that are excluded from fair valuation under paragraph 69 and that have a fixed maturity should be measured at amortised cost using the effective interest rate method. Those that do not have a fixed maturity should be measured at cost. All financial assets are subject to review for impairment as set out in paragraphs 109-119.~~

~~74. Short-duration receivables with no stated interest rate are normally measured at original invoice amount unless the effect of imputing interest would be significant.~~

75. Loans and receivables originated by an ~~enterprise~~entity ~~and~~ (which are not classified as held for trading or available for sale) are measured at amortised cost without regard to the ~~enterprise~~entity's intention to hold them to maturity.

76. For floating rate financial ~~instruments~~assets, periodic re-estimation of ~~determinable~~ cash flows to reflect movements in market rates of interest changes the effective yield ~~on a monetary financial asset~~. Such changes in cash flows are recognised over the remaining term of the asset, or the period to the next repricing date if the asset reprices at market. In the case of a floating rate financial asset recognised initially at an amount equal to the principal ~~repayable~~ receivable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset.

77.-78. [deleted] (see paragraphs 72A and 103B)

Held-to-Maturity Investments

79. An ~~enterprise~~entity does not have ~~the~~ a positive intention to hold to maturity an investment in a financial asset with a fixed maturity if any one of the following conditions is met:

(a) the ~~enterprise~~entity ~~has the intent~~ intends to hold the financial asset for ~~only~~ an undefined period;

(b) the ~~enterprise~~entity stands ready to sell the financial asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated by the ~~enterprise~~entity) in response to changes in market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources and terms, or changes in foreign currency risk; or

(c) the issuer has a right to settle the financial asset at an amount significantly below its amortised cost.

80. A debt security with a variable interest rate can satisfy the criteria for a held-to-maturity investment. Most equity securities cannot be held-to-maturity investments either because they have an indefinite life (such as ordinary shares) or because the amounts the holder may receive can vary in a manner that is not predetermined (such as for share options, warrants, and rights). With respect to the definition of held-to-maturity investments, fixed or determinable payments and fixed maturity means a contractual arrangement that defines the amounts and dates of payments to the holder, such as interest and principal payments ~~on debt~~. A

significant risk of non-payment does not preclude classification of a financial asset as held to maturity as long as its contractual payments are fixed or determinable and the other criteria for that classification are met. If the terms of a perpetual debt instrument provide for interest payments for an indefinite period, the instrument cannot be classified as held to maturity because there is no maturity date.

81. ~~A financial asset that is callable by the issuer satisfies t~~The criteria for classification as a held-to-maturity investment are met for a financial asset that is callable by the issuer if the holder intends and is able to hold it until it is called or until maturity and ~~if~~ the holder would recover substantially all of its carrying amount. The call option of the issuer, if exercised, simply accelerates the asset's maturity. However, if the financial asset is callable ~~in a manner~~on a basis ~~such~~ that would result in the holder ~~would~~ not recovering substantially all of its carrying amount, the financial asset is not classified as held-to-maturity. The ~~enterprise~~entity considers any premium paid and capitalised transaction costs in determining whether the carrying amount would be substantially recovered.

82. A financial asset that is puttable (the holder has the right to require that the issuer repay or redeem the financial asset before maturity) ~~is~~ cannot be classified as a held-to-maturity investment because paying for a put feature in a financial asset is inconsistent with expressing an ~~only if the holder has the positive~~ intention ~~and ability~~ to hold the financial asset ~~it~~ until maturity ~~and not to exercise the put feature~~.

83. An ~~enterprise~~entity ~~should~~shall not classify any financial assets as held-to-maturity if the ~~enterprise~~entity has, during the current financial year or during the two preceding financial years, sold~~, transferred~~ or reclassified~~, or exercised a put option on~~ more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity ~~portfolio~~investments) other than sales or reclassifications that: ~~by:~~

(a) ~~sales~~ are so close ~~enough~~ to maturity or ~~exercised~~ the financial asset's call date (for example, less than three months before maturity) ~~so~~ that changes in the market rate of interest ~~did~~ would not have had a significant effect on the financial asset's fair value;

(b) ~~sales~~ occur after the ~~enterprise~~entity has already collected substantially all of the financial asset's original principal (for example, 90 per cent) through scheduled payments or prepayments; or

(c) ~~sales~~ are due to an isolated event that is beyond the ~~enterprise~~entity's control ~~and that~~, is non-recurring and could not have been reasonably anticipated by the ~~enterprise~~entity.

Whenever sales or reclassifications of more than an insignificant amount of held-to-maturity investments do not meet any of the conditions in (a)-(c), any remaining held-to-maturity investments shall be reclassified as available for sale. ~~Paragraphs 90-92 address reclassifications between fair value and amortised cost.~~

84. ~~Under this Standard, f~~Fair value is a more appropriate measure for most financial assets than amortised cost. The held-to-maturity classification is an exception, but only if the ~~enterprise~~entity has ~~the~~ a positive intention and the ability to hold the investment to maturity. When an ~~enterprise~~entity's actions have cast doubt on its intention and ability to hold such investments to maturity, paragraph 83 precludes the use of the exception for a reasonable period of time.

85. A 'disaster scenario' that is extremely remote, such as a run on a bank or a similar situation affecting an insurance company, is not ~~anticipated~~ something that is assessed by an ~~enterprise~~entity in deciding whether it has the positive intention and ability to hold an investment to maturity.

86. Sales before maturity could satisfy the condition in paragraph 83 – and therefore not raise a question about the ~~enterprise~~entity's intention to hold other investments to maturity – if they are due to:

(a) a significant deterioration in the issuer's creditworthiness. For example, a sale following a downgrade in a credit rating by an external rating agency would not necessarily raise a question about the entity's intention to hold other investments to maturity if the downgrade provides evidence of a significant deterioration in the issuer's creditworthiness judged by reference to the credit rating at initial recognition. Similarly, if an entity uses internal ratings for assessing exposures, changes in those internal ratings may help to identify issuers for which there has been a significant deterioration in creditworthiness, provided the entity's approach to assigning internal ratings and changes in those ratings give a consistent, reliable, and objective measure of the credit quality of the issuers. If there is evidence that a financial asset is impaired (see paragraph 110), the deterioration in creditworthiness often is regarded as significant;

(b) a change in tax law that eliminates or significantly reduces the tax-exempt status of interest on the held-to-maturity investment (but not a change in tax law that revises the marginal tax rates applicable to interest income);

(c) a major business combination or major disposition (such as sale of a segment) that necessitates the sale or transfer of held-to-maturity investments to maintain the ~~enterprise~~entity's existing interest rate risk position or credit risk policy (although the business combination ~~itself~~ is an event within the ~~enterprise~~entity's control, the changes to its investment portfolio to maintain an interest rate risk position or credit risk policy may be consequential rather than anticipated);

(d) a change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of ~~certain kinds~~particular types of investments, thereby causing an ~~enterprise~~entity to dispose of a held-to-maturity investment;

(e) a significant increase ~~by the regulator~~ in the industry's regulatory capital requirements that causes the ~~enterprise~~entity to downsize by selling held-to-maturity investments; or

(f) a significant increase in the risk weights of held-to-maturity investments used for regulatory risk-based capital purposes.

87. An ~~enterprise~~entity does not have a demonstrated ability to hold to maturity an investment in a financial asset with a fixed maturity if either ~~one~~ of the following conditions is met:

(a) it does not have the financial resources available to continue to finance the investment until maturity; or

(b) it is subject to an existing legal or other constraint that could frustrate its intention to hold the financial asset to maturity

(however, an issuer's call option does not necessarily frustrate an ~~enterprise~~entity's intention to hold a financial asset to maturity – see paragraph 81).

88. Circumstances other than those described in paragraphs 79-87 can indicate that an ~~enterprise~~entity does not have a positive intention or the ability to hold an investment to maturity.

89. An ~~enterprise~~entity assesses its intention and ability to hold its held-to-maturity investments to maturity not only when those financial assets are initially ~~acquired~~ recognised, but also at each subsequent balance sheet date.

Subsequent Measurement of Financial Liabilities

~~93~~89A. After initial recognition, an ~~enterprise~~entity ~~should~~shall measure all financial liabilities, other than liabilities that are designated as held for trading and derivatives that are liabilities, at amortised cost using the effective interest method. After initial recognition, an ~~enterprise~~entity ~~should~~shall measure financial liabilities held for trading and derivatives that are liabilities at fair value, except for a derivative liability that is linked to and ~~that~~ must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which ~~should~~shall be measured at cost. Paragraphs 52-55 apply to the measurement of financial liabilities that arise when a transfer of a financial asset or a portion thereof does not qualify for derecognition. Financial liabilities that are designated as hedged items are subject to measurement under the hedge accounting ~~provisions~~ requirements in paragraphs 121-165 ~~of this Standard~~.

Reclassifications

~~107~~89B. Because the designation of a financial ~~asset~~ asset or financial liability as held for trading is ~~based on the objective for initially acquiring it~~made on initial recognition, an ~~enterprise~~entity ~~should~~shall not reclassify a financial instrument ~~its financial assets that are being remeasured to fair value~~into or out of the trading category while ~~they are~~it is held. ~~An enterprise should reclassify a financial asset into the trading category only if there is evidence of a recent actual pattern of~~

~~short-term profit taking that justifies such reclassification (see paragraph 21).~~

90. ***If, ~~due~~ as a result of ~~to~~ a change ~~of~~ in intention or ability, it is no longer appropriate to carry a held-to-maturity investment at amortised cost, it ~~should~~shall be reclassified into the available-for-sale category and remeasured at fair value, and the difference between its carrying amount and fair value ~~should~~shall be accounted for in accordance with paragraph 103(b).***

91. ***Similarly, if a reliable measure becomes available for a financial asset or financial liability for which such a measure previously was not available and the asset or liability is required to be measured at fair value if a reliable measure is available (see paragraph 69), the asset or liability ~~should~~shall be remeasured at fair value, and the difference between its carrying amount and fair value ~~should~~shall be accounted for in accordance with paragraph 103.***

92. ***If, ~~due~~as a result of ~~to~~ a change ~~of~~ in intention or ability or in the rare circumstance that a reliable measure of fair value is no longer available (see paragraph 69(c)) or because the 'two preceding financial years' referred to in paragraph 83 have ~~now~~ passed, it becomes appropriate to carry a financial asset at cost or amortised cost rather than at fair value, the fair value carrying amount of the financial asset on that date becomes its new cost or amortised cost, as applicable. Any previous gain or loss on that asset that has been recognised directly in equity in accordance with paragraph 103(b) ~~should~~shall be accounted for as follows:***

(a) ***in the case of a financial asset with a fixed maturity, a previous gain or loss on that asset that has been recognised directly in equity ~~should~~shall be amortised to profit or loss over the remaining life of the held-to-maturity investment. Any difference between the new amortised cost and maturity amount ~~should~~shall be amortised over the remaining life of the financial asset as an adjustment of yield, similar to amortisation of premium and discount; and***

(b) ***in the case of a financial asset that does not have a fixed maturity, a previous gain or loss on that asset that has been recognised directly in equity ~~should~~shall ~~be left~~ remain in equity until the financial asset ~~has been~~ is sold or otherwise disposed of, at which time it ~~should~~shall enter into the determination of ~~net~~ profit or loss.***

93.-94. [deleted] (see paragraph 89A) ~~An enterprise applies IAS 21, The Effects of Changes in Foreign Exchange Rates, to financial liabilities that are monetary items under IAS 21 and that are denominated in a foreign currency. Under IAS 21, any foreign exchange gains and losses on monetary liabilities are reported in net profit or loss. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraphs 121-165). Any recognised change in the fair value of such a monetary item apart from foreign exchange gains and losses is accounted for under paragraph 103. With respect to financial liabilities that are not monetary items under IAS 21 (such as some mandatorily redeemable preferred stock issued by the enterprise), any recognised change in fair value, including any component of that change that may relate to changes in foreign exchange rates, is accounted for under paragraph 103. Under the hedge accounting provisions of this Standard (paragraphs 121-165), if there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the fair values of those financial instruments will be reported in net profit or loss.~~

Fair Value Measurement Considerations

95. In determining the fair value of a financial asset or a financial liability for the purposes of applying this Standard or IAS 32, an entity shall apply paragraphs 98–100D.

(old text – see paragraph 101)

~~96. Situations in which fair value is reliably measurable include (a) a financial instrument for which there is a published price quotation in an active public securities market for that instrument, (b) a debt instrument that has been rated by an independent rating agency and whose cash flows can be reasonably estimated, and (c) a financial instrument for which there is an appropriate valuation model and for which the data inputs to that model can be measured reliably because the data come from active markets.~~

96.-97. [deleted]~~The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods. Valuation~~

~~techniques should incorporate the assumptions that market participants would use in their estimates of fair values, including assumptions about prepayment rates, rates of estimated credit losses, and interest or discount rates. Paragraph 167(a) requires disclosure of the methods and significant assumptions applied in estimating fair values.~~

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

Active Market: Quoted Price

99. The existence of published price quotations in an active market is ~~normally~~ the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability. A financial instrument is regarded as quoted in an active market if quoted prices reflecting normal market transactions are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction ~~may~~ provides evidence of the current fair value provided ~~that~~ there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an ~~enterprise~~entity has matching asset and liability positions, it may appropriately use mid-market prices as a basis for establishing fair values. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial

instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

No Active Market: Recent Market Transaction

100. If the market for a financial instrument is not ~~an~~ active ~~market~~, the best evidence of fair value is obtained by reference to recent market transactions between knowledgeable, willing parties in an arm's length transaction. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, as appropriate. ~~published price quotations may have to be adjusted to arrive at a reliable measure of fair value. If there is infrequent activity in a market, the market is not well established (for example, some 'over the counter' markets) or small volumes are traded relative to the number of trading units of a financial instrument to be valued, quoted market prices may not be indicative of the fair value of the instrument. In some cases where the volume traded is relatively small, a price quotation for a larger block may be available from the market maker in that instrument. In other circumstances, as well as when a quoted market price is not available, estimation techniques~~

No Active Market: Valuation Technique

100A. If an entity cannot otherwise determine fair value, it uses a valuation technique ~~may be used to determine~~to estimate fair value ~~with sufficient reliability to satisfy the requirements of this Standard~~. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. An entity calibrates the valuation technique and tests it for validity using prices from actual transactions. For example, when the instrument being valued is purchased or sold in an arm's length transaction, the valuation technique would be expected to result in an amount that equals the fair value of the consideration given or received.

100B. ~~Techniques~~ Valuation techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cash flow analysis, and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

100C. In applying valuation techniques, an entity uses estimates and assumptions that are consistent with available information about the estimates and assumptions market participants would use in setting a price for the financial instrument. In applying discounted cash flow analysis, an ~~enterprise~~entity uses the discount rate(s) equal to the prevailing rate of return for financial instruments having substantially the same terms and characteristics, including the creditworthiness of the debtor, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal, and the currency in which payments are to be made. When the term of an instrument extends beyond the period for which market prices are available, the valuation technique uses market prices for the period they are available and reasonable extrapolations of those market prices for later periods on the basis of historical experience of price changes under normal market conditions and all other available information. In particular, any assumed change in market prices is supported by reasonable evidence consistent with any available market forward prices.

100D. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a debt security or loan asset), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (ie similar remaining maturity, cash flow pattern, currency, credit risk, collateral, and interest basis). Alternatively, provided there is no change in the credit risk of the debtor after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument,

holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date.

No Active Market: Equity Instruments

~~95.~~101. The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 69(c) and 89A) ~~a financial instrument~~ is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) ~~if~~ the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. ~~Often, an enterprise will be able to make an estimate of the fair value of a financial instrument that is sufficiently reliable to use in financial statements. Occasionally, the variability in the range of reasonable fair value estimates is so great and the probabilities of the various outcomes are so difficult to assess that the usefulness of a single estimate of fair value is negated.~~

~~101. If a market price does not exist for a financial instrument in its entirety but markets exist for its component parts, fair value is constructed on the basis of the relevant market prices. If a market does not exist for a financial instrument but a market exists for a similar financial instrument, fair value is constructed on the basis of the market price of the similar financial instrument.~~

102. There are many situations ~~other than those enumerated in paragraphs 95-101~~ in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 69(c) and 89A) is likely not to be significant. ~~It is n~~Normally it is possible to estimate the fair value of a financial asset that an ~~enterprise~~entity has acquired from an outside party. ~~An enterprise is unlikely to purchase a financial instrument for which it does not expect to be able to obtain a reliable measure of fair value after acquisition. The IASC Framework states: 'In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.'~~ However,

if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

Gains and Losses ~~on Remeasurement to Fair Value~~

103. ***A recognised gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship (see paragraphs 121-165) ~~should~~shall be ~~reported~~ recognised as follows:***

(a) ***a gain or loss on a financial asset or financial liability held for trading ~~should~~shall be ~~included~~ recognised in ~~net~~ profit or loss for the period in which it arises (in this regard, a derivative ~~should~~shall always be ~~considered to be~~regarded as held for trading unless it is a designated hedging instrument – see paragraphs 122-126F);***

(b) ***a gain or loss on an available-for-sale financial asset ~~should~~shall be ~~either:~~***

~~***(i) included in net profit or loss for the period in which it arises; or***~~

~~***(ii)***~~ ***recognised directly in equity, through the statement of changes in equity (see IAS 1, Presentation of Financial Statements, paragraphs 86-~~88~~89), except for impairment losses (see paragraphs 117-119), until the financial asset is derecognised~~sold, collected, or otherwise disposed of~~, ~~or until the financial asset is determined to be impaired (see paragraphs 117-119),~~ at which time the cumulative gain or loss previously recognised in equity ~~should~~shall be ~~included~~ recognised in ~~net~~ profit or loss for the period. However, the amortisation using the effective interest method (see paragraph 10) of any difference between the amount recognised initially and the maturity amount of an available-for-sale financial asset represents interest and is recognised in profit or loss.***

~~Gains and Losses on Financial Assets and Liabilities Not Remeasured to Fair Value~~

~~108~~103A. For ~~those~~ financial assets and financial liabilities carried at amortised cost (see paragraphs 73 and ~~93~~89A), a gain or loss is recognised in ~~net~~ profit or loss when the financial asset or financial liability is derecognised or impaired, as well as through the amortisation process. However, if there is a hedging relationship between those financial assets or financial liabilities (the items being hedged) and a hedging instrument as described in paragraphs 121-152, accounting for the gain or loss ~~should~~shall follow paragraphs 153-164.

~~78.~~103B. An ~~enterprise~~entity applies IAS 21, The Effects of Changes in Foreign Exchange Rates, to financial assets and financial liabilities that are monetary items under IAS 21 and ~~that are~~ denominated in a foreign currency. Under IAS 21, any foreign exchange gains and losses on monetary assets and monetary liabilities are reported in ~~net~~ profit or loss. An exception is a monetary item that is designated as a hedging instrument in a cash flow hedge (see paragraphs 121-165). Any recognised change in the fair value of such a monetary item apart from foreign exchange gains and losses is accounted for under paragraph 103. For the purposes of recognising foreign exchange gains and losses under IAS 21, a monetary available-for-sale financial asset is treated as if it were carried at amortised cost in the foreign currency. Accordingly, for such a financial asset exchange differences resulting from changes in its amortised cost are recognised in profit or loss and other changes in its carrying amount are recognised directly in equity. With respect to financial assets that are not monetary items under IAS 21 (for example, equity instruments), any recognised change in fair value, including any component of that change that ~~may~~ relates to changes in foreign exchange rates, is accounted for under paragraph 103. Under the hedge accounting provisions of this Standard (see paragraphs 121-165), if there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component ~~fair values~~ of those financial instruments are ~~reported~~ recognised in ~~net~~ profit or loss.

104.-105. [deleted]

~~***104. An enterprise should choose either paragraph 103(b)(i) or paragraph 103(b)(ii) as its accounting policy and should apply that policy to all of***~~

~~its available-for-sale financial assets (except for hedges – see paragraph 121).~~

~~105. IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, provides that a voluntary change in accounting policy should be made only if the change will result in a more appropriate presentation of events or transactions in the financial statements of the enterprise. The Board believes that this is highly unlikely to be the case for a change from paragraph 103(b)(i) to paragraph 103(b)(ii).~~

106. If an ~~enterprise~~entity recognises ~~purchases of~~ financial assets using settlement date accounting (see paragraph 30), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets carried at cost or amortised cost (other than impairment losses). For assets remeasured to fair value, however, the change in fair value ~~should~~shall be recognised in ~~net~~ profit or loss or in equity, as appropriate under paragraph 103.

107.-108. [deleted] (see paragraphs 89B and 103A)

Impairment and Uncollectability of Financial Assets

109. ~~A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.~~ An ~~enterprise~~entity ~~should~~shall assess at each balance sheet date whether there is any objective evidence that a financial asset or group of assets ~~may be~~ is impaired. If any such evidence exists, the ~~enterprise~~entity ~~should~~shall ~~estimate the recoverable amount of that asset or group of assets and recognise any impairment loss in accordance with~~apply paragraph 111 (for financial assets carried at amortised cost), paragraph 116 (for financial assets carried at cost), or paragraph 117 (for available-for-sale financial assets ~~remeasured to fair value~~).

110. Objective evidence that a financial asset or group of assets is impaired or uncollectable includes information that comes to the attention of the holder of the asset about:

(a) significant financial difficulty of the issuer;

(b) a~~n actual~~ breach of contract, such as a default or delinquency in interest or principal payments;

(c) granting by the lender to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, of a concession that the lender would not otherwise consider;

(d) a high probability of bankruptcy or other financial reorganisation of the issuer;

(e) recognition of an impairment loss on that asset in a prior financial reporting period;

(f) the disappearance of an active market for that financial asset ~~due to~~ because of financial difficulties; or

(g) a historical pattern of collections of a group of financial assets ~~accounts receivable~~ that indicates that the entity will not be able to collect all amounts due (principal and interest)~~the entire face amount of a portfolio of accounts receivable will not be collected~~.

The disappearance of an active market because an ~~enterprise~~entity's securities are no longer publicly traded is not evidence of impairment. A downgrade of an ~~enterprise~~entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the basic, risk-free interest rate).

110A. In addition to the types of information in paragraph 110, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates and indicate that the cost of the investment in the equity instrument may not be recovered. A significant and prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Financial Assets Carried at Amortised Cost

111. If there is objective evidence of impairment and it is probable that an ~~enterprise~~entity will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans, receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The amount of the loss is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate (recoverable amount). Cash flows relating to short-term receivables generally are not discounted ~~(see paragraph 74)~~. The carrying amount of the asset ~~should~~shall be reduced to its estimated recoverable amount either directly or through use of an allowance account. The amount of the loss ~~should~~shall be ~~included~~ recognised in ~~net~~ profit or loss for the period.

~~112. Impairment and uncollectability are measured and recognised individually for financial assets that are individually significant. Impairment and uncollectability may be measured and recognised on a portfolio basis for a group of similar financial assets that are not individually identified as impaired.~~

112. An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and either individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics that are collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment or bad debt loss is or has been recognised are not included in a collective assessment of impairment.

113. Impairment of a financial asset carried at amortised cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair-value measurement on financial assets that this Standard would otherwise measure at amortised cost. If the terms of a loan, receivable, or held-to-maturity investment are renegotiated or otherwise modified

because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. If a loan, receivable, or held-to-maturity investment has a variable interest rate, the discount rate for measuring recoverable amount pursuant to paragraph 111 is the current effective interest rate(s) determined under the contract. As a ~~surrogate for such a fair value calculation~~practical expedient, a creditor may measure impairment of a financial asset carried at amortised cost based on an instrument's fair value using an observable market price. The estimation of the recoverable amount of a collateralised financial asset reflects the cash flows that may result from foreclosure, whether or not foreclosure is probable. If an asset is collateralised and foreclosure is probable, then the holder measures impairment based on the fair value of the collateral less costs for obtaining the collateral.

113A. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtor's ability to pay all amounts due according to the contractual terms (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status, and other relevant factors).

113B. Impairment losses recognised on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

113C. Expected cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in expected cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating expected cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

113D. In discounting expected cash flows of a group of financial assets that are collectively evaluated for impairment, an entity uses a weighted average of the original effective interest rates of the assets in the group that is being assessed for impairment. To ensure that an impairment loss is not recognised immediately after initial recognition, the original effective interest rate for each asset in the group is computed as an expected rate based on the originally estimated cash flows. For example, if the original contractual effective interest rate for an asset is 12 per cent and the entity on initial recognition, based on past loss experience for assets with similar credit risk characteristics, determines that the discount rate that equates the initial carrying amount of the asset with the present value of the expected cash flows for the asset (considering expected losses and prepayments) is 10 per cent, then the original effective interest rate that should be used for the purposes of computing a discount rate for the group of assets to which the asset belongs is the expected rate of 10 per cent.

114. If, in a subsequent period, the amount of the impairment or bad debt loss decreases and the decrease can be ~~objectively~~ related objectively to an event occurring after the write-down (such as an improvement in the debtor's credit rating), the write-down of the financial asset ~~should~~shall be reversed either directly or by adjusting an allowance account. The reversal ~~should~~shall not result in a carrying amount of the financial asset that exceeds what amortised cost would have been~~,~~ had the impairment not been recognised~~,~~ at the date the write-down of the financial asset is reversed. The amount of the reversal ~~should~~shall be included in ~~net~~ profit or loss for the period.

Interest Income After Impairment Recognition

~~116.~~115. Once an individual financial asset has been written down to its estimated recoverable amount, interest income is thereafter recognised based on the rate of interest ~~that was~~ used to discount the future cash flows for the purpose of measuring the recoverable amount. Additionally, after initially recognising an impairment loss, the ~~enterprise~~entity ~~will~~ reviews ~~this~~ the asset for further impairment at subsequent financial reporting dates (see paragraph 110(e)). ~~IAS 18 paragraph 30 provides guidance for recognising interest income on unimpaired financial assets.~~

Financial Assets Carried at Cost

~~115.~~116. ~~The carrying amount of any financial asset that is not carried at fair value because its fair value cannot be reliably measured (paragraph 69(c)) should be reviewed for an indication of impairment at each balance sheet date based on an analysis of expected net cash inflows.~~ If there is ~~an indication~~ objective evidence of impairment~~,~~ of an investment in an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured or a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument (see paragraph 69(c)), an impairment loss has occurred. ~~the~~ The amount of the impairment loss ~~of such a financial asset~~ is the difference between ~~its~~ the carrying amount of the financial asset and the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset (ie recoverable amount). Such impairment losses shall not be reversed as long as the instrument is recognised.

Available-for-Sale Financial Assets ~~Remeasured to Fair Value~~

117. ~~If~~ When a ~~loss on~~decline in the fair value of an available-for-sale financial asset ~~carried at fair value (recoverable amount is below original acquisition cost)~~ has been recognised directly in equity ~~in accordance with paragraph 103(b)(ii)~~ and there is objective evidence (see paragraph 110) that the asset is impaired, the cumulative net loss that had been recognised directly in equity ~~should~~shall be removed from equity and recognised in ~~net~~ profit or loss for the period even though the financial asset has not been derecognised.

118. The amount of the cumulative net loss that ~~should~~shall be removed from equity and reported in ~~net~~ profit or loss under paragraph 117 is the difference between ~~its~~ the acquisition cost (net of any principal repayment and amortisation) and current fair value (for equity instruments) or recoverable amount (for debt instruments), less any

impairment loss on that financial asset previously recognised in ~~net~~ profit or loss. The recoverable amount of a debt instrument remeasured to fair value is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.

119. ~~If, in a subsequent period, the fair value or recoverable amount of the financial asset carried at fair value increases and the increase can be objectively related to an event occurring after the loss was recognised in net profit or loss, the loss should be reversed, with the amount of the reversal included in net profit or loss for the period.~~Impairment losses recognised in profit or loss for a financial instrument classified as available for sale shall not be reversed through profit or loss as long as the instrument is recognised.

~~Fair Value Accounting in Certain Financial Services Industries~~

120. [deleted] ~~In some countries, either based on national law or accepted industry practice, enterprises in certain financial services industries measure substantially all financial assets at fair value. Examples of such industries include, in certain countries, mutual funds, unit trusts, securities brokers and dealers, and insurance companies. Under this Standard, such an enterprise will be able to continue to measure its financial assets at fair value if its financial assets are classified under this Standard as either available for sale or held for trading.~~

Hedging

121. If there is a designated hedging relationship between a hedging instrument and a related item being hedged as described in paragraphs 122-152, accounting for the gain or loss ~~should~~shall follow paragraphs 153-164.

Hedging Instruments

Qualifying Instruments

122. This Standard does not restrict the circumstances in which a derivative may be designated as a hedging instrument~~, for hedge accounting purposes, if~~ provided the conditions in paragraph 142 are met, except for ~~certain~~ some written options (see paragraph 124). However, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument~~, for hedge accounting purposes,~~ only for a hedge of a foreign currency risk. The reason for this limitation is the different bases for measuring derivatives and non-derivatives. ~~Under this Standard derivatives are always regarded as held for trading or hedging and, therefore, are (unless they are linked to and must be settled by delivery of an unquoted equity instrument whose fair value is not reliably measurable) remeasured to fair value, with changes in fair value included in net profit or loss, or in equity if the instrument is a cash flow hedge. Non-derivatives, on the other hand, are sometimes measured at fair value with changes in fair value included in net profit or loss, sometimes measured at fair value with changes in fair value reported in equity, and sometimes measured at amortised cost. To allow non-derivatives to be designated as hedging instruments in more than limited circumstances creates measurement inconsistencies.~~

123. [deleted] (see paragraph 126A)

124. ~~Hedging involves a proportionate income offset between changes in fair value of, or cash flows attributable to, the hedging instrument and the hedged item.~~ The potential loss on an option that an ~~enterprise~~entity writes could be significantly greater than the potential gain in value of a related hedged item. ~~That is~~In other words, a written option is not effective in reducing the exposure on ~~net~~ profit or loss. Therefore, a written option ~~is~~ does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument~~,~~ (for example, a written call option used to hedge a callable ~~debt~~liability). In contrast, a purchased option has potential gains equal to or greater than losses and~~,~~ therefore~~,~~ has the potential to reduce profit or loss exposure from changes in fair values or cash flows. Accordingly, it can qualify as a hedging instrument.

125. Held-to-maturity investments carried at amortised cost may be effective hedging instruments with respect to risks from changes in foreign currency exchange rates.

126. An investment in an unquoted equity instrument that is not carried at fair value because ~~A financial asset or financial liability whose~~its fair value

cannot be reliably measured or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 69(c) and 89A) cannot be designated as a hedging instrument ~~except in the case of a nonderivative instrument (a) that is denominated in a foreign currency, (b) that is designated as a hedge of foreign currency risk, and (c) whose foreign currency component is reliably measurable~~.

~~123.~~126A. An ~~enterprise~~entity's own equity securities are not financial assets or financial liabilities of the ~~enterprise~~entity and, therefore, ~~are~~ cannot be designated as hedging instruments.

~~134.~~126B. For hedge accounting purposes, only derivatives that involve a party external to the ~~enterprise~~entity can be designated as hedging instruments. Although individual ~~companies~~ entities within a consolidated group or divisions within an ~~company~~ entity may enter into hedging transactions with other ~~companies~~ entities within the group or divisions within the ~~company~~entity, any gains and losses on such transactions are eliminated on consolidation. Therefore, such intragroup or intra-entity ~~company~~ hedging transactions do not qualify for hedge accounting ~~treatment~~ in consolidation.

Designation of Hedging Instruments

~~144~~126C. There is normally a single fair value measure for a hedging instrument in its entirety, and the factors that cause changes in fair value are co-dependent. Thus, a hedging relationship is designated by an ~~enterprise~~entity for a hedging instrument in its entirety. The only exceptions permitted are (a) ~~splitting~~ separating the intrinsic value and the time value of an option and designating only the change in the intrinsic value of an option as the hedging instrument~~, while~~ and excluding the remaining component of the option (its time value) ~~is excluded~~ and (b) ~~splitting~~ separating the interest element and the spot price on a forward. Th~~ose~~ese exceptions ~~recognise that~~ are permitted because the intrinsic value of the option and the premium on the forward generally can be measured separately. A dynamic hedging strategy that assesses both the intrinsic value and the time value of an option can qualify for hedge accounting.

~~145.~~126D A proportion of the entire hedging instrument, such as 50 per cent of the notional amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging relationship may not be designated for only a portion of the time period ~~in~~ during which a hedging instrument ~~is~~ remains outstanding.

~~131.~~126E. A single hedging instrument may be designated as a hedge of more than one type of risk provided that~~:~~ (a) the risks hedged can be ~~clearly~~ identified clearly; ~~,~~ (b) the effectiveness of the hedge can be demonstrated; ~~,~~ and (c) it is possible to ensure that there is ~~a~~ specific designation of the hedging instrument and ~~the~~ different risk positions.

126F. Two or more derivatives, or proportions thereof, may be viewed in combination and jointly designated as the hedging instrument. However, an interest rate collar or other derivative instrument that combines a written option component and a purchased option component does not qualify as a hedging instrument if it is, in effect, a net written option (such that a net premium is received).

Hedged Items

Qualifying Items

127. A hedged item can be a recognised asset or liability, an unrecognised firm commitment, ~~or~~ an uncommitted but highly probable anticipated future transaction ('forecast~~ed~~ transaction'), or a net investment in a foreign operation. The hedged item can be (a) a single asset, liability, firm commitment, or forecast~~ed~~ transaction or (b) a group of assets, liabilities, firm commitments, or forecast~~ed~~ transactions with similar risk characteristics. Unlike originated loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held-to-maturity ~~involves~~ requires an intention to hold the investment until maturity without regard to ~~not accounting for associated~~ changes in the fair value or cash flows of such an investment attributable to changes in interest rates. However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.

~~135~~127A. A firm commitment to acquire a business in a business combination cannot be a hedged item, except ~~with respect to~~for foreign exchange risk because the other risks being hedged cannot be specifically identified and measured. It is a hedge of a general business risk.

~~150.~~127B. An equity method investment cannot be a hedged item in a fair value hedge because the equity method recognises in profit or loss the investor's share of the associate's accrued ~~net~~ profit or loss, rather than fair value changes~~, in net profit or loss~~. ~~If it were a hedged item, it would be adjusted for both fair value changes and profit and loss accruals – which would result in double counting because the fair value changes include the profit and loss accruals.~~ For a similar reason, an investment in a consolidated subsidiary cannot be a hedged item in a fair value hedge because consolidation recognises the parent's share of the subsidiary's accrued ~~net~~ profit or loss, rather than fair value changes, in ~~net~~ profit or loss. A hedge of a net investment in a foreign ~~subsidiary~~ operation is different~~. There is no double counting~~ because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.

Designation of Financial Items as Hedged Items

128. If the hedged item is a financial asset or financial liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value (such as one or more selected contractual cash flows or portions thereof or a percentage of the fair value)~~,~~ ~~if~~ provided that effectiveness can be measured. For example, an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free interest rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument).

Designation of Non-Financial Items as Hedged Items

129. If the hedged item is a non-financial asset or non-financial liability, it ~~should~~shall be designated as a hedged item either (a) for foreign currency risks or (b) in its entirety for all risks, because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks.

130. Because changes in the price of an ingredient or component of a non-financial asset or non-financial liability generally do not have a predictable, separately measurable effect on the price of the item that is comparable to the effect of, say, a change in market interest rates or the price of a bond, a non-financial asset or non-financial liability is a hedged item only in its entirety. If there is a difference between the terms of the hedging instrument and the hedged item (such as for a hedge of the forecast purchase of Brazilian coffee using a forward contract to purchase Colombian coffee on otherwise similar terms), the hedging relationship nonetheless may qualify as a hedge relationship provided all the conditions in paragraph 142 are met, including that the hedge is expected to be highly effective. However, the hedging relationship might result in ineffectiveness that would be recognised in profit or loss during the term of the hedging relationship.

131. [deleted] (see paragraph 126E)

Designation of Groups of Items as Hedged Items

132. If similar assets or similar liabilities are aggregated and hedged as a group, the individual assets or individual liabilities in the group ~~will~~ share the risk exposure for which they are designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group ~~will be~~ is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group.

133. Because hedge effectiveness ~~must be~~ is assessed by comparing the change in value or cash flow of a hedging instrument (or group of similar hedging instruments) and a hedged item (or group of similar hedged items), comparing a hedging instrument to an overall net position (for example, the net of all fixed rate assets and fixed rate liabilities with similar maturities) rather than to a specific hedged item ~~(for example, the net of all fixed rate assets and fixed rate liabilities with similar maturities)~~, does not qualify for hedge accounting. However, approximately the same effect on ~~net~~ profit or loss of hedge accounting for this ~~kind~~ type of hedging relationship can be achieved by designating part of the underlying items as the hedged position. For example, if a bank has 100 of assets and 90 of liabilities with risks and terms of a similar nature and ~~wishes to~~ hedges the net 10 exposure, it can designate

10 of those assets as the hedged item. This designation ~~could~~ can be used if such assets and liabilities are fixed rate instruments, in which case it is a fair value hedge, or if they are ~~both~~ variable rate instruments, in which case it is a cash flow hedge. Similarly, if an ~~enterprise~~entity has a firm commitment to make a purchase in a foreign currency of 100 and a firm commitment to make a sale in the foreign currency of 90, it can hedge the net amount of 10 by acquiring a derivative and designating it as a hedging instrument associated with 10 of the firm purchase commitment of 100.

134.-135[deleted](see paragraphs 126B and 127A)

Hedge Accounting

136. Hedge accounting recognises ~~symmetrically~~ the offsetting effects on ~~net~~ profit or loss of changes in the fair values of the hedging instrument and the hedged ~~related~~ item ~~being hedged~~.

137. Hedging relationships are of three types:

(a) fair value hedge: a hedge of the exposure to changes in ~~the~~ fair value of a recognised asset or liability or a previously unrecognised firm commitment to buy or sell an asset at a fixed price, or an identified portion of such an asset, ~~or~~ liability, or firm commitment, that is attributable to a particular risk and ~~that will~~ could affect reported ~~net income~~profit or loss;

(b) cash flow hedge: a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a forecast~~ed~~ transaction (such as an anticipated purchase or sale) and ~~that~~ (ii) ~~will~~ could affect reported ~~net~~ profit or loss~~. A hedge of an unrecognised firm commitment to buy or sell an asset at a fixed price in the enterprise's reporting currency is accounted for as a cash flow hedge even though it has a fair value exposure~~; and

(c) hedge of a net investment in a foreign ~~entity~~ operation as defined in IAS 21~~, The Effects of Changes in Foreign Exchange Rates~~.

138. An example of a fair value hedge is a hedge of exposure to changes in the fair value of fixed rate debt as a result of changes in interest rates. Such a hedge could be entered into either by the issuer or by the holder.

139. An ~~E~~example~~s~~ of a cash flow hedge is ~~are:~~

~~(a) a hedge of the future foreign currency risk in an unrecognised contractual commitment by an airline to purchase an aircraft for a fixed amount of a foreign currency;~~

~~(b) a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price, with payment in its domestic currency; and~~

~~(c)~~ use of a swap to~~, in effect,~~ change floating rate debt to fixed rate debt (~~this is~~ ie a hedge of a future transaction; the future cash flows being hedged are the future interest payments).

140. A hedge of a firm commitment (for example, a hedge of the foreign currency risk in an unrecognised contractual commitment by an airline to purchase an aircraft for a fixed amount of a foreign currency or a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electric utility to purchase fuel at a fixed price) ~~in an enterprise's own reporting currency~~ is ~~not~~ a hedge of ~~a cash flow exposure but rather of~~ an exposure to a change in fair value. ~~Nonetheless, s~~Accordingly, such a hedge is accounted for as a ~~cash flow hedge under this Standard, rather than as a~~ fair value hedge. When a previously unrecognised firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability and changes in the fair value attributable to the hedged risk are recognised in profit or loss (see paragraph 153(b)). ~~, to avoid recognising as an asset or a liability a commitment that otherwise would not be recognised as an asset or liability under current accounting practice.~~

141. [deleted]~~As defined in IAS 21, a foreign entity is a foreign operation, the activities of which are not an integral part of the reporting enterprise. Under IAS 21, all foreign exchange differences that result from translating the financial statements of the foreign entity into the parent's~~

~~reporting currency are classified as equity until disposal of the net investment.~~

142. Under this Standard, a hedging relationship qualifies for ~~special~~ hedge accounting ~~as set out in~~ under paragraphs 153-164 if, and only if, all of the following conditions are met:

(a) at the inception of the hedge there is formal documentation of the hedging relationship and the ~~enterprise~~entity's risk management objective and strategy for undertaking the hedge. That documentation ~~should~~shall include identification of the hedging instrument, the related hedged item or transaction, the nature of the risk being hedged, and how the ~~enterprise~~entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or the hedged transaction's cash flows that is attributable to the hedged risk;

(b) the hedge is expected to be highly effective (see paragraph 146) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;

(c) for cash flow hedges, a forecast~~ed~~ transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect reported ~~net~~ profit or loss;

(d) the effectiveness of the hedge can be reliably measured, ~~that is,~~ ie the fair value or cash flows of the hedged item and the fair value of the hedging instrument can be reliably measured (see paragraphs 95-100D for guidance on determining fair value); and

(e) the hedge ~~was~~ is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting period.

143. -145.[deleted] (see paragraphs 126C, 126D, and 150)

Assessing Hedge Effectiveness

146. A hedge is normally regarded as highly effective if, at inception and throughout the life of the hedge, the ~~enterprise~~entity can expect changes in the fair value or cash flows of the hedged item to be almost fully offset by the changes in the fair value or cash flows of the hedging instrument, and actual results are within a range of 80 per cent to 125 per cent. For example, if the loss on the hedging instrument is 120 and the gain on the cash instrument is 100, offset can be measured by 120/100, which is 120 per cent, or by 100/120, which is 83 per cent. In this example, ~~The enterprise~~the entity ~~will~~ would conclude that the hedge is highly effective.

147. The method an ~~enterprise~~entity adopts for assessing hedge effectiveness ~~will~~ depends on its risk management strategy. In some cases, an ~~enterprise~~entity ~~will~~ adopts different methods for different types of hedges. If the principal terms of the hedging instrument and of the ~~entire~~ hedged asset or liability or hedged forecast~~ed~~ transaction are the same, the changes in fair value and cash flows attributable to the risk being hedged may be likely to offset each other fully, both when the hedge is entered into and thereafter ~~until completion~~. For instance, an interest rate swap is likely to be an effective hedge if the notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item.

148. On the other hand, sometimes the hedging instrument ~~will~~ offsets the hedged risk only partially. For instance, a hedge would not be fully effective if the hedging instrument and hedged item are denominated in different currencies ~~and the two~~ that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is ~~due~~ attributable to the counterparty's credit risk.

149. To qualify for ~~special~~ hedge accounting, the hedge must relate to a specific identified and designated risk, and not merely to overall ~~enterprise~~entity business risks, and must ultimately affect the ~~enterprise~~entity's ~~net~~ profit or loss. A hedge of the risk of obsolescence of a physical asset or the risk of expropriation of property by a government would not be eligible for hedge accounting; effectiveness

cannot be measured ~~since~~ because those risks are not measurable reliably.

~~143.~~150. In the case of interest rate risk, hedge effectiveness may be assessed by preparing a maturity schedule for financial assets and financial liabilities that shows ~~a reduction of all or part of~~ the net interest rate exposure for each time period~~, for each strip of maturity schedule, resulting from the aggregation of elements, the net position of which is hedged,~~ provided that ~~ing such~~the net exposure ~~can be~~is associated with ~~an~~ a specific asset or liability (or a specific group of assets or liabilities or a specific portion thereof) giving rise to ~~such~~ the net exposure and ~~correlation~~ hedge effectiveness ~~can be~~is assessed against that asset or liability.

151. This Standard does not specify a single method for assessing hedge effectiveness. An ~~enterprise~~entity's documentation of its hedging strategy ~~will~~ includes its procedures for assessing effectiveness. Those procedures ~~will~~ state whether the assessment ~~will~~ includes all of the gain or loss on a hedging instrument or whether the instrument's time value ~~will be~~is excluded. Effectiveness is assessed, at a minimum, at the time an ~~enterprise~~entity prepares its annual or interim financial ~~report~~statements. If the critical terms of the hedging instrument and the entire hedged asset or liability ~~(as opposed to selected cash flows)~~ or hedged forecast~~ed~~ transaction are the same, an ~~enterprise~~entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to ~~completely~~ offset each other fully at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecast~~ed~~ purchase of a commodity with a forward contract will be highly effective and that there will be no ineffectiveness to be recognised in ~~net~~ profit or loss if:

(a) the forward contract is for the purchase of the same quantity of the same commodity at the same time and location as the hedged forecast~~ed~~ purchase;

(b) the fair value of the forward contract at inception is zero; and

(c) either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and included directly in ~~net~~ profit or loss or the change in expected cash flows on

the forecast~~ed~~ transaction is based on the forward price for the commodity.

152. In assessing the effectiveness of a hedge, an ~~enterprise~~entity ~~will~~ generally ~~need to~~ considers the time value of money. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on a swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on a swap designated as a cash flow hedge. A swap's fair value ~~comes~~ derives from its net settlements. The fixed and variable rates on a swap can be changed without affecting the net settlement if both are changed by the same amount.

Fair Value Hedges

153. If a fair value hedge meets the conditions in paragraph 142 during the financial reporting period, it ~~should~~shall be accounted for as follows:

(a) the gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount (for a non-derivative hedging instrument) ~~should~~shall be recognised immediately in ~~net~~ profit or loss; and

(b) the gain or loss on the hedged item attributable to the hedged risk ~~should~~shall adjust the carrying amount of the hedged item and be recognised immediately in ~~net~~ profit or loss. This applies even if a hedged item is otherwise measured at fair value with changes in fair value recognised directly in equity under paragraph 103(b). It also applies if the hedged item is otherwise measured at cost.

154. [deleted]~~The following illustrates how paragraph 153 applies to a hedge of exposure to changes in the fair value of an investment in fixed rate debt as a result of changes in interest rates. This example is presented from the perspective of the holder. In Year 1 an investor purchases for 100 a debt security that is classified as available for sale. At the end of Year 1, current fair value is 110. Therefore, the 10 increase is reported in equity (assuming the investor has elected this method), and the carrying amount is increased to 110 in the balance sheet. To protect the 110 value, the holder enters into a hedge by acquiring a derivative. By~~

~~the end of Year 2, the derivative has a gain of 5, and the debt security has a corresponding decline in fair value.~~

~~**Investor's Books Year 1:**~~	~~**Debit**~~	~~**Credit**~~
~~Investment in debt security~~	~~100~~	
~~Cash~~		~~100~~
~~To reflect the purchase of the security.~~		
~~Investment in debt security~~	~~10~~	
~~Increase in fair value (included in equity)~~		~~10~~
~~To reflect the increase in fair value of the security.~~		

~~**Investor's Books Year 2:**~~	~~**Debit**~~	~~**Credit**~~
~~Derivative asset~~	~~5~~	
~~Gain (included in net profit or loss)~~		~~5~~
~~To reflect the increase in fair value of the derivative.~~		
~~Loss (included in net profit or loss)~~	~~5~~	
~~Investment in debt security~~		~~5~~
~~To reflect the decrease in fair value of the debt security.~~		

~~The carrying amount of the debt security is 105 at the end of Year 2, and the carrying amount of the derivative is 5. The gain of 10 is reported in equity until the debt security is sold, and it is subject to amortisation in accordance with paragraph 157.~~

155. If only ~~certain~~ particular risks attributable to a hedged item have been hedged, recognised changes in the fair value of the hedged item unrelated to the hedge are ~~reported~~ recognised in one of the two ways set out in paragraph 103.

156. An ~~enterprise~~entity ~~should~~shall discontinue prospectively the hedge accounting specified in paragraph 153 if any one of the following occurs:

(a) the hedging instrument expires or is sold, terminated, or exercised (for this purpose, the replacement or a rollover of a hedging instrument into another hedging instrument is not

~~considered~~ regarded as an expiration or termination if such replacement or rollover is part of the ~~enterprise~~entity's documented hedging strategy); or

(b) the hedge no longer meets the criteria for ~~qualification for~~ hedge accounting in paragraph 142.

157. An adjustment to the carrying amount of a hedged interest-bearing financial instrument ~~should~~shall be amortised to ~~net~~ profit or loss. Amortisation may begin as soon as an adjustment exists and ~~should~~shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The adjustment is based on a recalculated effective interest rate at the date amortisation begins and ~~should~~shall be ~~fully~~ amortised fully by maturity.

Cash Flow Hedges

158. If a cash flow hedge meets the conditions in paragraph 142 during the financial reporting period, it ~~should~~shall be accounted for as follows:

(a) the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 142) ~~should~~shall be recognised directly in equity through the statement of changes in equity (see IAS 1, paragraphs 86-89~~88~~); and

(b) the ineffective portion of the gain or loss on the hedging instrument ~~should~~shall be ~~reported~~recognised:

(i) immediately in ~~net~~ profit or loss if the hedging instrument is a derivative; or

(ii) in accordance with paragraph 103 in the limited circumstances in which the hedging instrument is not a derivative.

159. More specifically, a cash flow hedge is accounted for as follows:

(a) the separate component of equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):

(i) the cumulative gain or loss on the hedging instrument ~~necessary to offset the cumulative change in expected future cash flows on the hedged item~~ from inception of the hedge

~~excluding the ineffective component discussed in paragraph 158(b);~~ and

(ii) the ~~fair value of the~~ cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;

(b) any remaining gain or loss on the hedging instrument (which is not an effective hedge) is included in ~~net~~ profit or loss or directly in equity as appropriate under paragraphs 103 and 158; and

(c) if an ~~enterprise~~entity's documented risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss or related cash flows on the hedging instrument from the assessment of hedge effectiveness (see paragraph~~s~~ 126C and 142(a)), that excluded component of gain or loss is recognised in accordance with paragraph 103.

160. If a ~~the~~ hedge of a ~~d firm commitment or~~ forecast~~ed~~ transaction subsequently results in the recognition of an asset or a liability, then ~~at the time the asset or liability is recognised~~ the associated gains or losses that were recognised directly in equity in accordance with paragraph 158 ~~should~~shall be ~~removed from equity and should enter into the initial measurement of the acquisition cost or other carrying amount of the asset or liability.~~ reclassified into profit or loss in the same period or periods during which the asset acquired or liability incurred affects profit or loss (such as in the periods that depreciation expense, interest expense, or cost of sales is recognised). However, if an entity expects at any time that all or a portion of a net loss recognised directly in equity will not be recovered in one or more future periods, it shall reclassify immediately into profit or loss the amount that is not expected to be recovered.

161. [deleted]~~The gain or loss on the hedging instrument that was included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability is subsequently included in net profit or loss when the asset or liability affects net profit or loss (such as in the periods that depreciation expense, interest income or expense, or cost of sales is recognised). The provisions of other International Accounting Standards with respect to impairment of assets (see IAS 36, Impairment of Assets) and net realisable values of inventories (see IAS 2, Inventories) apply to assets arising from hedges of forecasted transactions.~~

162. For all cash flow hedges other than those covered by paragraph 160, amounts that had been recognised directly in equity ~~should~~shall be included in ~~net~~ profit or loss in the same period or periods during which the hedged ~~firm commitment or~~ forecast~~ed~~ transaction affects ~~net~~ profit or loss (for example, when a forecast~~ed~~ sale actually occurs).

163. An ~~enterprise~~entity ~~should~~shall discontinue prospectively the hedge accounting specified in paragraphs 158-162 if any one of the following occurs:

(a) the hedging instrument expires or is sold, terminated, or exercised (for this purpose, the replacement or a rollover of a hedging instrument into another hedging instrument is not ~~considered~~ regarded as an expiration or termination if such replacement or rollover is part of the ~~enterprise~~entity's documented hedging strategy). In this case, the cumulative gain or loss on the hedging instrument that initially had been reported directly in equity when the hedge was effective (see paragraph 158(a)) ~~should~~shall remain separately in equity until the forecast~~ed~~ transaction occurs. When the transaction occurs, paragraphs 160 and 162 apply. ~~;~~

(b) the hedge no longer meets the criteria ~~for qualification~~ for hedge accounting in paragraph 142. In this case, the cumulative gain or loss on the hedging instrument that initially had been reported directly in equity when the hedge was effective (see paragraph 158(a)) ~~should~~shall remain separately in equity until the ~~committed or~~ forecast~~ed~~ transaction occurs. When the transaction occurs, paragraphs 160 and 162 apply. ~~; or~~

(c) the ~~committed or~~ forecast~~ed~~ transaction is no longer expected to occur, in which case any related ~~net~~ cumulative gain or loss that had ~~has~~ been ~~reported~~ recognised directly in equity ~~should~~shall be ~~reported~~ recognised in ~~net~~ profit or loss for the period. A forecast transaction that is no longer highly probable (see paragraph 142(c)) may still be expected to occur.

Hedges of a Net Investment ~~in a Foreign Entity~~

164. Hedges of a net investment in a foreign ~~entity~~ operation, including a hedge of a monetary item that is accounted for as part of the net

***investment** (see IAS 21, The Effects of Changes in Foreign Exchange Rates), ~~should~~shall be accounted for similarly to cash flow hedges:*

(a) the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 142) ~~should~~shall be recognised directly in equity through the statement of changes in equity (see IAS 1, Presentation of Financial Statements, paragraphs 86-~~88~~89); and

(b) the ineffective portion ~~should~~shall be ~~reported~~recognised:

(i) immediately in ~~net~~ profit or loss if the hedging instrument is a derivative; or

(ii) in accordance with paragraph 103, ~~19 of IAS 21,~~ in the limited circumstances in which the hedging instrument is not a derivative.

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognised directly in equity ~~should~~shall be recognised in profit or loss at ~~classified in the same manner as the foreign currency translation gain or loss~~ the disposal of the foreign operation.

~~If a~~ Hedges that Do~~es~~ Not Qualify for ~~Special~~ Hedge Accounting

165. If a hedge does not qualify for ~~special~~ hedge accounting because it fails to meet the criteria in paragraph 142, gains and losses arising from changes in the fair value of a hedged item that is measured at fair value after ~~subsequent to~~ initial recognition are ~~reported~~ recognised in one of the two ways ~~set out~~ in paragraph 103. Fair value adjustments of a hedging instrument that is a derivative would be ~~reported~~ recognised in ~~net~~ profit or loss.

~~Disclosure~~

166-170.[deleted] (see IAS 32)

~~***166. Financial statements should include all of the disclosures required by IAS 32, except that the requirements in IAS 32 for supplementary disclosure of fair values (paragraphs 77 and 88) are not applicable to those financial assets and financial liabilities carried at fair value.***~~

~~***167. The following should be included in the disclosures of the enterprise's accounting policies as part of the disclosure required by IAS 32 paragraph 47(b):***~~

~~***(a) the methods and significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value, separately for significant classes of financial assets (paragraph 46 of IAS 32 provides guidance for determining classes of financial assets);***~~

~~***(b) whether gains and losses arising from changes in the fair value of those available-for-sale financial assets that are measured at fair value subsequent to initial recognition are included in net profit or loss for the period or are recognised directly in equity until the financial asset is disposed of; and***~~

~~***(c) for each category of financial assets defined in paragraph 10, whether 'regular way' purchases and sales of financial assets are accounted for at trade date or settlement date (see paragraph 30).***~~

~~168. In applying paragraph 167(a), an enterprise will disclose prepayment rates, rates of estimated credit losses, and interest or discount rates.~~

~~***169. Financial statements should include all of the following additional disclosures relating to hedging:***~~

~~***(a) describe the enterprise's financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction (see paragraph 142(a));***~~

~~For example, in the case of hedges of risks relating to future sales, that description indicates the nature of the risks being hedged,~~

~~approximately how many months or years of expected future sales have been hedged, and the approximate percentage of sales in those future months or years;~~

~~***(b) disclose the following separately for designated fair value hedges, cash flow hedges, and hedges of a net investment in a foreign entity:***~~

~~***(i) a description of the hedge;***~~

~~***(ii) a description of the financial instruments designated as hedging instruments for the hedge and their fair values at the balance sheet date;***~~

~~***(iii) the nature of the risks being hedged; and***~~

~~***(iv) for hedges of forecasted transactions, the periods in which the forecasted transactions are expected to occur, when they are expected to enter into the determination of net profit or loss, and a description of any forecasted transaction for which hedge accounting had previously been used but that is no longer expected to occur; and***~~

~~***(c) if a gain or loss on derivative and non-derivative financial assets and liabilities designated as hedging instruments in cash flow hedges has been recognised directly in equity, through the statement of changes in equity, disclose:***~~

~~***(i) the amount that was so recognised in equity during the current period;***~~

~~***(ii) the amount that was removed from equity and reported in net profit or loss for the period; and***~~

~~***(iii) the amount that was removed from equity and added to the initial measurement of the acquisition cost or other carrying amount of the asset or liability in a hedged forecasted transaction during the current period (see paragraph 160).***~~

~~***170. Financial statements should include all of the following additional disclosures relating to financial instruments:***~~

~~***(a) if a gain or loss from remeasuring available-for-sale financial assets to fair value (other than assets relating to hedges) has been***~~

~~***recognised directly in equity, through the statement of changes in equity, disclose:***~~

~~***(i) the amount that was so recognised in equity during the current period; and***~~

~~***(ii) the amount that was removed from equity and reported in net profit or loss for the period;***~~

~~***(b) if the presumption that fair value can be reliably measured for all financial assets that are available for sale or held for trading has been overcome (see paragraph 70) and the enterprise is, therefore, measuring any such financial assets at amortised cost, disclose that fact together with a description of the financial assets, their carrying amount, an explanation of why fair value cannot be reliably measured, and, if possible, the range of estimates within which fair value is highly likely to lie. Further, if financial assets whose fair value previously could not be measured reliably are sold, that fact, the carrying amount of such financial assets at the time of sale, and the amount of gain or loss recognised should be disclosed;***~~

~~***(c) disclose significant items of income, expense, and gains and losses resulting from financial assets and financial liabilities, whether included in net profit or loss or as a separate component of equity. For this purpose:***~~

~~***(i) total interest income and total interest expense (both on a historical cost basis) should be disclosed separately;***~~

~~***(ii) with respect to available-for-sale financial assets that are adjusted to fair value after initial acquisition, total gains and losses from derecognition of such financial assets included in net profit or loss for the period should be reported separately from total gains and losses from fair value adjustments of recognised assets and liabilities included in net profit or loss for the period (a similar split of 'realised' versus 'unrealised' gains and losses with respect to financial assets and liabilities held for trading is not required);***~~

~~***(iii) the enterprise should disclose the amount of interest income that has been accrued on impaired loans pursuant to paragraph 116 and that has not yet been received in cash;***~~

~~***(d) if the enterprise has entered into a securitisation or repurchase agreement, disclose, separately for such transactions occurring in the current financial reporting period and for remaining retained interests from transactions occurring in prior financial reporting periods:***~~

~~***(i) the nature and extent of such transactions, including a description of any collateral and quantitative information about the key assumptions used in calculating the fair values of new and retained interests;***~~

~~***(ii) whether the financial assets have been derecognised;***~~

~~***(e) if the enterprise has reclassified a financial asset as one required to be reported at amortised cost rather than at fair value (see paragraph 92), disclose the reason for that reclassification;***~~

~~***(f) disclose the nature and amount of any impairment loss or reversal of an impairment loss recognised for a financial asset, separately for each significant class of financial asset (paragraph 46 of IAS 32 provides guidance for determining classes of financial assets);***~~

~~***(g) a borrower should disclose the carrying amount of financial assets pledged as collateral for liabilities and (consistent with IAS 32.47(a) and IAS 32.49(g)) any significant terms and conditions relating to pledged assets; and***~~

~~***(h) a lender should disclose:***~~

~~***(i) the fair value of collateral (both financial and non-financial assets) that it has accepted and that it is permitted to sell or repledge in the absence of default;***~~

~~***(ii) the fair value of collateral that it has sold or repledged; and***~~

~~***(iii) (consistent with IAS 32.47(a) and IAS 32.49(g)) any significant terms and conditions associated with its use of collateral.***~~

Effective Date and Transition

171. This ~~International Accounting~~ Standard becomes operative for annual financial statements covering financial years beginning on or after [to be inserted after exposure] 2003. ~~1 January 2001.~~ ~~Earlier application is permitted only as of the beginning of a financial year that ends after 15 March 1999 (the date of issuance of this Standard).~~ The Standard shall be applied retrospectively except as specified in paragraphs 171A-171C. The opening balance of retained earnings for the earliest prior period presented and the other comparative amounts shall be adjusted as if the Standard had always been in use unless restating the information would require undue cost or effort. ~~Retrospective application is not permitted.~~

171A. At the beginning of the financial year in which this Standard is initially applied, an entity is permitted to designate a previously recognised financial instrument as held for trading or available for sale notwithstanding the requirement in paragraph 10 that such designation be made upon initial recognition. Any adjustment of previous carrying amounts shall be recognised as an adjustment to the opening balance of retained earnings of the financial year in which this Standard is first applied.

171B. If an entity had derecognised financial assets before the beginning of the financial year in which this Standard becomes operative and those assets would not have been derecognised had this Standard been applied, those assets shall be recognised at the beginning of the financial year in which this Standard is first applied.

171C. An entity shall not adjust the carrying amount of non-financial items to exclude gains and losses related to cash flow hedges that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied. At the beginning of the financial year in which this Standard is initially applied, any amount recognised directly in equity for a hedge of a firm commitment shall be reclassified as an asset or liability.

~~***172. The transition to this Standard should be as follows:***~~

~~***(a) recognition, derecognition, measurement, and hedge accounting policies followed in financial statements for periods prior to the***~~

~~***effective date of this Standard should not be reversed and, therefore, those financial statements should not be restated;***~~

~~***(b) for those transactions entered into before the beginning of the financial year in which this Standard is initially applied that the enterprise did previously designate as hedges, the recognition, derecognition, and measurement provisions of this Standard should be applied prospectively. Therefore, if the previously designated hedge does not meet the conditions for an effective hedge set out in paragraph 142 and the hedging instrument is still held, hedge accounting will no longer be appropriate starting with the beginning of the financial year in which this Standard is initially applied. Accounting in prior financial years should not be retrospectively changed to conform to the requirements of this Standard. Paragraphs 156 and 163 explain how to discontinue hedge accounting;***~~

~~***(c) at the beginning of the financial year in which this Standard is initially applied, an enterprise should recognise all derivatives in its balance sheet as either assets or liabilities and should measure them at fair value (except for a derivative that is linked to and that must be settled by delivery of an unquoted equity instrument whose fair value cannot be measured reliably). Because all derivatives, other than those that are designated hedging instruments, are considered held for trading, the difference between previous carrying amount (which may have been zero) and fair value of derivatives should be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which this Standard is initially applied (other than for a derivative that is a designated hedging instrument);***~~

~~***(d) at the beginning of the financial year in which this Standard is initially applied, an enterprise should apply the criteria in paragraphs 66-102 to identify those financial assets and liabilities that should be measured at fair value and those that should be measured at amortised cost, and it should remeasure those assets as appropriate. Any adjustment of the previous carrying amount should be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which this Standard is initially applied;***~~

~~***(e) at the beginning of the financial year in which this Standard is initially applied, any balance sheet positions in fair value hedges of existing assets and liabilities should be accounted for by adjusting their carrying amounts to reflect the fair value of the hedging instrument;***~~

~~***(f) if an enterprise's hedge accounting policies prior to initial application of this Standard had included deferral, as assets and liabilities, of gains or losses on cash flow hedges, at the beginning of the financial year in which this Standard is initially applied, those deferred gains and losses should be reclassified as a separate component of equity to the extent that the transactions meet the criteria in paragraph 142 and, thereafter, accounted for as set out in paragraphs 160-162;***~~

~~***(g) transactions entered into before the beginning of the financial year in which this Standard is initially applied should not be retrospectively designated as hedges;***~~

~~***(h) if a securitisation, transfer, or other derecognition transaction was entered into prior to the beginning of the financial year in which this Standard is initially applied, the accounting for that transaction should not be retrospectively changed to conform to the requirements of this Standard; and***~~

~~***(i) at the beginning of the financial year in which this Standard is initially applied, an enterprise should classify a financial instrument as equity or as a liability in accordance with paragraph 11 of this Standard.***~~

Appendix A

Application Guidance

This appendix forms an integral part of the Standard.

Definitions

Embedded Derivatives (paragraphs 22-26A)

A1. If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument (either an asset or a liability), and an embedded derivative would need to possess principally equity characteristics related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument (either an asset or a liability).

A2. The terms of an embedded non-option derivative (such as an embedded forward or swap) that is required to be separated from a host contract are determined on the basis of its stated or implied substantive terms so as to result in a fair value of the embedded derivative of zero upon initial recognition. The terms of an embedded option-based derivative that is required to be separated from a host contract (such as an embedded put, call, cap, floor, or swaption) are determined on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

A3. Generally, multiple embedded derivative features in a hybrid instrument other than one that is classified as equity by the entity (see IAS 32, Financial Instruments: Disclosure and Presentation) are treated as a single compound embedded derivative. However, if a hybrid instrument has more than one embedded derivative feature that each relates to different

risk exposures and are readily separable and independent of each other, those features are treated as separate embedded derivatives.

A4.~~24.~~ The economic characteristics and risks of an embedded derivative are not ~~considered to be~~regarded as closely related to the host contract (paragraph 23(a)) in the following examples. In these circumstances, assuming the conditions in paragraph~~s~~ 23(b) and ~~23~~(c) also are ~~also~~ met, an ~~enterprise~~entity accounts for the embedded derivative separately from the host contract under this Standard:

(a) a put option embedded in ~~on~~ an ~~equity~~ instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies based on the change in an equity or commodity price or index ~~held by an enterprise~~ is not closely related to ~~the~~ a host ~~equity~~ debt instrument.~~;~~

(b) a call option embedded in an equity instrument that enables the issuer to reacquire that equity instrument at a specified price~~held by an enterprise~~ is not closely related to the host equity instrument from the perspective of the holder (from the issuer's perspective, the call option is an equity instrument of the issuer provided it meets the conditions for that classification under IAS 32, ~~if the issuer is required to or has the right to require settlement in shares,~~ in which case it is excluded from the scope of this Standard).~~;~~

(c) an option or automatic provision to extend the remaining term to ~~(~~maturity~~ date)~~ of a debt instrument is not closely related to the host debt instrument ~~contract held by an enterprise~~ unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, then the issuer regards the call option as an option that extends the term to maturity of the debt instrument provided the entity can be required to participate or facilitate the remarketing of the debt instrument as a result of the call option being exercised.~~;~~

(d) equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract~~–~~by which the amount of interest or principal is indexed to the value of equity ~~shares~~ instruments~~–~~are not closely related to the host ~~debt~~ instrument~~ or~~

~~insurance contract~~ because the risks inherent in the host and the embedded derivative are dissimilar.~~;~~

(e) commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract~~–~~by which the amount of interest or principal is indexed to the price of a commodity (such as gold)~~–~~are not closely related to the host ~~debt~~ instrument ~~or insurance contract~~ because the risks inherent in the host and the embedded derivative are dissimilar.~~;~~

(f) an equity conversion feature embedded in a convertible debt instrument is not closely related to the host debt instrument from the perspective of the holder of the instrument (from the issuer's perspective, the equity conversion option is an equity instrument and excluded from the scope of this Standard provided it is classified as such under IAS 32.~~;~~

(g) a call ~~or~~, put, or prepayment option embedded in a ~~on~~ host debt instrument ~~that is issued at a significant discount or premium~~ is not closely related to the host instrument unless the option's exercise price is approximately equal to the debt instrument's amortised cost on each exercise date. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host debt instrument is made before separating the equity element under IAS 32. ~~debt except for debt (such as a zero coupon bond) that is callable or puttable at its accreted amount; and~~

(h) ~~arrangements known as~~ credit derivatives that are embedded in a host debt instrument and ~~that~~ allow one party (the 'beneficiary') to transfer the credit risk of a particular reference ~~n~~ asset, which it ~~may or~~ may not ~~actually~~ own, to another party (the 'guarantor') are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with ~~a~~ the reference asset without directly ~~purchasing~~ owning it.

A5. An example of a hybrid instrument is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies based on the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer on initial recognition designates the puttable instrument as held for trading, it is required to

separate an embedded derivative (ie the indexed principal payment) under paragraph 23 because the host contract is a debt instrument under paragraph A1 and the indexed principal payment is not closely related to a host debt instrument under paragraph A4(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

A6. In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as for units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the combined instrument at the redemption amount that is payable at the balance sheet date if the holder were to exercise its right to put the instrument back to the issuer.

A7.~~25.~~ On the other hand, the economic characteristics and risks of an embedded derivative are ~~considered to be~~regarded as closely related to the economic characteristics and risks of the host contract in the following examples. In these circumstances, an ~~enterprise~~entity does not account for the embedded derivative separately from the host contract under this Standard:

(a) ~~the~~ an embedded derivative in which the underlying is ~~linked to~~ an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing ~~the~~ host debt instrument is closely related to the host instrument unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recorded investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. ~~(that is, this Standard does not permit floating rate debt to be treated as fixed rate debt with an embedded derivative);~~

(b) an embedded floor or cap on ~~interest rates is considered to be closely related to~~ the interest rate on a debt instrument is closely related to the host debt instrument, provided ~~if~~ the cap is at or above the market rate of interest ~~or if~~and the floor is at or below the market rate of interest when the instrument is issued, and the cap or floor is not leveraged in relation to the host instrument. Similarly, provisions included in a contract to purchase or sell an asset (for example, a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged. ~~;~~

(c) ~~the~~ an embedded foreign currency derivative that provides ~~is~~ a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (for example, a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host ~~contract~~ instrument because IAS 21, The Effects of Changes in Foreign Exchange Rates, requires ~~that~~ foreign currency ~~translation~~ gains and losses on ~~the entire host~~ monetary items to be recognised in ~~net~~ profit or loss. ~~;~~

(d) an embedded foreign currency derivative in a ~~the~~ host contract that is not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and ~~it~~ requires payments denominated in one of the following currencies: (i) the functional currency of ~~the primary economic environment in which~~ any substantial party to that contract ~~operates~~ ~~; or~~ (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in ~~international~~ commercial transactions ~~e~~ around the world (~~for example,~~such as the U~~.~~S~~.~~ dollar for crude oil transactions); or (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (for example, a relatively stable and liquid currency that is commonly used in local business transactions or external trade). ~~That is, such~~ Such a contract is not regarded as a host contract with an embedded foreign currency derivative. ~~;~~

~~(e) the embedded derivative is a prepayment option with an exercise price that would not result in a significant gain or loss;~~

~~(f)~~(e) an~~the~~ embedded ~~derivative is a~~ prepayment option ~~that is embedded~~ in an interest-only or principal-only strip is closely related to the host contract provided the host contract ~~that~~ (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and ~~that~~ (ii) does not contain any terms not present in the original host debt contract. ~~;~~

~~(g)~~(f) ~~with regard to a host contract that is a lease, the~~an embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the ~~enterprise~~entity's own economic environment), (ii) contingent rentals based on related sales, ~~and~~ or (iii) a contingent rental~~s~~ based on variable interest rates. ~~; or~~

~~(h) the embedded derivative is an interest rate or interest rate index that does not alter the net interest payments that otherwise would be paid on the host contract in such a way that the holder would not recover substantially all of its recorded investment or (in the case of a derivative that is a liability) the issuer would pay a rate more than twice the market rate at inception.~~

Recognition

Accounting for Transfers that Do Not Qualify for Derecognition (paragraphs 52-57)

A8. The following are examples of applying the principle in paragraph 52 that a transferor accounts for a transferred asset and the associated borrowing that arises when a transfer does not qualify for derecognition on a basis that is consistent with, and reflects, the transferor's rights and obligations related to the transfer.

(a) If a call option right retained by the transferor prevents a transferred asset from being derecognised and the transferor measures the transferred asset at fair value, the borrowing is measured at the option exercise price less the time value of the option. The measurement of the asset at fair value is limited to the higher of the fair value and the option exercise price because the transferor does not suffer any losses as a result of decreases in the fair value of the transferred asset below the exercise price of the call option. This ensures that the net carrying amount of the asset and the borrowing is the fair value of the call option right. For instance, if the fair value of the underlying asset is 80, the option exercise price is 95, and the time value of the option is 5, then the carrying amount of the borrowing is 90 (95-5) and the carrying amount of the asset is 95 (the option exercise price).

(b) If a put option obligation written by the transferor prevents a transferred asset from being derecognised and the transferor measures the asset at fair value, the borrowing is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the transferor has no right to increases in the fair value of the transferred asset above the exercise price of the put option. This ensures that the net carrying amount of the asset and the borrowing is the fair value of the put option obligation. For instance, if the fair value of the underlying asset is 120, the option exercise price is 100, and the time value of the option is 5, then the carrying amount of the borrowing is 105 (100+5) and the carrying amount of the asset is 100 (the option exercise price).

(c) If a put option obligation written by the transferor or call option right held by the transferor prevents a transferred asset from being derecognised and the transferor measures the transferred asset at amortised cost, the borrowing is measured at its cost (ie the consideration received) adjusted for the amortisation of any difference between the cost of the borrowing and the amortised cost of the transferred asset at the expiration date of the option. For instance, if the amortised cost and carrying amount of the asset on the date of the transfer is 98, the consideration received is 95, and the amortised cost of the asset on the option exercise date will be 100, then the initial carrying amount of the borrowing is 95 and the difference between 95 and 100 is amortised to profit or loss using the effective interest method. If the option is exercised, any difference between the carrying amount of the borrowing and the exercise price is recognised in profit or loss.

(d) If a guarantee to pay for default losses on the transferred asset provided by the transferor prevents a transferred asset from being derecognised, the borrowing is measured at the maximum amount of

the consideration received in the transfer that the transferor could be required to repay (‘the guarantee amount’). At the date of the transfer, the asset is measured at the guarantee amount less any consideration received for the guarantee. Subsequently, the asset is measured at the guarantee amount less impairment losses or, if the asset is measured at fair value, the guarantee amount less the fair value of the guarantee to ensure that the net carrying amount of the asset and the related liability reflect the fair value of the transferor’s obligation under the credit guarantee.

A9. The following examples illustrate the application of the derecognition principles of this Standard.

(a) *Repurchase agreements and securities lending.* If a security is sold under an agreement to repurchase it or if it is loaned under an agreement to return it to the transferor, it is not derecognised because the transferor could regain control of the contractual rights to the cash flows that comprise the financial asset. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset on its balance sheet, for example, as a loaned asset or repurchase receivable (see paragraph 56(a)).

(b) *Repurchase agreements and securities lending – Assets that are substantially the same.* If a security is sold under an agreement to repurchase the same or substantially the same asset or if a security is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognised because the transferor could regain control of the contractual rights to the cash flows that constitute the asset.

(c) *Repurchase agreements and securities lending – Right of substitution.* If a repurchase agreement or securities lending transaction provides the transferee with a right to substitute similar assets of equal fair value for the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognised because the transferor could regain control of the contractual rights to the cash flows that constitute the asset.

(d) *Repurchase right of first refusal at fair value.* A transferor's right of first refusal to repurchase a transferred financial asset that the transferee subsequently decides to sell does not preclude derecognition provided that the transferee is not obligated to sell the transferred financial asset and the transferor has no obligation to purchase the asset.

(e) *Wash sale transaction.* The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with, and in contemplation of, an agreement to repurchase the same asset, then the asset is not derecognised.

(f) *Put options and call options.* If the financial asset can be called back by the transferor, the transfer does not qualify for derecognition to the extent of the amount of the transferred asset that is subject to repurchase upon exercise of the call option. If the financial asset can be put back by the transferee, it has not been transferred to the extent of the amount of the transferred asset that is subject to repurchase upon exercise of the put option. Although a put option held by the transferee provides the transferee with control over the right to put the asset back to the transferor, its contractual ability to require the transferor to repurchase the asset may result in the transferor regaining control of the asset and, therefore, the transferred asset does not qualify for derecognition to the extent of the amount of the asset that is subject to the put.

(g) *Put options and call options that are deeply out of the money.* No exception to the derecognition principles is made for a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor on transferred financial assets. Derecognition is precluded to the extent of the amounts subject to being reacquired because the transferor may regain control of the rights to the benefits of the cash flows of the transferred financial assets. The probability of the transferor exercising its option is not considered.

(h) *Readily obtainable assets subject to a put or call option or a forward repurchase agreement.* No exception to the derecognition principle is made for a transfer of a financial asset that is readily obtainable in the marketplace and is subject to a put or call option or a forward repurchase agreement. Derecognition is precluded to the extent of the amount of the asset that is subject to the put or call option or forward repurchase agreement. However, if the transferee has the right to sell or pledge the financial asset, the transferor reclassifies the asset on its balance sheet to identify it as an asset on loan to a transferee (for example, as a loaned asset, pledged security, or repurchase receivable) (see paragraph 56(a)).

(i) *Assets subject to a fair value put or call option or a forward repurchase agreement.* No exception to the derecognition principle is made for a transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the asset at the time of repurchase. Derecognition is precluded to the extent of the amount of the asset that is subject to the put or call option or forward repurchase agreement because the transferor may regain control of the transferred financial asset.

(j) *Cash settled call or put options.* No exception to the derecognition principle is made for a transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash. Derecognition is precluded to the extent of the amount of the asset that is subject to the put or call option or forward repurchase agreement because the transferor has a continuing involvement in changes in the value of the transferred asset.

(k) *Removal of accounts provision.* A removal of accounts provision is an unconditional repurchase (call) option that gives the transferor a right to reclaim assets transferred subject to certain restrictions. Such an option precludes derecognition to the extent of the amount subject to repurchase. For example, if the carrying amount and proceeds from the transfer of loan assets are 100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed 10,000, 90,000 of the loans would qualify for derecognition.

(l) *Clean-up calls.* A clean-up call is a call option held by a servicer, which may be the transferor, to purchase remaining transferred financial assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. A clean-up call held by a transferor precludes derecognition to the extent of the amount of the assets that is subject to the call.

(m) *Conditional put options on defaulted assets.* A transferee may have the right to put defaulted assets back to the transferor. For a special purpose entity, the exercise of the put option may be automatic whereby, if and when a loan defaults, the special purpose entity is required to put the defaulted loan back to the transferor. Although the exercise of the put options is conditional upon the occurrence of default and is for the protection of the transferee, the options nonetheless provide a means by which the transferor regains control of the rights to the cash flows of the transferred asset and thereby preclude derecognition to the extent of the amount of the assets that is subject to the put.

(n) *Subordinated retained interests and credit guarantees.* The transferor may agree to provide the transferee with credit enhancement in the form of a subordination in which the transferor subordinates some amount or all of its interest retained in the transferred asset. Alternatively, a transferor may agree to provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. Such agreements could result in the transferor in effect repurchasing the transferred asset if the debtor fails to make payments or the asset is impaired. Derecognition is precluded to the extent of the amount that the transferor could be required to pay.

(o) *Total return swaps.* A transferor may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the transferor in exchange for a fixed payment or variable rate payment and any increases or declines in the market value of the underlying asset are absorbed by the transferor. Although a total return swap is a cash settled derivative, the transferor could potentially be required to compensate the transferee for a loss of the entire amount of the underlying principal in the event, no matter how remote, of a loss. Accordingly, derecognition is prohibited.

(p) *Interest rate swaps.* A transferor may transfer a fixed rate financial asset to a transferee and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.

(q) *Amortising interest rate swaps.* A transferor may transfer a fixed rate financial asset that is paid off over time to a transferee and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount outstanding of the transferred financial asset at any point in time. The amortising interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset.

~~Trade Date vs. Settlement Date~~Regular Way Purchase or Sale of a Financial Asset (paragraph 57A)

~~30.~~A10. A 'regular way' purchase or sale of financial assets ~~should be~~is recognised using either trade date accounting or settlement date accounting as described in paragraphs ~~32~~ A13 and ~~33~~A14. The method used ~~should be~~is applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets defined in paragraph 10.

~~31.~~A11. A contract for the purchase or sale of financial assets that requires delivery of the assets within the time frame generally established by regulation or convention in the marketplace concerned (sometimes called a 'regular way' contract) is a financial instrument ~~as described in~~under this Standard. The fixed price commitment between trade date and settlement date meets the definition of a derivative – it is a forward contract. However, because of the short duration of the commitment, such a contract is not recognised as a derivative financial instrument under this Standard.

A12. A contract that requires or permits net settlement of the change in the value of the contract is not a 'regular way' contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

~~32.~~A13. The trade date is the date that an ~~enterprise~~entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date and (b) derecognition of an asset that is sold and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.

~~33.~~A14. The settlement date is the date that an asset is delivered to or by an ~~enterprise~~entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by ~~transferred to an enterprise~~the entity and (b) the derecognition of an asset on the day that it is ~~transferred~~ delivered by the ~~enterprise~~entity. When settlement date accounting is applied, under paragraph 106 an ~~enterprise~~entity ~~will~~ accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it ~~will~~ accounts for the acquired asset under this Standard. ~~That is~~In other words, the ~~value~~ change in value is not recognised for assets carried at cost or amortised cost; it is recognised in ~~net~~ profit or loss for assets classified as trading; and it is recognised in ~~net profit or loss or in~~ equity ~~(as appropriate under paragraph 103)~~ for assets classified as available for sale.

Measurement

Fair Value Measurement Considerations (paragraphs 95-100D)

Estimating Fair Value without Observable Market Prices

A15. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument, and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

A16. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing the instrument on that date. If an entity does not make loans as a primary business activity, it may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. The entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. Where evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.

Inputs to Valuation Techniques

A17. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate available market information about the market conditions and other factors that are likely to affect the instrument's fair value. The fair value of a financial instrument will be based on one or more of the following (and perhaps other) factors:

(a) The time value of money (ie interest at the basic or 'risk-free' rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general rate, such as a LIBOR/swap rate, as the benchmark rate. (Since a rate such as LIBOR is not the basic interest rate, the credit risk adjustment appropriate to the particular financial instrument would be determined on the basis of its credit risk in relation to the credit risk in this benchmark rate.) In some countries, the central government's bonds may carry a significant credit risk and may not provide a useful, stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have better credit standings and lower borrowing rates than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.

(b) Credit risk. The effect on fair value of credit risk (ie the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded corporate bonds of varying credit quality or from observable interest rates charged by lenders for loans of various credit ratings.

(c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.

(d) Commodity prices. There are observable market prices for many commodities.

(e) Equity prices. Prices (and indexes of prices) of traded equity securities are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.

(g) Marketability (the return market participants demand to compensate for the risk that they may not be able to sell an asset or obtain relief from a liability immediately). In some cases it may be reasonable to assume that the effects of marketability are included in the credit risk interest rate premium. In some other cases it may be reasonable to assume that there has been no significant change in the marketability of a financial instrument and the effect on the instrument's fair value during a reporting period.

(h) Volatility (ie the frequency and magnitude of future changes in price of the financial instrument or other item that is the subject of an option). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data.

Relationship between Discount Rates and Projected Cash Flows

A18. The present value of projected cash flows may be estimated using a discount rate adjustment approach or a cash flow adjustment approach, as appropriate.

A19. *Discount rate adjustment approach.* Under the discount rate adjustment approach, the stream of contracted cash flows forms the basis for the present value computation, and the rate(s) used to discount those cash flows reflects the uncertainties of the cash flows. This approach is most readily applied to financial instrument contracts to receive or pay fixed cash flows at fixed future times, ie instruments for which the only significant uncertainties in amount and timing of cash flows are caused by credit risk.

A20. The discount rate adjustment approach is consistent with the manner in which assets and liabilities with contractually specified cash flows are commonly described (as in 'a 12 per cent bond') and it is useful and well accepted for those instruments. However, because the discount rate adjustment approach places the emphasis on determining the interest rate, it is more difficult to apply to complex financial instruments where cash flows are conditional or optional, and where there are uncertainties in addition to credit risk that affect the amount and timing of future cash flows.

A21. *Cash flow adjustment approach.* Under the cash flow adjustment approach, the projected cash flows for a financial instrument reflect the uncertainties in timing and amount, ie they are weighted according to the probability of their occurrence, and adjusted to reflect the market's evaluation of the non-diversifiable risk relating to the uncertainty of those cash flows. The cash flow adjustment approach has advantages over the discount rate adjustment approach if an instrument's cash flows are conditional, optional, or otherwise particularly uncertain for reasons other than credit risk.

A22. To illustrate this, suppose that an entity holds a financial asset such as a derivative that has no specified cash flows and the entity has estimated that there is a 10 per cent probability that it will receive 100; a 60 per cent probability that it will receive 200; and a 30 per cent probability that it will receive 300. Further, suppose that the cash flows are expected to occur one year from the measurement date regardless of the amount. The expected cash flow is then 10 per cent of 100 plus 60 per cent of 200 plus 30 per cent of 300, which gives a total of 220. The discount rate used to estimate the instrument's fair value based on that expected cash flow would then be the basic ('risk-free') rate adjusted for the premium that market participants would be expected to receive for bearing the uncertainty of expected cash flows with the same level of risk.

A23. The cash flow adjustment approach also can incorporate uncertainties with respect to the timing of projected cash flows. For example, if the cash flow in the previous example was certain to be 200, and there was a 50 per cent chance it would be received in one year and a 50 per cent chance it would be received in three years, the present value computation would weight those possibilities accordingly. Because the interest rate for a two-year instrument is not likely to be the weighted average of the rates for one-year and three-year instruments, two separate present value computations would be required. One computation would discount 200 for one year at the basic interest rate for a one-year instrument and the other would discount 200 for three years at the basic interest rate for a three-year instrument. The ultimate result would be determined by probability weighting the results of the two computations. Since the probabilities of each are 50 per cent, the fair value would be the sum of 50 per cent of the results of each present value computation, after adjustment for the estimated effect of any non-diversifiable risk related to the uncertainty of the timing of the cash flow.

A24. The discount rate adjustment approach would be difficult to apply in the previous example because it would be difficult to find a discount rate that would reflect the uncertainties in timing.

Retained Interests

A25. When a portion of a financial asset is transferred, the transferor may provide credit enhancement to the transferee by subordinating the residual interest retained to make good any credit losses in the portion of the underlying asset that was the subject of the transfer. The credit enhancement is similar to a written option because the retained beneficial interest is subject to downside risk from credit exposure and has limited upside potential. The excess interest spread retained by a transferor in the form of a servicing fee or interest-only strip may be subject to downside risk from prepayments and has little upside potential. In these circumstances, it would be inappropriate to use a discounted cash flow approach that does not take into account the asymmetrical nature of the risk to estimating the fair value of the retained residual interest. While an option-pricing model takes such risk into consideration, it is more complex than a discounted cash flow model and it may rely on subjective estimates of credit, interest rate, and prepayment volatilities. Preferably, the fair value of a retained residual interest should be based on actual market transactions, which provide an objective market-based valuation.

Appendix B

Illustrative Examples

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

Recognition

Derecognition of a Financial Asset

Sale of a Financial Asset with a Credit Guarantee

B1. The following example illustrates the application of the derecognition principles of the Standard to a transfer of a financial asset where only a portion of the asset transferred qualifies for derecognition because of a credit guarantee provided by the transferor to the transferee.

B2. Company A sells receivables to Company B for a single, fixed cash payment of 100. The sale results in a transfer of control of Company A's contractual rights to the cash flows that constitute the receivables. Company A is not obligated to make future payments of interest on the cash it has received from Company B. However, Company A guarantees Company B against default loss on the receivables up to a specified amount, 20. Actual losses in excess of the amount guaranteed will be borne by Company B. As a result of the transaction, Company A has transferred control over the rights to the cash flows of the receivables in excess of its credit guarantee of 20. Company B has obtained control of the contractual right to receive the cash flows inherent in the receivables as well as a guarantee of 20 from Company A.

B3. The accounting is as follows:

(a) Company A removes from its balance sheet the amount of the receivables that exceeds its guarantee amount because that portion

qualifies for derecognition (in this simplified example, it is assumed that the transaction does not involve any gain or loss);

(b) Company A recognises a liability for the full amount of consideration received that it could be required to repay, ie the guarantee amount, and

(c) Company B recognises the receivables on its balance sheet for the amount of consideration it pays to A.

Transaction Date Journal Entry

Company A (Transferor)		
Cash	100	
Receivables		80
Debt arising from failed sale		20
Company B (Transferee)		
Receivables from A	20	
Receivables	80	
Cash		100

Sale of a Portion of a Financial Asset with Subordination

B4. The following example illustrates the application of the derecognition principles of the Standard when a portion of a financial asset is derecognised and the other portion continues to be recognised. In that case, the carrying amount of the asset is allocated between the portion that is derecognised and the portion that does not qualify for derecognition.

B5. Company A originates 10,000 of loan assets. The loans have an effective yield and coupon of 11 per cent. Company A later transfers the loans to a special purpose entity (SPE) that it controls and consolidates. The SPE sells a portion of the total principal amount of the loans to investors in the form of beneficial interests that meet the conditions for accounting as a 'pass-through' arrangement under IAS 39 (paragraph 41). Under the terms of the sales agreement, the investors purchase 90 per cent of the principal with interest at 6 per cent for net proceeds of 9,000. The SPE retains the remaining 10 per cent of the principal and the excess interest of 5 per cent due on the underlying loans that were sold to the investors. The SPE continues to have responsibility for servicing activities related to the loan assets. The excess interest consists of a servicing fee of 1.75 per cent and an interest-only strip of 3.25 per cent. The SPE subordinates its residual interests in the loans and the interest-only strip on a first-loss basis to the 90 per cent portion of the loans sold to the investors and pledges these residual interests as collateral to the investors.

B6. The fair value of the portion of the loans sold is the net proceeds obtained of 9,000. There is no quoted market price for the interest-only strip and residual interests in the loans that are held by the SPE and for the servicing asset, and there is no sales transaction history of similar assets to serve as a basis for estimating their fair values. Dealer quotations are available, however, for loans that are similar to the underlying loans that are the subject of the sale. Based on such quotations, Company A determines that the fair value of the underlying loans is 10,100 at the transfer date.

B7. The SPE therefore estimates the fair value of its residual interests in the loans as 1,100, representing the difference between the estimated fair value of the underlying loans of 10,100 and the net proceeds it receives of 9,000.

B8. The SPE allocates the carrying value of its loans between the portion transferred and the portion retained as follows:

	Estimated Fair Value	Percentage	Allocated Carrying Value
Portion transferred	9,000	89.11%	8,911
Retained interests	1,100	10.89%	1,089
Underlying loans	10,100	100.00%	10,000

B9. Although the SPE has estimated the fair value of its residual interest of 1,100 based on the fair value of the underlying loans less proceeds, it also estimates the 'stand-alone' fair values of the components that constitute its retained interest (a total of 1,304), as a means of allocating its remaining basis to those components. The SPE estimates the fair value of

the servicing, subordinated interest-only strip, and subordinated residual interest and by allocating the retained interest of 1,089 to these assets based on their relative fair values as follows:

	Estimated 'Stand-Alone Fair Value'	Percentage	Allocated Carrying Value
Servicing asset	251	19.28%	210
Subordinated interest-only strip	486	37.27%	406
Subordinated residual interest	566	43.44%	473
Total	1,304		1,089

B10. The SPE reduces the amount transferred by the retained interests of 879 (406 for the interest-only strip and 473 residual) that are subordinated to the portion of the loans that were transferred and allocates the proceeds of 9,000 to the portion derecognised and the portion that continues to be recognised based on the allocated carrying amounts of the subordinated interests that do not qualify for derecognition and the remaining portion that is derecognised. The portion that is derecognised is the amount that is not subject to being reacquired by the SPE. The allocation is as follows:

	Allocated Carrying Amount	Percentage of Portion Transferred	Allocation of Proceeds	Gain on Sale
Portion transferred	8,911	100.00%	9,000	89
Less:				
Subordinated interests	879	9.86%	888	9
Portion derecognised	8,032	90.14%	8,112	80

B11. All of this information is used to record the transaction. The credit to loans is 9,121 and consists of the carrying amount allocated to the portion derecognised of 8,032 and the carrying amount allocated to the portion that continues to be recognised of 1,089. There is a gain on the sale of the portion derecognised of 80.

Transaction Date Journal Entry

B12. The SPE records the following journal entry to recognise the transfer:

Cash	9,000	
Servicing asset	210	
Subordinated interest-only strip	406	
Subordinated residual interest	473	
Loans		9,121
Debt arising from failed sale		888
Gain on partial sale of loans		80

B13. The remaining balance of the loans is 879. It represents the portion of the transferred loans that does not qualify for derecognition because it is subject to being reacquired by the SPE as a result of the subordination of the retained interest-only strip and residual interest.

B14. Assume that one year after the loans are transferred, the fair value of the subordinated retained interests is 707, consisting of 297 in the interest-only strip and 410 in the residual interest. Since the subordinated interests have been reduced, the debt and the retained interest also are reduced by the following journal entry:

Journal Entry at End of One Year

Debt	174	
Retained interest	172	
Amortisation of premium		2

B15. The balance of the retained interest of 879 is reduced by 172 to equal the balance of the subordinated retained interests of 707 at the end of the year. The original amount of debt of 888 is reduced by 19.6 per cent which is the percentage reduction in the retained interest (172 divided by 879).

B16. If, in this example, the loans sold by the SPE were part of a revolving credit arrangement where loans are being transferred on a recurring basis, each transfer would have to be evaluated for whether and to what extent derecognition was appropriate.

B17. If the facts in this example are changed so that Company A or the SPE retained a call option on the beneficial interests issued to the investors, the transfer would not qualify as a sale and the entire proceeds of 9,000 would be accounted for as a collateralised borrowing. The call option is a right to repurchase the beneficial interests.

Sale of a Financial Asset with a Retained Call Option

B18. The following example illustrates the application of the derecognition principles of this Standard to a transfer of an available-for-sale financial asset where the asset transferred does not qualify for derecognition because of a call option written by the transferee to the transferor on the transferred asset.

B19. Company A sells to Company B a debt security originally purchased at 90 and classified as available for sale (AFS) with a fair value of 100. Company A attaches a call option (to buy at 120) to the debt security transferred to Company B. The fair value (in this case, time value) of the call option on the date of the transfer is 5. Company B pays Company A a single, fixed cash payment of 95. As a result of the call option held, Company A has not transferred control over the rights to the cash flows of the debt security to Company B. Company B has, however, purchased a loan to Company A.

B20. The accounting is as follows:

(a) Company A does not remove the debt security from its balance sheet because the transfer does not qualify for derecognition. It remeasures the debt security at the option exercise price (120) because Company A has no exposure to decreases in the fair value of the asset below the exercise price;

(b) Company A recognises a borrowing of 115 for the option exercise price less the time value of the call option (120-5), and

(c) Company B recognises a loan due from A on its balance sheet for the consideration paid to A. Company B classifies the purchased loan as available for sale.

Transaction Date Journal Entry:

Company A (Transferor)

Cash	95	
Pledged AFS security	120	
Borrowing		115
AFS security		100

Company B (Transferee)

Purchased loan	95	
Cash		95

B21. Assume that after one year the fair value of Company B's loan is 92 (95 relating to the debt security less 3 for the call option).

Company A (Transferor)

Interest expense (*)	2	
Borrowing		2

Company B (Transferee)

Equity	5	
Purchased loan		3
Interest income (*)		2

(*) = represents the change in the time value of the option

B22. Now assume the call option expires unexercised and the fair value of the debt security is 95.

Company A (Transferor)

Borrowing	117	
Equity	10	
Interest expense (*)	3	
Pledged AFS security		120
Income		10

Company B (Transferee)

Debt security	95	
Purchased loan		92
Interest income (*)		3

(*) = represents the change in the time value of the option

Accounting for a Collateralised Borrowing

B23. The following example illustrates the accounting for a securities lending transaction treated as a collateralised borrowing, in which the transferee (securities borrower) sells the securities upon receipt and later buys similar securities to return to the transferor (securities lender):

Facts:

1,000	Transferor's carrying amount and fair value of securities loaned
1,020	Cash 'collateral'
5.00%	Transferor's annual return from investing cash collateral
4.00%	Transferor's annual rebate to the transferee (securities borrower)

B24. For simplicity, the fair value of the security is assumed not to change during the 35-day term of the transaction.

Journal Entries for the Transferor

At inception:

Cash	1,020	
Payable under securities loan agreements		1,020

To record the receipt of cash collateral

Securities pledged to creditors	1,000	
Securities		1,000

To reclassify loaned securities that the secured party has the right to sell or repledge

Money market instrument	1,020	
Cash		1,020

To record investment of cash collateral

At conclusion:

Cash	1,025	
Interest income		5
Money market instrument		1,020

To record results of investment

Securities	1,000	
Securities pledged to creditors		1,000

To record return of securities

Payable under securities loan agreements	1,020	
Interest expense ('rebate')	4	
Cash		1,024

To record repayment of cash collateral plus interest

Journal Entries for the Transferee

At inception:

Receivable under securities loan agreements	1,020	
Cash		1,020

To record transfer of cash collateral

Cash	1,000	
Obligation to return borrowed securities		1,000

To record sale of borrowed securities to a third party and the resulting obligation to return securities that it no longer holds

At conclusion:

Obligation to return borrowed securities	1,000	
Cash		1,000

To record the repurchase of securities borrowed

Cash	1,024	
Receivable under securities loan agreements		1,020
Interest income ('rebate')		4

To record the receipt of cash collateral and rebate interest

Regular Way Purchase or Sale of a Financial Asset

Amounts to be Recorded for a Purchase of a Financial Asset

B25. The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a purchase of a financial asset. On 29 December 20x1, an entity commits itself to purchase a financial asset for 1,000 (including transaction costs), which is its fair value on commitment (trade) date. On 31 December 20x1 (financial year-end) and on 4 January 20x2 (settlement date) the fair value of the asset is 1,002 and 1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below:

SETTLEMENT DATE ACCOUNTING			
Balances	**Held-to-Maturity Investments – Carried at Amortised Cost**	**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**	**Assets Held for Trading– Remeasured to Fair Value with Changes in Profit or Loss**
29 December 20x1			
Financial asset	--	--	--
Liability	--	--	--
31 December 20x1			
Receivable	--	2	2
Financial asset	--	--	--
Liability	--	--	--
Equity (fair value adjustment)	--	(2)	--
Retained earnings (through net profit or loss)	--	--	(2)
4 January 20x2			
Receivable	--	--	--
Financial asset	1,000	1,003	1,003
Liability	--	--	--
Equity (fair value adjustment)	--	(3)	--
Retained earnings (through net profit or loss)	--	--	(3)

TRADE DATE ACCOUNTING			
Balances	**Held-to-Maturity Investments – Carried at Amortised Cost**	**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**	**Assets Held for Trading– Remeasured to Fair Value with Changes in Profit or Loss**
29 December 20x1			
Financial asset	1,000	1,000	1,000
Liability	(1,000)	(1,000)	(1,000)
31 December 20x1			
Receivable	--	--	--
Financial asset	1,000	1,002	1,002
Liability	(1,000)	(1,000)	(1,000)
Equity (fair value adjustment)	--	(2)	--
Retained earnings (through net profit or loss)	--	--	(2)
4 January 20x2			
Receivable	--	--	--
Financial asset	1,000	1,003	1,003
Liability	--	--	--
Equity (fair value adjustment)	--	(3)	--
Retained earnings (through net profit or loss)	--	--	(3)

Amounts to be Recorded for a Sale of a Financial Asset

B26. The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a sale of a financial asset. On 29 December 20x2 (trade date) an enterprise enters into a contract to sell a financial asset for its current fair value of 1,010. The asset was acquired one year earlier for 1,000 and its amortised cost is 1,000. On 31 December 20x2 (financial year-end), the fair value of the asset is 1,012. On 4 January 20x3 (settlement date), the fair value is 1,013. The amounts to be recorded will depend on how the asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any interest that might have accrued on the asset is disregarded).

B27. A change in the fair value of a financial asset that is sold on a 'regular way' basis is not recorded in the financial statements between trade date and settlement date even if the enterprise applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

SETTLEMENT DATE ACCOUNTING			
Balances	**Held-to-Maturity Investments – Carried at Amortised Cost**	**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**	**Assets Held for Trading– Remeasured to Fair Value with Changes in Profit or Loss**
29 December 20x2			
Receivable	--	--	--
Financial asset	1,000	1,010	1,010
Equity (fair value adjustment)	--	10	--
Retained earnings (through net profit or loss)	--	--	10
31 December 20x2			
Receivable	--	--	--
Financial asset	1,000	1,010	1,010
Equity (fair value adjustment)	--	10	--
Retained earnings (through net profit or loss)	--	--	10
4 January 20x3			
Equity (fair value adjustment)	--	--	--
Retained earnings (through net profit or loss)	10	10	10

TRADE DATE ACCOUNTING			
Balances	**Held-to-Maturity Investments – Carried at Amortised Cost**	**Available-for-Sale Assets – Remeasured to Fair Value with Changes in Equity**	**Assets Held for Trading– Remeasured to Fair Value with Changes in Profit or Loss**
29 December 20x2			
Receivable	1,010	1,010	1,010
Financial asset	--	--	--
Equity (fair value adjustment)	--	--	--
Retained earnings (through net profit or loss)	10	10	10
31 December 20x2			
Receivable	1,010	1,010	1,010
Financial asset	--	--	--
Equity (fair value adjustment)	--	--	--
Retained earnings (through net profit or loss)	10	10	10
4 January 20x3			
Equity (fair value adjustment)	--	--	--
Retained earnings (through net profit or loss)	10	10	10

Measurement

Subsequent Measurement of Financial Assets

Amortised Cost

B28.The following example illustrates how amortised cost is calculated using the effective interest method. Entity A purchases a debt instrument with five years remaining to maturity for its fair value of 1,000 (including transaction costs). The instrument has a principal amount of 1,250 and carries fixed interest of 4.7 per cent that is paid annually (1,250 x 4.7% = 59 per year). It can be shown that in order to allocate interest receipts and the initial discount over the term of the debt instrument at a constant rate on the carrying amount, they must be accrued at the rate of 10 per cent annually. The table below provides information about the amortised cost, interest income, and cash flows of the debt instrument in each reporting period.

Year	*(a) Amortised cost at the beginning of the year*	*(b = a x 10%) Interest income*	*(c) Cash flows*	*(d = a + b - c) Amortised cost at the end of the year*
20x0	1,000	100	59	1,041
20x1	1,041	104	59	1,086
20x2	1,086	109	59	1,136
20x3	1,136	113	59	1,190
20x4	1,190	119	1,250+59	-

B29.If the debt instrument becomes impaired, say, at the end of year 20x2, the impairment loss is calculated as the difference between the carrying amount (1,136) and the present value of expected future cash flows discounted at the original effective interest rate (10 per cent).

Amortised Cost for Instrument with Stepped Interest

B30. The following example illustrates how amortised cost is calculated using the effective interest method for an instrument with a predetermined rate of interest that increases or decreases over the term of the debt instrument (‘stepped interest’).

B31. On 1 January 2000, Company A issues a debt instrument for a price of 1,250. The principal amount is 1,250 and the debt instrument is repayable on 31 December 2004. The rate of interest is specified in the debt agreement as a percentage of the principal amount as follows: 6.0 per cent in 2000 (75), 8.0 per cent in 2001 (100), 10.0 per cent in 2002 (125), 12.0 per cent in 2003 (150), and 16.4 per cent in 2004 (205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is 10 per cent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining amortised cost in each period. In each period, the amortised cost at the beginning of the period is multiplied by the effective interest rate of 10 per cent and added to the amortised cost. Any cash payments in the period are deducted from the resulting number. Accordingly, the amortised cost in each period is as follows:

Year	*(a) Amortised cost at the beginning of the year*	*(b = (a) x 10%) Reported interest*	*(c) Cash flows*	*(d) Amortised cost at the end of the year*
2000	1,250	125	75	1,300
2001	1,300	130	100	1,330
2002	1,330	133	125	1,338
2003	1,338	134	150	1,322
2004	1,322	133	1,250+205	0

Impairment and Uncollectability of Financial Assets

Financial Assets Carried at Amortised Cost (paragraphs 111-114)

B32. The following example illustrates the application of the principles of the Standard to the recognition and measurement of impairment in a group of financial assets that are collectively evaluated for impairment.

B33. Entity A originates ten unsecured loans to corporate borrowers. Each loan has a ten-year term to maturity, an initial carrying amount of 1,000, and carries contractual interest of 12 per cent. In the entity’s internal credit rating process, each loan is assigned a rating of BB based on an assessment of the debtor’s ability to make principal and interest payments when due. Based on information about contractual cash flows and past experience of cumulative cash flow loss rates, the entity estimates expected cash flows for the group of loans as indicated below. This estimate is based on data about default rates, cash flow losses given default, and recovery rates for loans of this type that on initial recognition are assigned a rating of BB in the entity’s internal rating system. By equating the initial carrying amount of 10,000 with the present value of the estimated expected cash flows, the entity determines that the original expected interest rate is 10.21 per cent.

Year	*Contractual interest and principal cash flows*	*Estimated cumulative cash flow loss rate per year*	*Estimated expected cash flows*	*Present value (at 10.21%)*
0	-10,000	-	-	10,000
1	1,200	0.01	1,188	1,078
2	1,200	0.02	1,176	968
3	1,200	0.05	1,140	852
4	1,200	0.07	1,116	756
5	1,200	0.07	1,116	686
6	1,200	0.09	1,092	609
7	1,200	0.11	1,068	541
8	1,200	0.13	1,044	480
9	1,200	0.14	1,032	430
10	11,200	0.15	9,520	3,600
Total	22,000	-	19,492	10,000

B34. At the end of year 1, no cash flow losses have yet occurred. Each loan is still rated BB. No new loans have been added to the group. The amount reported as interest income is calculated individually for each asset in the group based on its original effective contractual interest rate of 12 per cent and is 1,200 (10 x 1,000 x 12%). Estimated expected cash flows for years 2-10 are the same as those estimated on initial recognition (ie 1176, 1140, 1116, 1116, 1092, 1068, 1044, 1032, and 9520). The recoverable amount for the group of loans is the present value of this cash flow stream discounted using the weighted average original expected interest rate of 10.21 per cent. This amount is 9,833. Accordingly, Entity A reports an impairment loss for year 1 equal to the difference between the carrying amount of the group of ten loans of 10,000 and the recoverable amount of the group of 9,833, ie 167.

B35. At the end of year 2, one loan has been individually identified as impaired and is removed from the group that is collectively assessed for impairment. The other loans are still rated BB. No new loans have been added to the group. The amount reported as interest income for the nine remaining loans in the group is 1,080 (9 x 1,000 x 12%). The estimated expected cash flows for years 3-10 for the nine remaining loans are unchanged (ie 1026, 1004, 1004, 983, 961, 940, 929, and 8568

computed on the basis of the estimated cumulative cash flow rates indicated in the table above). The recoverable amount for the group is the present value of this cash flow stream discounted using the weighted average original expected interest rate of 10.21 per cent, ie 8,695. The carrying amount of the group is 8,833 computed as the sum of the individually determined amortised costs for each of the nine loans (9,000 = 9 x 1,000) less the allowance for collectively assessed impairment that was established for the group in year 1 (ie 167). Accordingly, Entity A reports an impairment loss for year 2 that is equal to the difference between 8,833 and 8,695, ie 138.

B36. In years where the recoverable amount of the group exceeds the carrying amount of the group, the difference is recognised as income. This ensures that no allowance for the group remains when all contractual cash flows in the group have been either collected or recognised as a loss.

Hedging

Fair Value Hedges (paragraphs 153-157)

B37. The following example illustrates how paragraph 153 applies to a hedge of exposure to changes in the fair value of an investment in fixed rate debt as a result of changes in interest rates. This example is presented from the perspective of the holder.

B38. In year 1 an investor purchases for 100 a debt security that is classified as available for sale. At the end of year 1, current fair value is 110. Therefore, the increase of 10 is reported in equity, and the carrying amount is increased to 110 in the balance sheet. To protect the value of 110, the holder acquires a derivative at the beginning of year 2 with no cost. By the end of year 2, the derivative has a gain of 5, and the debt security has a corresponding decline in fair value.

Investor's Books Year 1:

Investment in debt security	100	
Cash		100
To reflect the purchase of the security.		

Investment in debt security	10	
Increase in fair value (included in equity)		10
To reflect the increase in fair value of the security.		

Investor's Books Year 2:

Derivative asset	5	
Gain (included in profit or loss)		5
To reflect the increase in fair value of the derivative.		

Loss (included in profit or loss)	5	
Investment in debt security		5
To reflect the decrease in fair value of the debt security.		

The carrying amount of the debt security is 105 at the end of year 2, and the carrying amount of the derivative is 5. The gain of 10 is reported in equity until the debt security is derecognised or impaired and is subject to amortisation in accordance with paragraph 103.

Cash Flow Hedges (paragraphs 158-163)

B39. The following example illustrates the application of the principles of the Standard to the recognition and measurement of ineffectiveness for a cash flow hedge.

B40. Entity A has a floating rate liability of 1,000 with five years remaining to maturity. It enters into a five-year pay-fixed, receive-floating interest rate swap in the same currency and with the same principal terms as the liability to hedge the exposure to variable cash flow payments on the floating rate liability attributable to interest rate risk. At inception, the fair value of the swap is zero. Subsequently, there is an increase of 49 in the fair value of the swap. This increase consists of a change of 50 resulting from an increase in market interest rates and a change of minus 1 resulting from an increase in the credit risk of the swap counterparty. There is no change in the fair value of the floating rate liability, but the fair value (present value) of the future cash flows needed to offset the exposure to variable interest cash flows on the liability increases by 50.

B41. A hedge of interest rate risk is not fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk (IAS 39.148). However, because Entity A determines that the hedge relationship is still highly effective, it credits the effective portion of the change in fair value of the swap, ie the net change in fair value of 49 to equity. There is no debit to profit or loss for the change in fair value of the swap attributable to the deterioration in the credit quality of the swap counterparty because the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, ie 50, exceeds the cumulative change in value of the hedging instrument, ie 49.

Swap	49	
Equity		49

B42. If Entity A concludes that the hedge is no longer highly effective, it discontinues hedge accounting prospectively as from the date the hedge ceased to be highly effective in accordance with IAS 39.163.

B43. If the fair value of the swap instead increases by 51 of which 50 results from the increase in market interest rates and 1 from a decrease in the credit risk of the swap counterparty, there is a credit to profit or loss of 1 for the change in fair value of the swap attributable to the improvement in the credit quality of the swap counterparty. This is because the cumulative change in the value of the hedging instrument, ie 51, exceeds the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, ie 50. The difference of 1 represents the excess ineffectiveness attributable to the derivative hedging instrument, the swap, and is reported in profit or loss.

Swap	51	
Equity		50
Profit or loss		1

Appendix C

Basis for Conclusions (Revisions 200X)

C1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.

C2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to amend IAS 39, Financial Instruments: Recognition and Measurement. The Board also agreed to revise IAS 32, Financial Instruments: Disclosure and Presentation, as necessary, to remove duplications and inconsistencies, and make other improvements.

C3. As the intention of the project to improve IAS 39 is 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

C4. IAS 39 became effective for financial statements covering financial years beginning on or after 1 January 2001. IAS 39 reflects 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.

C5. In December 2000 a Financial Instruments Joint Working Group of Standard Setters (JWG), comprising representatives or members of accounting standard-setters or professional organisations from a range of countries, published a Draft Standard and Basis for Conclusions entitled Financial Instruments and Similar Items. That Draft Standard proposes 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 received on the proposals of the JWG, it is evident that significant further work is needed before a comprehensive fair value accounting model could be introduced.

C6. 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, or others, and other issues identified in the IAS 39 implementation guidance process or by IASB staff.

C7. The Board is not reconsidering the fundamental approach to accounting for financial instruments. Some of the complexity in the 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 Board expects that the proposed amendments will reduce some of the complexity by clarifying the Standards, eliminating internal inconsistencies, and incorporating additional guidance into the Standards.

C8. The proposed amendments will 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 Statement 114, Accounting by Creditors for Impairment of a Loan, Statement 115, Accounting for Certain Investments in Debt and Equity Securities, and Statement 133, Accounting for Derivative Instruments and Hedging Activities.

C9. The Board will continue its consideration of issues related to the accounting for financial instruments. It expects, however, that the basic principles in the improved IAS 32 and IAS 39, once finalised, will be in place for a considerable period.

Scope

Loan Commitments (paragraph 1(i))

C10. Loan commitments are firm commitments to extend credit under pre-specified terms and conditions. In the IAS 39 implementation guidance process, the question was raised whether a bank's loan commitments should be accounted for as derivatives 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 to the potential borrower to obtain a loan at a specified rate.

C11.Question 30-1 of the IAS 39 Implementation Guidance concludes that a bank's commitment to make a loan at a specified rate of interest during a fixed period of time meets the definition of a derivative, but concludes that ''IAS 39 does not require that it be recognised as a derivative if the loan commitment allows draw-down of a loan within the timeframe generally established by regulation or convention in the market place concerned (IAS 39.31)''. This interpretation is based on an application of trade date and settlement date accounting rules.

C12.The Board is proposing to replace the guidance issued by the IAS 39 Implementation Guidance Committee (IGC) by a paragraph in IAS 39 explicitly to exclude particular loan commitments from the scope of IAS 39.

C13.Excluding particular loan commitments from the scope of IAS 39 simplifies the accounting for both holders and issuers of loan commitments. The effect is that an entity will not recognise and measure the change in fair value of the loan commitment that results from changes in market interest rates or credit spreads. This is consistent with the measurement of a loan or receivable that is originated 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 originated loans and receivables). The Board decided, however, that an entity should be permitted to measure a loan commitment at fair value based on the designation of the loan commitment as held for trading at inception. This may be appropriate, for instance, if the entity manages risk exposures related to loan commitments on a fair value basis.

C14.The Board further proposes that a loan commitment should be excluded from the scope of IAS 39 only if it cannot be settled net. If the value of the loan commitment can be settled net in cash or by some other financial instrument, including by selling the resulting loan assets shortly after origination, it is difficult to justify its exclusion from the requirement in

IAS 39 to measure similar instruments, which meet the definition of a derivative, at fair value.

C15.The practical consequence of excluding particular loan commitments from the scope of IAS 39 is that IAS 37, Provisions, Contingent Liabilities, and Contingent Assets, applies to those excluded loan commitments. IAS 18, Revenue, applies to the accounting for any commitment fees.

Financial Guarantee Contracts (paragraph 1(f))

C16.The Board decided to propose that issued financial guarantee contracts that provide for specified payments to be made to reimburse the holder for a loss it has incurred because a specified debtor fails to make payment when due should be initially recognised and measured in accordance with IAS 39. Subsequently, they should be measured in accordance with IAS 37, paragraphs 36-39, at the amount an entity would rationally be expected to pay to settle the obligation or to transfer it to a third party. This amendment clarifies that an issued financial guarantee contract meets the definition of a liability and should be recognised as such.

Contracts to Buy or Sell a Non-Financial Item (paragraphs 6, 7 and 10)

C17.The existing guidance in IAS 39 and IAS 32 with respect to the circumstances for which a commodity-based contract meets the definition of a financial instrument and is accounted for as a derivative is not fully consistent. IAS 32, paragraph 14, specifies that contractual rights and obligations that do not involve the transfer of a financial asset are not a financial instrument. IAS 32, paragraph A13, explains that the ability to buy or sell for cash a commodity-based contract, such as a commodity futures contract, and the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. On the other hand, Question 14-2 of the IAS 39 Implementation Guidance specifies that a contract that is to be contractually settled by taking delivery of a non-financial asset may meet the definition of a derivative in IAS 39, paragraph 10, provided the contract does not qualify for the exemption for delivery in the normal course of business in paragraph 14 of IAS 39.

According to the definition of a derivative in IAS 39, paragraph 10, a derivative is a financial instrument.

C18. In the light of this, the Board proposes to amend the paragraphs that deal with this issue in IAS 39 to clarify when commodity-based contracts are within the scope of IAS 39 and thereby resolve the apparent conflict between IAS 39 and IAS 32.

Definitions

Originated Loans and Receivables (paragraphs 10, 19 and 20)

C19. The principal difference between originated loans and receivables and other financial assets under the existing requirements in IAS 39 is that originated loans and receivables cannot be classified as available for sale and are not subject to the tainting provisions that apply to held-to-maturity investments. Originated loans and receivables that are not held for trading are measured at amortised cost even if an entity does not have the positive intention or ability to hold the loan asset until maturity.

C20. The Board decided that the ability to measure a financial asset at amortised cost without a consideration of the entity's intention and ability to hold the asset until maturity is most appropriate when there is no liquid market for the asset. It is less appropriate to extend the category to debt securities traded in liquid markets. Nevertheless, a bond that is acquired at original issue is normally classified as an originated loan or receivable under the existing requirements in IAS 39 (see Question 10-11-a of the IAS 39 Implementation Guidance). The only exception to this requirement is when the entity has the intention to sell the bond immediately or in the short term, when it is classified as held for trading. This result arises because the definition of originated loans and receivables in IAS 39, paragraph 10, does not distinguish between loans that take the form of debt securities and those that do not.

C21. The distinction for measurement purposes between liquid debt securities that are acquired upon issue and liquid debt securities that are acquired shortly afterwards is difficult to justify on conceptual grounds. Why should a liquid debt security that is purchased on the day of issue be treated differently from a liquid debt security that is purchased one week

after issue? Why should it not be possible to classify a liquid debt security that is acquired direct from the issuer as available for sale, with fair value gains and losses recognised in equity? Why should a liquid debt security that is bought shortly after it is issued be subject to tainting provisions, if a liquid debt security that is bought at the time of issue is not subject to tainting provisions?

C22. The Board proposes that these apparent anomalies should be eliminated by adding an additional condition to the definition of an originated loan or receivable in paragraph 10 of IAS 39. More specifically, an entity should not be permitted to classify an investment in a debt instrument that is quoted in an active market, such as a quoted debt security, as a loan or receivable originated by the entity. For such an investment, an entity should be required to demonstrate its positive intention and ability to hold the investment until maturity to be permitted to measure the investment at amortised cost by classifying it as held to maturity.

Embedded Foreign Currency Provisions (paragraphs 23 and A7(d))

C23. A rationale for the embedded derivatives provisions is that an entity should not be able to circumvent the recognition and measurement requirements for derivatives merely by embedding a derivative in a non-derivative financial instrument or other contract, for example, a commodity forward in a debt security. To achieve consistency in the accounting for such embedded derivatives, all derivatives embedded in financial instruments that are not measured at fair value with gains and losses reported in profit or loss ought to be accounted for separately as derivatives. As a practical expedient, however, IAS 39 provides that an embedded derivative need not be separated if it is regarded as closely related to its host contract. When the embedded derivative bears a close economic relationship to the host contract, such as a cap or floor on the interest rate on a loan, it is less likely that the derivative has been embedded to achieve a desired accounting result.

C24. It follows from IAS 39, paragraph 25(d) (before amendments), that an embedded foreign currency derivative in a non-financial host contract (such as a supply contract denominated in a foreign currency) is not separated if it requires payments denominated in either the currency of the primary economic environment in which any substantial party to the contract operates (their functional currencies) or the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in international commerce (such as the US dollar for crude oil transactions). Such foreign currency provisions are regarded as bearing such a close economic relationship to their host contracts that they do not have to be separated.

C25.The requirement to separate embedded foreign currency derivatives may be burdensome for entities that operate in economies where business contracts denominated in a foreign currency are common. For example, companies domiciled in small countries may find it convenient to denominate business contracts with companies from other small countries in an internationally liquid currency (such as the US dollar, euro, or yen) rather than the local currency of any of the parties to the transaction. In addition, an entity operating in a hyperinflationary economy may use a price list in a hard currency to protect against inflation, for example, an entity that has a foreign operation in a hyperinflationary economy that denominates local contracts in the functional currency of the parent.

C26.The Board has concluded that an embedded foreign currency provision may be integral to the contractual arrangements in cases other than those mentioned in IAS 39, paragraph 25(d). It proposes that a foreign currency provision in a contract should not be required to be separated as an embedded derivative if it is denominated in a currency that is commonly used in business transactions (that are not financial instruments) in the environment in which the transaction takes place. A foreign currency provision would be viewed as closely related to the host contract if the currency is commonly used in local business transactions, for example, when monetary amounts are viewed by the general population not in terms of the local currency but in terms of a relatively stable foreign currency, and prices may be quoted in that foreign currency (cf IAS 29, Financial Reporting in Hyperinflationary Economies, paragraph 3(b)). See paragraph A7(d).

Recognition

Derecognition of a Financial Asset (paragraphs 35-57)

C27.The Board proposes to clarify the derecognition provisions in IAS 39 by establishing as the guiding principle a continuing involvement approach

that disallows derecognition to the extent to which the transferor has continuing involvement in an asset or a portion of an asset it has transferred. It proposes that a transferor should be regarded as having a continuing involvement when (a) it could, or could be required to, reacquire control of the transferred asset (for example, if the financial asset can be called back by the transferor, the transfer does not qualify for derecognition to the extent of the asset that is subject to the call option) or (b) compensation based on the performance of the transferred asset will be paid (for example, if the transferor provides a guarantee, derecognition is precluded up to the amount that may be paid out under the guarantee).

C28.The purpose of the proposed amendments is to facilitate the implementation and application of IAS 39 by eliminating conflicting concepts and establishing an unambiguous, more internally consistent, and workable approach to the derecognition of financial instruments.

C29.The results of applying the proposed amendment are generally consistent with the guidance that already exists in IAS 39 and with the interpretations on derecognition issued by the IGC. However, under the proposed amendment derecognition is assessed on the basis of the continuing involvement of the transferor with components of the financial asset being transferred. It is not necessary to consider the relative amount of risk retained as a basis for qualifying for derecognition. A component of a financial asset is derecognised to the extent that the transferor has no continuing involvement with the component. This approach eliminates the internal inconsistencies relating to control and risks and rewards in the Standard. In addition, it addresses more fully the ‘look through’ notion for special purpose entities developed in Questions 35-2 and 35-3 of the IAS 39 Implementation Guidance as a means of limiting the complexity that would result if special rules were created for dealing with transfers involving an SPE.

Competing derecognition models - Risks and rewards vs control

C30.There is controversy about, and much complexity in, the application of the existing derecognition requirements in IAS 39. There is a view that some of its provisions relating to risks and rewards and to control are internally inconsistent.

C31. There is no controversy about whether financial assets should be derecognised when a transfer results in the transferor having no continuing involvement with the transferred assets or with the transferee. However, when a transfer results in the transferor having continuing involvement, such as the retention of credit risk, there is much debate about whether derecognition is appropriate. There also is debate about whether a transfer of a portion of a financial asset should be treated as a sale if the transferor retains risks and rewards related to the transferred assets. Some believe that a transfer of financial assets should be accounted for as a financing if the transferor retains any risks and rewards. Others believe that a transfer can be accounted for as a sale if all substantive risks relating to the financial assets are transferred to the transferee or, in a transfer to an SPE, the majority of the risks and rewards are transferred to the investors in the SPE. Still others believe that a transfer can be accounted for as a sale without any consideration of the risks and rewards being transferred, provided control over the financial assets is transferred.

C32. IAS 39 is founded primarily on a control model. However, it also uses risks and rewards as a basis for derecognition. The use of both models makes the application of the Standard confusing.

C33. In particular, paragraph 38 (before amendments) is based on the notion that substantive risks and benefits have to be transferred before a transfer of an asset that is not readily obtainable in the market qualifies for derecognition. This guidance suggests an all-or-nothing approach to derecognition in the sense that the asset is not derecognised at all unless substantive risks and rewards have been transferred. On the other hand, other paragraphs in IAS 39 focus on control and look to each of the rights and obligations that the transferor has related to the transfer, and treat those components as separate assets and liabilities. For instance, paragraph 53 (before amendments) specifies that if a transferor of receivables guarantees the transferee against default loss on the transferred receivables up to a specified amount, the receivables are derecognised and the guarantee is recognised separately as a liability.

C34. It may not always be obvious how to determine whether sufficient risks and benefits have been transferred for paragraph 53 to apply instead of paragraph 38. For example, if a transferor provides a credit guarantee for default losses up to 10 per cent of the principal amount of transferred

receivables and the expectation is that default losses will not exceed 5 per cent, what are the relevant considerations in determining whether the transferor should apply paragraph 38, and keep all of the receivables on the balance sheet, or paragraph 53, and derecognise the receivables in full while recognising a liability for the guarantee? Alternatively, should the transaction be viewed as a transfer of a portion of the receivables and the transferor keep 10 per cent of the receivables on its balance sheet? The proposed approach to derecognition eliminates the need for assessments of this type. Because the transferor has transferred 90 per cent of the receivables unconditionally and has a continuing involvement of 10 per cent through the guarantee, the transferor derecognises 90 per cent of the receivables and treats the consideration received for the other 10 per cent as a collateralised borrowing.

C35. The proposed amendments eliminate the mix of 'risk and reward' and 'control' notions that exists at present in IAS 39. The proposed approach eliminates the notion in IAS 39, paragraph 38 (before amendments), that substantially all of the risks and returns of particular assets must be transferred for an asset to qualify for derecognition (which is a type of 'risks and rewards' test). Some believe that such a test cannot be applied in an objective and consistent manner. In particular, it is not clear how to identify, measure, and aggregate different risks and returns. For example, should risk be viewed as the amount at risk or the variability of possible outcomes, should probabilities be considered, and how should risks and returns be weighed against each other? Another issue related to the risks and returns approach in paragraph 38 (before amendments) is that a transferor may retain on its balance sheet a portion of a transferred asset to which it has no exposure to gains or losses. This can arise because the transferor has an exposure to the risks and returns of another portion of the transferred asset and that portion contains substantively all of the risks and returns of the transferred asset.

C36. Under the proposed approach, these issues have been eliminated by focusing not on whether substantial risk and returns have been transferred, but on the extent to which the transferor has a continuing involvement in the asset and by treating transferred assets as divisible units.

C37. The control model avoids the difficulties of trying to assess risks and rewards. However, it too has its own set of complications. Under the control model it is necessary to determine whether control has been transferred. The assessment can be made from the perspective of the transferor, the transferee, or both parties.

C38. When a transferor retains an interest in the underlying assets that are the subject of the transfer, the transferor may not give the transferee the unilateral right to sell or pledge the underlying assets because the transferor wants to protect its retained rights and obligations. However, the transferee also wants to protect its interest. As a result, an agreement may be reached that protects both parties and specifies what can and cannot be done with respect to the underlying assets. Where the transferor retains an interest in the underlying assets and neither party has the right to sell or pledge the underlying assets, it is difficult to apply the control model because neither the transferor nor the transferee has unilateral control.

C39. One possibility is to focus on the ability of the transferee to sell or pledge the transferred assets. It is not clear, however, how control should be assessed where neither party controls the underlying assets, which is often the case when only a portion of the underlying asset is transferred. At present, IAS 39 specifies that a transferor ''generally'' has lost control if the transferee is free to sell or repledge approximately the full fair value of the transferred asset (paragraph 41(a) before amendments). However, the 'right to sell or repledge' is not always a decisive factor under IAS 39. For example, if a bank transfers a loan to another bank, but the transferee bank is not allowed to sell or repledge the loan, the loan may be derecognised by the transferor bank if the reason for the restriction on the transferee's right to sell or repledge the asset is to preserve the relationship of the transferor bank with its customer (paragraph 42 before amendments).

C40. Under the existing requirements in IAS 39, for some types of transfers, a sufficient condition for derecognition is that the transferred asset is readily obtainable in the market (such as for some transfers with retained call options, written unconditional put options, or total return swaps) (see paragraph 38(a) and (c), before amendment). For other types of transfers, derecognition may be precluded even though the asset is readily obtainable in the market (such as for repurchase transactions) (see paragraph 38(b), before amendment).

C41. It is difficult to justify why the transferee having the right to sell or repledge a transferred asset or the asset being readily obtainable in the market are sufficient conditions for derecognition in some cases, but not in others. The proposed approach eliminates these inconsistencies by removing the 'sell or repledge' and 'readily obtainable in the market' conditions as factors to consider in determining whether an asset should be derecognised. The sole guiding principle is the extent to which the asset has been transferred unconditionally. The proposed approach is consistent with the view that, for example, a repurchase transaction should be accounted for as a collateralised borrowing. The proposal also requires that the transferor reclassify the transferred asset in its balance sheet and report it separately from other assets to enhance transparency about transfers in which the transferee has the right to sell or repledge the transferred asset.

General considerations for simplifying the derecognition model

C42. As mentioned previously, both the risks and rewards model and the control model have a number of complexities and limitations, and there is extensive debate about which model should prevail. Much of the controversy and complexity surrounding these models can be reduced by building on what is not controversial. There is no controversy that a transfer of a financial asset qualifies for derecognition if the transferor has no continuing involvement with the transferred asset. There is also little debate today that financial assets can be divided into many different pieces, sometimes referred to as components. As examples, IAS 39 provides for the bifurcation of embedded derivatives from hybrid financial instruments and permits hedge accounting for hedging relationships involving specified portions of assets and liabilities, and IAS 32 requires the bifurcation of compound financial instruments.

C43. From this foundation it seems that if a transferred financial asset is a component of another financial asset and the transferor has no continuing involvement with such transferred financial asset, there should be no controversy about the transferor derecognising that asset. When a transferor has some continuing involvement with a transferred asset, only the portion of the transferred asset that is transferred unconditionally qualifies for derecognition. The complexity of the derecognition provisions is reduced significantly by focusing on what is the asset that is transferred unconditionally, instead of focusing on what has been retained and whether sufficient risks of the entire asset have been transferred.

C44. The recommendations that are included in the proposed amendment to IAS 39 are founded on the premise that a financial asset or portion thereof that is transferred unconditionally qualifies for derecognition. A transfer is unconditional when there are no contractual provisions, conditional or otherwise, that can cause the transfer to be reversed or compensation to be paid or received based on changes in the value of the transferred asset. This condition is met if the transferor gives up control of the rights that constitute the financial asset and cannot get them back, the transferee obtains those rights and cannot make the transferor take them back, and the transferor does not have any right or obligation to receive or pay subsequent changes in the value of the transferred asset. If the condition is not met, the transferor continues to recognise the asset and recognises a liability to the extent of the continuing involvement. Since the transferor has a continuing involvement in the future benefits of the transferred asset, Board members believe that it is conceptually appropriate that the asset continues to be recognised. They correspondingly believe that it is conceptually appropriate for the transferor to recognise a liability for the amount that it may repay to the transferee. The Board has concluded that the continuing involvement creates a liability although it may be a conditional liability.

C45. The Board believes that this approach to derecognition provides significant improvements in comparison to the existing requirements in IAS 39 because it rests on a clear principle, ie whether there is a discontinuation of involvement, and because this principle is followed without exception. These features, in the Board's view, offer benefits in terms of clarity of meaning, consistency of application and ease of use – benefits that can be enjoyed until the Board can look more broadly at the derecognition of all assets and liabilities, rather than just at financial assets and liabilities.

C46. The Board recognises that the proposed approach will not address all conceptual arguments that may be raised against the requirements in IAS 39 related to derecognition. For example, some believe that it is not consistent with the definitions of assets and liabilities in the Framework to present a continuing involvement resulting from a retained right or obligation as an asset and an associated borrowing because, in their view,

the right or obligation cannot create both an asset and a liability. In addition, implementing the proposed approach requires an override of measurement and presentation standards applicable to other similar financial instruments that do not arise from derecognition transactions. It may also result in very different accounting by two entities when they have identical contractual rights and obligations only because one entity once owned the transferred financial asset. Furthermore, the 'borrowing' that is recognised when a transfer does not qualify for derecognition is not accounted for like other loans, so no interest expense may be recorded. The Board notes that issues like these also arise under derecognition requirements issued by national standard-setters.

C47. The Board concluded that the proposed approach would result in significant improvements to the current requirements related to derecognition in IAS 39. The proposed amendments are not intended to preclude longer-term debate about whether additional or different criteria should be applied in determining when a financial asset should be derecognised. The IASB will continue to consider the conceptual issues related to derecognition as part of future projects. Remaining issues include:

(a) Should history matter, ie should the recognition of financial assets and financial liabilities be affected by the sequence of transactions that led to their existence? The proposed approach does not eliminate the problem that some perceive in IAS 39 and other derecognition standards that two entities with identical rights and obligations may report different assets and liabilities depending on the order in which they acquired or incurred those rights and obligations (because once recognised, assets are 'sticky'). An alternative approach would be a components approach under which forward contracts, put or call options and guarantees that are actually created in the 'failed sales' circumstances are recognised.

(b) Should legal isolation be a condition for derecognition? As in the existing requirements in IAS 39, the proposed approach does not include any requirement that the transferred asset be put presumptively beyond the reach of the transferor and its creditors for the transfer to qualify for derecognition.

(c) Should it matter whether the transferee has the right to sell or repledge the transferred asset? Some believe that the transferee's right to sell or repledge the transferred asset indicates that the transferor has lost control of the asset. Some believe that the transferee's right to sell or repledge the transferred asset indicates that the transferor has lost control of the asset for transactions other than repurchase agreements and securities lending transactions. Under the proposed approach, whether the transferee has the right to sell or repledge the transferred asset is not a factor that affects whether a transferred asset should be derecognised (although it does affect the classification of the asset on the transferor's balance sheet).

(d) Should the criteria governing the consolidation of SPEs to which assets have been transferred be reconsidered?

Pass-Through Arrangements (paragraph 41)

C48. IAS 39 does not provide explicit guidance about the extent to which derecognition is appropriate when a transferor sells its contractual rights to all or a portion of the cash flows that constitute a financial asset and retains custody of the asset (a so-called 'pass-through' arrangement). For example, if an entity sells a portion of the cash flows from a loan portfolio and retains the other portion and the custody of the loan assets, it may not be obvious whether the portion sold can be derecognised. Alternatively, if an entity transfers receivables to an SPE and the SPE issues securities that transfer the rights to all or a portion of the underlying cash flows to investors, is derecognition of the sold portion appropriate?

C49. The IAS 39 Implementation Guidance specifies that control is not only a physical or custody notion (see Question 35-2 of the IAS 39 Implementation Guidance). Therefore, derecognition may be appropriate in situations such as those described above, depending on an assessment of various factors. Factors that suggest derecognition is appropriate include the absence of reacquisition provisions, the transferor's inability to sell or repledge the underlying asset, the transferee's ability to sell or repledge the transferred portion, and the transferor's obligation to remit cash flows to investors on a timely basis. Factors that limit the extent to which derecognition is appropriate include some call options, written put options, total return swaps, and guarantees. Application of this guidance

is not necessarily simple and may require making difficult judgements of the relative importance of various factors.

C50. The proposed amendments establish clear guidance for derecognition in these circumstances. Under the proposed amendments, financial assets that are transferred in pass-through structures and for which there are no reacquisition provisions qualify for derecognition provided that (a) the transferor does not have an obligation to pay cash flows to the transferee unless it collects equivalent amounts from the transferred asset; (b) the transferor does not have the right to sell or repledge the asset or otherwise use that asset for its benefit; and (c) the transferor has an obligation to remit any cash flows it collects on behalf of investors on a timely basis. This guidance is based on the observation that there is no asset and no liability in pass-through structures that meet these conditions. Condition (a) indicates that the transferor has no liability (because there is no present obligation to pay cash), and conditions (b) and (c) indicate that the transferor has no asset (because the transferor does not control the future economic benefits associated with the transferred asset).

C51. Under the proposed amendment, the evaluation of whether a transfer of a portion of financial assets meets the derecognition criteria generally does not differ if the transfer is direct to investors or through an SPE or trust that obtains the financial assets and, in turn, transfers a portion of those financial assets to third party investors. If a transfer by an SPE to a third party investor meets the conditions specified for derecognition, the transfer would be accounted for as a sale by the SPE and those derecognised assets or portions thereof would not be brought back on the balance sheet in the entity's consolidated financial statements.

Accounting for Transfers that Do Not Qualify for Derecognition (paragraphs 52-57)

C52. At present, IAS 39 does not provide any guidance about how to account for the proceeds received when a transfer of a financial asset does not qualify for derecognition (a so-called 'collateralised borrowing'). The proposed amendments include such guidance. To ensure that the accounting reflects the rights and obligations that the transferor has in relation to the transferred asset, there is a need to consider the accounting for the asset as well as the accounting for the borrowing.

C53.Special measurement and income recognition issues arise if derecognition is precluded because the transferor has retained a call option right or written a put option obligation and the asset is measured at fair value. In those situations, application of the general measurement and income recognition requirements for financial assets and financial liabilities in IAS 39 may result, in the absence of additional guidance, in an accounting that does not represent the transferor's rights and obligations related to the transfer.

C54.For example, if the transferor retains a call option on a transferred available-for-sale financial asset and the fair value of the asset decreases below the exercise price, the transferor does not suffer a loss because it has no obligation to exercise the call option. In that case, the Board decided that it is appropriate to measure the asset at the option exercise price rather than the lower fair value because the transferor has no exposure to decreases in the fair value of the asset below the option exercise price. Similarly, if a transferor writes a put option obligation and the fair value of the asset exceeds the exercise price, the transferee cannot be expected to exercise the put. Because the transferor has no right to increases in the fair value of the asset above the option exercise price, it is appropriate to measure the asset at the exercise price rather than the higher fair value.

Measurement

Fair Value Measurement (paragraphs 10 and 95-100D)

C55.The Board has concluded it can simplify the application of IAS 39 for some entities with more fair value measurement of financial instruments. With one exception (see paragraph C64), this greater use of fair value would be optional. It is not proposed to force entities to measure more financial instruments at fair value.

C56.At present under IAS 39, it is not permitted to measure particular categories of financial instruments at fair value with changes in fair value recognised in profit or loss. Examples include:

- originated loans and receivables, including a debt security acquired directly from the issuer, unless they meet the conditions for classification as held for trading in paragraph 10.

- financial assets classified as available for sale, unless they meet the conditions for classification as held for trading in paragraph 10.

- non-derivative debt obligations even if the entity has a policy and practice of actively repurchasing such liabilities or they form part of an arbitrage/customer facilitation strategy or fund trading activities.

C57.The Board proposes to permit entities to measure any financial instrument at fair value with gains and losses recognised in profit or loss by designating the instruments as held for trading. In presenting and disclosing information, an entity uses an appropriate descriptor for financial instruments that have been designated in this way, such as 'financial instruments at fair value (through net income)'. To impose discipline on this approach, the Board further proposes that financial instruments should not be reclassified into or out of the trading category while they are held. At present, financial instruments may not be reclassified out of the trading category, but in some circumstances are reclassified into the trading category (IAS 39, paragraph 107).

C58.The proposed change would simplify the application of IAS 39 by mitigating some of the anomalies that result from different measurement attributes in the Standard. In particular, for financial instruments designated in this way:

- it eliminates the need for hedge accounting for hedges of fair value exposures when there are natural offsets and thereby eliminates the related burden of designating, tracking, and analysing hedge effectiveness.

- it eliminates the burden of separating embedded derivatives.

- it eliminates problems arising from a mixed-measurement model where assets are measured at fair value and related liabilities are measured at amortised cost. In particular, it eliminates the artificial volatility in profit or loss and equity that results when matched positions of assets and liabilities are not measured consistently.

- the option to recognise unrealised gains and losses on available-for-sale financial assets in profit or loss is no longer necessary.

- it de-emphasises interpretive issues around what constitutes trading.

C59.Permitting entities to designate at inception any financial instrument as held for trading reduces the need for hedge accounting for hedges of fair value exposures and the resulting complexity in accounting for such hedges. The hedged item could, rather than being designated as a hedged item, be designated as held for trading to achieve recognition of offsetting fair value gains and losses in the same periods.

C60.Permitting classification by designation also reduces the burden of separating embedded derivatives from hybrid instruments into host instruments and embedded derivative contracts. Under IAS 39, an entity does not separate embedded derivatives in financial instruments that are measured at fair value with gains and losses recognised in profit or loss (such as financial instruments held for trading, see IAS 39, paragraph 23). There is evidence that many preparers, auditors, and others find the requirements to separate embedded derivatives difficult to apply in practice. For example, the application of these requirements requires an entity to carry out a detailed analysis of its financial instruments to identify embedded derivatives. To perform this task and to measure the embedded derivatives, an entity may need to employ derivatives specialists and other finance professionals. Often it may be easier for the entity to determine the fair value of the combined instrument as a whole rather than to identify the terms of the embedded derivative and separately measure the embedded derivative at fair value, for instance, if the combined instrument is traded in an active market.

C61.An additional benefit of permitting classification by designation is that the choice of recognising fair value gains and losses on available-for-sale financial assets either in equity or in profit or loss is no longer necessary because an entity can achieve recognition of gains and losses on such assets in profit or loss by designating the asset as held for trading. In addition, elimination of that choice brings IAS 39 slightly closer to US GAAP, which requires unrealised holding gains and losses on available-for-sale securities to be recognised in other comprehensive income (see FASB Statement 130, Reporting Comprehensive Income,

paragraph 33). It also increases comparability across entities in how gains and losses on available-for-sale financial assets are recognised. Accordingly, the Board proposes that the choice be removed and that gains and losses on available-for-sale financial assets be recognised in equity.

C62.Permitting classification as held for trading by designation mitigates problems arising from a mixed-measurement model where assets are measured at fair value and related liabilities are measured at amortised cost. For example, the inability to classify non-derivative liabilities as held for trading under IAS 39 creates problems for entities with matched asset and liability positions. Because an entity is not permitted to designate non-derivative assets or liabilities as hedging instruments under IAS 39, other than for foreign currency exposures, an entity may not use hedge accounting to eliminate such a mismatch. If liabilities can be designated as held for trading, an entity can recognise fair value changes on matched asset liability positions consistently.

C63.The proposed change would enable (not require) entities to measure financial instruments at fair value with changes in fair value recognised in profit or loss. Accordingly, it would not restrict an entity's ability to use different accounting methods (such as amortised cost). In theory, more drastic changes to expand the use of fair values and limit the choices available to entities, such as the elimination of the held-to-maturity category or the cash flow hedge approach, are conceivable. Although such changes have the potential to make the principles in IAS 39 conceptually more coherent and less complex, the Board has not considered such changes as part of this project.

C64.In addition, the proposed revisions include a requirement for an entity to classify a financial liability as held for trading if it is incurred principally for the purpose of repurchasing it in the near term or 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. In these instances, the absence of a requirement to measure such debt securities at fair value permits cherry-picking of unrealised gains or losses (for instance, if an entity wishes to recognise a gain, it can repurchase a fixed-rate debt security that was issued in an environment where interest rates were lower than in the reporting period and if it wishes to recognise a loss, it can repurchase an issued debt security that was issued in an environment where interest rates were higher than in the reporting period). However, a liability would not be classified as held for trading merely because it funds assets that are held for trading.

C65. The proposed amendments to IAS 32 include a requirement to disclose the settlement amount repayable at maturity of a liability that is designated as held for trading. This gives users of financial statements information about the amount owed by the entity to its creditors in the event it is liquidated.

C66. The proposed amendments to IAS 39 also include the ability for entities to designate an originated loan or receivable as available-for-sale (see paragraph 10). The Board decided that, in the context of the existing mixed-measurement model, there are no reasons to limit the ability to designate an asset as available for sale to any particular type of asset.

C67. The proposed amendments to IAS 39 also include expanded guidance about how to determine fair values, in particular for financial instruments for which no quoted market price is available (paragraphs 95-100D). The Board decided that it is desirable to provide clear and reasonably detailed guidance about the objective and use of valuation techniques to achieve reliable and comparable fair value estimates when financial instruments are measured at fair value.

Impairment of Investments in Equity Instruments (paragraph 110A)

C68. Under IAS 39, investments in equity securities that are classified as available-for-sale with gains and losses recognised in equity, and investments in unquoted equity instruments whose fair value cannot be reliably measured are subject to an impairment assessment.

C69. Any impairment trigger in the case of marketable investments in equity securities is likely to be arbitrary to some extent. If markets are reasonably efficient, today's market price is the best estimate of the discounted value of the future market price.

C70. The proposed new paragraph 110A includes proposed impairment triggers that are reasonable in the case of investments in equity instruments. Those would apply in addition to those specified in

paragraph 110 of IAS 39, which focus on the assessment of impairment in debt securities.

Impairment and Uncollectability of Financial Assets Carried at Amortised Cost (paragraphs 111-114)

C71. It is not clear in IAS 39 whether originated loans and certain other financial assets, when reviewed for impairment and determined as not impaired, can subsequently be included in the assessment of impairment for a group of financial assets with similar characteristics. Views differ on what is conceptually appropriate.

C72. Arguments in favour of an additional portfolio assessment for individually assessed assets that are found not to be impaired are:

(a) IAS 39 specifies that if it is probable that an enterprise will not collect all amounts due according to the contractual terms of loans, impairment or bad debt loss has occurred (paragraph 111). Impairment that cannot be identified with an individual loan may be probable on a portfolio basis. The Framework for the Preparation and Presentation of Financial Statements states that for a large population of receivables, some degree of non-payment is normally regarded as probable. In that case, an expense representing the expected reduction in economic benefits is recognised (Framework, paragraph 85). For example, a lender may have some concerns about identified loans with similar characteristics, but not have sufficient evidence to conclude that an impairment loss has occurred on any of those loans based on an individual assessment. Experience may indicate that some of those loans will default. The amount of loss in a large population of items can be estimated based on experience and other factors by weighing all possible outcomes by their associated probabilities.

(b) It may take time between the occurrence of an event that affects the ability of a borrower to repay a loan and the time when the borrower actually defaults. For instance, if the market forward price for wheat decreases by 10 per cent, experience may indicate that the expected payments from borrowers that are wheat farmers will decrease by 1 per cent over a one-year period. When the forward price decreases, there may be no objective evidence that any individual wheat farmer will default on an individually significant loan. On a portfolio basis, however, the decrease in the forward price may provide objective evidence that the expected future cash flows on loans to wheat farmers have decreased by 1 per cent over a one-year period.

(c) Under IAS 39, impairment of loans is measured based on the present value of expected future cash flows. Expectations of future cash flows may change because of systematic factors affecting a group of loans, such as country and industry factors, even if there is no objective evidence of impairment of an individual loan. For example, if unemployment increases by 10 per cent in a quarter in a particular region, it may be probable that expected cash flows from loans to borrowers in that region in the next quarters will decrease even though no objective evidence of impairment exists based on an individual assessment of loans to borrowers in that region. In that case, it may be argued that objective evidence of impairment exists at the group level, even though it does not exist at an individual level. A requirement for objective evidence to exist to recognise and measure impairment in individually significant loans may result in delayed recognition of loan impairment that has already occurred.

(d) Fair values incorporate the market's expectation of changes in future cash flows discounted using current market interest rates regardless of whether objective evidence of impairment exists for individual assets. In the absence of observable market prices, fair values of loans may be estimated based on internal credit ratings or other similar methodologies that group loans by credit quality. Under an amortised cost model, an approach that incorporates changes in the credit quality component of the fair value is to discount expected future cash flows using the original effective interest rate. It appears inconsistent with the move towards greater use of fair values for financial assets to insist on the existence of objective evidence of impairment for individually significant loans on an individual basis to recognise and measure impairment on those loans.

(e) Accepted accounting practice in a number of countries is to establish a provision to cover impairment losses that, although not specifically

identified to individual assets, are known from experience to exist in a loan portfolio as of the balance sheet date.

(f) If assets that are individually not significant are collectively assessed for impairment and assets that are individually significant are not, assets will not be measured on a consistent basis because the loss recognition threshold is more difficult to meet asset by asset.

C73. Arguments against an additional portfolio assessment for individually assessed loans that are found not to be impaired are:

(a) It appears illogical to make an impairment provision on a group of loans that have been assessed for impairment on an individual basis and have been found not to be impaired.

(b) The measurement of impairment should not depend on whether a lender has only one loan or a group of similar loans. If the measurement of impairment is affected by whether the lender has groups of similar loans, identical loans may be measured differently by different lenders. To ensure consistent measurement of identical loans, impairment in individually significant financial assets should be recognised and measured asset by asset.

(c) The Framework specifies that financial statements are prepared on the accrual basis of accounting, according to which the effects of transactions and events are recognised when they occur and are reported in the financial statements in the periods to which they relate. Financial statements should reflect the outcome of events that took place before the balance sheet date and should not reflect events that have not yet occurred. If an impairment loss cannot be identified with a specifically identified financial asset or a group of financial assets that are not individually significant, it is questionable whether an event has occurred that justifies the recognition of impairment. Even though the risk of loss may have increased, a loss has not yet materialised.

(d) The Framework, paragraph 94, requires that an expense be recognised only if it can be measured reliably. The process of estimating impairment in a group of loans that have been individually assessed for impairment but found not to be impaired may involve a significant degree of subjectivity. There may be a wide range of reasonable estimates of impairment. In practice, the establishment of general loan loss provisions is sometimes viewed as more of an art than a science. This portfolio approach should be applied only if it is necessary on practical grounds and not to override an assessment made on an individual loan, which must provide a better determination of whether an allowance is necessary.

(e) IAS 39 requires impairment to be measured on a present value basis using the original effective interest rate. Mechanically, it may not be obvious how to do this for a group of loans with similar characteristics that have different effective interest rates. In addition, measurement of impairment in a group of loans based on the present value of expected cash flows discounted using the original contractual effective interest rate may result in double-counting of losses that were expected on a portfolio basis when the loans were originated because the lender included compensation for those losses in the contractual interest rate charged. As a result, a portfolio assessment of impairment may result in the recognition of a loss almost as soon as a loan is issued. (This issue arises also in measuring impairment on a portfolio basis for loans that are not individually assessed for impairment under IAS 39.)

C74.The Board concluded that a loan or other financial asset measured at amortised cost that is individually assessed for impairment and found not to be impaired should be included in a group of similar financial assets that are assessed for impairment on a portfolio basis. This is to reflect that, in the light of the law of large numbers, impairment may be probable in a group of assets, but not yet probable in assessing any individual asset in that group. The Board also agreed that it is important to provide additional guidance about how to assess impairment on a portfolio basis to introduce discipline into a portfolio assessment.

C75.Guidance is proposed to clarify and explain how to apply the existing impairment principles in IAS 39 to groups of financial assets that are collectively assessed for impairment. Such guidance should help promote consistency in practice and ensure that information is comparable across entities. It should also mitigate concerns that collective assessments of impairment should not be used to conceal changes in asset values or as a cushion for potential future losses.

C76.The proposed amendment builds on the existing principles in IAS 39 for recognition of measurement of impairment of financial assets measured at amortised cost, ie that losses attributable to bad debt or impairment should be determined by comparing the carrying amount of a financial asset with the present value of expected future cash flows discounted at the instrument's original effective interest rate (paragraph 111). It supplements those principles by providing guidance on how to apply those principles to the assessment of impairment in groups of financial assets that are collectively evaluated for impairment.

Assets that are individually identified as impaired

C77.In making a portfolio assessment of impairment, one issue that arises is whether the collective assessment should include assets that have been individually evaluated and identified as impaired.

C78.One view is that methods used to estimate impairment losses on a portfolio basis are equally valid whether or not an asset has been specifically identified as impaired. Those who support this view note that the law of large numbers applies equally whether or not an asset has been individually identified as impaired and that a portfolio assessment may enable a more accurate prediction of expected future cash flows.

C79.Another view is that there should be no need to complement an individual assessment of impairment for an asset that is specifically identified as impaired by an additional portfolio assessment, because objective evidence of impairment exists on an individual basis and expectations of losses can be incorporated in the measurement of impairment for the individual assets. Double-counting of losses in terms of expected future cash flows should not be permitted. Moreover, recognition of impairment losses for groups of assets should not be a substitute for the recognition of impairment losses on individual assets.

C80.The Board decided that assets that are individually assessed for impairment and identified as impaired should be excluded from a portfolio assessment of impairment. Excluding assets that are individually identified as impaired from a portfolio assessment of impairment is consistent with the view that collective evaluation of impairment is an interim step pending the identification of impairment losses on individual assets. A collective evaluation identifies losses that are probable on a group basis as of the balance sheet date, but cannot yet be identified with individual assets. As soon as information is available to identify losses on individually impaired assets, those assets are removed from the group that is collectively assessed for impairment.

Assets included in a collective evaluation of impairment

C81. What assets should be included in a portfolio that is collectively evaluated for impairment? One approach (Approach A) is to include all assets (other than those that have been individually identified as impaired) in a portfolio assessment, including assets that were only recently originated or acquired. Proponents of this approach note that the assessment of impairment in IAS 39 is based on estimating expected future cash flows. Apart from assets that do not have any credit risk, such as government securities in some countries, historical loss experience typically suggests that expected future cash flows are less than future contractual cash flows on a portfolio level even if the assets are recently originated or acquired. Indeed, IAS 39, paragraph 110 (before amendments), specifies that objective evidence of impairment includes a historical pattern of collection of accounts that indicates that the entire face amount of a portfolio of accounts receivable will not be collected. Because the methodology for determining impairment under IAS 39 is based on discounting expected future cash flows, any shortfall in cash flows ought to be regarded as an impairment.

C82. A second approach (Approach B) is to require an event or a combination of events to occur before an asset can be included in a portfolio assessment. Proponents of this approach do not believe it is appropriate to include an asset in a portfolio assessment unless there is a change in conditions after origination or acquisition of an asset. If any shortfall in cash flows is viewed as objective evidence of impairment on a portfolio basis, groups of any types of asset other than those that are absolutely risk-free are impaired on initial recognition. Therefore, proponents of Approach B believe that an event should occur before an asset may be included in a portfolio assessment. Events that may justify including an asset in a portfolio assessment of impairment could include changes in payment status, national and local economic trends and conditions (such as changes in unemployment rates, property prices, or commodity prices), changes in industry conditions, and internal or external credit downgrades.

C83. Proponents of Approach A reject Approach B because they believe it is arbitrary to identify events that justify the inclusion of an asset in a portfolio. In practice, it may be impossible to identify a single, distinct past causative event that gives rise to impairment in a group of assets. Furthermore, in estimating expected future cash flows, it may be technically difficult and somewhat arbitrary to relate data on past loss experience only to assets for which an event had been identified after initial recognition. Requiring an event to occur after initial recognition before computing expected future cash flows of a group of loans in effect makes a change in the loss probability a precondition for loss recognition although a loss in cash flow terms normally would have been expected on a portfolio basis on initial recognition.

C84. On the other hand, proponents of Approach B reject Approach A because including assets in a collective evaluation on initial recognition would result in an immediate loss being recognised if expected future cash flows are discounted using an original contractual effective interest rate (rather than an interest rate that is adjusted for the expected loss rate). The recognition of an immediate impairment loss appears problematic from a conceptual perspective. According to the Framework, losses and other expenses represent decreases in economic benefits during the accounting period. The origination of a loan or the acquisition of a loan or other financial asset generally cannot be expected to represent a decrease in economic benefits if the transaction is on arm's length terms between knowledgeable, willing parties. An economically rational lender cannot be expected to grant a loan with an expectation of making a loss on initial recognition on fair value terms.

C85. The Board decided that all assets (other than those that have been individually identified as impaired) should be included in a portfolio assessment, including assets only recently originated or acquired. To ensure that an impairment loss is not recognised immediately on initial recognition, the discount rate used in discounting estimated expected cash flows should be adjusted for losses expected on initial recognition to result in a net present value of zero on initial recognition.

Grouping of assets that are collectively evaluated for impairment

C86. How should those assets that are collectively assessed for impairment be grouped for purposes of assessing impairment on a portfolio basis? In practice, different methods are conceivable for grouping assets for the purposes of assessing impairment and computing historical and expected loss rates. For example, assets may be grouped on the basis of one or more of the following characteristics: (a) estimated default probabilities or credit risk grades; (b) type (for example, mortgage loans, credit card loans); (c) geographical location; (d) collateral type; (e) counterparty type (for example, consumer, commercial, sovereign); (f) past-due status; and (g) maturity. More sophisticated credit risk models or methodologies for estimating expected future cash flows may combine several factors, for example, a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status, and other relevant characteristics of the assets being evaluated and associated loss data.

C87. The Board decided that for the purposes of assessing impairment on a portfolio basis, the method employed for grouping assets should, as a minimum, ensure that individual assets are allocated to groups of assets that share similar credit risk characteristics. Those characteristics should be relevant to the estimation of expected future cash flows for groups of such assets by being indicative of the debtor's ability to pay all amounts due according to the contractual terms of the assets being evaluated. When using historical loss rates in estimating expected future cash flows, it is important that information about historical loss rates is applied to groups that are defined in a manner consistent with the groups to which the historical loss rates applied. Therefore, the method employed should enable the association of each group with information about past loss experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions.

Estimates of expected future cash flows in groups

C88. To promote consistency in the estimation of impairment on assets that are collectively evaluated for impairment, the Board proposes that guidance should be provided about the process for estimating expected future cash flows in groups of financial assets that are collectively assessed for

impairment. It identified the following elements as critical to an adequate process:

- Contractual cash flows and historical loss experience should provide the basis for estimating expected future cash flows in a group of financial assets that are collectively assessed for impairment.

- Entities that have no loss experience of their own or insufficient experience should use peer group experience for comparable groups of financial assets.

- Historical loss experience should be adjusted, based on observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

- Changes in estimates of expected future cash flows should be expected to be directionally consistent with changes in underlying observable data.

- Estimation methods should be adjusted to reduce differences between estimates of expected future cash flows and actual cash flows.

Discount rate for groups

C89. The measurement of impairment in a group of financial assets builds on the same concepts as the measurement of impairment in an individual financial asset. Once expected future cash flows have been computed, those cash flows are discounted using an original effective interest rate to determine the amount of impairment in the group.

C90. Which discount rate should be used in discounting expected future cash flows in a group of financial assets that are collectively assessed for impairment? It would appear obvious that it is necessary to use a weighted average interest rate. However, it is less clear whether the original contractual effective interest rate should be adjusted for the expected loss rate on initial recognition. Two alternatives are: (a) a weighted average original contractual effective interest rate, ie a rate computed on the basis of the contractual terms of the assets in the group that does not consider expected losses; and (b) a weighted average original expected effective interest rate, ie a rate adjusted for the expected loss rate.

C91. Discounting expected cash flows using a contractual rate results in an overstatement of impairment, as illustrated in the example below. If expected cash flows in a group of loans are discounted using a contractual interest rate, a lender could be expected to recognise an impairment loss immediately on initial recognition because one component of the contractual interest rate is the lender's compensation for the expected losses in the group. However, a lender generally cannot be expected to make a loan if it does not obtain compensation for expected losses through the contractual interest rate.

> Assume a bank lends 1,000 for one year to 100 customers at 12 per cent interest rate payable in one year so that the total amount lent is 100,000 (1,000 x 100). Accordingly, the contractual principal and interest cash flows in one year are 112,000 [1,000 x 100 x 1.12]. Discounting contractual cash flows using the contractual rate results in a present value of 100,000, which is equal to the amount lent.
>
> Based on historical loss experience for assets similar to those in the group, the bank expects losses of 1.78 per cent of contractual principal and interest cash flows yearly in the group. Accordingly, the expected principal and interest cash flows in one year are 110,000 [{112,000 x (1.00 – 0.0178)} = 110,000]. The expected loss rate (default premium) is 2 per cent [(112,000 – 110,000) / 100,000]
>
> Discounting the expected future cash flows of 110,000 using the original contractual interest rate of 12 per cent would result in an immediate impairment loss being recognised that is equal to 1,786 [{(110,000 / 1.12) – 100,000} = (98,214 – 100,000)]. Recognising an immediate impairment loss overstates the amount of impairment, because the bank compensates itself for the expected losses in the contractual interest rate.
>
> To avoid an overstatement of impairment losses, expected cash flows should be discounted using the effective expected interest rate of 10 per cent, ie the contractual interest rate of 12 per cent less the original expected loss rate of 2 per cent. In this case, no impairment loss is recognised on initial recognition because the present value of expected future cash flows equals the amount lent (110,000 / 1.10 = 100,000).

C92. To avoid an overstatement of impairment losses, the Board decided that estimated expected future cash flows should be discounted using a rate that takes into account an adjustment for the initial expected loss rate. Any methodology for recognising impairment losses that would result in an immediate impairment loss being recognised on initial recognition is contrary to fundamental accounting concepts.

Impairment of Investments in Available-For-Sale Financial Assets (paragraphs 117-119)

C93. Given the difficulties in determining objectively when impairment losses on debt and equity instruments classified as available for sale have been recovered and related measurement and income recognition issues, the Board proposes that such losses should not be reversed through the income statement if conditions change after the recognition of an impairment loss. Accordingly, any increase in the fair value of an available-for-sale financial asset would be recognised directly in equity even though the entity had previously recognised an impairment loss on that asset. This is consistent with the recognition of changes in the fair value of available-for-sale financial assets directly in equity (see paragraph 103(b)).

Hedges of Firm Commitments (paragraphs 137 and 140)

C94. IAS 39 (before amendment) requires a hedge of a firm commitment to be accounted for as a cash flow hedge. As a result, hedging gains and losses (to the extent that the hedge is effective) are initially recognised in equity and are subsequently 'recycled' to profit or loss in the same period(s) that the hedged firm commitment affects profit or loss.

C95. IAS 39 notes that, in concept, a hedge of a firm commitment is a fair value hedge. This is because the fair value of the item being hedged (the firm commitment) changes with changes in the hedged risk. However, IAS 39 requires that such a hedge should be accounted for as a cash flow hedge to avoid partial recognition of a firm commitment that would otherwise not be recognised.

C96. Some believe that it is conceptually incorrect to recognise the hedged fair value exposure of a firm commitment as an asset or liability merely because it has been hedged.

C97. It is questionable whether this argument is valid. For all fair value hedges, applying hedge accounting has the effect that amounts are recognised as assets or liabilities that would otherwise not be recognised. For example, assume an entity hedges a fixed rate loan asset with a pay-fixed, receive-variable interest rate swap. If there is a loss on the swap, applying fair value hedge accounting requires that the offsetting gain on

the loan is recognised, ie that the carrying amount of the loan is increased. Thus, applying hedge accounting has the effect of recognising a part of an asset (the increase in the loan's value attributable to interest rate movements) that would otherwise not have been recognised. The only difference in the case of a firm commitment is that, without hedge accounting, none of the commitment is recognised, ie the carrying amount is zero. However, this difference merely reflects that the historical cost of a firm commitment is usually zero. It is not a fundamental difference in concept.

C98. The treatment of hedges of firm commitments is a difference between IAS 39 and FASB Statement 133. It causes practical problems for entities that report under both standards. Hence, its elimination would both promote convergence (no other standard-setter has a similar standard on hedge accounting) and generally ease implementation for those entities that apply both IAS 39 and Statement 133.

C99. The Board proposes that, for both conceptual and practical reasons, IAS 39 should be changed so that a hedge of a firm commitment is classified as a fair value hedge.

Basis Adjustments (paragraph 160)

C100. The question of basis adjustment arises when an entity hedges the future purchase of an asset or the issue of a liability. One example is that of a US company that expects to make a future purchase of a German machine that it will pay for in euro. The company enters into a derivative to hedge against possible future changes in the US dollar/euro exchange rate. Such a hedge is classified as a cash flow hedge under IAS 39, with the effect that gains and losses on the hedging instrument (to the extent that the hedge is effective) are initially recognised in equity. The question is what the accounting should be once the future transaction takes place. The choices are:

(a) To remove the hedging gain or loss from equity and recognise it as part of the initial carrying amount of the asset or liability (in the example above, the machine). In future periods, the hedging gain or loss is automatically recognised in profit or loss by being included in amounts such as depreciation expense (for a fixed asset), interest income or expense (for a financial asset or liability), or cost of sales (for inventories). This treatment, commonly referred to as 'basis adjustment', is the one required at present by IAS 39, paragraph 160.

(b) To leave the hedging gain or loss in equity. In future periods, the gain or loss on the hedging instrument is 'recycled' to profit or loss in the same period(s) as the acquired asset or liability affects profit or loss. This recycling requires a separate adjustment and is not automatic.

C101.It should be noted that both approaches have the same effect on profit or loss for all periods affected, as long as the hedge is accounted for as cash flow hedge. The difference relates to balance sheet presentation and, possibly, the line item in the income statement.

C102.Some believe that it would unnecessarily complicate the accounting to leave the hedging gain or loss in equity when the hedged forecast transaction occurs and would prefer a basis adjustment approach. Also, they note that treating hedges of firm commitments as fair value hedges has the same effect as a basis adjustment when the firm commitment relates to an asset or liability. For example, for a perfectly effective hedge of the foreign currency risk of a firm commitment to buy a machine, the effect is to recognise the machine initially at its foreign currency price translated at the forward rate in effect at the inception of the hedge rather than the spot rate. Therefore, they question whether it is consistent to treat a hedge of a firm commitment as a fair value hedge while precluding basis adjustments for hedges of forecast transactions.

C103.Others believe that a basis adjustment is difficult to justify in principle for forecast transactions. Whilst the Board has not considered the wider issue of what costs may be capitalised at initial recognition, hedging gains and losses that are not necessary to incur and result from hedges of forecast transactions are among the more doubtful candidates for capitalisation. In addition, a basis adjustment in the case of a forecast transaction impairs comparability. Two identical assets that are purchased at the same time and in the same way except for the fact that the acquisition of one was hedged and the acquisition of the other was not are recognised at different amounts. Moreover, eliminating the basis adjustment approach would bring IAS 39 into line with FASB Statement 133. On balance, therefore, the Board proposes that the 'basis

adjustment' approach for forecast transactions in IAS 39 should be eliminated and replaced by approach (b) above.

Disclosure

C104.The disclosure requirements in IAS 39, paragraphs 166-170, have been moved to IAS 32 and, where appropriate, amended to reflect the proposed revisions to IAS 32 and IAS 39. The purpose of moving to IAS 32 the disclosure requirements provided in IAS 39 is to present all disclosure requirements in one Standard.

Elimination of Certain Differences from US GAAP

C105.As part of this project, the Board has considered opportunities to eliminate differences between IAS 39 and US GAAP that may lead to differences in accounting. The guidance on measurement and hedge accounting under IAS 39 is generally similar to that under US GAAP. The Board expects that the proposed amendments will reduce further or eliminate differences between IAS 39 and US GAAP in the areas listed below. In some other areas, a difference will remain. For example, US GAAP in many, but not all, areas is more detailed, which may result in a difference in accounting when an entity applies an accounting approach under IAS 39 that would not be permitted under US GAAP.

- **Unrealised gains and losses on available-for-sale securities**

  The proposal is to eliminate the option to recognise gains and losses on available-for-sale investments in profit or loss (IAS 39, paragraph 103), and thus require such gains and losses to be recognised in equity. The proposed change is consistent with FASB Statement 115, which does not provide the option in IAS 39 to recognise gains and losses on available-for-sale financial assets in profit or loss. Statement 115 requires that those unrealised gains and losses be recognised in other comprehensive income (not profit or loss).

- **Hedges of firm commitments**

  The proposal is to treat hedges of firm commitments as fair value hedges instead of cash flow hedges as is required at present by IAS 39, paragraph 137. The proposal is consistent with FASB Statement 133, which requires hedges of firm commitments to be treated as fair value hedges.

- **Basis adjustments to assets or liabilities resulting from hedges of forecast transactions**

  The proposal is to replace the approach in IAS 39, paragraph 160, to adjust the basis of assets or liabilities resulting from hedges of forecast transactions by the amount of gains or losses recognised directly in equity. The proposed change is consistent with US GAAP because FASB Statement 133 does not permit such basis adjustments.

- **Designation as held for trading**

  The proposal is to permit entities to classify financial assets as held for trading by designation. This enables entities to achieve accounting similar to US GAAP for financial assets within the scope of FASB Statement 115 because that Statement does not preclude trading designation simply because an intention to trade does not exist.

- **Reversal of impairment losses on investments in equity securities**

  The proposal is to eliminate reversal of impairment losses on investments in equity securities (required by IAS 39, paragraph 119 under certain conditions). Under US GAAP such reversals are not permitted.

- **Fair value in active markets**

  The proposal is to amend the wording in IAS 39, paragraph 99, to state that, instead of a quoted price normally being the best evidence of fair value, a quoted market price is the best evidence of fair value.

This is similar to FASB Statement 107, Disclosures about Fair Value of Financial Instruments.

- **Scope: loan commitments**

  The proposal is to add a paragraph to IAS 39 to exclude particular loan commitments that are not settled net (IAS 39, paragraph 1(i)). At present, such loan commitments are within the scope of IAS 39. The proposed amendment is expected to move IAS 39 closer to US GAAP.

- **Impaired fixed rate loans: observable market price**

  The proposal is to permit an impaired fixed interest rate loan to be measured using an observable market price (IAS 39, paragraph 113). FASB Statement 114 allows impairment to be measured on the basis of a loan's observable market price.

Appendix D

Alternative Views (Revisions 200X)

D1. Two Board members support the need to modify the derecognition requirements of IAS 39 and agree that the Standard is internally inconsistent in that it combines the requirements of a control approach with those of a risks and rewards approach. However, they object to the continuing involvement alternative proposed in this Exposure Draft as it also combines a control approach with a risks and rewards approach, in that any continuing involvement in a transferred asset precludes derecognition to the extent of the involvement. For example, a retained call at fair value precludes derecognition because of the retention of control; a retained subordinated interest precludes derecognition because of the retention of residual risks and rewards.

D2. The two Board members believe that the proposed approach is not supported by the Framework for the Preparation and Presentation of Financial Statements. First, it results in recognising assets and liabilities that do not meet the definitions of those elements in the Framework. In addition, the application of the approach does not faithfully measure the contractual rights and obligations that are the result of the continuing involvement.

D3. The two Board members believe a components approach would create a model superior to accounting for the transfer as if it were a borrowing because it is a 'failed sale' due to some continuing involvement. They would record forward contracts, put or call options and guarantees that are actually created in the 'failed sales' circumstances rather than recognise what they regard as a fictitious borrowing.

D4. There are other consequences to the continuing involvement approach. For transferors, it results in very different accounting by two entities when they have identical contractual rights and obligations only because one entity once owned the transferred financial asset. Furthermore, the 'borrowing' that is recognised is not accounted for like other loans so no interest expense may be recorded. Indeed, implementing the proposed approach requires the specific override of measurement and presentation standards applicable to other similar financial instruments that do not arise from derecognition transactions. For transferees, the approach also requires the override of the recognition and measurement requirements applicable to other similar financial instruments. If two instruments are acquired in a transfer transaction with the same counterparty, the transferee recognises and measures them differently from the requirements that apply to instruments acquired separately.

D5. The two Board members believe that this consideration of the combined effects of separate contracts is inconsistent with the other requirements of this Standard, and the requirements of other Standards. In their view, the proposed approach is replacing one set of conceptual inconsistencies with another and may have significant unanticipated consequences.

D6. One of these Board members also objects to including an asset that has been judged not to be impaired in a portfolio of similar assets for an additional portfolio assessment of impairment. That Board member believes the arguments set forth in paragraph C73 to be compelling. Once an asset is judged not to be impaired, it is irrelevant whether the entity owns one or more similar assets, as those assets have no implications for whether the asset that was separately considered for impairment is or is not impaired.

Consequential Amendments

Amendments to IAS 18, Revenue

Example 5 of the Appendix to IAS 18, Revenue, is amended as follows:

5. *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods.*

   For a transfer of an asset other than a financial asset, ~~T~~the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a transfer of a financial asset, IAS 39, Financial Instruments: Recognition and Measurement, applies.

Example 14 of Appendix to IAS 18, Revenue, is amended as follows:

14. *Financial service fees.*

    The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees ~~which~~ that are an integral part of the effective yield of a financial instrument, fees ~~which~~ that are earned as services are provided, and fees ~~which~~ that are earned on the execution of a significant act.

(a) Fees ~~which~~ that are an integral part of the effective yield of a financial instrument.

Such fees are generally treated as an adjustment to the effective yield. However, when the financial instrument is to be measured at fair value with the change in fair value recognised in profit or loss after ~~subsequent to its~~ initial recognition the fees are recognised as revenue when the instrument is initially recognised.

(i) Origination fees received by the enterprise relating to the creation or acquisition of a financial instrument other than one that under IAS 39 is designated as held for trading. ~~which is held by the enterprise as an investment.~~

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an ~~ongoing~~ involvement with the resulting ~~ant~~ financial instrument and, together with the related direct costs, are deferred and recognised as an adjustment to the effective yield.

(ii) Commitment fees received by the enterprise to originate ~~or purchase~~ a loan where the loan commitment (a) cannot be settled net in cash or by some other financial instrument and (b) is not designated as held for trading under IAS 39.

If it is probable that the enterprise will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related direct costs, is deferred and recognised as an adjustment to the effective yield. If the commitment expires without the enterprise making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

(b) Fees earned as services are provided.

~~*(i) Fees charged for servicing a loan.*~~

~~Fees charged by an enterprise for servicing a loan are recognised as revenue as the services are provided. If the enterprise sells a loan but retains the servicing of that loan at a fee which is lower than a normal fee for such services, part of the sales price of the loan is deferred and recognised as revenue as the servicing is provided.~~

~~(ii)~~ Commitment fees to originate ~~or purchase~~ a loan where the loan commitment (a) cannot be settled net in cash or by some other financial instrument and (b) is not designated as held for trading under IAS 39.

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is not within the scope of IAS 39, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

~~(iii)~~ Fees that are earned on the execution of a significant act ~~Loan syndication fees~~.

Loan syndication fees.

~~It is necessary to distinguish between fees earned on completion of a significant act and fees related to future performance or risk retained.~~ A syndication fee received by an enterprise ~~which~~ that arranges a loan and ~~which~~ retains no part of the loan package for itself (or retains a part at the same effective yield for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognised as revenue when the syndication has been completed. ~~However, when a syndicator retains a portion of the loan package at an effective yield for comparable risk which is lower than that earned by other participants in the syndicate, part of the syndication fee~~

~~received relates to the risk retained. The relevant portion of the fee is deferred and recognised as revenue as an adjustment to the effective yield of the investment, as in *14(a)* above. Conversely, when a syndicator retains a portion of the loan package at an effective yield for comparable risk which is higher than that earned by other participants in the syndicate, part of the effective yield relates to the syndication fee. The relevant portion of the effective yield is recognised as part of the syndication fee when the syndication has been completed.~~

Withdrawal of SIC Interpretations

The following SIC Interpretations are withdrawn as these issues are addressed in the proposed amendments to IAS 32, Financial Instruments: Disclosure and Presentation:

- SIC-5, Classification of Financial Instruments – Contingent Settlement Provisions;
- SIC-16, Share Capital – Reacquired Own Equity Instruments (Treasury Shares);
- SIC-17, Equity – Costs of an Equity Transaction.

The following draft SIC Interpretation is withdrawn as this issue is addressed in the proposed amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement:

- SIC-D34, Financial Instruments – Instruments or Rights Redeemable by the Holder.

Impact on Existing IAS 39 Implementation Guidance

This Appendix has not been formally considered by the Board and does not necessarily represent the views of the Board. It is provided for information.

At its meeting in March 2000, the IASC Board approved an approach to publish implementation guidance on IAS 39 in the form of Questions and Answers (Q&A). At that meeting, it appointed an IAS 39 Implementation Guidance Committee (IGC) to review and approve the draft Q&A and to seek public comment before approval of the final Q&A. In April 2001, the IASB agreed to continue that approach. By November 2001, more than 200 Q&A had been issued. While the Q&A have not been formally considered by the Board and do not necessarily represent the views of the Board, entities should consider the guidance as they select and apply accounting policies.

The following table sets out the IASB staff's assessment of the impact of the proposed amendments to IAS 32 and IAS 39 on each of the Q&A on IAS 39 that have been approved for issue by the IGC. It also indicates whether the main elements of each Q&A have been incorporated into the proposed amendments to IAS 39. The status of individual Q&A will be reassessed when the amendments are finalised.

Questions and Answers (Q&A)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Scope			
Scope: financial guarantee contracts (credit rating)	1-1	No	Yes (1(f))
Scope: credit derivatives	1-2	No	Yes (1(f))
Scope: financial reinsurance	1-3-a	No	Yes (1(d))
Scope: insurance contracts	1-3-b	No	Yes (1(d))
Scope: investments in associates	1-4	No	Yes (1(a))
Scope: financial guarantee contracts	1-5-a	No	Yes (1(f))
Scope: issued financial guarantee contract	1-5-b	No	Yes (1(f))
Scope: contracts with more than one underlying	1-6	No	Yes (1(h))
Definitions			
Definition of a financial instrument: gold bullion	8-1	No	Addressed in IAS 32
Definition of a derivative: examples of derivatives and underlyings	10-1	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Definition of a derivative: settlement at a future date, interest rate swap with net or gross settlement	10-2	No	Yes (14)
Definition of a derivative: gross exchange of currencies	10-3	No	Yes (15)
Definition of a derivative: prepaid interest rate swap (fixed rate payment obligation prepaid at inception or subsequently)	10-4-a	No	No
Definition of a derivative: prepaid pay-variable, receive-fixed interest rate swap	10-4-b	No	No
Definition of a derivative: contract to purchase fixed rate debt	10-5	No	Yes (14)
Definition of a derivative: settlement amount does not vary proportionately	10-6	No	Yes (15)

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Definition of originated loans and receivables: banks' deposits in other banks	10-7	No	Yes (20)
Definition of a derivative: offsetting loans	10-8	No	No
Definition of trading activities: balancing a portfolio	10-9	No	No
Definition of a derivative: initial net investment	10-10	Yes (15)	Not applicable
Definition of originated loans and receivables	10-11-a	In part	Yes (10, 20)
Definition of originated loans and receivables: equity security	10-11-b	No	Yes (10)
Definition of amortised cost: debt instruments with stepped interest payments	10-12	No	Yes (App. B)
Definition of amortised cost: perpetual debt instruments with fixed or market-based variable rate	10-13	No	No

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Definition of amortised cost: perpetual debt instruments with decreasing interest rate	10-14	No	No
Definition of held for trading: purpose of acquisition	10-15	Yes (10)	Not applicable
Definition of held-to-maturity investment: high default risk	10-16	No	Yes (80)
Definition of held-to-maturity investment: fixed maturity	10-17	No	Yes (80)
Definition of a derivative: option not expected to be exercised	10-18	No	No
Effective interest method: expected future cash flows	10-19	No	Yes (10)
Loans and receivables originated by the enterprise: sovereign debt	10-20	No	No
Definition of held for trading: portfolio with a recent actual pattern of short-term profit taking	10-21	Yes (10)	Not applicable

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Liability vs. equity classification	11-1	Yes	No (see IAS 32)
Definition of a derivative: royalty agreements	13-1	No	Yes (3)
Definition of a derivative: foreign currency contract based on sales volume	13-2	No	No
Practice of settling net: forward contract to purchase a commodity	14-1	No	No
Forward contract to purchase a commodity: pattern of net settlement	14-2	No	Yes (7)
Option to put a non-financial asset	14-3	No	No
Definition of a derivative: prepaid forward	15-1	No	No
Definition of a derivative: initial net investment	15-2	No	No
"Regular way" contracts: no established market	16-1	No	No
"Regular way" contracts: forward contract	16-2	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
"Regular way" contracts: which customary settlement provisions apply?	16-3	No	No
"Regular way" contracts: share purchase by call option	16-4	No	No
Liabilities held for trading: short sales	18-1	No	Yes (18)
Liability held for trading: short sales of loan assets	18-2	No	Yes (18)
Embedded derivatives: separation of host debt instrument	22-1	No	Yes (App. A)
Embedded derivatives: separation of embedded option	22-2	No	Yes (App. A)
Embedded derivatives: presentation	23-1	No	Yes (22)
Embedded derivatives: accounting for convertible bond	23-2	No	No
Embedded derivatives: allocation of carrying amounts	23-3	No	Yes (App. A)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Separation of embedded derivatives	23-4	No	Yes (23)
Commodity-indexed interest	23-5	No	Yes (App. A)
Embedded derivatives: transferable derivative that is attached to a non-derivative financial instrument	23-6	No	Yes (22)
Embedded derivatives: derivative attached to a financial instrument by a third party	23-7	No	Yes (22)
Embedded derivatives: more than one embedded derivative	23-8	No	Yes (App. A)
Embedded derivatives: equity kicker	23-9	No	No
Embedded derivatives: no reliable measurement	23-10	No	Yes (26A)
Embedded derivatives: issued puttable convertible debt	23-11	No	Yes (App. A)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Embedded derivatives: debt or equity host contract	23-12	No	Yes (App. A)
Embedded derivatives: synthetic instruments	25-1	No	No
Embedded derivatives: purchases and sales contracts in foreign currency	25-2	Yes (App. A)	Not applicable
Embedded derivatives: dual currency bond	25-3	No	Yes (App. A)
Embedded foreign currency derivative: unrelated foreign currency provision	25-4	No	No
Embedded foreign currency derivative: currency of international commerce	25-5	No	Yes (App. A)
Foreign currency derivative: currency of primary economic environment	25-6	No	Yes (App. A)

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Embedded derivatives: holder permitted, but not required, to settle without recovering substantially all of its recorded investment	25-7	No	Yes (App. A)
Embedded derivatives: purchase price subject to a cap and a floor	25-8	No	Yes (App. A)
Embedded derivatives: hard currency supply contracts	25-9	Yes	Not applicable
Recognition			
Recognition and derecognition of financial liabilities using trade date or settlement date accounting	27-1	No	No
Recognition: cash collateral	27-2	No	No
Trade date vs. settlement date "Regular way" transactions: loan commitments	30-1	Yes (1(i))	Not applicable
Trade date vs. settlement date: net settlement	30-2	No	Yes (App. A)

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Trade date vs. settlement date: amounts to be recorded for a sale	34-1	Partially	Yes (App. B)
Derecognition of a portion of a loan with disproportionate risk sharing	35-1	No	Yes (40 and App. A)
Factors affecting derecognition of a portion of a loan	35-2	Partially	Yes (35-57)
Factors affecting derecognition of financial assets transferred to a special purpose entity	35-3	No	Yes (35-57)
Interaction between recognition and derecognition requirements	35-4	No	Yes (57)
Derecognition: "wash sale" transaction	35-5	No	Yes (App. A)
Derivatives that serve as impediments to the derecognition of a financial asset	36-1	No	Yes (55)
Derecognition: full recourse	37-1	Yes	Not applicable
Derecognition: right of first refusal	38-1	No	Yes (App. A)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Derecognition: put option	38-2	No	Yes (App. A)
Derecognition: repo or securities lending transaction and right of substitution	38-3	No	Yes (App. A)
Derecognition: deep–in-the money put option held by transferee	38-4	Partially	Not applicable
Derecognition: "clean-up call"	38-5	Yes	Not applicable
Derecognition: call option on beneficial interest in SPE	41-1	No	Yes (35-57)
Estimating fair values when a portion of financial assets is sold – bonds	47-1	No	Yes (50-51)
Estimating fair values when a portion of financial assets is sold – loans	47-2	No	Yes (50-51)
Derecognition of part of a financial asset: interest-only strips and servicing assets	50-1	No	Yes (49)
Derecognition of financial liabilities: third party receives a fee to assume the obligation	57-1	No	Yes (62)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Derecognition of financial liabilities: buy-back of bond obligation with intention to resell	57-2	No	Yes (60)
Derecognition of a financial liability: joint responsibility for debt	57-3	No	Yes (62)
Extinguishment of debt: substantially different terms	62-1	No	No
Measurement			
Initial measurement: transaction costs	66-1	No	No
Transaction costs	66-2	No	Yes (66)
Initial measurement: interest-free loan	66-3	No	Yes (67)
Reliability of fair value measurement	70-1	No	Yes (69)
Fair value measurement for an unquoted equity instrument	70-2	No	Yes (69)
Reliable determination of fair value: embedded derivatives	70-3	No	No
Example of calculating amortised cost: financial asset	73-1	No	Yes (App. A)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Amortised cost: variable rate debt instrument	76-1	No	No
Hedge accounting: non-derivative monetary asset or non-derivative monetary liability used as a hedging instrument	78-1	No	No
Held-to-maturity financial assets: index-linked principal	80-1	No	No
Held-to-maturity financial assets: index-linked interest	80-2	No	No
Held-to-maturity financial assets: permitted sales	83-1	No	Yes (83)
Held-to-maturity financial assets: change of intent or ability – permitted sales	83-2	No	Yes (83)
Held-to-maturity financial assets: insignificant exercises of put options and insignificant transfers	83-3	No	Yes (83)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Held-to-maturity financial assets: ‘‘tainting’’	83-4	No	Yes (86)
Held-to-maturity investments: sub-categorisation for the purposes of applying the ‘tainting’ rule	83-5	No	No
Held-to-maturity investments: application of the ‘tainting’ rule on consolidation	83-6	No	No
Held-to-maturity financial assets: sale following rating downgrade	83-7	No	Yes (86)
Held-to-maturity investments: internal downgrade	83-8	No	Yes (86)
Held-to-maturity financial assets: permitted sales	86-1	No	No
Sales of held-to-maturity investments: entity-specific capital requirements	86-2	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Held-to-maturity financial assets: pledged collateral, repurchase agreements (repos) and securities lending agreements	87-1	No	No
Amortising discount and premium on liabilities	93-1	No	Yes (89A)
Fair value measurement considerations for investment funds	99-1	No	No
Fair value measurement: large holding	100-1	In part (99)	No
Amortisation of premium or discount: classification	103-1	No	Yes (103)
Available-for-sale financial assets: exchange of shares	103-2	No	No
Settlement date accounting: fair value changes on sale of financial asset	106-1	No	Yes (App. B)
Settlement date accounting: exchange of non-cash financial assets	106-2	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Reclassification from available-for-sale to trading	107-1	Yes (89B)	Not applicable
Reclassification to trading: decision to sell	107-2	Yes (89B)	Not applicable
Objective evidence of impairment	109-1	No	No
Impairment: future losses	110-1	No	Yes (113D)
Assessment of impairment: principal and interest	111-1	No	Yes (113)
Assessment of impairment: fair value hedge	111-2	No	No
Impairment: provisioning matrix	111-3	No	No
Impairment: excess losses	111-4	No	No
Recognition of impairment on a portfolio basis	112-1	No	No
Impairment: portfolio assessment for individually impaired asset	112-2	No	Yes (112)
Impairment: consideration of the value of collateral	113-1	No	Yes (113)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Impairment: recognition of collateral	113-2	No	No
Impairment: observable market price	113-3	Yes (113)	Not applicable
Impairment: assets carried at cost because fair value cannot be reliably measured	115-1	Yes (116)	Not applicable
Impairment of available-for-sale financial assets	117-1	No	Yes (110, 110A)
Impairment of non-monetary available-for-sale financial asset	117-2	No	No
Impairment: whether the available-for-sale reserve in equity can be negative	117-3	No	Yes (110, 110A)
Impairment: debt instrument remeasured to fair value	118-1	No	No
Hedge accounting: management of interest rate risk in financial institutions	121-1	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Hedge accounting considerations when interest rate risk is managed on a net basis	121-2	No	No
Hedging instrument: hedging using more than one derivative	122-1	No	Yes (126F)
Hedging the fair value exposure of a bond denominated in a foreign currency	122-2	No	No
Hedging with a non-derivative financial asset or liability	122-3	No	No
Hedge accounting: use of written options in combined hedging instruments	124-1	No	Yes (126F)
Hedge accounting: netting of assets and liabilities	127-1	No	No
Held-to-maturity investments: hedging variable rate interest rate payments	127-2	No	No
Hedged items: purchase of held-to-maturity investment	127-3	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Cash flow hedges: reinvestment of funds obtained from held-to-maturity investments	127-4	No	No
Whether a derivative can be designated as a hedged item	127-5	No	No
Hedge of prepayment risk of a held-to-maturity investment	127-6	No	Yes (127)
Hedge accounting: prepayable financial asset	128-1	No	No
Partial term hedging	128-2	No	No
Hedge accounting: risk components	128-3	No	Yes (128)
Hedged items: hedge of foreign currency risk of publicly traded shares	128-4	No	No
Hedges of more than one type of risk	131-1	No	No
Hedging instrument: cross-currency interest rate swap	131-2	No	No
Hedging instrument: dual foreign currency forward exchange contract	131-3	No	No
Hedge accounting: stock index	132-1	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Internal hedges	134-1	No	No
Offsetting internal derivative contracts used to manage interest rate risk	134-1-a	No	No
Offsetting internal derivative contracts used to manage foreign currency risk	134-1-b	No	No
Intragroup and intra–company hedging transactions	134-2	No	No
Internal contracts: single offsetting external derivative	134-3	No	No
Internal contracts: external derivative contracts that are settled net	134-4	No	No
Fair value hedge: risk that could affect reported income	137-1	No	No
Cash flow hedge: anticipated fixed rate debt issuance	137-2	No	No
Hedge accounting: unrecognised assets	137-3	No	No
Hedge accounting: hedging of future foreign currency revenue streams	137-4	No	No

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Cash flow hedges: ''all in one'' hedge	137-5	No	No
Hedge relationships: enterprise-wide risk	137-6	No	No
Cash flow hedge: fixed interest rate cash flows	137-7	No	No
Cash flow hedge: reinvestment of fixed interest rate cash flows	137-8	No	No
Foreign currency hedge	137-9	No	No
Foreign currency cash flow hedge	137-10	No	No
Fair value hedge: variable rate debt instrument	137-11	No	No
Fair value hedge: inventory	137-12	No	No
Intra-group monetary item that will affect consolidated net income	137-13	No	No
Forecasted intra-group foreign currency transactions that will affect consolidated net income	137-14	No	No

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Concurrent offsetting swaps and use of one as hedging instrument	137-15	No	No
Cash flow hedge: forecasted transaction related to an enterprise's equity	137-16	No	No
Hedge accounting: forecasted transaction	142-1	No	No
Hedging on an after-tax basis	142-2	No	No
Hedge effectiveness: assessment on cumulative basis	142-3	No	No
Retroactive designation of hedges	142-4	No	No
Hedge accounting: identification of hedged forecasted transaction	142-5	No	No
Hedge effectiveness: counterparty credit risk	142-6	No	No
Hedge accounting: designation at the inception of the hedge	142-7	No	No

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Cash flow hedge: documentation of timing of forecasted transaction	142-8	No	No
Combination of written and purchased options	144-1	No	No
Delta-neutral hedging strategy	144-2	No	No
Hedging instrument: out-of-the money put option	144-3	No	No
Hedging instrument: proportion of the cash flows of a cash instrument	145-1	No	No
Hedge effectiveness: effectiveness tests	146-1	No	No
Hedge effectiveness: less than 100 per cent offset	146-2	No	No
Hedge effectiveness: "underhedging"	146-3	No	No
Assuming perfect hedge effectiveness	147-1	No	No
Hedge accounting: risk of a transaction not occurring	149-1	No	No
Fair value hedge: measurement of a non-derivative hedging instrument	153-1	No	Yes (153)

	Q&A	*Q&A affected by the proposed amendments? (if yes, which paragraph?)*	*Q&A incorporated into the proposed amendments? (if yes, which paragraph?)*
Fair value hedge: amortisation of the adjustment to the carrying amount of a hedged interest bearing financial instrument	157-1	No	Yes (157)
Cash flow hedges: performance of hedging instrument	158-1	No	Yes (App. B)
Cash flow hedges: performance of hedging instrument	158-2	No	Yes (158)
Cash flow hedges: forecasted transaction occurs prior to the specified period	158-3	No	No
Cash flow hedges: measuring effectiveness for a hedge of a forecasted transaction in a debt instrument	158-4	No	No
Cash flow hedges: firm commitment to purchase inventory in a foreign currency	158-5	No	No
Cash flow hedge: forecasted issuance of debt in foreign currency	160-1	Yes (160)	Not applicable

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Cash flow hedges: forecasted transaction that is not highly probable, but is expected to occur	163-1	No	Yes (163)
Hedge accounting: premium or discount on forward exchange contract	164-1	No	No
Disclosure			
Disclosure of changes in fair value	170-1	No	No
Presentation of interest income	170-2	Yes (see IAS 32)	Not applicable
Effective Date and Transition			
Transition rules: available-for-sale financial assets previously carried at cost	172-1	No	No
Transition rules: cash flow hedges	172-2	No	No
Transition rules: previous revaluation under IAS 25	172-3	No	No
Transition rules: prior derecognition	172-4	No	No

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
Transition rules: retrospective application of hedging criteria by first-time adopters	172-5	No	No
Transition rules: fair value hedges	172-6	No	No
Transition rules: held-to-maturity financial assets	172-7	No	No
Transition rules: hedge documentation on first day of initial application	172-8	No	No
Transition rules: internal hedging derivatives	172-9	No	No
Transition: impairment	172-10	No	No
Interaction between IAS 39 and Other IAS			
IAS 7: Hedge accounting: cash flow statements	Other-1	No	No
IAS 21: Hedge of a net investment in a foreign entity: whether IAS 39 applies	Other-2	No	Not applicable (see ED on IAS 21)

	Q&A	***Q&A affected by the proposed amendments? (if yes, which paragraph?)***	***Q&A incorporated into the proposed amendments? (if yes, which paragraph?)***
IAS 21: Exchange differences arising on translation of foreign entities: equity or income?	Other-3	No	No
IAS 21: Fair value hedge of asset measured at cost	Other-4	No	No
Interaction between IAS 39 and IAS 21	Other-5	No	No
Available-for-sale financial assets: separation of currency component	Other-6	No	Yes (103B)
Illustrative example of applying the approach in Question 121-2	Appendix to the IAS 39 Implementation Guidance	No	No
Internal derivatives: examples of applying Question 134-1-b	Appendix to the IAS 39 Implementation Guidance	No	No