

# MEMBERS' HANDBOOK

## Update No. 120

(Issued 25 July 2012)

### **Handbook Improvements only**

<i>Document Reference and Title</i>	<i>Instructions</i>	<i>Explanations</i>
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### **VOLUME II**

Contents of Volume II	Insert the revised pages i - iii. Discard the replaced pages i - iii.	Revised contents pages
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Amendments to the following Standards, Basis for Conclusions and Implementation Guidance were previously set out in the Appendix to the Standards as they were not yet effective. The Institute has taken this opportunity to incorporate the amendments applicable on 1 January 2012 in the relevant affected Standards, Basis for Conclusions and Implementation Guidance, for greater clarity.

### **HONG KONG ACCOUNTING STANDARDS (HKAS)**

HKAS 2 <a href="#">Inventories</a>	Replace the cover page and page 18 with revised cover page and page 18	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 8 <a href="#">Accounting Policies, Changes in Accounting Estimates and Errors</a>	Replace the cover page and page 22 with revised cover page and page 22	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 17 <a href="#">Leases</a>	Replace the cover page and page 25 with revised cover page and page 25	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 18 <a href="#">Revenue</a>	Replace the cover page, pages 2 and 19 with revised cover page, pages 2 and 19	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 19 <a href="#">Employee Benefits</a> (Basis for Conclusions)	Replace the cover page and page 40 with revised cover page and page 40	Amendments due to - HKFRS 9 (issued in 2010)

HKAS 21 <a href="#"><u>The Effects of Changes in Foreign Exchange Rates</u></a>	Replace the cover page, pages 2-3, 15-16 and 19 with revised cover page, pages 2-3, 15-16 and 19	Amendments due to - <i>Improvements to HKFRSs 2010</i> - HKFRS 9 (issued in 2010)
HKAS 24 <i>Related Party Disclosures</i>	Discard the document	Amendments due to - HKAS 24 (Revised)
HKAS 27 (Revised) <a href="#"><u>Consolidated and Separate Financial Statements</u></a>	Replace the cover page, pages 17, 33-34 and 44 with revised cover page, pages 17, 33-34 and 44	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 28 <a href="#"><u>Investments in Associates</u></a>	Replace the cover page, pages 2-4, 17-18, 21-22 and 30 with revised cover page, pages 2-4, 17-18, 21-22 and 30	Amendments due to - <i>Improvements to HKFRSs 2010</i> - HKFRS 9 (issued in 2010)
HKAS 31 <a href="#"><u>Interests in Joint Ventures</u></a>	Replace the cover page, pages 2-3, 14, 17-18 and 23 with revised cover page, pages 2-3, 14, 17-18 and 23	Amendments due to - <i>Improvements to HKFRSs 2010</i> - HKFRS 9 (issued in 2010)
HKAS 32 <a href="#"><u>Financial Instruments: Presentation</u></a>	Replace the Standard, Basis for Conclusions and Illustrative Examples with revised Standard, Basis for Conclusions and Illustrative Examples	Amendments due to - <i>Classification of Rights Issues</i> (Amendment to HKAS 32) - <i>Improvements to HKFRSs 2010</i>
HKAS 36 <a href="#"><u>Impairment of Assets</u></a>	Replace the cover page, pages 2 and 50 with revised cover page, pages 2 and 50	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 39 <a href="#"><u>Financial Instruments: Recognition and Measurement</u></a> (Standard)	Replace the cover page, pages 2, 5, 15, 42-44 and 97-110 with revised cover page, pages 2, 5, 15, 42-44, 97-110	Amendments due to - <i>Improvements to HKFRSs 2010</i> - HKFRS 9 (issued in 2010)
HKAS 39 <a href="#"><u>Financial Instruments: Recognition and Measurement</u></a> (Basis for Conclusions)	Replace the cover page and pages 83-84 with revised cover page and pages 83-84	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 39 <a href="#"><u>Financial Instruments: Recognition and Measurement</u></a> (Implementation Guidance)	Replace the cover page and pages 181-190 with revised cover page and pages 181-190	Amendments due to - HKFRS 9 (issued in 2010)

HKAS 40 <a href="#"><u>Investment Property</u></a>	Replace the cover page and page 38 with revised cover page and page 38	Amendments due to - HKFRS 9 (issued in 2010)
HKAS 41 <a href="#"><u>Agriculture</u></a> (Basis for Conclusions)	Replace the cover page and page 20 with revised cover page and page 20	Amendments due to - HKFRS 9 (issued in 2010)

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HKFRS 2 <a href="#"><u>Share-based Payment</u></a> (Basis for Conclusions)	Replace the cover page and page 75 with revised cover page and page 75	Amendments due to - HKFRS 9 (issued in 2010)
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HKFRS 5 <a href="#"><u>Non-current Assets Held for Sale and Discontinued Operations</u></a> (Basis for Conclusions)	Replace the cover page and page 23 with revised cover page and page 23	Amendments due to - HKFRS 9 (issued in 2010)

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HK(IFRIC)-Int 4 <a href="#"><u>Determining whether an Arrangement contains a Lease</u></a>	Replace the cover page and page 19 with revised cover page and page 19	Amendments due to - HKFRS 9 (issued in 2010)
HK(IFRIC)-Int 5 <a href="#"><u>Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds</u></a>	Replace the cover page and page 13 with revised cover page and page 13	Amendments due to - HKFRS 9 (issued in 2010)
HK(IFRIC)-Int 9 <a href="#"><u>Reassessment of Embedded Derivatives</u></a>	Replace the cover page and page 12 with revised cover page and page 12	Amendments due to - HKFRS 9 (issued in 2010)
HK(IFRIC)-Int 10 <a href="#"><u>Interim Financial Reporting and Impairment</u></a>	Replace the cover page, pages 6 and 9 with revised cover page and pages 6 and 9	Amendments due to - HKFRS 9 (issued in 2010)

HK(IFRIC)-Int 12 <a href="#"><u>Service Concession Arrangements</u></a>	Replace the cover page, pages 12, 26 and 41 with revised cover page and pages 12, 26 and 41	Amendments due to - HKFRS 9 (issued in 2010)
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HK(IFRIC)-Int 17 <a href="#"><u>Distributions of Non-cash Assets to Owners</u></a>	Replace the cover page and page 19 with revised cover page and page 19	Amendments due to - HKFRS 9 (issued in 2010)
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#### **IMPROVEMENTS TO HKFRSs**

<i>Improvements to HKFRSs 2010</i>	Discard the document	Amendments have been incorporated into relevant HKFRSs
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HKAS 2  
Revised January 2010 July 2012

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Effective for annual periods beginning  
on or after 1 January 2005

*Hong Kong Accounting Standard 2*

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# Inventories



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## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013~~

Paragraph 2(b) is amended and paragraph 40A added as follows:

~~2~~ This Standard applies to all inventories, except:

...

~~(b) financial instruments (see HKAS 32 *Financial Instruments: Presentation*, and HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 9 *Financial Instruments*); and~~

...

~~40A~~ HKFRS 9, issued in November 2009, amended paragraph 2(b). An entity shall apply that amendment when it applies HKFRS 9.

HKAS 8  
Revised January 2010 July 2012

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Effective for annual periods  
beginning on or after 1 January 2005

*Hong Kong Accounting Standard 8*

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# **Accounting Policies, Changes in Accounting Estimates and Errors**



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**Certified Public Accountants**  
香港會計師公會

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

Paragraph 53 is amended and paragraph 54A is added as follows:

~~53~~ — Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with ~~HKAS 39 *Financial Instruments: Recognition and Measurement*~~, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with ~~HKAS 19 *Employee Benefits*~~, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

~~54A~~ — ~~HKFRS 9 *Financial Instruments*, issued in November 2009, amended paragraph 53. An entity shall apply that amendment when it applies HKFRS 9.~~

*Hong Kong Accounting Standard 17*

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# Leases



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香港會計師公會

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~In the Basis for Conclusions on IAS 17 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC21 is footnoted as follows:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.~~

*Hong Kong Accounting Standard 18*

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# Revenue



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## Appendix B

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In the rubric the reference to ‘paragraphs 1–38’ is amended to ‘paragraphs 1–39’. Paragraph 6(d) and the last sentence of paragraph 11 are amended and paragraph 39 is added as follows:

~~6~~ This Standard does not deal with revenue arising from:

...

~~(d) changes in the fair value of financial assets and financial liabilities or their disposal (see *HKFRS 9 Financial Instruments* and *HKAS 39 Financial Instruments: Recognition and Measurement*);~~

~~11~~ In most cases ... The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with *HKAS 39* and *HKFRS 9*.

~~39~~ *HKFRS 9*, issued in November 2009, amended paragraphs 6(d) and 11. An entity shall apply these amendments when it applies *HKFRS 9*.

In the appendix to IAS 18, examples 5 and 14(a) are amended as follows:

~~5~~ ...

~~For a sale and repurchase agreement on an asset other than a financial asset, 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 sale and repurchase agreement on a financial asset, *IFRS 9 Financial Instruments* and *IAS 39 Financial Instruments: Recognition and Measurement* apply.~~

~~14~~ *Financial service fees*

...

~~(a) Fees that are an integral part of the effective interest rate of a financial instrument.~~

...

~~(i) Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under *IFRS 9* *IAS 39* is measured classified as a financial asset ‘at fair value through profit or loss’.~~

~~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 involvement with the resulting financial instrument and, together with the related transaction costs [footnote omitted] (as defined in *IAS 39*), are deferred and recognised as an adjustment to the effective interest rate.~~

...

*Basis for Conclusions on  
Hong Kong Accounting Standard 19*

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# Employee Benefits



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## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

The Basis for Conclusions on IAS 19 is amended as described below.

In paragraph BC48W the reference to 'available for sale' is footnoted as follows:

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.~~

In paragraph BC75A the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

*Hong Kong Accounting Standard 21*

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# **The Effects of Changes in Foreign Exchange Rates**



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Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) is set out in paragraphs 1-62 and Appendices B and C. All the paragraphs have equal authority. HKAS 21 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for the Preparation and Presentation of Financial Statements* ~~Financial Reporting~~. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

- 55 When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with HKFRSs only if they comply with all the requirements of HKFRSs including the translation method set out in paragraphs 39 and 42.**
- 56 An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 55. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with HKFRSs and the disclosures set out in paragraph 57 are required.
- 57 When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 55 are not met, it shall:**
- (a) **clearly identify the information as supplementary information to distinguish it from the information that complies with HKFRSs;**
  - (b) **disclose the currency in which the supplementary information is displayed; and**
  - (c) **disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

## Effective date and transition

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- 58 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 58A *Net Investment in a Foreign Operation* (Amendment to HKAS 21), issued in January 2006, added paragraph 15A and amended paragraph 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.
- 59 An entity shall apply paragraph 47 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this Standard is first applied. Retrospective application of paragraph 47 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.
- 60 All other changes resulting from the application of this Standard shall be accounted for in accordance with the requirements of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 60a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.
- 60A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 27, 30–33, 37, 39, 41, 45, 48 and 52. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 60B HKAS 27 (as amended in 2008) added paragraphs 48A–48D and amended paragraph 49. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

60C [This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]

60D Paragraph 60B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

## **Withdrawal of other pronouncements**

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61 This Standard supersedes SSAP 11 *Foreign Currency Translation* (revised in 2001).

62 [Not used]

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### **~~HKFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~**

Paragraphs 3(a), 4 and 52(a) are amended and paragraph 60C is added as follows:

~~3~~ **This Standard shall be applied:** [footnote omitted]

~~(a)~~ **in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of HKAS 39 Financial Instruments: Recognition and Measurement and HKFRS 9 Financial Instruments;**

~~...~~

~~4~~ **HKFRS 9 and HKAS 39 apply** applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of HKFRS 9 and HKAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

~~52~~ **An entity shall disclose:**

~~(a)~~ **the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with HKFRS 9 and HKAS 39; and**

~~(b)~~ **...**

~~60C~~ **HKFRS 9, issued in November 2009, amended paragraphs 3(a), 4 and 52(a). An entity shall apply those amendments when it applies HKFRS 9.**

HKAS 27 (Revised)  
Revised June 2011 July 2012

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Effective for annual periods  
beginning on or after 1 July 2009\*

*Hong Kong Accounting Standard 27 (Revised)*

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# Consolidated and Separate Financial Statements

\*HKAS 27 (Revised) is applicable for annual periods beginning on or after 1 July 2009 but before 1 January 2013. HKAS 27 (2011) and HKFRS 10 *Consolidated Financial Statements* issued in June 2011 are applicable for annual periods beginning on or after 1 January 2013 and supersede HKAS 27 (Revised).



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## Appendix B

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In paragraph IN10 after the reference to ‘HKAS 39 *Financial Instruments: Recognition and Measurement*’ is added ‘and HKFRS 9 *Financial Instruments*’. Paragraphs 35, 37, 38 and 40 are amended and paragraph 45D is added as follows:

~~35~~ If a parent loses control of a subsidiary, ... For example, if a subsidiary has cumulative exchange differences relating to a foreign operation available for sale financial assets and the parent loses control of the subsidiary, the parent shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation those assets. Similarly, ...

~~37~~ The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with HKFRS 9 *Financial Instruments* ~~HKAS 39 *Financial Instruments: Recognition and Measurement*~~ or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity.

~~38~~ When an entity prepares separate financial statements, it shall account for investments in subsidiaries, jointly controlled entities and associates either:

~~(a) at cost, or~~

~~(b) in accordance with HKFRS 9 and HKAS 39.~~

~~The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when they are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5. The accounting for measurement of investments accounted for in accordance with HKFRS 9 and HKAS 39 is not changed in such circumstances.~~

~~40~~ Investments in jointly controlled entities and associates that are accounted for in accordance with HKFRS 9 and HKAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor’s separate financial statements.

~~45D~~ HKFRS 9, issued in November 2009, amended paragraphs 35, 37, 38 and 40. An entity shall apply these amendments when it applies HKFRS 9.

## Appendix B

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IAS 27 is amended as described below.~~

~~In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:~~

~~\* In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.~~

~~In paragraphs BC65–BC66C the references to IAS 39 are footnoted as follows:~~

~~BC65 Paragraph 29 of IAS 27 (as revised in 2000) permitted investments in subsidiaries to be measured in any one of three ways in a parent's separate financial statements. These were cost, the equity method or as available-for-sale financial assets in accordance with IAS 39\*. Paragraph 12 of IAS 28 (as revised in 2000) permitted the same choices for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (as revised in 2000) mentioned that IAS 31 did not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39<sup>†</sup> for all investments included in separate financial statements.~~

~~BC66 Although the equity method would provide users with some profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and does not need to be provided to the users of its separate financial statements. For separate statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39<sup>†</sup> or the cost method would be relevant. Using the fair value method in accordance with IAS 39<sup>†</sup> would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.~~

~~BC66A As part of its annual improvements project begun in 2007, the Board identified an apparent inconsistency with IFRS 5. The inconsistency relates to the accounting by a parent in its separate financial statements when investments it accounts for in accordance with IAS 39<sup>†</sup> are classified as held for sale in accordance with IFRS 5. Paragraph 38 requires an entity that prepares separate financial statements to account for such investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5. However, financial assets that an entity accounts for in accordance with IAS 39<sup>†</sup> are excluded from IFRS 5's measurement requirements.~~

~~BC66B Paragraph BC13 of the Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell.' The Board acknowledged in the Basis for Conclusions on IFRS 5 that not all financial assets within the scope of IAS 39<sup>†</sup> are recognised at fair~~

~~value with changes in fair value recognised in profit or loss, but it did not want to make any further changes to the accounting for financial assets at that time.~~

~~BC66C Therefore, the Board amended paragraph 38 by *Improvements to IFRSs* issued in May 2008 to align the accounting in separate financial statements for those investments that are accounted for in accordance with IAS 39<sup>‡</sup> with the measurement exclusion that IFRS 5 provides for other assets that are accounted for in accordance with IAS 39 before classification as held for sale. Thus, an entity should continue to account for such investments in accordance with IAS 39 when they meet the held for sale criteria in IFRS 5.~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available for sale financial assets.~~

~~‡ In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.~~

~~BCA12 In the dissenting opinions on the amendments issued in May 2008, the references to IAS 39 are footnoted as follows:~~

~~DO3 These Board members acknowledge that a new parent could choose to apply paragraph 38(b) of IAS 27 and account for its investment in the original parent in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.<sup>‡</sup> However, the new parent then would be required to account for the investment in accordance with IAS 39<sup>‡</sup> in subsequent periods and to account for all other investments in the same category in accordance with IAS 39<sup>‡</sup>.~~

~~‡ In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.~~

## Appendix B

### Amendments to guidance from other IFRSs

The following amendments to guidance on other IFRSs are necessary in order to ensure consistency with the revised IAS 27. In the amended paragraphs, new text is underlined and deleted text is struck through. The amendments contained in this appendix when this Guidance was issued have been incorporated into the text of the relevant Guidance.

#### ~~IFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In the guidance on implementing IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates*, and IAS 31 *Interests in Joint Ventures*, paragraph IG7 is amended as follows:

~~IG7 IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* does not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IAS 27, IAS 28 and IAS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of IAS 39 and IFRS 9. In all other cases, instruments containing potential voting rights are accounted for in accordance with IAS 39 and IFRS 9.~~

HKAS 28  
Revised ~~June 2011~~ July 2012

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Effective for annual periods  
beginning on or after 1 January 2005\*

*Hong Kong Accounting Standard 28*

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# Investments in Associates

\*HKAS 28 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKAS 28 (2011) issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes HKAS 28 issued in 2004.



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Hong Kong Accounting Standard 28 *Investments in Associates* (HKAS 28) is set out in paragraphs 1-43 and Appendices B and C. All the paragraphs have equal authority. HKAS 28 should be read in the context of the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for the Preparation and Presentation of Financial Statements* *Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

- 38 Investments in associates accounted for using the equity method shall be classified as non-current assets. The investor's share of the profit or loss of such associates, and the carrying amount of those investments, shall be separately disclosed. The investor's share of any discontinued operations of such associates shall also be separately disclosed.**
- 39 The investor's share of changes recognised in other comprehensive income by the associate shall be recognised by the investor in other comprehensive income.**
- 40 In accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the investor shall disclose:**
- (a) its share of the contingent liabilities of an associate incurred jointly with other investors; and**
  - (b) those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.**

## **Effective date and transition**

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- 41 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 41a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.
- 41A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 11 and 39. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 41B HKAS 27 (as amended in 2008) amended paragraphs 18, 19 and 35 and added paragraph 19A. An entity shall apply the amendment to paragraph 35 retrospectively and the ~~those~~ amendments to paragraphs 18 and 19 and paragraph 19A prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.
- 41C Paragraphs 1 and 33 were amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of HKFRS 7 *Financial Instruments: Disclosures*, paragraph 1 of HKAS 31 and paragraph 4 of HKAS 32 *Financial Instruments: Presentation* issued in October 2008. An entity is permitted to apply the amendments prospectively.

41D [This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]

41E Paragraph 41B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.

## **Withdrawal of other pronouncements**

- 42 This Standard supersedes SSAP 10 *Accounting for Investments in Associates* (revised in 2001).
- 43 This Standard supersedes Interpretation 18, *Consolidation and Equity Method—Potential Voting Rights and Allocation of Ownership Interests*.

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

Paragraph IN5 is amended as follows:

~~IN5~~ The Standards does not apply to investments that would otherwise be associates or interests of venturers in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are classified as held for trading and accounted for in accordance with ~~HKAS 39 *Financial Instruments: Recognition and Measurement*~~. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.

Paragraphs 1 and 18–19A are amended and paragraph 41D is added as follows:

~~1~~ This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) ~~venture capital organisations, or~~

(b) ~~mutual funds, unit trusts and similar entities including investment-linked insurance funds~~

~~that are measured upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. An entity shall measure such~~ Such investments shall be measured at fair value through profit or loss in accordance with HKFRS 9 HKAS 39, with changes in fair value recognised in profit or loss in the period of the change. An entity holding such an investment shall make the disclosures required by paragraph 37(f).

~~18~~ An investor shall discontinue the use of the equity method from the date when it ceases to have significant influence over an associate and shall account for the investment in accordance with HKFRS 9 and HKAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in HKAS 31. On the loss of significant influence,  
...

~~19~~ — ~~When an investment ceases to be an associate and is accounted for in accordance with HKFRS 9 and HKAS 39, the fair value of the investment at the date when it ceases to be an associate shall be regarded as its fair value on initial recognition as a financial asset in accordance with HKFRS 9 HKAS 39.~~

~~19A~~ — ~~If an investor loses significant influence over an associate, ... For example, if an associate has cumulative exchange differences relating to a foreign operation available for sale financial assets and the investor loses significant influence over the associate, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation those assets. If ...~~

~~41D~~ — ~~HKFRS 9, issued in November 2009, amended paragraphs 1 and 18–19A of this Standard as amended in May 2008. An entity shall apply those amendments if using that version of this Standard when it applies HKFRS9.~~

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

The Basis for Conclusions on IAS 28 is amended as described below:

In paragraph BC7 the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ is footnoted as follows:

~~\* In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

In paragraph BC9 the first reference to ‘IAS 39’ is footnoted as follows:

~~\* In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 eliminated the available for sale category and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.~~

In paragraph BC22 the first reference to ‘IAS 39’ is footnoted as follows:

~~\* In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

In paragraph BC26 the reference to ‘IAS 39’ is footnoted as follows:

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available for sale financial assets.~~

HKAS 31  
Revised ~~June 2011~~ July 2012

---

Effective for annual periods  
beginning on or after 1 January 2005\*

*Hong Kong Accounting Standard 31*

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# Interests in Joint Ventures

\*HKAS 31 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2013. HKFRS 11 *Joint Arrangements* issued in June 2011 is applicable for annual periods beginning on or after 1 January 2013 and supersedes HKAS 31.



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Hong Kong Accounting Standard 31 *Interests in Joint Ventures* (HKAS 31) is set out in paragraphs 1-59 and Appendices B and C. All the paragraphs have equal authority. HKAS 31 should be read in the context of the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

- 58a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the same effective date for that same period. However, it is required to apply the amendments set out in the appendix on amendments to other pronouncements for that earlier period.
- 58A** **HKAS 27 (as amended in 2008) amended paragraphs 45 and 46 and added paragraphs 45A and 45B. An entity shall apply the amendment to paragraph 46 retrospectively and the those amendments to paragraph 45 and paragraphs 45A and 45B prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.**
- 58B Paragraph 1 was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of HKFRS 7 *Financial Instruments: Disclosures*, paragraph 1 of HKAS 28 and paragraph 4 of HKAS 32 *Financial Instruments: Presentation* issued in October 2008. An entity is permitted to apply the amendment prospectively.
- 58C *[This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]*
- 58D Paragraph 58A was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.

## **Withdrawal of SSAP 21 (revised 2001)**

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- 59 This Standard supersedes SSAP 21 *Accounting for Interests in Joint Ventures* (revised in 2001).

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In amended paragraphs, deleted text is struck through and new text is underlined.

### ~~HKFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

Paragraph IN5 is amended as follows:

~~IN5~~ The Standard does not apply to investments that would otherwise be interests of venturers in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are classified as held for trading and accounted for at fair value through profit or loss in accordance with ~~HKFRS 9 Financial Instruments and HKAS 39 Financial Instruments: Recognition and Measurement~~. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.

Paragraphs 1, 45–45B and 51 are amended and paragraph 58C is added as follows:

~~1~~ This Standard shall be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:

- ~~(a)~~ venture capital organisations, or
- ~~(b)~~ mutual funds, unit trusts and similar entities including investment-linked insurance funds

~~that are measured upon initial recognition are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with HKFRS 9 Financial Instruments and HKAS 39 Financial Instruments: Recognition and Measurement. An entity shall measure such~~ Such investments shall be measured at fair value through profit or loss in accordance with ~~HKFRS 9~~ HKAS 39, with changes in fair value recognised in profit or loss in the period of the change. A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

~~45~~ When an investor ceases to have joint control over an entity, it shall account for any remaining investment in accordance with ~~HKFRS 9 and HKAS 39~~ from that date, provided that the former jointly controlled entity does not become a subsidiary or associate. From ...

~~45A~~ When an investment ceases to be a jointly controlled entity and is accounted for in accordance with ~~HKFRS 9 and HKAS 39~~, the fair value of the investment when it ceases to be a jointly controlled entity shall be regarded as its fair value on initial recognition as a financial asset in accordance with ~~HKFRS 9~~ HKAS 39.

~~45B~~ If an investor loses joint control of an entity, ... For example, if a jointly controlled entity has cumulative exchange differences relating to a foreign operation available for sale financial assets and the investor loses joint control of the entity, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation these assets. If ...

~~51~~ **An investor in a joint venture that does not have joint control shall account for that investment in accordance with HKFRS 9 and HKAS 39 or, if it has significant influence in the joint venture, in accordance with HKAS 28.**

~~58C~~ HKFRS 9, issued in November 2009, amended paragraphs 1, 45–45B and 51. An entity shall apply these amendments when it applies HKFRS 9.

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In paragraph BC7 the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ is footnoted as follows:

\* ~~In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

In paragraph BC9 the first reference to IAS 39 is footnoted as follows:

\* ~~In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 eliminated the available-for-sale category and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.~~

In paragraph BC17 the first reference to ‘IAS 39’ is footnoted as follows:

\* ~~In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

Effective for annual periods  
beginning on or after 1 January 2005

*Hong Kong Accounting Standard 32*

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# **Financial Instruments: Presentation**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

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Hong Kong Accounting Standard 32 *Financial Instruments: Presentation* (HKAS 32) is set out in paragraphs 2–100 and Application Guidance. All the paragraphs have equal authority. HKAS 32 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting* ~~the Preparation and Presentation of Financial Statements~~. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

### Reasons for issuing HKAS 32

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- IN1 Hong Kong Accounting Standard 32 *Financial Instruments: Presentation* (HKAS 32)<sup>\*</sup> should be applied for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 39. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- IN2 The objective of Hong Kong Institute of Certified Public Accountants (HKICPA) issuing HKAS 32 is to maintain international convergence with the International Accounting Standards Board (IASB).
- IN3 [Deleted]

### The main features

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- IN4 The main features of HKAS 32 are described below.

#### Scope

- IN5 The scope of HKAS 32 has, where appropriate, been conformed to the scope of HKAS 39.

#### Principle

- IN6 In summary, when an issuer determines whether a financial instrument is a financial liability or an equity instrument, the instrument is an equity instrument if, and only if, both conditions (a) and (b) are met.
- (a) The instrument includes no contractual obligation:
- (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
- (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - (ii) a derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

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<sup>\*</sup> In September 2005 the HKICPA amended HKAS 32 by relocating all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*. In June 2008 the HKICPA amended HKAS 32 by requiring some puttable financial instruments and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.

- IN7 In addition, when an issuer has an obligation to purchase its own shares for cash or another financial asset, there is a liability for the amount that the issuer is obliged to pay.
- IN8 The definitions of a financial asset and a financial liability, and the description of an equity instrument, are amended consistently with this principle.

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

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

#### *Puttable instruments*

- IN10 HKAS 32 incorporates a guidance that a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability of the issuer. In response to comments received on the Exposure Draft, the Standard provides additional guidance and illustrative examples for entities that, because of this requirement, have no equity or whose share capital is not equity as defined in HKAS 32.

#### *Contingent settlement provisions*

- IN11 IAS 32 incorporates a conclusion that a financial instrument is a financial liability when the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder. Contingent settlement provisions are ignored when they apply only in the event of liquidation of the issuer or are not genuine.

#### *Settlement options*

- IN12 Under HKAS 32, a derivative financial instrument is a financial asset or a financial liability when it gives one of the parties to it a choice of how it is settled unless all of the settlement alternatives would result in it being an equity instrument.

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

- IN13 Any asset and liability components are separated first and the residual is the amount of any equity component. These requirements for separating the liability and equity components of a compound financial instrument are conformed to both the definition of an equity instrument as a residual and the measurement requirements in HKAS 39.

### **Treasury shares**

- IN14 HKAS 32 incorporates a conclusion that the acquisition or subsequent resale by an entity of its own equity instruments does not result in a gain or loss for the entity. Rather it represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument.

## **Interest, dividends, losses and gains**

IN15 HKAS 32 incorporates a guidance that transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of that transaction and are deducted from equity.

## **Disclosure**

IN16– [Deleted]  
N19

IN19A In September 2005 the HKICPA revised disclosures about financial instruments and relocated them to HKFRS 7 *Financial Instruments: Disclosures*.

## **Withdrawal of other pronouncements**

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IN20 [Deleted]

## **Potential impact of proposals in exposure drafts**

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IN21 [Deleted]

## **Reasons for amending HKAS 32 in June 2008**

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

IN23 The amendment addresses the classification of some:

- (a) puttable financial instruments, and
- (b) instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

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

# Hong Kong Accounting Standard 32

## *Financial Instruments: Presentation*

### Objective

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- 1 [Deleted]
- 2 The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.
- 3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in HKAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in HKFRS 7 *Financial Instruments: Disclosures*.

### Scope

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- 4 **This Standard shall be applied by all entities to all types of financial instruments except:**
  - (a) **those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 *Investments in Associates* or HKAS 31 *Interests in Joint Ventures*. However, in some cases, HKAS 27, HKAS 28 or HKAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.**
  - (b) **employers' rights and obligations under employee benefit plans, to which HKAS 19 *Employee Benefits* applies.**
  - (c) [deleted]
  - (d) **insurance contracts as defined in HKFRS 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if HKAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies HKAS 39 in recognising and measuring the contracts, but shall apply HKFRS 4 if the issuer elects, in accordance with paragraph 4(d) of HKFRS 4, to apply HKFRS 4 in recognising and measuring them.**
  - (e) **financial instruments that are within the scope of HKFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see HKAS 39).**

- (f) **financial instruments, contracts and obligations under share-based payment transactions to which HKFRS 2 *Share-based Payment* applies, except for**
- (i) **contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,**
  - (ii) **paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

5-7 [Deleted]

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

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

- (a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
- (b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
- (c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
- (d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 8 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirement, and accordingly, whether they are within the scope of this Standard.

10 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 9(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

## Definitions (see also paragraphs AG3-AG23)

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

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

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

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
  - (i) to receive cash or another financial asset from another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

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

- (a) a contractual obligation:
  - (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

- (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, ~~For this~~ these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

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

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

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

12 The following terms are defined in paragraph 9 of HKAS 39 and are used in this Standard with the meaning specified in HKAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale
- transaction costs.

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

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

## Presentation

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### Liabilities and equity (see also paragraphs AG13–AG14J and AG25–AG29A)

- 15 *The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.*
- 16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.
- (a) The instrument includes no contractual obligation:
- (i) to deliver cash or another financial asset to another entity; or
  - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
- (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, ~~for this~~ these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

## Puttable instruments

- 16A A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:
- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
    - (i) dividing the entity's net assets on liquidation into units of equal amount; and
    - (ii) multiplying that amount by the number of the units held by the financial instrument holder.
  - (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
    - (i) has no priority over other claims to the assets of the entity on liquidation, and
    - (ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
  - (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.
  - (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.
  - (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).
- 16B For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
- (a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

- (b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16A that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

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

16C Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

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

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

- (a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and
- (b) the effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16C that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

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

- 16E An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all the features and meet all the conditions in paragraphs 16A and 16B, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.
- 16F An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 16E:
- (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognise in equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.
  - (b) It shall reclassify a financial liability as equity from the date when the instrument has all the features and meets the conditions set out in paragraphs 16A and 16B or paragraphs 16C and 16D. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

**No contractual obligation to deliver cash or another financial asset (paragraph 16(a))**

- 17 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

- 18 The substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:
- (a) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.
  - (b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).
- 19 If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example:
- (a) a restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.
  - (b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.
- 20 A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:
- (a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.

- (b) a financial instrument is a financial liability if it provides that on settlement the entity will deliver either:
- (i) cash or another financial asset; or
  - (ii) its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 21).

### **Settlement in the entity's own equity instruments (paragraph 16(b))**

- 21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g. an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100,\* and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.
- 22 Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.
- 22A If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all the features and meeting the conditions described in paragraphs 16A and 16B, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all the features and meeting the conditions described in paragraphs 16C and 16D, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

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

- 23 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised initially under HKAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with HKAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (e.g. a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).
- 24 A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold.

#### **Contingent settlement provisions**

- 25 A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:
- (a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;
  - (b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or
  - (c) the instrument has all the features and meets the conditions in paragraphs 16A and 16B.

#### **Settlement options**

- 26 **When a derivative financial instrument gives one party a choice over how it is settled (e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.**
- 27 An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the

non-financial item or net in cash or another financial instrument (see paragraphs 8-10). Such contracts are financial assets or financial liabilities and not equity instruments.

## **Compound financial instruments (see also paragraphs AG30-AG35 and Illustrative Examples 9-12)**

- 28 The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.**
- 29 An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its statement of financial position.
- 30 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 way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.
- 31 HKAS 39 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.
- 32 Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

## Treasury shares (see also paragraph AG36)

- 33 **If an entity reacquires its own equity instruments, those instruments (“treasury shares”) shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity’s own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.**
- 34 The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with HKAS 1 *Presentation of Financial Statements*. An entity provides disclosure in accordance with HKAS 24 *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

## Interest, dividends, losses and gains (see also paragraph AG37)

- 35 **Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, net of any related income tax benefit.**
- 36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.
- 37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.
- 38 Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.
- 39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under HKAS 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 HKAS 12 *Income Taxes*.

- 40 Dividends classified as an expense may be presented in the statement of comprehensive income or separate income statement (if presented) either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of HKAS 1 and HKFRS 7. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement of comprehensive income or separate income statement (if presented). Disclosures of the tax effects are made in accordance with HKAS 12.
- 41 Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under HKAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of comprehensive income when it is relevant in explaining the entity's performance.

### **Offsetting a financial asset and a financial liability (see also paragraphs AG38 and AG39)**

- 42 **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**
- (a) **currently has a legally enforceable right to set off the recognised amounts; and**
  - (b) **intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.**

**In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see HKAS 39, paragraph 36).**

- 43 This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.
- 44 Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.
- 45 A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

- 46 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.
- 47 An 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 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 entity's credit risk exposure is disclosed in accordance with paragraph 36 of HKFRS 7.
- 48 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 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 treated as simultaneous only when the transactions occur at the same moment.
- 49 The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:
- (a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');
  - (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
  - (c) financial or other assets are pledged as collateral for non-recourse financial liabilities;
  - (d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or
  - (e) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

- 50 An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 36 of HKFRS 7.

## Disclosure

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51-95 [Deleted]

## Effective date and transition

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- 96 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 39. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 96A *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1), issued in June 2008, required financial instruments that contain all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the changes for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 1, HKAS 39, HKFRS 7 and HK(IFRIC)-Int 2 at the same time.
- 96B *Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy.
- 96C The classification of instruments under this exception shall be restricted to the accounting for such an instrument under HKAS 1, HKAS 32, HKAS 39 and HKFRS 7. The instrument shall not be considered an equity instrument under other guidance, for example HKFRS 2.
- 97 This Standard shall be applied retrospectively, and accounting policies adopted in respect of each period presented shall be disclosed. When comparative information for prior periods is not available when this Standard is first applied, such information need not be presented, but an entity shall disclose that fact.
- 97A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

- 97B HKFRS 3 *Business Combinations* (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of HKFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A–65E of HKFRS 3 (as amended in 2010).
- 97C When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to HKAS 32 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.
- 97D Paragraph 4 was amended by *Improvements to HKFRSs* issued in October 2008. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of HKFRS 7, paragraph 1 of HKAS 28 and paragraph 1 of HKAS 31 issued in October 2008. An entity is permitted to apply the amendment prospectively.
- 97E Paragraphs 11 and 16 were amended by *Classification of Rights Issues* issued in October 2009. An entity shall apply that amendment for annual periods beginning on or after 1 February 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.
- 97F [This paragraph refers to amendments with an effective date after 1 January 2012, and is therefore not included in this edition.]
- 97G Paragraph 97B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

## Withdrawal of Other Pronouncements

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- 98 This Standard, together with HKAS 39 *Financial Instruments: Recognition and Measurement*, supersede SSAP 24 Accounting for Investments in Securities issued in 1999.\*

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\* In September 2005 the Institute relocated all disclosures relating to financial instruments to HKFRS 7 *Financial Instruments: Disclosures*.

## **Appendix BA**

### **Comparison with International Accounting Standards**

This comparison appendix, which was prepared as at 20 April 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 32.

The International Accounting Standard comparable with HKAS 32 is IAS 32 *Financial Instruments: Presentation*.

There are no major textual differences between HKAS 32 and IAS 32.

## Appendix GB

### Amendments resulting from other HKFRSs

*The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

#### **Amendments to HKFRS 7 *Disclosures – Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2013**

Paragraph 43 is amended (new text is underlined).

- 43 This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 13B–13E of HKFRS 7 for recognised financial instruments that are within the scope of paragraph 13A of HKFRS 7.

## **Annual Improvement 2009-2011 Cycle – effective for annual periods beginning on or after 1 January 2013**

Paragraphs 35, 37 and 39 are amended (new text is underlined and deleted text is struck through) and paragraphs 35A and 97M are added.

### **Presentation**

#### **Interest, dividends, losses and gains (see also paragraph AG37)**

- 35** Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised debited by the entity directly to in equity, net of any related income tax benefit. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, ~~net of any related income tax benefit~~.
- 35A** Income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with HKAS 12 *Income Taxes*.
- 37** An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity ~~(net of any related income tax benefit)~~ to the extent that they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.
- 39** The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under in accordance with HKAS 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 HKAS 12 *Income Taxes*.~~

### **Effective date and transition**

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

## Appendix DC

### **Amendments to HKAS 32 *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2014**

*The following sets out amendment required for this Standard resulting from amendments to HKAS 32 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

#### **Effective date and transition**

Paragraph 97L is added.

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

## Application Guidance

Immediately after the heading 'Offsetting a financial asset and a financial liability (paragraphs 42–50)', paragraph AG38 is deleted. Headings and paragraphs AG38A–AG38F are added.

### Criterion that an entity 'currently has a legally enforceable right to set off the recognised amounts' (paragraph 42(a))

**AG38A** A right of set-off may be currently available or it may be contingent on a future event (for example, the right may be triggered or exercisable only on the occurrence of some future event, such as the default, insolvency or bankruptcy of one of the counterparties). Even if the right of set-off is not contingent on a future event, it may only be legally enforceable in the normal course of business, or in the event of default, or in the event of insolvency or bankruptcy, of one or all of the counterparties.

**AG38B** To meet the criterion in paragraph 42(a), an entity must currently have a legally enforceable right of set-off. This means that the right of set-off:

- (a) must not be contingent on a future event; and
- (b) must be legally enforceable in all of the following circumstances:
  - (i) the normal course of business;
  - (ii) the event of default; and
  - (iii) the event of insolvency or bankruptcy
 of the entity and all of the counterparties.

**AG38C** The nature and extent of the right of set-off, including any conditions attached to its exercise and whether it would remain in the event of default or insolvency or bankruptcy, may vary from one legal jurisdiction to another. Consequently, it cannot be assumed that the right of set-off is automatically available outside of the normal course of business. For example, the bankruptcy or insolvency laws of a jurisdiction may prohibit, or restrict, the right of set-off in the event of bankruptcy or insolvency in some circumstances.

**AG38D** The laws applicable to the relationships between the parties (for example, contractual provisions, the laws governing the contract, or the default, insolvency or bankruptcy laws applicable to the parties) need to be considered to ascertain whether the right of set-off is enforceable in the normal course of business, in an event of default, and in the event of insolvency or bankruptcy, of the entity and all of the counterparties (as specified in paragraph AG38B(b)).

**Criterion that an entity ‘intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously’ (paragraph 42(b))**

**AG38E** To meet the criterion in paragraph 42(b) an entity must intend either to settle on a net basis or to realise the asset and settle the liability simultaneously. Although the entity may have a right to settle net, it may still realise the asset and settle the liability separately.

**AG38F** If an entity can settle amounts in a manner such that the outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion in paragraph 42(b). This will occur if, and only if, the gross settlement mechanism has features that eliminate or result in insignificant credit and liquidity risk, and that will process receivables and payables in a single settlement process or cycle. For example, a gross settlement system that has all of the following characteristics would meet the net settlement criterion in paragraph 42(b):

- (a) financial assets and financial liabilities eligible for set-off are submitted at the same point in time for processing;
- (b) once the financial assets and financial liabilities are submitted for processing, the parties are committed to fulfil the settlement obligation;
- (c) there is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing (unless the processing fails—see (d) below);
- (d) assets and liabilities that are collateralised with securities will be settled on a securities transfer or similar system (for example, delivery versus payment), so that if the transfer of securities fails, the processing of the related receivable or payable for which the securities are collateral will also fail (and vice versa);
- (e) any transactions that fail, as outlined in (d), will be re-entered for processing until they are settled;
- (f) settlement is carried out through the same settlement institution (for example, a settlement bank, a central bank or a central securities depository); and
- (g) an intraday credit facility is in place that will provide sufficient overdraft amounts to enable the processing of payments at the settlement date for each of the parties, and it is virtually certain that the intraday credit facility will be honoured if called upon.

## Appendix

### Application Guidance

### HKAS 32 *Financial Instruments: Presentation*

*This appendix is an integral part of the Standard.*

- AG1 This Application Guidance explains the application of particular aspects of the Standard.
- AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in HKAS 39.

### Definitions (paragraphs 11-14)

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#### Financial assets and financial liabilities

- AG3 Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.
- AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:
- (a) trade accounts receivable and payable;
  - (b) notes receivable and payable;
  - (c) loans receivable and payable; and
  - (d) bonds receivable and payable.

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

- AG5 Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.
- AG6 'Perpetual' debt instruments (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial

instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.\* Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

- AG7 A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.
- AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of HKFRS 4.
- AG9 Under HKAS 17 *Leases* a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).
- AG10 Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.
- AG11 Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.
- AG12 Liabilities or assets that are not contractual (such as income taxes 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 HKAS 12. Similarly, constructive obligations, as defined in HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, do not arise from contracts and are not financial liabilities.

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

## Equity instruments

- AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.
- AG14 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 22A). Instead, any consideration paid for such a contract is deducted from equity.

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

- AG14A One of the features of paragraphs 16A and 16C is that the financial instrument is in the class of instruments that is subordinate to all other classes.
- AG14B When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.
- AG14C An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.
- AG14D If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

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

- AG14E The total expected cash flows of the instrument over the life of the instrument must be substantially based on the profit or loss, change in the recognised net assets or fair value of the recognised and unrecognised net assets of the entity over the life of the instrument. Profit or loss and the change in the recognised net assets shall be measured in accordance with relevant HKFRSs.

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

AG14F The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder may also be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as equity under paragraph 16A or paragraph 16C.

AG14G An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG14H Another example is a profit or loss sharing arrangement that allocates profit or loss to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 16A or paragraph 16C. However, profit or loss sharing arrangements that allocate profit or loss to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 16A or paragraph 16C.

AG14I The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

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

AG14J A condition for classifying as equity a financial instrument that otherwise meets the criteria in paragraph 16A or paragraph 16C is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 16A or paragraph 16C from being classified as equity:

- (a) instruments with total cash flows substantially based on specific assets of the entity.
- (b) instruments with total cash flows based on a percentage of revenue.

- (c) contracts designed to reward individual employees for services rendered to the entity.
- (d) contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

## Derivative financial instruments

- AG15 Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.
- AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favourable or unfavourable.
- AG17 A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favourable conditions and the writer's obligation to exchange the financial asset under potentially unfavourable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

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

- AG18 Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.
- AG19 Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardised and traded on an exchange.

### **Contracts to buy or sell non-financial items (paragraphs 8-10)**

- AG20 Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (e.g. 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 bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 8).

- AG21 A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.
- AG22 Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.
- AG23 The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.
- AG24 [Deleted]

## Presentation

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### Liabilities and equity (paragraphs 15-27)

#### No contractual obligation to deliver cash or another financial asset (paragraphs 17-20)

- AG25 Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.

AG26 When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

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

**Settlement in the entity's own equity instruments (paragraphs 21-24)**

AG27 The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

- (a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 22A). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.
- (b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.
- (c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is a net cash-settled share option.

- (d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

### **Contingent settlement provisions (paragraph 25)**

- AG28 Paragraph 25 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

### **Treatment in Consolidated Financial Statements**

- AG29 In consolidated financial statements, an entity presents non-controlling interests—i.e. the interests of other parties in the equity and income of its subsidiaries—in accordance with HKAS 1 and HKAS 27. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a subsidiary in a group issues a financial instrument and a parent or other group entity agrees additional terms directly with the holders of the instrument (e.g. a guarantee), the group may not have discretion over distributions or redemption. Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.
- AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the group.

## Compound financial instruments (paragraphs 28-32)

- AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. HKAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and equity features.
- AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the statement of financial position, as follows:
- (a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.
  - (b) The equity instrument is an embedded option to convert the liability into equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.
- AG32 On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.
- AG33 When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and equity components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 28-32.
- AG34 Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:
- (a) the amount of gain or loss relating to the liability component is recognised in profit or loss; and
  - (b) the amount of consideration relating to the equity component is recognised in equity.
- AG35 An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favourable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognised as a loss in profit or loss.

## **Treasury shares (paragraphs 33 and 34)**

- AG36 An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired. Paragraph 33 requires an entity that reacquires its own equity instruments to deduct those equity instruments from equity. However, when an entity holds its own equity on behalf of others, e.g. a financial institution holding its own equity on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

## **Interest, dividends, losses and gains (paragraphs 35-41)**

- AG37 The following example illustrates the application of paragraph 35 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (e.g. commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense.

## **Offsetting a financial asset and a financial liability (paragraphs 42-50)**

- AG38 To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.
- AG39 The Standard does not provide special treatment for so-called 'synthetic instruments', which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt. Each of the individual financial instruments that together constitute a 'synthetic instrument' represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a 'synthetic instrument' is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 42.

## **Disclosure**

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### **Financial assets and financial liabilities at fair value through profit or loss (paragraph 94(f))**

- AG40 [Deleted]

HKAS 32 BC  
Revised December 2011 July 2012

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Effective for annual periods  
beginning on or after 1 January 2005

*Basis for Conclusions on  
Hong Kong Accounting Standard 32*

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# **Financial Instruments: Presentation**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

# Basis for Conclusions

## IAS 32 *Financial Instruments: Presentation*

HKAS 32 is based on IAS 32 *Financial Instruments: Presentation*. In approving HKAS 32, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 32. Accordingly, there are no significant differences between HKAS 32 and IAS 32. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 32 referred to below generally correspond with those in HKAS 32.

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~~A~~ — ~~Amendment to Basis for Conclusions on IAS 32 *Classification of Rights Issues*~~

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CA Amendments resulting from other Basis for Conclusions

DB Amendments to Basis for Conclusions on IAS 32

## Basis for Conclusions on IAS 32 *Financial Instruments: Presentation*

*This Basis for Conclusions accompanies, but is not part of, IAS 32.*

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

- BC1 This Basis for Conclusions summarises the International Accounting Standard Board's considerations in reaching its conclusions on revising IAS 32 *Financial Instruments: Disclosure and Presentation* in 2003. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. The Board received over 170 comment letters on the Exposure Draft.
- BC3 Because the Board did not 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.
- BC3A In July 2006 the Board published an exposure draft of proposed amendments to IAS 32 relating to the classification of puttable instruments and instruments with obligations arising on liquidation. The Board subsequently confirmed the proposals and in 2008 issued an amendment that now forms part of IAS 32. A summary of the Board's considerations and reasons for its conclusions is in paragraphs BC50–BC74.

## Definitions (paragraphs 11-14 and AG3-AG24)

### Financial asset, financial liability and equity instrument (paragraphs 11 and AG3 – AG14)

- BC4 The revised IAS 32 addresses the classification as financial assets, financial liabilities or equity instruments of financial instruments that are indexed to, or settled in, an entity's own equity instruments. As discussed further in paragraphs BC6–BC15, the Board decided to preclude equity classification for such contracts when they (a) involve an obligation to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity, (b) in the case of a non-derivative, are not for the receipt or delivery of a fixed number of shares or (c) in the case of a derivative, are not for the exchange of a fixed number of shares for a fixed amount of cash or another financial asset. The Board also decided to preclude equity classification for contracts that are derivatives on derivatives on an entity's own equity. Consistently with this decision, the Board also decided to amend the definitions of financial asset, financial liability and equity instrument in IAS 32 to make them consistent with the guidance about contracts on an entity's own equity instruments. The Board did not reconsider other aspects of the definitions as part of this project to revise IAS 32, for example the other changes to the definitions proposed by the Joint Working Group in its Draft Standard *Financial Instruments and Similar Items* published by the Board's predecessor body, IASC, in 2000.

<sup>\*</sup> In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7. The paragraphs relating to disclosures that were originally published in this Basis for Conclusions were relocated, if still relevant, to the Basis for Conclusions on IFRS 7.

## **Foreign currency denominated pro rata rights issues**

- BC4A In 2005 the International Financial Reporting Interpretations Committee (IFRIC) was asked whether the equity conversion option embedded in a convertible bond denominated in a foreign currency met IAS 32's requirements to be classified as an equity instrument. IAS 32 states that a derivative instrument relating to the purchase or issue of an entity's own equity instruments is classified as equity only if it results in the exchange of a fixed number of equity instruments for a fixed amount of cash or other assets. At that time, the IFRIC concluded that if the conversion option was denominated in a currency other than the issuing entity's functional currency, the amount of cash to be received in the functional currency would be variable. Consequently, the instrument was a derivative liability that should be measured at its fair value with changes in fair value included in profit or loss.
- BC4B However, the IFRIC also concluded that this outcome was not consistent with the Board's approach when it introduced the 'fixed for fixed' notion in IAS 32. Therefore, the IFRIC decided to recommend that the Board amend IAS 32 to permit a conversion or stand-alone option to be classified as equity if the exercise price was fixed in any currency. In September 2005 the Board decided not to proceed with the proposed amendment.
- BC4C In 2009 the Board was asked by the IFRIC to consider a similar issue. This issue was whether a right entitling the holder to receive a fixed number of the issuing entity's own equity instruments for a fixed amount of a currency other than the issuing entity's functional currency (foreign currency) should be accounted for as a derivative liability.
- BC4D These rights are commonly described as 'rights issues' and include rights, options and warrants. Laws or regulations in many jurisdictions throughout the world require the use of rights issues when raising capital. The entity issues one or more rights to acquire a fixed number of additional shares pro rata to all existing shareholders of a class of non-derivative equity instruments. The exercise price is normally below the current market price of the shares. Consequently, a shareholder must exercise its rights if it does not wish its proportionate interest in the entity to be diluted. Issues with those characteristics are discussed in IFRS 2 *Share-based Payment* and IAS 33 *Earnings per Share*.
- BC4E The Board was advised that rights with the characteristics discussed above were being issued frequently in the current economic environment. The Board was also advised that many issuing entities fixed the exercise price of the rights in currencies other than their functional currency because the entities were listed in more than one jurisdiction and might be required to do so by law or regulation. Therefore, the accounting conclusions affected a significant number of entities in many jurisdictions. In addition, because these are usually relatively large transactions, they can have a substantial effect on entities' financial statement amounts.
- BC4F The Board agreed with the IFRIC's 2005 conclusion that a contract with an exercise price denominated in a foreign currency would not result in the entity receiving a fixed amount of cash. However, the Board also agreed with the IFRIC that classifying rights as derivative liabilities was not consistent with the substance of the transaction. Rights issues are issued only to existing shareholders on the basis of the number of shares they already own. In this respect they partially resemble dividends paid in shares.
- BC4G The Board decided that a financial instrument that gives the holder the right to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency is an equity instrument if, and only if, the entity offers the financial instrument pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

- BC4H In excluding grants of rights with these features from the scope of IFRS 2, the Board explicitly recognised that the holder of the right receives it as a holder of equity instruments, ie as an owner. The Board noted that IAS 1 *Presentation of Financial Statements* requires transactions with owners in their capacity as owners to be recognised in the statement of changes in equity rather than in the statement of comprehensive income.
- BC4I Consistently with its conclusion in IFRS 2, the Board decided that a pro rata issue of rights to all existing shareholders to acquire additional shares is a transaction with an entity's owners in their capacity as owners. Consequently, those transactions should be recognised in equity, not comprehensive income. Because the Board concluded that the rights were equity instruments, it decided to amend the definition of a financial liability to exclude them.
- BC4J Some respondents to the exposure draft expressed concerns that the wording of the amendment was too open-ended and could lead to structuring risks. The Board rejected this argument because of the extremely narrow amendment that requires the entity to treat all of its existing owners of the same class of its own non-derivative equity instruments equally. The Board also noted that a change in the capital structure of an entity to create a new class of non-derivative equity instruments would be transparent because of the presentation and disclosure requirements in IFRSs.
- BC4K The Board decided not to extend this conclusion to other instruments that grant the holder the right to purchase the entity's own equity instruments such as the conversion feature in convertible bonds. The Board also noted that long-dated foreign currency rights issues are not primarily transactions with owners in their capacity as owners. The equal treatment of all owners of the same class of equity instruments was also the basis on which, in IFRIC 17 *Distributions of Non-cash Assets to Owners*, the IFRIC distinguished non-reciprocal distributions to owners from exchange transactions. The fact that the rights are distributed pro rata to existing shareholders is critical to the Board's conclusion to provide an exception to the 'fixed for fixed' concept in IAS 32 as this is a narrow targeted transaction with owners in their capacity as owners.

## **Presentation (paragraphs 15-50 and AG25-AG39)**

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### **Liabilities and equity (paragraphs 15-27 and AG25-AG29)**

- BC5 The revised IAS 32 addresses whether derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments are financial assets, financial liabilities or equity instruments. The original IAS 32 dealt with aspects of this issue piecemeal and it was not clear how various transactions (e.g. net share settled contracts and contracts with settlement options) should be treated under the Standard. The Board concluded that it needed to clarify the accounting treatment for such transactions.
- BC6 The approach agreed by the Board can be summarised as follows:
- A contract on an entity's own equity is an equity instrument if, and only if:
- (a) it contains no contractual obligation to transfer cash or another financial asset, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and
  - (b) if the instrument will or may be settled in the entity's own equity instruments, it is either (i) a non-derivative that includes no contractual obligation for the entity to deliver a variable number of its own equity instruments, or (ii) a derivative that will be settled by the entity exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

## **No contractual obligation to deliver cash or another financial asset (paragraphs 17-20 and AG25-AG26)**

### **Puttable Instruments (paragraph 18(b))**

- BC7 The Board decided that a financial instrument that gives the holder the right to put the instrument back to the entity for cash or another financial asset is a financial liability of the entity. Such financial instruments are commonly issued by mutual funds, unit trusts, co-operative and similar entities, often with the redemption amount being equal to a proportionate share in the net assets of the entity. Although the legal form of such financial instruments often 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 entity for cash or another financial asset means that the instrument meets the definition of a financial liability. The classification as a financial liability is independent of considerations such as when the right is exercisable, how the amount payable or receivable upon exercise of the right is determined, and whether the puttable instrument has a fixed maturity.
- BC7A The Board reconsidered its conclusions with regards to some puttable instruments and amended IAS 32 in February 2008 (see paragraphs BC50–BC74).
- BC8 The Board noted that the classification of a puttable instrument as a financial liability does not preclude the use of descriptors such as ‘net assets attributable to unitholders’ and ‘change in net assets attributable to unitholders’ on the face of the financial statements of an entity that has no equity (such as some mutual funds and unit trusts) or whose share capital is a financial liability under IAS 32 (such as some co-operatives). The Board also agreed that it should provide examples of how such entities might present their income statement<sup>\*</sup> and balance sheet<sup>†</sup> (see Illustrative Examples 7 and 8).

### **Implicit obligations (paragraph 20)**

- BC9 The Board did not debate whether an obligation can be established implicitly rather than explicitly because this is not within the scope of an improvements project. This question will be considered by the Board in its project on revenue, liabilities and equity. Consequently, the Board retained the existing notion that an instrument may establish an obligation indirectly through its terms and conditions (see paragraph 20). However, it decided that the example of a preference share with a contractually accelerating dividend which, within the foreseeable future, is scheduled to yield a dividend so high that the entity will be economically compelled to redeem the instrument, was insufficiently clear. The example was therefore removed and replaced with others that are clearer and deal with situations that have proved problematic in practice.

### **Settlement in the entity’s own equity instruments (paragraphs 21-24 and AG27)**

- BC10 The approach taken in the revised IAS 32 includes two main conclusions:
- (a) When an entity has an obligation to purchase its own shares for cash (such as under a forward contract to purchase its own shares), there is a financial liability for the amount of cash that the entity has an obligation to pay.

<sup>\*</sup> IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

<sup>†</sup> IAS 1 (revised 2007) replaced the term ‘balance sheet’ with ‘statement of financial position’.

- (b) When an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability. In other words, when a contract is settled in a variable number of the entity's own equity instruments, or by the entity exchanging a fixed number of its own equity instruments for a variable amount of cash or another financial asset, the contract is not an equity instrument but is a financial asset or a financial liability.

*When an entity has an obligation to purchase its own shares for cash, there is a financial liability for the amount of cash that the entity has an obligation to pay.*

- BC11 An entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those shares cease to be equity instruments when the entity assumes the obligation. This treatment under IAS 32 is consistent with the treatment of shares that provide for mandatory redemption by the entity. Without a requirement to recognise a financial liability for the present value of the share redemption amount, entities with identical obligations to deliver cash in exchange for their own equity instruments could report different information in their financial statements depending on whether the redemption clause is embedded in the equity instrument or is a free-standing derivative contract.
- BC12 Some respondents to the Exposure Draft suggested that when an entity writes an option that, if exercised, will result in the entity paying cash in return for receiving its own shares, it is incorrect to treat the full amount of the exercise price as a financial liability because the obligation is conditional upon the option being exercised. The Board rejected this argument because the entity has an obligation to pay the full redemption amount and cannot avoid settlement in cash or another financial asset for the full redemption amount unless the counterparty decides not to exercise its redemption right or specified future events or circumstances beyond the control of the entity occur or do not occur. The Board also noted that a change would require a reconsideration of other provisions in IAS 32 that require liability treatment for obligations that are conditional on events or choices that are beyond the entity's control. These include, for example, (a) the treatment of financial instruments with contingent settlement provisions as financial liabilities for the full amount of the conditional obligation, (b) the treatment of preference shares that are redeemable at the option of the holder as financial liabilities for the full amount of the conditional obligation, and (c) the treatment of financial instruments (puttable instruments) that give the holder the right to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined by reference to an index, and which therefore has the potential to increase and decrease, as financial liabilities for the full amount of the conditional obligation.

*When an entity uses its own equity instruments as currency in a contract to receive or deliver a variable number of shares, the contract is not an equity instrument, but is a financial asset or a financial liability.*

- BC13 The Board agreed that it would be inappropriate to account for a contract as an equity instrument when an entity's own equity instruments are used as currency in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a net share-settled derivative contract on gold or an obligation to deliver as many shares as are equal in value to CU10,000). Such a contract represents a right or obligation of a specified amount rather than a specified equity interest. A contract to pay or receive a specified amount (rather than a specified equity interest) is not an equity instrument. For such a contract, the entity does not know, before the transaction is settled, how many of its own shares (or how much cash) it will receive or deliver and the entity may not even know whether it will receive or deliver its own shares.

- BC14 In addition, the Board noted that precluding equity treatment for such a contract limits incentives for structuring potentially favourable or unfavourable transactions to obtain equity treatment. For example, the Board believes that an entity should not be able to obtain equity treatment for a transaction simply by including a share settlement clause when the contract is for a specified value, rather than a specified equity interest.
- BC15 The Board rejected the argument that a contract that is settled in the entity's own shares must be an equity instrument because no change in assets or liabilities, and thus no gain or loss, arises on settlement of the contract. The Board noted that any gain or loss arises before settlement of the transaction, not when it is settled.

#### **Contingent settlement provisions (paragraphs 25 and AG28)**

- BC16 The revised Standard incorporates the conclusion previously 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 (i.e. a 'contingent settlement provision'), is a financial liability.
- BC17 The amendments do not include the exception previously provided in paragraph 6 of SIC-5 for circumstances in which the possibility of the entity being required to settle in cash or another financial asset is remote at the time the financial instrument is issued. The Board concluded that it is not consistent with the definitions of financial liabilities and equity instruments to classify an obligation to deliver cash or another financial asset as a financial 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 entity is unable to avoid a settlement in cash or another financial asset unless an event occurs or does not occur in the future.
- BC18 However, the Board also concluded that contingent settlement provisions that would apply only in the event of liquidation of an entity should not influence the classification of the instrument because to do so would be inconsistent with a going concern assumption. A contingent settlement provision that provides for payment in cash or another financial asset only on the liquidation of the entity is similar to an equity instrument that has priority in liquidation and therefore should be ignored in classifying the instrument.
- BC19 Additionally, the Board decided that if the part of a contingent settlement provision that could require settlement in cash or a variable number of own shares is not genuine, it should be ignored for the purposes of classifying the instrument. The Board also agreed to provide guidance on the meaning of 'genuine' in this context (see paragraph AG28).

#### **Settlement options (paragraphs 26 and 27)**

- BC20 The revised Standard requires that if one of the parties to a contract has one or more options as to how it is settled (e.g. net in cash or by exchanging shares for cash), the contract is a financial asset or a financial liability unless all of the settlement alternatives would result in equity classification. The Board concluded that entities should not be able to circumvent the accounting requirements for financial assets and financial liabilities simply by including an option to settle a contract through the exchange of a fixed number of shares for a fixed amount. The Board had proposed in the Exposure Draft that past practice and management intentions should be considered in determining the classification of such instruments. However, respondents to the Exposure Draft noted that such requirements can be difficult to apply because some entities do not have any history of similar transactions and the assessment of whether an established practice exists and of what is management's intention can be subjective. The Board agreed with these comments and accordingly

concluded that past practice and management intentions should not be determining factors.

### Alternative approaches considered

BC21 In finalising the revisions to IAS 32 the Board considered, but rejected, a number of alternative approaches:

- (a) To classify as an equity instrument any contract that will be settled in the entity's own shares. The Board rejected this approach because it does not deal adequately with transactions in which an entity is using its own shares as currency, e.g. when an entity has an obligation to pay a fixed or determinable amount that is settled in a variable number of its own shares.
- (b) To classify a contract as an equity instrument only if (i) the contract will be settled in the entity's own shares, and (ii) the changes in the fair value of the contract move in the same direction as the changes in the fair value of the shares from the perspective of the counterparty. Under this approach, contracts that will be settled in the entity's own shares would be financial assets or financial liabilities if, from the perspective of the counterparty, their value moves inversely with the price of the entity's own shares. An example is an entity's obligation to buy back its own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions, compared with the existing *Framework* and IAS 32, that had not been exposed for comment.
- (c) To classify as an equity instrument a contract that will be settled in the entity's own shares unless its value changes in response to something other than the price of the entity's own shares. The Board rejected this approach to avoid an exception to the principle that non-derivative contracts that are settled in a variable number of an entity's own shares should be treated as financial assets or financial liabilities.
- (d) To limit classification as equity instruments to outstanding ordinary shares, and classify as financial assets or financial liabilities all contracts that involve future receipt or delivery of the entity's own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions compared with the existing IAS 32 that had not been exposed for comment.

### Compound financial instruments (paragraphs 28-32 and AG30-AG35)

BC22 The Standard requires the separate presentation in an entity's balance sheet\* of liability and equity components of a single financial instrument. It is more a matter of form than a matter of substance that both liabilities and equity interests are created by a single financial instrument rather than two or more separate instruments. The Board believes that an entity's financial position is more faithfully represented by separate presentation of liability and equity components contained in a single instrument.

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\* IAS 1 (as revised in 2007) replaced the term "balance sheet" with "statement of financial position".

*Allocation of the initial carrying amount to the liability and equity components (paragraphs 31, 32 and AG36-AG38 and Illustrative Examples 9-12)*

- BC23 The previous version of IAS 32 did not prescribe a particular method for assigning the initial carrying amount of a compound financial instrument to its separated liability and equity components. Rather, it suggested approaches that might be considered, such as:
- (a) assigning to the less easily measurable component (often the equity component) 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
  - (b) measuring the liability and equity components separately and, to the extent necessary, adjusting these amounts pro rata so that the sum of the components equals the amount of the instrument as a whole (a 'relative fair value' method).
- BC24 This choice was originally justified on the grounds that IAS 32 did not deal with the measurement of financial assets, financial liabilities and equity instruments.
- BC25 However, since the issue of IAS 39, IFRSs contain requirements for the measurement of financial assets and financial liabilities. Therefore, the view that IAS 32 should not prescribe a particular method for separating compound financial instruments because of the absence of measurement requirements for financial instruments is no longer valid. IAS 39, paragraph 43, requires a financial liability to be measured on initial recognition at its fair value. Therefore, a relative fair value method could result in an initial measurement of the liability component that is not in compliance with IAS 39.
- BC26 After initial recognition, a financial liability that is classified as at fair value through profit or loss is measured at fair value under IAS 39, and other financial liabilities are measured at amortised cost. If the liability component of a compound financial instrument is classified as at fair value through profit or loss, 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 31, which states that no gain or loss arises from recognising the components of the instrument separately.
- BC27 Under the *Framework*, and IASs 32 and 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. Paragraph 67 of the *Framework*<sup>\*</sup> further states that the amount at which equity is recognised in the balance sheet is dependent on the measurement of assets and liabilities.
- BC28 The Board concluded that the alternatives in IAS 32 to measure on initial recognition the liability component of a compound financial instrument as a residual amount after separating the equity component or on the basis of a relative fair value method should be eliminated. Instead the liability component 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 component.
- BC29 The objective of this amendment is to make the requirements about the entity's separation of the liability and equity components of a single compound financial instrument consistent with the requirements about the initial measurement of a financial liability in IAS 39 and the definitions in IAS 32 and the *Framework* of an equity instrument as a residual interest.

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<sup>\*</sup> now paragraph 4.22 of the *Conceptual Framework*

- BC30 This approach removes the need to estimate inputs to, and apply, complex option pricing models to measure the equity component of some compound financial instruments. The Board also noted that the absence of a prescribed approach led to a lack of comparability among entities applying IAS 32 and that it therefore was desirable to specify a single approach.
- BC31 The Board noted that a requirement to use the with-and-without method, under which the liability component is determined first, is consistent with the proposals of the Joint Working Group of Standard Setters in its Draft Standard and Basis for Conclusions in *Financial Instruments and Similar Items*, published by IASC in December 2000 (see Draft Standard, paragraphs 74 and 75 and Application Supplement, paragraph 318).

### **Treasury shares (paragraphs 33, 34 and AG36)**

- BC32 The revised Standard incorporates 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.

### **Interest, dividends, losses and gains (paragraphs 35-41 and AG37)**

#### **Costs of an equity transaction (paragraphs 35 and 37-39)**

- BC33 The revised Standard incorporates 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 in equity the total cost of the transaction.
- BC34 [Deleted]  
-BC48

## **Summary of changes from the exposure draft**

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- BC49 The main changes from the Exposure Draft's proposals are as follows:
- (a) The Exposure Draft proposed to define a financial liability as a contractual obligation to deliver cash or another financial asset to another entity or to exchange financial instruments with another entity under conditions that are potentially unfavourable. The definition in the Standard has been expanded to include some contracts that will or may be settled in the entity's own equity instruments. The Standard's definition of a financial asset has been similarly expanded.
  - (b) The Exposure Draft proposed that a financial instrument that gives the holder the right to put it back to the entity for cash or another financial asset is a financial liability. The Standard retains this conclusion, but provides additional guidance and illustrative examples to assist entities that, as a result of this requirement, either have no equity as defined in IAS 32 or whose share capital is not equity as defined in IAS 32.

- (c) The Standard retains and clarifies the proposal in the Exposure Draft that terms and conditions of a financial instrument may indirectly create an obligation.
- (d) The Exposure Draft proposed to incorporate in IAS 32 the conclusion previously in SIC-5. This is 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 is a financial liability. The Standard clarifies this conclusion by requiring contingent settlement provisions that apply only in the event of liquidation of an entity or are not genuine to be ignored.
- (e) The Exposure Draft proposed that a derivative contract that contains an option as to how it is settled meets the definition of an equity instrument if the entity had all of the following: (i) an unconditional right and ability to settle the contract gross; (ii) an established practice of such settlement; and (iii) the intention to settle the contract gross. These conditions have not been carried forward into the Standard. Rather, a derivative with settlement options is classified as a financial asset or a financial liability unless all the settlement alternatives would result in equity classification.
- (f) The Standard provides explicit guidance on accounting for the repurchase of a convertible instrument.
- (g) The Standard provides explicit guidance on accounting for the amendment of the terms of a convertible instrument to induce early conversion.
- (h) The Exposure Draft proposed that a financial instrument that is an equity instrument of a subsidiary should be eliminated on consolidation when held by the parent, or presented in the consolidated balance sheet within equity when not held by the parent (as a minority interest<sup>\*</sup> separate from the equity of the parent). The Standard requires all terms and conditions agreed between members of the group and the holders of the instrument to be considered when determining if the group as a whole has an obligation that would give rise to a financial liability. To the extent there is such an obligation, the instrument (or component of the instrument that is subject to the obligation) is a financial liability in consolidated financial statements.
- (i) [Deleted]
- (j) [Deleted]
- (k) In August 2005, the IASB issued IFRS 7 *Financial Instruments: Disclosures*. As a result, disclosures relating to financial instruments, if still relevant, were relocated to IFRS 7.

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<sup>\*</sup> In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'.

## **Amendments for some puttable instruments and some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation**

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### **Amendment for puttable instruments**

BC50 As discussed in paragraphs BC7 and BC8, puttable instruments meet the definition of a financial liability and the Board concluded that all such instruments should be classified as liabilities. However, constituents raised the following concerns about classifying such instruments as financial liabilities if they represent the residual claim to the net assets of the entity:

- (a) On an ongoing basis, the liability is recognised at not less than the amount payable on demand. This can result in the entire market capitalisation of the entity being recognised as a liability depending on the basis for which the redemption value of the financial instrument is calculated.
- (b) Changes in the carrying value of the liability are recognised in profit or loss. This results in counter-intuitive accounting (if the redemption value is linked to the performance of the entity) because:
  - (i) when an entity performs well, the present value of the settlement amount of the liabilities increases, and a loss is recognised.
  - (ii) when the entity performs poorly, the present value of the settlement amount of the liability decreases, and a gain is recognised.
- (c) It is possible, again depending on the basis for which the redemption value is calculated, that the entity will report negative net assets because of unrecognised intangible assets and goodwill, and because the measurement of recognised assets and liabilities may not be at fair value.
- (d) The issuing entity's statement of financial position portrays the entity as wholly, or mostly, debt funded.
- (e) Distributions of profits to shareholders are recognised as expenses. Hence, it may appear that profit or loss is a function of the distribution policy, not performance.

Furthermore, constituents contended that additional disclosures and adapting the format of the statement of comprehensive income and statement of financial position did not resolve these concerns.

BC51 The Board agreed with constituents that many puttable instruments, despite meeting the definition of a financial liability, represent a residual interest in the net assets of the entity. The Board also agreed with constituents that additional disclosures and adapting the format of the entity's financial statements did not resolve the problem of the lack of relevance and understandability of that current accounting treatment. Therefore, the Board decided to amend IAS 32 to improve the financial reporting of these instruments.

BC52 The Board considered the following ways to improve the financial reporting of instruments that represent a residual interest in the net assets of the entity:

- (a) to continue to classify these instruments as financial liabilities, but amend their measurement so that changes in their fair value would not be recognised;
- (b) to amend IAS 32 to require separation of all puttable instruments into a put option and a host instrument; or
- (c) to amend IAS 32 to provide a limited scope exception so that financial instruments puttable at fair value would be classified as equity, if specified conditions were met.

*Amend the measurement of some puttable financial instruments so that changes in their fair value would not be recognised*

BC53 The Board decided against this approach because:

- (a) it is inconsistent with the principle in IAS 32 and IAS 39 that only equity instruments are not remeasured after their initial recognition;
- (b) it retains the disadvantage that entities whose instruments are all puttable would have no equity instruments; and
- (c) it introduces a new category of financial liabilities to IAS 39, and thus increases complexity.

*Separate all puttable instruments into a put option and a host instrument*

BC54 The Board concluded that conducting further research into an approach that splits a puttable share into an equity component and a written put option component (financial liability) would duplicate efforts of the Board's longer-term project on liabilities and equity. Consequently, the Board decided not to proceed with a project at this stage to determine whether a puttable share should be split into an equity component and a written put option component.

*Classify as equity instruments puttable instruments that represent a residual interest in the entity*

BC55 The Board decided to proceed with proposals to amend IAS 32 to require puttable financial instruments that represent a residual interest in the net assets of the entity to be classified as equity provided that specified conditions are met. The proposals represented a limited scope exception to the definition of a financial liability and a short-term solution, pending the outcome of the longer-term project on liabilities and equity. In June 2006 the Board published an exposure draft proposing that financial instruments puttable at fair value that meet specific criteria should be classified as equity.

BC56 In response to comments received from respondents to that exposure draft, the Board amended the criteria for identifying puttable instruments that represent a residual interest in the entity, to those included in paragraphs 16A and 16B. The Board decided on those conditions for the following reasons:

- (a) to ensure that the puttable instruments, as a class, represent the residual interest in the net assets of the entity;
- (b) to ensure that the proposed amendments are consistent with a limited scope exception to the definition of a financial liability; and

- (c) to reduce structuring opportunities that might arise as a result of the amendments.

- BC57 The Board decided that the instrument must entitle the holder to a pro rata share of the net assets on liquidation because the net assets on liquidation represent the ultimate residual interest of the entity.
- BC58 The Board decided that the instrument must be in the class of instruments that is subordinate to all other classes of instruments on liquidation in order to represent the residual interest in the entity.
- BC59 The Board decided that all instruments in the class that is subordinate to all other classes of instruments must have identical contractual terms and conditions. In order to ensure that the class of instruments as a whole is the residual class, the Board decided that no instrument holder in that class can have preferential terms or conditions in its position as an owner of the entity.
- BC60 The Board decided that the puttable instruments should contain no contractual obligation to deliver a financial asset to another entity other than the put. That is because the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to instruments that also contain other contractual obligations is not appropriate. Moreover, the Board concluded that if the puttable instrument contains another contractual obligation, that instrument may not represent the residual interest because the holder of the puttable instrument may have a claim to some of the net assets of the entity in preference to other instruments.
- BC61 As well as requiring a direct link between the puttable instrument and the performance of the entity, the Board also decided that there should be no financial instrument or contract with a return that is more residual. The Board decided to require that there must be no other financial instrument or contract that has total cash flows based substantially on the performance of the entity and has the effect of significantly restricting or fixing the return to the puttable instrument holders. This criterion was included to ensure that the holders of the puttable instruments represent the residual interest in the net assets of the entity.
- BC62 An instrument holder may enter into transactions with the issuing entity in a role other than that of an owner. The Board concluded that it is inappropriate to consider cash flows and contractual features related to the instrument holder in a non-owner role when evaluating whether a financial instrument has the features set out in paragraph 16A or paragraph 16C. That is because those cash flows and contractual features are separate and distinct from the cash flows and contractual features of the puttable financial instrument.
- BC63 The Board also decided that contracts (such as warrants and other derivatives) to be settled by the issue of puttable financial instruments should be precluded from equity classification. That is because the Board noted that the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to such contracts is not appropriate.

### **Amendment for obligations to deliver to another party a pro rata share of the net assets of the entity only on liquidation**

- BC64 Issues similar to those raised by constituents relating to classification of puttable financial instruments apply to some financial instruments that create an obligation only on liquidation of the entity.

- BC65 In the exposure draft published in June 2006, the Board proposed to exclude from the definition of a financial liability a contractual obligation that entitles the holder to a pro rata share of the net assets of the entity only on liquidation of the entity. The liquidation of the entity may be:
- (a) certain to occur and outside the control of the entity (limited life entities); or
  - (b) uncertain to occur but at the option of the holder (for example, some partnership interests).
- BC66 Respondents to that exposure draft were generally supportive of the proposed amendment.
- BC67 The Board decided that an exception to the definition of a financial liability should be made for instruments that entitle the holder to a pro rata share of the net assets of an entity only on liquidation if particular requirements are met. Many of those requirements, and the reasons for them, are similar to those for puttable financial instruments. The differences between the requirements are as follows:
- (a) there is no requirement that there be no other contractual obligations;
  - (b) there is no requirement to consider the expected total cash flows throughout the life of the instrument;
  - (c) the only feature that must be identical among the instruments in the class is the obligation for the issuing entity to deliver to the holder a pro rata share of its net assets on liquidation.

The reason for the differences is the timing of settlement of the obligation. The life of the financial instrument is the same as the life of the issuing entity; the extinguishment of the obligation can occur only at liquidation. Therefore, the Board concluded that it was appropriate to focus only on the obligations that exist at liquidation. The instrument must be subordinate to all other classes of instruments and represent the residual interests only at that point in time. However, if the instrument contains other contractual obligations, those obligations may need to be accounted for separately in accordance with the requirements of IAS 32.

## Non-controlling interests

- BC68 The Board decided that puttable financial instruments or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation should be classified as equity in the separate financial statements of the issuer if they represent the residual class of instruments (and all the relevant requirements are met). The Board decided that such instruments were not the residual interest in the consolidated financial statements and therefore that non-controlling interests that contain an obligation to transfer a financial asset to another entity should be classified as a financial liability in the consolidated financial statements.

## Analysis of costs and benefits

- BC69 The Board acknowledged that the amendments made in February 2008 are not consistent with the definition of a liability in the *Framework*, or with the underlying principle of IAS 32, which is based on that definition. Consequently, those amendments added complexity to IAS 32 and introduced the need for detailed rules. However, the Board also noted that IAS 32 contains other exceptions to its principle (and the definition of a liability in the *Framework*) that require instruments to be classified as liabilities that otherwise would be treated as equity. Those exceptions

highlight the need for a comprehensive reconsideration of the distinctions between liabilities and equity, which the Board is undertaking in its long-term project.

- BC70 In the interim, the Board concluded that classifying as equity the instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D would improve the comparability of information provided to the users of financial statements. That is because financial instruments that are largely equivalent to ordinary shares would be consistently classified across different entity structures (eg some partnerships, limited life entities and co-operatives). The specified instruments differ from ordinary shares in one respect; that difference is the obligation to deliver cash (or another financial asset). However, the Board concluded that the other characteristics of the specified instruments are sufficiently similar to ordinary shares for the instruments to be classified as equity. Consequently, the Board concluded that the amendments will result in financial reporting that is more understandable and relevant to the users of financial statements.
- BC71 Furthermore, in developing the amendments, the Board considered the costs to entities of obtaining information necessary to determine the required classification. The Board believes that the costs of obtaining any new information would be slight because all of the necessary information should be readily available.
- BC72 The Board also acknowledged that one of the costs and risks of introducing exceptions to the definition of a financial liability is the structuring opportunities that may result. The Board concluded that financial structuring opportunities are minimised by the detailed criteria required for equity classification and the related disclosures.
- BC73 Consequently, the Board believed that the benefits of the amendments outweigh the costs.
- BC74 The Board took the view that, in most cases, entities should be able to apply the amendments retrospectively. The Board noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides relief when it is impracticable to apply a change in accounting policy retrospectively as a result of a new requirement. Furthermore, the Board took the view that the costs outweighed the benefits of separating a compound financial instrument with an obligation to deliver a pro rata share of the net assets of the entity only on liquidation when the liability component is no longer outstanding on the date of initial application. Hence, there is no requirement on transition to separate such compound instruments.

## Dissenting opinions

### Dissent of James J Leisenring from the issue of IAS 32 in December 2003

- DO1 Mr Leisenring dissents from IAS 32 because, in his view, the conclusions about the accounting for forward purchase contracts and written put options on an issuer's equity instruments that require physical settlement in exchange for cash are inappropriate. IAS 32 requires a forward purchase contract to be recognised as though the future transaction had already occurred. Similarly it requires a written put option to be accounted for as though the option had already been exercised. Both of these contracts result in combining the separate forward contract and the written put option with outstanding shares to create a synthetic liability.
- DO2 Recording a liability for the present value of the fixed forward price as a result of a forward contract is inconsistent with the accounting for other forward contracts. Recording a liability for the present value of the strike price of an option results in recording a liability that is inconsistent with the *Framework*<sup>2</sup> as there is no present obligation for the strike price. In both instances the shares considered to be subject to the contracts are outstanding, have the same rights as any other shares and should be accounted for as outstanding. The forward and option contracts meet the definition of a derivative and should be accounted for as derivatives rather than create an exception to the accounting required by IAS 39. Similarly, if the redemption feature is embedded in the equity instrument (for example, a redeemable preference share) rather than being a free-standing derivative contract, the redemption feature should be accounted for as a derivative.
- DO3 Mr Leisenring also objects to the conclusion that a purchased put or call option on a fixed number of an issuer's equity instruments is not an asset. The rights created by these contracts meet the definition of an asset and should be accounted for as assets and not as a reduction in equity. These contracts also meet the definition of derivatives that should be accounted for as such consistently with IAS 39.

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<sup>2</sup> The reference to the *Framework* is to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

## **Dissent of Mary E Barth and Robert P Garnett from the issue of *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1) in February 2008**

- DO1 Professor Barth and Mr Garnett voted against the publication of *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1 *Presentation of Financial Statements*). The reasons for their dissent are set out below.
- DO2 These Board members believe that the decision to permit entities to classify as equity some puttable financial instruments and some financial instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation is inconsistent with the *Framework*<sup>2</sup>. The contractual provisions attached to those instruments give the holders the right to put the instruments to the entity and demand cash. The *Framework*'s definition of a liability is that it is a present obligation of the entity arising from a past event, the settlement of which is expected to result in an outflow of resources of the entity. Thus, financial instruments within the scope of the amendments clearly meet the definition of a liability in the *Framework*.
- DO3 These Board members do not agree with the Board that an exception to the *Framework* is justified in this situation. First, the Board has an active project on the *Framework*, which will revisit the definition of a liability. Although these Board members agree that standards projects can precede decisions in the *Framework* project, the discussions to date in the *Framework* project do not make it clear that the Board will modify the existing elements definitions in such a way that these instruments would be equity. Second, the amendments would require disclosure of the expected cash outflow on redemption or repurchase of puttable instruments classified as equity. These disclosures are similar to those for financial liabilities; existing standards do not require similar disclosure for equity instruments. The Board's decision to require these disclosures reveals its implicit view these instruments are, in fact, liabilities. Yet, the *Framework* is clear that disclosure is not a substitute for recognition. Third, these Board members see no cost-benefit or practical reasons for making this exception. The amendments require the same or similar information to be obtained and disclosed as would be the case if these obligations were classified as liabilities. Existing standards offer presentation alternatives for entities that have no equity under the *Framework*'s definitions.
- DO4 These Board members also do not agree with the Board that there are benefits to issuing these amendments. First, paragraph BC70 in the Basis for Conclusions states that the amendments will result in more relevant and understandable financial reporting. However, as noted above, these Board members do not believe that presenting as equity items that meet the *Framework*'s definition of a liability results in relevant information. Also as noted above, existing standards offer presentation alternatives that result in understandable financial reporting.

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<sup>2</sup> References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

- DO5 Second, paragraph BC70 states that the amendments would increase comparability by requiring more consistent classification of financial instruments that are largely equivalent to ordinary shares. These Board members believe that the amendments decrease comparability. These instruments are not comparable to ordinary shares because these instruments oblige the entity to transfer its economic resources; ordinary shares do not. Also, puttable instruments and instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation will be classified as equity by some entities and as liabilities by other entities, depending on whether the other criteria specified in the amendments are met. Thus, these amendments account similarly for economically different instruments, which decreases comparability.
- DO6 Finally, these Board members do not believe that the amendments are based on a clear principle. Rather, they comprise several paragraphs of detailed rules crafted to achieve a desired accounting result. Although the Board attempted to craft these rules to minimise structuring opportunities, the lack of a clear principle leaves open the possibility that economically similar situations will be accounted for differently and economically different situations will be accounted for similarly. Both of these outcomes also result in lack of comparability.

## **Dissent of James J Leisenring and John T Smith from the issue of *Classification of Rights Issues***

- DO1 Messrs Leisenring and Smith dissent from the amendment *Classification of Rights Issues* for the reasons set out below.
- DO2 Mr Smith agrees with the concept of accounting for a rights issue as equity in specified circumstances and supports both the IFRIC recommendation and staff recommendation in July 2009 that the Board make 'an extremely narrow amendment' to IAS 32 to deal with this issue. However, he dissents because he believes the change is not extremely narrow and will provide a means for an entity to use its equity instruments as a way to engage in speculative foreign currency transactions and structure them as equity transactions, a concern identified by the Board in the Basis for Conclusions on IAS 32.
- DO3 In their comment letters on the exposure draft, some respondents expressed concerns that the wording of the amendment was too open-ended and could lead to structuring risks. Mr Smith believes that these concerns are well-founded because there is no limitation on what qualifies as a class of equity. Without some limitation, an entity could, for example, establish a foreign currency trading subsidiary, issue shares to a non-controlling interest and deem the shares to be a class of equity in the consolidated group.
- DO4 The staff acknowledged the concerns expressed in comment letters that a new class of equity could be created for the purpose of obtaining a desired accounting treatment. However, the Board decided not to attempt to limit such structuring opportunities. The Board was concerned that a requirement that a pro rata offer of rights must be made to all existing owners (rather than only all existing owners of a particular class) of equity instruments would mean that the amendment would not be applicable to most of the transactions to which the Board intended the amendment to apply.
- DO5 Instead of trying to narrow the amendment, the Board simply acknowledged that under the amendment, 'You could set up a new class of shares today and one minute later issue shares to that class and ... speculate in foreign currency without it going through the income statement.' Mr Smith believes the Board should have explored other alternatives. Mr Smith believes that the Board should have sought solutions that could in fact provide a means of narrowing the amendment to limit structuring while accommodating appropriate transactions.
- DO6 Mr Smith believes that structuring opportunities could be curtailed significantly if some limitations were placed on the type of class of equity instruments that qualify for the exemption. There are a number of factors or indicators that could have been incorporated into the amendment that would limit the exception. For example, the amendment could have specified that non-controlling interests do not constitute a class. The amendment could have further required that qualification for the exemption is limited to those classes of equity instruments in which (a) ownership in the class is diverse or (b) the class is registered on an exchange and shares are exchanged in the marketplace or (c) shares in that class when issued were offered to the public at large and sold in more than one jurisdiction and there was no agreement to subsequently offer rights to shares of the entity; and the amount of capital provided by the class is substantial relative to the other classes of equity. Clearly, some combination of these and other alternatives could have been used to limit structuring opportunities. Mr Smith believes that a better solution could have been found and without introducing some limits around the type of class of equity instruments that qualify, the Board did not produce an extremely narrow amendment.

- DO7 Mr Leisenring agrees that when an entity issues rights to acquire its own equity instruments those rights should be classified as equity. However, he does not accept that the issue must be pro rata to all existing shareholders of a class of non-derivative equity instruments. He does not accept that whether or not the offer is pro rata is relevant to determining if the transaction meets the definition of a liability.
- DO8 Paragraph BC4J suggests that the Board limited its conclusion to those transactions issued on a pro rata basis because of concerns about structuring risks. If that is of concern the suggestions contained in Mr Smith's dissent would be much more effective and desirable than introducing a precedent that transactions such as this rights offering must simply be pro rata to be considered a transaction with owners as owners.
- DO9 Mr Leisenring would have preferred to conclude that a right granted for a fixed amount of a currency was a 'fixed for fixed' exchange rather than create additional conditions to the determination of a liability.

## Appendix **GA**

### Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

#### **Annual Improvements 2009-2011 Cycle – effective for annual periods beginning on or after 1 January 2013**

*The Basis for Conclusions accompanies, but is not part of, the amendment.*

A heading and paragraphs BC33A–BC33C are added.

#### **Income tax consequences of distributions to holders of an equity instrument and of transaction costs of an equity transaction**

**BC33A** In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board addressed perceived inconsistencies between IAS 12 *Income Taxes* and IAS 32 *Financial Instruments: Presentation* with regards to recognising the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. Paragraph 52B of IAS 12 requires the recognition of the income tax consequences of dividends in profit or loss except when the circumstances described in paragraph 58(a) and (b) of IAS 12 arise. However, paragraph 35 of IAS 32 required the recognition of income tax relating to distributions to holders of an equity instrument in equity (prior to the amendment).

**BC33B** The Board noted that the intention of IAS 32 was to follow the requirements in IAS 12 for accounting for income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction. Consequently, the Board decided to add paragraph 35A to IAS 32 to clarify this intention.

**BC33C** The Board noted that this amendment is not intended to address the distinction between income tax consequences of dividends in accordance with paragraph 52B, and withholding tax for dividends in accordance with paragraph 65A, of IAS 12. In this respect, the Board observed that the income tax consequences of distributions to holders of an equity instrument are recognised in profit or loss in accordance with paragraph 52B of IAS 12. Consequently, to the extent that the distribution relates to income arising from a transaction that was originally recognised in profit or loss, the income tax on the distribution should be recognised in profit or loss. However, if the distribution relates to income or to a transaction that was originally recognised in other comprehensive income or equity, the entity should apply the exception in paragraph 58(a) of IAS 12, and recognise the income tax consequences of the distribution outside of profit or loss. The Board also observed that, in accordance with paragraph 65A, when an entity pays dividends to its shareholders the portion of the dividends paid or payable to taxation authorities as withholding tax is charged to equity as part of the dividends.

## Appendix DB

### Amendments to Basis for Conclusions on IAS 32 *Offsetting Financial Assets and Financial Liabilities* (issued in December 2011) - effective for annual periods beginning on or after 1 January 2014

The following sets out amendments required for this Basis for Conclusions resulting from amendments to IAS 32 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

After paragraph BC74, headings and paragraphs BC75–BC120 are added.

### Amendments to the application guidance for offsetting financial assets and financial liabilities

#### Background

- BC75 Following requests from users of financial statements and recommendations from the Financial Stability Board, in June 2010 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), added a project to their respective agendas to improve, and potentially achieve convergence of, the requirements for offsetting financial assets and financial liabilities. The boards made this decision because the differences in their requirements for offsetting financial assets and financial liabilities cause significant differences between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP. This is particularly so for entities that have large amounts of derivative activities.
- BC76 Consequently, in January 2011 the Board published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. The proposals in the exposure draft would have established a common approach with the FASB. The exposure draft also proposed disclosures about financial assets and financial liabilities that are subject to set-off rights and related arrangements (such as collateral agreements), and the effect of those rights and arrangements on an entity's financial position.
- BC77 As a result of the feedback received on the exposure draft, the IASB and the FASB decided to maintain their current offsetting models. However, the boards noted that requiring common disclosures of gross and net information would be helpful for users of financial statements. Accordingly, the boards agreed on common disclosure requirements by amending and finalising the disclosures that were initially proposed in the exposure draft. The amendments *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) were issued in December 2011.
- BC78 In addition, the IASB decided to add application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This included clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.

## Requirements for offsetting financial assets and financial liabilities

### Criterion that an entity 'currently has a legally enforceable right to set off the recognised amounts' (paragraph 42(a))

- BC79 To meet the criterion in paragraph 42(a) of IAS 32, an entity must currently have a legally enforceable right to set off the recognised amounts. However, IAS 32 did not previously provide guidance on what was meant by 'currently has a legally enforceable right to set off'. Feedback from the exposure draft revealed inconsistencies in the application of this criterion by IFRS preparers. Consequently, the Board decided to include application guidance in IAS 32 (paragraphs AG38A–AG38D) to clarify the meaning of this criterion.
- BC80 The Board believes that the net amounts of financial assets and financial liabilities presented in the statement of financial position should represent an entity's exposure in the normal course of business and its exposure if one of the parties will not or cannot perform under the terms of the contract. The Board therefore clarified in paragraph AG38B that to meet the criterion in paragraph 42(a) of IAS 32 a right of set-off is required to be legally enforceable in the normal course of business, the event of default and the event of insolvency or bankruptcy of the entity and all of the counterparties. The right must exist for all counterparties so that if an event occurs for one of the counterparties, including the entity, the other counterparty or parties will be able to enforce the right of set-off against the party that has defaulted or gone insolvent or bankrupt.
- BC81 If a right of set-off cannot be enforced in the event of default and in the event of insolvency or bankruptcy, then offsetting would not reflect the economic substance of the entity's rights and obligations and would therefore not meet the objective of offsetting in paragraph 43 of IAS 32. The Board uses the term 'in the event of default and in the event of insolvency or bankruptcy' to describe scenarios where an entity will not or cannot perform under the contract.
- BC82 The use of the word 'currently' in paragraph 42(a) of IAS 32 means that the right of set-off cannot be contingent on a future event. If a right of set-off were contingent or conditional on a future event an entity would not currently have a (legally enforceable) right of set-off. The right of set-off would not exist until the contingency occurred, if at all.
- BC83 In addition, the Board believes that the passage of time or uncertainties in amounts to be paid do not preclude an entity from currently having a (legally enforceable) right of set-off. The fact that the payments subject to a right of set-off will only arise at a future date is not in itself a condition or a form of contingency that prevents offsetting in accordance with paragraph 42(a) of IAS 32.
- BC84 However, if the right of set-off is not exercisable during a period when amounts are due and payable, then the entity does not meet the offsetting criterion as it has no right to set off those payments. Similarly, a right of set-off that could disappear or that would no longer be enforceable after a future event that could take place in the normal course of business or in the event of default, or in the event of insolvency or bankruptcy, such as a ratings downgrade, would not meet the currently (legally enforceable) criterion in paragraph 42(a) of IAS 32.
- BC85 The application of the word 'currently' in paragraph 42(a) of IAS 32 was not a source of inconsistency in practice but rather a question that arose as a result of the wording in the exposure draft. Consequently, the Board decided that further application guidance was only required for the legal enforceability part of the criterion.

- BC86 In developing the proposals in the exposure draft, the Board concluded that the net amount represents the entity's right or obligation if (a) the entity has the ability to insist on net settlement or to enforce net settlement in all situations (ie the exercise of that right is not contingent on a future event), (b) that ability is assured, and (c) the entity intends to receive or pay a single net amount, or to realise the asset and settle the liability simultaneously.
- BC87 Some respondents were concerned that the terms 'in all situations' and 'the ability is assured' as referred to in paragraph BC86 create a higher hurdle than IAS 32 today. The Board however believes that the conclusions in the exposure draft are consistent with the offsetting criteria and principle in IAS 32, specifically paragraphs 42, 43, 46 and 47. In addition, the application guidance in paragraph AG38B of IAS 32 addresses respondents' concerns by clarifying the circumstances in which an entity should be able to net (ie what 'in all situations' means), and by requiring legal enforceability in such circumstances, a term commonly used in applying IAS 32 today.

### *Applicability to all counterparties*

- BC88 The proposals in the exposure draft required that the right of set-off be legally enforceable in the event of default and in the event of insolvency or bankruptcy of 'one of the counterparties' (including the entity itself). There were differing views as to whether the requirement that the right of set-off must be enforceable in the event of the entity's default and/or insolvency or bankruptcy changed the criteria in IAS 32 today.
- BC89 Some respondents disagreed that the right of set-off must be enforceable in the events of default and insolvency or bankruptcy of the entity. Although consideration is given to enforceability today to achieve offsetting in accordance with IAS 32, some have only focused on the effects of the insolvency or bankruptcy of the counterparty. These respondents questioned whether legal opinions as to enforceability in the event of their own insolvency or bankruptcy could be obtained and considered this to be a change in practice from IAS 32 that could increase costs and the burden for preparers. They also believed that such a requirement would be inconsistent with the going concern basis of preparation for financial statements.
- BC90 Other respondents, however, agreed that, to represent the entity's net exposure at all times, the right of set-off must be enforceable in the insolvency or bankruptcy of all of the counterparties to the contract.
- BC91 The Board believes that limiting the enforcement of the right of set-off to the event of default and the event of insolvency or bankruptcy of the counterparty (and not the entity itself) is not consistent with the principle and objective of offsetting in IAS 32.
- BC92 If a right of set-off cannot also be enforced in the event of default and in the event of insolvency or bankruptcy of the entity, then offsetting would not reflect the economic substance of the entity's rights and obligations or the financial position of the entity (ie offsetting would not reflect an entity's expected future cash flows from settling two or more separate financial instruments in accordance with paragraph 43 of IAS 32) and would therefore not meet the objective of offsetting in IAS 32.
- BC93 Consequently, the Board decided to clarify that, to meet the offsetting criterion in paragraph 42(a) of IAS 32, a right of set-off must be enforceable in the event of default and in the event of insolvency or bankruptcy of both the entity and its counterparties (paragraphs AG38A and AG38B of IAS 32).

**Criterion that an entity ‘intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously’ (paragraph 42(b))**

- BC94 In the exposure draft the boards noted that offsetting financial assets and financial liabilities is appropriate and reflects the financial position of an entity only if the entity has, in effect, a right to, or an obligation for, only the net amount (ie the entity has, in effect, a single net financial asset or net financial liability). The amount resulting from offsetting must also reflect the entity’s expected future cash flows from settling two or more separate financial instruments. This is consistent with the principle in paragraph 43 of IAS 32.
- BC95 When developing that principle the boards understood that entities may currently have a legally enforceable right and desire to settle net, but may not have the operational capabilities to effect net settlement. The gross positions would be settled at the same moment such that the outcome would not be distinguishable from net settlement. As a result the boards included simultaneous settlement as a practical exception to net settlement. Simultaneous settlement was intended to capture payments that are essentially equivalent to actual net settlement. The proposals in the exposure draft also defined simultaneous settlement as settlement ‘at the same moment’.
- BC96 Simultaneous settlement as ‘at the same moment’ is already a concept in paragraph 48 of IAS 32 that enables an entity to meet the criterion in paragraph 42(b) of IAS 32. However, feedback received during outreach indicated that there was diversity in practice related to the interpretation of ‘simultaneous settlement’ in IAS 32. Many preparers and accounting firms have interpreted paragraph 48 of IAS 32 to mean that settlement through a clearing house always meets the simultaneous settlement criterion even if not occurring at the same moment.
- BC97 Respondents also noted that settlement of two positions by exchange of gross cash flows at exactly the same moment (simultaneously) rarely occurs in practice today. They argued that ‘simultaneous’ is not operational and ignores settlement systems that are established to achieve what is economically considered to be net exposure.
- BC98 Some preparers also indicated that settlement through some gross settlement mechanisms, though not simultaneous, effectively results in the same exposure as in net settlement or settlement at the same moment and are currently considered to meet the requirements in IAS 32, without actually taking place ‘at the same moment’. For particular settlement mechanisms, once the settlement process commences, the entity is not exposed to credit or liquidity risk over and above the net amount and therefore the process is equivalent to net settlement.
- BC99 Paragraph 48 of IAS 32 states that simultaneous settlement results in ‘no exposure to credit or liquidity risk’. In its redeliberations the Board considered gross settlement mechanisms with features that both (i) eliminate credit and liquidity risk; and (ii) process receivables and payables in a single settlement process. The Board agreed that gross settlement systems with such features are effectively equivalent to net settlement.
- BC100 To clarify the application of the IAS 32 offsetting criteria and to reduce diversity in practice, the Board therefore clarified the principle behind net settlement and included an example of a gross settlement system with characteristics that would satisfy the IAS 32 criterion for net settlement in paragraph AG38F of IAS 32.

BC101 However, the Board decided not to refer specifically to clearing houses or central counterparties when describing systems that may be treated as equivalent to net settlement for the purposes of the set-off criterion. Systems that meet the principle in paragraph AG38F of IAS 32 may be referred to by different names in different jurisdictions. Referring to specific types of settlement systems may exclude other systems that are also considered equivalent to net settlement. In addition, the Board did not want to imply that settlement through specific systems would always meet the net settlement criterion. Entities must determine whether a system meets the principle in paragraph AG38F of IAS 32 by determining whether or not the system eliminates or results in insignificant credit and liquidity risk and processes receivables and payables in the same settlement process or cycle.

### **Offsetting collateral amounts**

BC102 The proposals in the exposure draft specifically prohibited offsetting assets pledged as collateral (or the right to reclaim the collateral pledged) or the obligation to return collateral sold with the associated financial assets and financial liabilities. A number of respondents disagreed with the proposed treatment of collateral and noted that the proposed prohibition was more restrictive than the offsetting criteria in paragraph 42 of IAS 32.

BC103 The offsetting criteria in IAS 32 do not give special consideration to items referred to as 'collateral'. The Board confirmed that a recognised financial instrument referred to as collateral should be set off against the related financial asset or financial liability in the statement of financial position if, and only if, it meets the offsetting criteria in paragraph 42 of IAS 32. The Board also noted that if an entity can be required to return or receive back collateral, the entity would not currently have a legally enforceable right of set-off in all of the following circumstances: in the normal course of business, the event of default and the event of insolvency or bankruptcy of one of the counterparties.

BC104 Because no particular practice concerns or inconsistencies were brought to the Board's attention related to the treatment of collateral in accordance with the offsetting criteria in IAS 32, and as the concerns that arose originated from the proposals in the exposure draft, the Board did not consider it necessary to add application guidance for the treatment of collateral.

### **Unit of account**

BC105 Neither IAS 32 nor the exposure draft specifies the unit of account to which the offsetting requirements should be applied. During the outreach performed on the exposure draft, it became apparent that there was diversity in practice regarding the unit of account that was used for offsetting in accordance with IAS 32.

BC106 Entities in some industries (for example, energy producers and traders) apply the offsetting criteria to identifiable cash flows. Other entities apply the offsetting criteria to entire financial assets and financial liabilities. For those entities (for example, financial institutions), applying the offsetting criteria to individual identifiable cash flows (portions of financial assets and financial liabilities) within contracts would be impractical and burdensome, even though requiring application of the offsetting criteria to entire financial instruments results in less offsetting in the statement of financial position.

BC107 The Board acknowledged that the focus of the offsetting model is the entity's net exposure and expected future cash flows from settling the related financial instruments.

- BC108 The Board also noted that some of the entities for whom the offsetting requirements are most relevant are those that would have the most significant operational challenges with applying the model to individual cash flows (such as financial institutions with large derivative activities). This is important to consider because IAS 32 requires offsetting if the offsetting criteria are met.
- BC109 On the other hand, if the application of the offsetting criteria to individual cash flows was prohibited, entities in some industries (for example, energy producers and traders) that apply the criteria in IAS 32 to individual cash flows of financial instruments, and achieve set-off on that basis today, would no longer be permitted to do so.
- BC110 The Board considered clarifying the application guidance in IAS 32 to indicate that offsetting should apply to individual cash flows of financial instruments. However, if it made such clarification, the Board felt that it would be necessary to consider an exemption from this requirement on the basis of operational complexity. This would result in the offsetting requirements still being applied differently between entities.
- BC111 Although different interpretations of the unit of account are applied today, the Board concluded that this does not result in inappropriate application of the offsetting criteria. The benefits of amending IAS 32 would not outweigh the costs for preparers and therefore the Board decided not to amend the application guidance to IAS 32 on this subject.

## Cost-benefit considerations

- BC112 Before issuing an IFRS or an amendment to an IFRS, the Board seeks to ensure that it will meet a significant need and that the overall benefits of the resulting information will justify the costs of providing it. The Board issued *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32) to eliminate inconsistencies in the application of the offsetting criteria in paragraph 42 of IAS 32 by clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.
- BC113 Some respondents were concerned that requiring a right of set-off to be enforceable in the event of default and in the event of insolvency or bankruptcy of the entity would increase the cost of applying the offsetting criteria in IAS 32, if, for example, they needed to obtain additional legal opinions on enforceability. However, the Board noted that without this clarification the offsetting criteria would continue to be applied inconsistently, and the resulting offsetting would be inconsistent with the offsetting objective in IAS 32. This would also reduce comparability for users of financial statements. Consequently, the Board concluded that the benefit of clarifying this criterion outweighed the cost to preparers of applying these amendments.
- BC114 During redeliberations the Board also considered feedback received on the proposals in the exposure draft related to the treatment of collateral and unit of account. However, as described in greater detail in other sections of this Basis for Conclusions, the Board did not consider it necessary to add application guidance for the treatment of these items.
- BC115 The amendments to the IAS 32 application guidance (paragraphs AG38A–AG38F of IAS 32) are intended to clarify the Board's objective for the offsetting criteria and therefore eliminate inconsistencies noted in applying paragraph 42 of IAS 32.
- BC116 Based on the considerations described in the Basis for Conclusions of these amendments, and summarised in paragraphs BC112–BC115, the Board concluded that the benefits of *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32) outweigh the costs to preparers of applying those amendments.

## Transition and effective date

- BC117 During redeliberations, the Board originally decided to require retrospective application of the application guidance in paragraphs AG38A–AG38F of IAS 32 for annual periods beginning on or after 1 January 2013. The Board did not expect significant changes in practice as a result of the clarifications made to the application guidance and hence aligned the effective date and transition of these amendments with that of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), issued in December 2011.
- BC118 However, the Board received additional feedback from some preparers that the clarifications to the application guidance could change their practice. These preparers indicated that they needed more time to evaluate the effects of the amendments. They indicated that it would be difficult for them to make this assessment in time to allow application of the amendments to the application guidance for the first comparative reporting period.
- BC119 Preparers therefore requested that the Board consider aligning the effective date of the amendments with the revised effective date of IFRS 9 *Financial Instruments* (1 January 2015), with earlier application allowed. This would give them sufficient time to determine if there would be any changes to their financial statements.
- BC120 The Board believed that the amendments to the IAS 32 application guidance should be effective as soon as possible to ensure comparability of financial statements prepared in accordance with IFRSs. In addition, the Board did not consider that the effective date needed to be aligned with that of IFRS 9. However, the Board also understood the concerns of preparers. The Board therefore decided to require the amendments to the IAS 32 application guidance to be effective for periods beginning 1 January 2014 with earlier application permitted. This would provide a balance between the time needed to implement the amendments with the need for consistent application of the IAS 32 offsetting requirements.

Effective for annual periods  
beginning on or after 1 January 2005

*Illustrative Examples*  
*Hong Kong Accounting Standard 32*

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# **Financial Instruments: Presentation**



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*paragraphs*

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## IAS 32 *Financial Instruments: Presentation* Illustrative examples

*These examples accompany, but are not part of, IAS 32.*

### Accounting for contracts on equity instruments of an entity

IE1 The following examples<sup>\*</sup> illustrate the application of paragraphs 15–27 and IAS 39 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

#### **Example 1: Forward to buy shares**

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

##### *Assumptions:*

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

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

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

On 1 February 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for a payment of CU104,000 in cash (i.e. CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

<sup>\*</sup> In these examples, monetary amounts are denominated in 'currency units' (CU).

**1 February 20X2**

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

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

**31 December 20X2**

On 31 December 20X2, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr	Forward asset	CU6,300	
	Cr	Gain	CU6,300

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

**31 January 20X3**

On 31 January 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ( $[\text{CU}106 \times 1,000] - \text{CU}104,000$ ).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 ( $\text{CU}106 \times 1,000$ ) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr	Loss	CU4,300	
	Cr	Forward asset	CU4,300

*To record the decrease in the fair value of the forward contract (ie  $\text{CU}4,300 = \text{CU}6,300 - \text{CU}2,000$ ).*

Dr	Cash	CU2,000	
	Cr	Forward asset	CU2,000

*To record the settlement of the forward contract.*

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

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

**31 January 20X3**

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ( $\text{CU}104 \times 1,000$ ) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 ( $\text{CU}106 \times 1,000$ ) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 ( $\text{CU}106,000 - \text{CU}104,000$ ) worth of shares to Entity A, i.e. 18.9 shares ( $\text{CU}2,000 / \text{CU}106$ ).

Dr	Equity	CU2,000	
	Cr	Forward asset	CU2,000

*To record the settlement of the forward contract.*

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

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

**1 February 20X2**

Dr	Equity	CU100,000	
	Cr	Liability	CU100,000

*To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IAS 39, paragraph AG64).*

**31 December 20X2**

Dr	Interest expense	CU3,660	
	Cr	Liability	CU3,660

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

**31 January 20X3**

Dr	Interest expense	CU340	
	Cr	Liability	CU340

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

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

Dr	Liability	CU104,000	
	Cr	Cash	CU104,000

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

**(d) Settlement options**

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

## Example 2: Forward to sell shares

- IE7 This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by receiving cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (i.e. the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

### Assumptions:

Contract date	1 February 20X2
Maturity date	31 January 20X3
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU110
Market price per share on 31 January 20X3	CU106
Fixed forward price to be paid on 31 January 20X3	CU104
Present value of forward price on 1 February 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 20X2	CU0
Fair value of forward on 31 December 20X2	CU(6,300)
Fair value of forward on 31 January 20X3	CU(2,000)

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

- IE8 On 1 February 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for CU104,000 in cash (i.e. CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

#### 1 February 20X2

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

#### 31 December 20X2

Dr	Loss	CU6,300	
	Cr	Forward liability	CU6,300

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

#### 31 January 20X3

Dr	Forward liability	CU4,300	
	Cr	Gain	CU4,300

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

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

Dr	Forward liability	CU2,000	
	Cr      Cash		CU2,000

*To record the settlement of the forward contract.*

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

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

**31 January 20X3**

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

Dr	Forward liability	CU2,000	
	Cr      Equity		CU2,000

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

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

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

**1 February 20X2**

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

**31 December 20X2**

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

**31 January 20X3**

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

Dr	Cash		CU104,000	
	Cr	Equity		CU104,000

*To record the settlement of the forward contract*

**(d) Settlement options**

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

**Example 3: Purchased call option on shares**

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

**Assumptions:**

Contract date	1 February 20X2
Exercise date	31 January 20X3
	(European terms, ie it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

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

- IE13 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 20X3 in exchange for CU102,000 in cash (i.e. CU102 per share) on 31 January 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

**1 February 20X2**

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

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

*To recognise the purchased call option.*

**31 December 20X2**

On 31 December 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value  $([CU104 - CU102] \times 1,000)$ , and CU1,000 is the remaining time value.

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

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

**31 January 20X3**

On 31 January 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value  $([CU104 - CU102] \times 1,000)$  because no time value remains.

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

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

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

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

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

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

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

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

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

**1 February 20X2**

Dr	Equity	CU5,000	
	Cr	Cash	CU5,000

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

**31 December 20X2**

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

**31 January 20X3**

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

Dr	Equity	CU102,000	
	Cr	Cash	CU102,000

*To record the settlement of the option contract.*

**(d) Settlement options**

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

**Example 4: Written call option on shares**

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

*Assumptions:*

Contract date	1 February 20X2
Exercise date	31 January 20X3
	(European terms, ie it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

**(a) Cash for cash (“net cash settlement”)**

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

**1 February 20X2**

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

*To recognise the written call option.*

**31 December 20X2**

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

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

**31 January 20X3**

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

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

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

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

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

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

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

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

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

**1 February 20X2**

Dr	Cash		CU5,000	
	Cr	Equity		CU5,000

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

**31 December 20X2**

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

**31 January 20X3**

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

Dr	Cash		CU102,000	
	Cr	Equity		CU102,000

*To record the settlement of the option contract.*

**(d) Settlement options**

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

**Example 5: Purchased put option on shares**

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

*Assumptions:*

Contract date	1 February 20X2
Exercise date	31 January 20X3
	(European terms, ie it can be exercised only at maturity)

Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU95
Market price per share on 31 January 20X3	CU95
Fixed exercise price to be paid on 31 January 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU4,000
Fair value of option on 31 January 20X3	CU3,000

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

IE23 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 at a strike price of CU98,000 (i.e. CU98 per share) on 31 January 2003, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

**1 February 20X2**

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

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

*To recognise the purchased put option.*

**31 December 20X2**

On 31 December 20X2 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value  $([CU98 - CU95] \times 1,000)$  and CU1,000 is the remaining time value.

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

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

**31 January 20X3**

On 31 January 20X3 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value  $([CU98 - CU95] \times 1,000)$  because no time value remains.

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

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

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver CU98,000 to Entity A and Entity A has an obligation to deliver CU95,000 (CU95 x 1,000) to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

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

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

*To record the settlement of the option contract.*

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

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

**1 February 20X2**

Dr	Equity	CU5,000	
	Cr	Cash	CU5,000

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

**31 December 20X2**

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

**31 January 20X3**

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

Dr	Cash		CU98,000	
	Cr	Equity		CU98,000

*To record the settlement of the option contract.*

**(d) Settlement options**

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

**Example 6: Written put option on shares**

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

*Assumptions:*

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

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

IE28 Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of 31 January 20X3 in exchange for CU98,000 in cash (ie CU98 per share) on 31 January 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

**1 February 20X2**

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

*To recognise the written put option.*

**31 December 20X2**

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

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

**31 January 20X3**

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

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

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver CU98,000 to Entity B, and Entity B has an obligation to deliver CU95,000 (CU95 x 1,000) to Entity A. Thus, Entity A pays the net amount of CU3,000 to Entity B.

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver CU98,000 worth of shares to Entity B, and Entity B has an obligation to deliver CU95,000 worth of Entity A's shares (CU95 x 1,000) to Entity A. Thus, Entity A delivers the net amount of CU3,000 worth of Entity A's shares to Entity B, ie 31.6 shares (3,000 / 95).

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

*To record the settlement of the option contract. The issue of Entity A's own shares is*

accounted for as an equity transaction.

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

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

**1 February 20X2**

Dr	Cash	CU5,000	
	Cr	Equity	CU5,000

*To recognise the option premium received of CU5,000 in equity.*

Dr	Equity	CU95,000	
	Cr	Liability	CU95,000

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

**31 December 20X2**

Dr	Interest expense	CU2,750	
	Cr	Liability	CU2,750

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

**31 January 20X3**

Dr	Interest expense	CU250	
	Cr	Liability	CU250

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

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

Dr	Liability	CU98,000	
	Cr	Cash	CU98,000

*To record the settlement of the option contract.*

**(d) Settlement options**

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

## Entities such as mutual funds and Co-operatives whose share capital is not equity as Defined in IAS 32

### Example 7: Entities with no equity

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

#### Statement of comprehensive income for the year ended 31 December 20X1

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

#### Statement of financial position at 31 December 20X1

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

### Example 8: Entities with some equity

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in IAS 32 because the entity has an obligation to repay the share capital on demand but does not have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. Other formats are possible.

**Statement of comprehensive income for the year ended 31 December 20X1**

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

**Statement of financial position at 31 December 20X1**

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

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

## Accounting for compound financial instruments

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

- IE34 Paragraph 28 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.
- IE35 An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.
- IE36 The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

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

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

- IE37 The following example illustrates the application of paragraph 31 to the separation of the liability and equity components of a compound financial instrument with multiple embedded derivative features.
- IE38 Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 31 is CU55 (CU57 – CU2) and the value allocated to the equity component is CU5 (CU60 – CU55).

## Example 11: Repurchase of a convertible instrument

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

IE40 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

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

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

IE42 On 1 January 20X5, the convertible debenture has a fair value of CU1,700.

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

IE44 The repurchase price is allocated as follows:

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

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

IE45 Entity A recognises the repurchase of the debenture as follows:

Dr	Liability component	CU962	
Dr	Debt settlement expense (profit or loss)	CU119	
	Cr Cash		CU1,081

*To recognise the repurchase of the liability component.*

Dr	Equity	CU619	
	Cr Cash		CU619

*To recognise the cash paid for the equity component.*

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

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

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

IE48 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 11. On 1 January 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before 1 March 20X1 (i.e. within 60 days).

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

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

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

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

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

*Number of incremental ordinary shares issued upon conversion*

	<u>10 shares</u>
--	------------------

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

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

IE50 The incremental consideration of CU400 is recognised as a loss in profit or loss.

*Hong Kong Accounting Standard 36*

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# Impairment of Assets



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## Appendix D

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued pronouncements that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### **~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~**

Paragraphs 2(e) and 5 are amended and paragraph 140F is added as follows:

~~2~~ ...

~~(e) financial assets that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement* HKFRS 9 *Financial Instruments*;~~

~~5 This Standard does not apply to financial assets within the scope of HKAS 39 HKFRS 9, investment property measured at fair value in accordance with HKAS 40, or biological assets related to agricultural activity measured at fair value less costs to sell in accordance with HKAS 41. However, ...~~

~~140F HKFRS 9, issued in November 2009, amended paragraphs 2(e) and 5. An entity shall apply those amendments when it applies HKFRS 9.~~

*Hong Kong Accounting Standard 39*

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# **Financial Instruments: Recognition and Measurement**



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<i>No active market: equity instruments</i>	AG80-AG81
<i>Inputs to valuation techniques</i>	AG82
Gains and losses	AG83
Impairment and uncollectibility of financial assets	AG84-AG93
<i>Financial assets carried at amortised cost</i>	AG84-AG92
<i>Interest income after impairment recognition</i>	AG93
<b>Hedging</b>	<b>AG94-AG132</b>
Hedging instruments	AG94-AG97
<i>Qualifying instruments</i>	AG94-AG97
Hedged items	AG98-AG101
<i>Qualifying items</i>	AG98-AG99BA
<i>Designation of financial items as hedged items</i>	AG99C-AG99F
<i>Designation of non-financial items as hedged items</i>	AG100
<i>Designation of groups of items as hedged items</i>	AG101
Hedge accounting	AG102-AG132
<i>Assessing hedge effectiveness</i>	AG105-AG113
<i>Fair value hedge accounting for a portfolio hedge of interest rate risk</i>	AG114-AG132
<b>Transition</b>	<b>AG133</b>
<b>Appendix B: Amendments to other pronouncements</b>	
<b>Appendix C: Amendments resulting from other HKFRSs</b>	
<b>BASIS FOR CONCLUSIONS</b>	
<b>DISSENTING OPINIONS</b>	
<b>ILLUSTRATIVE EXAMPLE</b>	
<b>IMPLEMENTATION GUIDANCE</b>	

Hong Kong Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (HKAS 39) is set out in paragraphs 1-109 and Appendices A-C. All the paragraphs have equal authority. HKAS 39 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

- (i) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- (ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in HKAS 24 *Related Party Disclosures* (~~issued in 2004~~)), for example the entity’s board of directors and chief executive officer.

In HKFRS 7, paragraphs 9-11 and B4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions. For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity’s documented risk management or investment strategy.

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.

It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69-AG82, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

*Held-to-maturity investments* are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG16-AG25) other than:

- (a) those that the entity upon initial recognition designates as at fair value through profit or loss;
- (b) those that the entity designates as available for sale; and
- (c) those that meet the definition of loans and receivables.

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified 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 investments) other than sales or reclassifications that:

- (i) are so close to maturity or the financial asset’s call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset’s fair value;

## Effective date and transitional provisions

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- 103** An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies HKAS 32. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact. Except as provided for in paragraphs 104 and 105 below, retrospective application is not permitted.
- 103A** An entity shall apply the amendment in paragraph 2(j) for annual periods beginning on or after 1 January 2006. If an entity applies HK(IFRIC)-Int 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* for an earlier period, this amendment shall be applied for that earlier period.
- 103B** *Financial Guarantee Contracts* (Amendments to HKAS 39 and HKFRS 4), issued in September 2005, amended paragraphs 2(e) and (h), 4, 47 and AG4, added paragraph AG4A, added a new definition of financial guarantee contracts in paragraph 9, and deleted paragraph 3. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies these changes for an earlier period, it shall disclose that fact and apply the related amendments to HKAS 32\* and HKFRS 4 at the same time.
- 103C** HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 26, 27, 34, 54, 55, 57, 67, 68, 95(a), 97, 98, 100, 102, 105, 108, AG4D, AG4E(d)(i), AG56, AG67, AG83 and AG99B. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 103D** HKFRS 3 (as revised in 2008) deleted paragraph 2(f). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. However, the amendment does not apply to contingent consideration that arose from a business combination for which the acquisition date preceded the application of HKFRS 3 (revised 2008). Instead, an entity shall account for such consideration in accordance with paragraphs 65A–65E of HKFRS 3 (as amended in 2010).
- 103E** HKAS 27 (as amended in 2008) amended paragraph 102. An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendment shall be applied for that earlier period.
- 103F** An entity shall apply the amendment in paragraph 2 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to HKAS 32 and HKAS 1) issued in June 2008, for an earlier period, the amendment in paragraph 2 shall be applied for that earlier period.
- 103G** An entity shall apply paragraphs AG99BA, AG99E, AG99F, AG110A and AG110B retrospectively for annual periods beginning on or after 1 July 2009, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies *Eligible Hedged Items* (Amendment to HKAS 39) for periods beginning before 1 July 2009, it shall disclose that fact.

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\* When an entity applies HKFRS 7, the reference to HKAS 32 is replaced by a reference to HKFRS 7.

- 103H *Reclassification of Financial Assets* (Amendments to HKAS 39 and HKFRS 7), issued in October 2008, amended paragraphs 50 and AG8, and added paragraphs 50B–50F. An entity shall apply those amendments on or after 1 July 2008. An entity shall not reclassify a financial asset in accordance with paragraph 50B, 50D or 50E before 1 July 2008. Any reclassification of a financial asset made on or after 1 November 2008 shall take effect only from the date when the reclassification is made. Any reclassification of a financial asset in accordance with paragraph 50B, 50D or 50E shall not be applied retrospectively before 1 July 2008.
- 103I *Reclassification of Financial Assets—Effective Date and Transition* (Amendments to HKAS 39 and HKFRS 7), issued in December 2008, amended paragraph 103H. An entity shall apply that amendment on or after 1 July 2008.
- 103J An entity shall apply paragraph 12, as amended by *Embedded Derivatives* (Amendments to HK(IFRIC)-Int 9 and HKAS 39), issued in March 2009, for annual periods ending on or after 30 June 2009.
- 103K *Improvements to HKFRSs* issued in May 2009 amended paragraphs 2(g), 97, 100 and AG30(g). An entity shall apply the amendments to paragraphs 2(g), 97 and 100 prospectively to all unexpired contracts for annual periods beginning on or after 1 January 2010. An entity shall apply the amendment to paragraph AG30(g) for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

103L- [These paragraphs refer to amendments with an effective date after 1 January 2012, and 103M are therefore not included in this edition.]

103N Paragraph 103D was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

**104 The transition to this Standard should be as follows:**

- (a) [not used]
- (b) for those transactions entered into before the beginning of the financial year in which this Standard is initially applied that the entity 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 88 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 91 and 101 explain how to discontinue hedge accounting;
- (c) at the beginning of the financial year in which this Standard is initially applied, an entity should recognise all derivatives in its statement of financial position 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 entity should apply the criteria in paragraphs 43-54 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 or, if appropriate, another category of equity\* 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 entity'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 88 and, thereafter, accounted for as set out in paragraphs 97-100;**
- (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 shall not be retrospectively changed to conform to the requirements of this Standard; and**
- (i) sales or transfers of held-to-maturity investments before the beginning of the financial year in which this Standard is initially applied do not trigger the "tainting" rules in paragraph 9. If an entity has sold or transferred held-to-maturity investments previously so designated under SSAP 24 in the two preceding financial years, it is not prevented to continue to classify such financial assets as held-to-maturity investments at the beginning of the financial year in which this Standard is initially applied.**

**105 When this Standard is first applied, an entity is permitted to designate a previously recognised financial asset as available for sale. For any such financial asset the entity shall recognise all cumulative changes in fair value in a separate component of equity until subsequent derecognition or impairment, when the entity shall reclassify that cumulative gain or loss from equity to profit or loss as a reclassification adjustment (see HKAS 1 (revised 2007)). The entity shall also:**

- (a) restate the financial asset using the new designation in the comparative financial statements; and**

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\* Preparers are reminded of the requirement to apply the revised transitional provision consistently for all similar transactions and to disclose the accounting policy used in the notes to the financial statements.

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### **~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~**

In the Introduction paragraphs IN1–IN26 are deleted. A new Introduction is added as follows:

~~The International Accounting Standards Board has decided to replace HKAS 39 *Financial Instruments: Recognition and Measurement* over a period of time. The first instalment, dealing with classification and measurement of financial assets, was issued as HKFRS 9 *Financial Instruments* in November 2009. As a consequence, part of HKAS 39 is being superseded and will become obsolete for annual periods beginning on or after 1 January 2013. Proposals to replace the requirements on impairment and derecognition have been published and further proposals are expected in 2009 and 2010. The remaining requirements of HKAS 39 continue in effect until superseded by future instalments of HKFRS 9. The Board aims to have replaced HKAS 39 in its entirety by the end of 2010.~~

Paragraph 1 is amended as follows:

~~1 The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non financial items. Requirements for presenting information about financial instruments are in HKAS 32 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in HKFRS 7 *Financial Instruments: Disclosures*. Requirements for classifying and measuring financial assets are in *HKFRS 9 Financial Instruments*.~~

In paragraph 9, a definition of ‘held for trading’ is added and the heading ‘Definitions of four categories of financial instruments’ and the definition of ‘financial asset or financial liability at fair value through profit or loss’ are amended as follows:

~~Definitions of four categories of financial instruments~~

~~...~~

~~**A financial asset or financial liability is held for trading if:**~~

- ~~(a) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;~~
- ~~(b) on initial recognition 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; or~~
- ~~(c) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).~~

~~A financial asset or financial liability at fair value through profit or loss is a financial asset or financial liability that meets either of the following conditions.~~

~~(a) — It is classified as meets the definition of held for trading. A financial asset or financial liability is classified as held for trading if:~~

~~(i) — it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;~~

~~(ii) — on initial recognition 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; or~~

~~(iii) — it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).~~

~~(b) — Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either~~

~~...~~

~~(ii) — a group of financial assets, financial liabilities or both financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in HKAS 24 *Related Party Disclosures* (as revised in 2004-2009)), for example the entity's board of directors and chief executive officer.~~

~~In HKFRS 7, paragraphs 9-10 and 11 and B4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions (see paragraphs B4 and B5 of HKFRS 7). For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.~~

~~Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.~~

~~It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69-AG82, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.~~

~~...~~

~~In paragraph 9 the following terms are deleted:~~

- ~~held to maturity investments~~
- ~~loans and receivables~~
- ~~available for sale financial assets~~

Paragraphs 10–11A, 13 and 14 are amended as follows:

~~10 — An embedded derivative is a component of a hybrid (combined) contract instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined contract instrument vary in a way similar to a stand-alone derivative. An ...~~

~~11 — An embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:~~

~~...~~

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

~~(c) — the hybrid (combined) contract instrument is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated); and~~

~~(d) — the host is outside the scope of HKFRS 9.~~

~~If an embedded derivative is separated, the host contract shall be accounted for under this Standard if it is a financial instrument, and in accordance with the other appropriate HKFRSs Standards if it is not a financial instrument. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.~~

~~11A — Notwithstanding paragraph 11, if a contract contains one or more embedded derivatives and the host is outside the scope of HKFRS 9, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:~~

~~...~~

~~13 — If an entity is unable to determine reliably the fair value of an embedded derivative on the basis of 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 (combined) contract 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 12 applies and the hybrid (combined) contract instrument is designated as at fair value through profit or loss.~~

~~14 — An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument. (See paragraph 38 with respect to regular way purchases of financial assets.)~~

Paragraphs 26, 27, 31, 33 and 34 are amended as follows:

~~26 — On derecognition of a financial asset in its entirety, the difference between:~~

- ~~(a) — the carrying amount (measured at the date of derecognition) and~~
- ~~(b) — the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income (see paragraph 55(b))~~

~~shall be recognised in profit or loss.~~

~~27 — ... The difference between:~~

- ~~(a) — the carrying amount (measured at the date of derecognition) allocated to the part derecognised and~~
- ~~(b) — the sum of (i) the consideration received for the part derecognised (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss allocated to it that had been recognised in other comprehensive income (paragraph 55(b))...~~

~~shall be recognised in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is derecognised, based on the relative fair values of those parts.~~

~~31 — When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard and HKFRS 9, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is ...~~

~~(a) — ...~~

~~33 — For the purpose of subsequent measurement, recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 55 and HKFRS 9 paragraph 5.4.1, and shall not be offset.~~

~~34 — ... The difference between:~~

- ~~(a) — the carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised; and~~
- ~~(b) — the sum of (i) the consideration received for the part no longer recognised and (ii) any cumulative gain or loss allocated to it that had been recognised in other comprehensive income (see paragraph 55(b))~~

~~shall be recognised in profit or loss. A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised, on the basis of the relative fair values of those parts.~~

In the section titled 'Measurement' the following are deleted: the headings above paragraphs 45, 63, 66 and 67; and paragraphs 45, 46, 50B–52, 61 and 66–70. The heading above paragraphs 43 and 58 and paragraphs 43, 44, 47, 48, 50, 50A, 53–58 and 63 are amended as follows:

### **Initial measurement of financial assets and financial liabilities**

~~43 — When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value minus plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.~~

~~44 — When an entity uses settlement date accounting for an asset that is subsequently measured at cost or amortised cost, the asset is recognised initially at its fair value on the trade date (see Appendix A paragraphs AG53–AG56).~~

~~47 — After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:~~

~~(a) — financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost (see Appendix A paragraphs AG80 and AG81).~~

~~...~~

~~48 — In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, HKAS 32, or HKFRS 7 or HKFRS 9, an entity shall apply paragraphs AG69–AG82 of Appendix A.~~

~~50 — An entity: shall not reclassify a financial liability except in accordance with paragraphs 53 and 54.~~

~~(a) — shall not reclassify ...~~

~~... after initial recognition.~~

~~50A — The following changes in circumstances are not reclassifications for the purposes of paragraph 50:~~

~~(a) — a derivative that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such;~~

~~(b) — a derivative becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge;~~

~~(c) — [deleted]~~

~~53 — If a reliable measure becomes available for a financial asset or financial liability for which such a measure was previously not available, and the asset or liability is required to be measured at fair value if a reliable measure is available (see paragraphs 46(c) and 47(a)), the asset or liability shall be remeasured at fair~~

~~value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 55.~~

~~54 — If, as a result of a change in intention or ability or in the rare circumstances that a reliable measure of fair value is no longer available (see paragraphs 46(c) and 47(a)), or because the ‘two preceding financial years’ referred to in paragraph 9 have passed, it becomes appropriate to carry a financial asset or an entity shall measure the financial liability at cost or amortised cost rather than at fair value., the fair value carrying amount of the financial asset or the financial liability on that the date of reclassification becomes its new cost, or amortised cost, as applicable. Any previous gain or loss on that asset that has been recognised in other comprehensive income in accordance with paragraph 55(b) shall be accounted for as follows:~~

~~(a) — In the case of a ....~~

~~(b) — ... in accordance with paragraph 67.~~

~~55 — A gain or loss arising from a change in the fair value of a financial asset or financial liability measured at fair value through profit or loss that is not part of a hedging relationship (see paragraphs 89–102), shall be recognised in profit or loss., as follows~~

~~(a) — A gain or loss ...~~

~~(b) — ... the entity’s right to receive payment is established (see HKAS 18).~~

~~56 — For financial assets and financial liabilities carried measured at amortised cost (see paragraphs 46 and 47), a gain or loss is recognised in profit or loss when the financial asset or financial liability is derecognised or impaired, and through the amortisation process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 78–84 and Appendix A paragraphs AG98–AG101) the accounting for the gain or loss shall follow paragraphs 89–102.~~

~~57 — If an entity recognises financial assets using settlement date accounting (see paragraph 38 and Appendix A paragraphs AG53 and AG56), 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 measured at amortised cost (other than impairment losses). For assets carried measured at fair value, however, the change in fair value shall be recognised in profit or loss or in other comprehensive income, as appropriate under paragraph 55 and paragraph 5.4.1 of HKFRS 9.~~

### **Impairment and uncollectibility of financial assets measured at amortised cost**

~~58 — An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets measured at amortised cost is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available for sale financial assets) to determine the amount of any impairment loss.~~

~~63 — If there is objective evidence that an impairment loss on financial assets measured at amortised cost has been incurred, the amount of the loss is measured as ...~~

Paragraph 79 is deleted and paragraphs 88(d), 89(b), 90 and 96(e) are amended as follows:

~~88 — A hedging relationship qualifies for hedge accounting under paragraphs 89–102 if, and only if, all of the following conditions are met.~~

~~...~~

~~(d) — The effectiveness of the hedge can be reliably measured, ie the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured (see paragraphs 46 and 47(a) and Appendix A paragraphs AG80 and AG81 for guidance on determining fair value).~~

~~...~~

~~89 — If a fair value hedge meets the conditions in paragraph 88 during the period, it shall be accounted for as follows:~~

~~...~~

~~(b) — the gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognised in profit or loss. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in profit or loss applies if the hedged item is an available-for-sale financial asset.~~

~~90 — If only particular risks attributable to a hedged item are hedged, recognised changes in the fair value of the hedged item unrelated to the hedged risk are recognised as set out in paragraph 55 of this Standard and paragraph 5.4.1 of HKFRS 9.~~

~~96 — ...~~

~~(e) — if an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 74, 75 and 88(a)), that excluded component of gain or loss is recognised in accordance with paragraph 55 of this Standard and paragraph 5.4.1 of HKFRS 9.~~

Paragraphs 103L and 103M are added as follows:

103L — HKFRS 9, issued in November 2009, amended paragraphs 1, 9–11A, 13, 14, 26(b), 27(b), 31, 33, 34(b), 43, 44, 47, 48, 50, 50A, 53–58, 63, 88(d), 89(b), 90, 96(e), AG3, AG3A, AG4B–AG4E, AG4H, AG4I, AG8, AG50, AG53, AG56, AG64, AG76A, AG80, AG81, AG83, AG84, AG95, AG96 and AG114(a) and deleted paragraphs 45, 46, 50B–52, 61, 66–70, 79, AG16–AG26, AG30(b), AG30(f) and AG65–AG68. An entity shall apply those amendments when it applies HKFRS 9.

103M — At the date of initial application of HKFRS 9, an entity:

(a) — may designate a financial liability as measured at fair value through profit or loss in accordance with paragraph 9(b)(i) of HKAS 39.

~~(b) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with paragraph 9(b)(i) of HKAS 39 and such designation does not satisfy that condition at the date of initial application of HKFRS 9.~~

~~(c) may revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with paragraph 9(b)(i) of HKAS 39 and such designation satisfies that condition at the date of initial application of HKFRS 9.~~

~~Such designation shall be made on the basis of the facts and circumstances that exist at the date of initial application of HKFRS 9. That classification shall be applied retrospectively.~~

Appendix A of HKAS 39 (Application guidance) is amended as described below.

Paragraphs AG3, AG3A, AG4B, AG4E, AG4H, AG4I and AG8 are amended as follows:

~~AG3 ... If neither the equity method nor proportionate consolidation is appropriate, the entity applies this Standard and HKFRS 9 to that strategic investment.~~

~~AG3A This Standard and HKFRS 9 apply applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise under contracts within the scope of HKFRS 4.~~

~~AG4B Paragraph 9 of this Standard and paragraph 4.5 of HKFRS 9 allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through profit or loss provided that doing so results in more relevant information.~~

~~AG4C The decision of an entity to designate a financial asset or financial liability as at fair value through profit or loss is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in the case of designation of a financial liability as at fair value through profit or loss, paragraph 9 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 9, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.~~

~~AG4D Under HKAS 39 and HKFRS 9 measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as measured at fair value in accordance with HKFRS 9 available for sale (with most changes in fair value recognised in other comprehensive income) and a liability the entity considers related would be measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial~~

~~statements would provide more relevant information if both the asset and the liability were classified measured as at fair value through profit or loss.~~

~~AG4E The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9(b)(i) or paragraph 4.5 of HKFRS 9.~~

~~(a) — [deleted] An entity has liabilities ... the value of liabilities.~~

~~(b) — An entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by HKFRS 4, paragraph 24), and financial assets it considers related that would otherwise be classified as available for sale or measured at amortised cost.~~

~~(c) — ...~~

~~(d) — An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example,:~~

~~(i) — the entity has financed a portfolio of fixed rate assets that would otherwise be classified as available for sale with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through profit or loss corrects the inconsistency that would otherwise arise from measuring the assets at fair value with changes recognised in other comprehensive income and the debentures at amortised cost.~~

~~(ii) — the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through profit or loss eliminates the inconsistency in the timing of recognition of gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.~~

~~*Paragraph 9(b)(ii): A group of financial assets, financial liabilities or both financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy*~~

~~AG4H An entity may manage and evaluate the performance of a group of financial assets, financial liabilities or both financial assets and financial liabilities in such a way that measuring that group at fair value through profit or loss results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, rather than on the nature of its financial instruments.~~

~~AG4I For example, The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9(b)(ii) and.~~

- (a) ~~The entity is a venture capital organisation ... HKAS 28 or HKAS 31.~~
- (b) ~~The entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued 'structured products' containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments. A similar ... financial instruments.~~
- (c) ~~The entity is an insurer ... subject to the insurer's discretion.~~

~~AG8—If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 92. The adjustment is recognised in profit or loss as income or expense. If a financial asset is reclassified in accordance with paragraph 50B, 50D or 50E, and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase shall be recognised as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.~~

~~The heading above paragraph AG14 and paragraphs AG29 and AG31–AG35 are amended as follows and the headings above paragraphs AG16 and AG26 and paragraphs AG16–AG26 and AG30(b) and (f) are deleted.~~

### **Financial assets and financial liabilities held for trading**

~~AG14 ...~~

~~AG29—Generally, multiple embedded derivatives in a single hybrid contract instrument are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see HKAS 32) are accounted for separately from those classified as assets or liabilities. In addition, if an hybrid contract instrument has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.~~

~~AG31—An example of a hybrid contract 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 on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer ...~~

~~AG32—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 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 hybrid contract combined instrument at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.~~

~~AG33—The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.~~

~~(a) —An embedded derivative in which the underlying is 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 host debt contract or insurance contract is closely related to the host contract unless the hybrid contract combined instrument can be settled in such a way that the holder would not recover substantially all of its recognised 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.~~

~~(b) —...~~

~~AG33A When an entity becomes a party to a hybrid (combined) contract instrument that contains one or more embedded derivatives, paragraph 11 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through profit or loss. For that reason this Standard permits the entire hybrid contract instrument to be designated as at fair value through profit or loss.~~

~~AG33B Such designation may be used whether paragraph 11 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 11A would not justify designating the hybrid (combined) contract instrument as at fair value through profit or loss in the cases set out in paragraph 11A(a) and (b) because doing so would not reduce complexity or increase reliability.~~

~~AG34—As a consequence of the principle in paragraph 14 and paragraph 3.1.1 of HKFRS 9, an entity recognises ...~~

~~AG35—The following are examples of applying the principle in paragraph 14 and paragraph 3.1.1 of HKFRS 9:~~

~~(a) —...~~

~~Paragraphs AG50, AG53 and AG56 are amended as follows:~~

~~AG50—To the extent that 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 measure account for its receivable at amortised cost if it meets the criteria in paragraph 4.2 of HKFRS 9 as a loan or receivable.~~

~~AG53—A regular way purchase or sale of financial assets is recognised using either trade date accounting or settlement date accounting as described in paragraphs AG55 and AG56. An entity shall apply the same method The method used is applied consistently for all purchases and sales of financial assets that are classified in the~~

~~same way in accordance with HKFRS 9 belong to the same category of financial assets defined in paragraph 9. For this purpose assets that are meet the definition of held for trading form a separate category classification from assets designated as measured at fair value through profit or loss. In addition, investments in equity instruments accounted for using the option provided in paragraph 5.4.4 of HKFRS 9 form a separate classification.~~

~~AG56 —... In other words, the change in value is not recognised for assets measured carried at cost or amortised cost; it is recognised in profit or loss for assets classified as financial assets measured at fair value through profit or loss; and it is recognised in other comprehensive income for investments in equity instruments accounted for in accordance with paragraph 5.4.4 of HKFRS 9 assets classified as available for sale.~~

~~Paragraphs AG65–AG68 are deleted. The headings above paragraph AG64 and paragraphs AG64 and AG76A are amended as follows:~~

## **Measurement (paragraphs 43–7065)**

### **Initial measurement of financial assets and financial liabilities (paragraph 43)**

~~AG64 —The fair value of a financial instrument liability on initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph AG76). However, if part of the consideration given or received is for something other than the financial instrument liability, the fair value of the financial instrument liability is estimated, using a valuation technique (see paragraphs AG74–AG79). For example, the fair value of a long term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.~~

~~AG76A The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard or HKFRS 9 as appropriate. The application ...~~

~~The heading above paragraph AG80 and paragraphs AG80 and AG81 are amended as follows:~~

### **No active market: derivatives on unquoted equity instruments**

~~AG80 —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 instruments (see paragraphs 46(c) and 47(a)) is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.~~

~~AG81 —There are many situations 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 and derivatives that are linked to and must be settled by delivery of such an unquoted equity instruments (see paragraphs 46(c) and 47(a)) is likely not to be significant. Normally it is possible to estimate the fair value of such derivatives a financial asset~~

that an entity has acquired from an outside party. 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.

The headings above paragraph AG84 and paragraphs AG83 and AG84 are amended as follows:

~~AG83—An entity applies HKAS 21 to financial assets and financial liabilities that are monetary items in accordance with HKAS 21 and denominated in a foreign currency. Under HKAS 21, any foreign exchange gains and losses on monetary assets and monetary liabilities are recognised in profit or loss. An exception is a monetary item that is designated as a hedging instrument in either a cash flow hedge (see paragraphs 95–101) or a hedge of a net investment (see paragraph 102). For the purpose of recognising foreign exchange gains and losses under HKAS 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 amortised cost are recognised in profit or loss and other changes in carrying amount are recognised in accordance with paragraph 55(b). For available for sale financial assets that are not monetary items under HKAS 21 (for example, equity instruments), the gain or loss that is recognised in other comprehensive income under paragraph 55(b) includes any related foreign exchange component. If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are recognised in profit or loss.~~

## **Impairment and uncollectibility of financial assets measured at amortised cost (paragraphs 58–7065)**

### **Financial assets carried at amortised cost (paragraphs 63–65)**

~~AG84—Impairment of a financial asset carried measured 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 are otherwise measured at amortised cost. If the terms of a financial asset measured at amortised cost 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. Cash flows relating to short term receivables are not discounted if the effect of discounting is immaterial. If a financial asset measured at amortised cost loan, receivable or held to maturity investment has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 63 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset measured carried at amortised cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.~~

Paragraphs AG95 and AG96 are amended as follows:

~~AG95—A financial asset measured held to maturity investment carried at amortised cost may be designated as a hedging instrument in a hedge of foreign currency risk.~~

~~AG96—An investment in an A derivative that is linked to and must be settled by delivery of unquoted equity instruments and is not carried at fair value because 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 46(c) and 47(a)) cannot be designated as a hedging instrument.~~

Paragraph AG114(a) is amended as follows:

~~AG114 ...~~

- ~~(a) —As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios (eg the entity may group its available for sale assets into a separate portfolio), in which case it applies the guidance below to each portfolio separately.~~

~~In the heading above paragraph AG133, the reference to ‘paragraphs 103–108B’ is amended to ‘paragraphs 103–108C’.~~

*Basis for Conclusions*  
*Hong Kong Accounting Standard 39*

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# **Financial Instruments: Recognition and Measurement**



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## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IAS 39 Financial Instruments: Recognition and Measurement is amended as described below.~~

~~The following paragraph is added to the rubric:~~

~~In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 Financial Instruments. Accordingly, the following were deleted: paragraphs BC13 and BC14, the heading above paragraph BC25 and paragraphs BC25–BC29, paragraph BC70, the heading above paragraph BC104A and paragraphs BC104A–BC104E, the headings above paragraphs BC125, BC127 and BC129 and paragraphs BC125–BC130, the heading above paragraph BC221 and that paragraph and the heading above paragraph BC222 and that paragraph.~~

~~The following are deleted: paragraphs BC13 and BC14, the heading above paragraph BC25 and paragraphs BC25–BC29, paragraph BC70, the heading above paragraph BC104A and paragraphs BC104A–BC104E, the headings above paragraphs BC125, BC127 and BC129 and paragraphs BC125–BC130, the heading above paragraph BC221 and that paragraph and the heading above paragraph BC222 and that paragraph.~~

~~The following footnotes are added:~~

~~At the end of paragraph BC11E~~

~~Superseded by IFRS 9 Financial Instruments~~

~~At the end of paragraph BC11F~~

~~IFRS 9 Financial Instruments applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.~~

~~To the reference to ‘IAS 39’ in paragraph BC12~~

~~In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 Financial Instruments. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~At the end of paragraph BC16~~

~~IFRS 9 Financial Instruments, issued in November 2009, eliminated the category of loans and receivables~~

<u>To the heading above paragraph BC37</u>	<u>IFRS 9 <i>Financial Instruments</i> applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non financial hosts and financial hosts outside the scope of IFRS 9.</u>
<u>To the heading above paragraph BC40A</u>	<u>IFRS 9 <i>Financial Instruments</i> applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non financial hosts and financial hosts outside the scope of IFRS 9.</u>
<u>The second sentence in paragraph BC40B</u>	<u>IFRS 9 <i>Financial Instruments</i> eliminated the requirement to separate embedded derivatives from financial hosts within the scope of IFRS 9. However, this amendment is still relevant to derivatives embedded in host insurance contracts and other host contracts outside the scope of IFRS 9.</u>
<u>To the heading ‘Recognition and derecognition’ above paragraph BC41</u>	<u>In November 2009 the requirements for the recognition of assets within the scope of IAS 39 were relocated in IFRS 9 <i>Financial Instruments</i>.</u>
<u>To the heading ‘Measurement’ above paragraph BC70A</u>	<u>The relevant paragraphs relating to measurement of assets within the scope of IAS 39 have been relocated in the Basis for Conclusions on IFRS 9 <i>Financial Instruments</i>. The remaining paragraphs still apply to financial liabilities within the scope of IAS 39 and have not been amended.</u>
<u>To the reference to ‘IAS 39’ in paragraph BC72</u>	<u>IFRS 9 <i>Financial Instruments</i> eliminated the loans and receivables and available for sale categories from IAS 39.</u>
<u>To the heading ‘Impairment of investments in equity instruments’ above paragraph BC105</u>	<u>IFRS 9 <i>Financial Instruments</i>, issued in November 2009, amended the measurement requirements for investments in equity instruments. However, the section on impairment remains relevant for assets that are measured at amortised cost in accordance with IFRS 9.</u>
<u>To the reference to ‘loans and receivables’ in paragraph BC111</u>	<u>IFRS 9 <i>Financial Instruments</i>, issued in November 2009, eliminated the category of loans and receivables.</u>
<u>The reference to ‘held to maturity’ in paragraph BC201(f)</u>	<u>IFRS 9 <i>Financial Instruments</i>, issued in November 2009, eliminated the held to maturity category.</u>

*Guidance on Implementing  
Hong Kong Accounting Standard 39*

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# **Financial Instruments: Recognition and Measurement**



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## Appendix

### Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### **IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013**

In the guidance on implementing IAS 39 the following Questions and Answers (Q&A) are deleted:

- ~~Section B Definitions: B.12– B.23~~
- ~~Section C Embedded Derivatives: C.3, C.5, C.11~~
- ~~Section E Measurement: E.3.1, E.3.2, E.4.9, E.4.10~~
- ~~Section F Hedged items: F.1.1, F.1.10, F.2.9– F.2.11, F.2.19, F.2.20~~

In the answer to Question B.4, the last paragraph is amended as follows:

~~If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IAS 39 and IFRS 9.~~

In the answer to Question B.5, the reference to ‘IAS 39’ in the second last sentence is replaced with ‘IAS 39 or IFRS 9’.

Question B.26 is amended as follows:

~~**Financial assets that are excluded from fair valuation and have a fixed maturity should be measured at amortised cost. How is amortised cost calculated for financial assets measured at amortised cost in accordance with IFRS 9?**~~

In Q&As C.1 and C.2, references to ‘hybrid instrument’ are replaced with ‘hybrid contract’.

Q&A C.6 is amended as follows:

~~**Entity A issues** acquires a five-year floating rate debt instrument issued by Entity B. At the same time, it enters into a five-year pay-fixed variable, receive-variable fixed interest rate swap with Entity B. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument and classifies the instrument as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity. Entity A contends that separate accounting for the swap is inappropriate since IAS 39.AG33(a) requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity’s analysis correct?~~

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument ('synthetic instrument' accounting) for the purpose of applying IAS 39 or IFRS 9. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

In Q&A C.10, references to 'combined instrument' are replaced with 'combined contract'.

The tables in Q&A D.2.1 are amended to read as follows:

<b>Balances</b>	<b>Settlement-date accounting</b>		
	<b>Financial assets- measured at- amortised cost</b>	<b>Financial assets- measured at fair- value with changes- presented in other- comprehensive- income</b>	<b>Financial assets- measured at fair- value through- profit or loss</b>
<b>29 December 20X1</b>			
Financial asset	—	—	—
Financial liability	—	—	—
<b>31 December 20X1</b>			
Receivable	—	2	2
Financial asset	—	—	—
Financial liability	—	—	—
Other comprehensive income- (fair value adjustment)	—	(2)	—
Retained earnings (through profit or loss)	—	—	(2)
<b>4 January 20X2</b>			
Receivable	—	—	—
Financial asset	1,000	1,003	1,003
Financial liability	—	—	—
Other comprehensive income- (fair value adjustment)	—	(3)	—
Retained earnings (through profit or loss)	—	—	(3)

<b>Trade-date accounting</b>			
<b>Balances</b>	<b>Financial assets- measured at amortised cost</b>	<b>Financial assets- measured at fair value with changes- presented in other- comprehensive- income</b>	<b>Financial assets- measured at fair- value through profit- or loss</b>
<b>29 December 20X1</b>			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
<b>31 December 20X1</b>			
Receivable	-	-	-
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Other comprehensive- income (fair value- adjustment)	-	(2)	-
Retained earnings- (through profit or loss)	-	-	(2)
<b>4 January 20X2</b>			
Receivable	-	-	-
Financial asset	1,000	1,003	1,003
Financial liability	-	-	-
Other comprehensive- income (fair value- adjustment)	-	(3)	-
Retained earnings- (through profit or loss)	-	-	(3)

The tables in Q&A D.2.2 are amended to read as follows:

<b>Settlement date accounting</b>		
<b>Balances</b>	<b>Financial assets measured at amortised cost</b>	<b>Financial assets measured at fair value through profit or loss</b>
<b>29 December 20X2</b>		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
<b>31 December 20X2</b>		
Receivable	–	–
Financial asset	1,000	1,000
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
<b>4 January 20X3</b>		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
<b>Trade date accounting</b>		
<b>Balances</b>	<b>Financial assets measured at amortised cost</b>	<b>Financial assets measured at fair value through profit or loss</b>
<b>29 December 20X2</b>		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
<b>31 December 20X2</b>		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
<b>4 January 20X3</b>		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

In the answer to Question D.2.3, the second paragraph is amended as follows:

To illustrate: on 29 December 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is carried ~~measured~~ at amortised cost, in exchange for Bond B, which ~~meets the definition of~~ will be classified as held for trading and ~~is~~ measured at fair value. Both assets have a fair value of CU1,010 on 29 December, while the amortised cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for loans and receivables ~~financial assets measured at amortised cost and trade date accounting for assets that meet the definition of~~ held for trading. On 31 December 20X2 (financial year end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On 4 January 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

...

The answer to Question E.1.1 is amended as follows:

~~For financial assets not measured at fair value through profit or loss, incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions, transaction costs are added to the fair value at initial recognition amount originally recognised. For financial liabilities, transaction costs are deducted from the fair value at initial recognition. directly related costs of issuing debt are deducted from the amount of debt originally recognised. For financial instruments that are measured at fair value through profit or loss, transaction costs are not added to the fair value measurement at initial recognition.~~

~~For financial instruments that are carried ~~measured~~ at amortised cost, such as held to maturity investments, loans and receivables, and financial liabilities that are not at fair value through profit or loss, transaction costs are subsequently included in the calculation of amortised cost using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.~~

~~For available for sale financial assets, transaction costs are recognised in other comprehensive income as part of a change in fair value at the next remeasurement. If an available for sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortised to profit or loss using the effective interest method. If an available for sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costs are recognised in profit or loss when the asset is derecognised or becomes impaired.~~

~~Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.~~

Q&A E.3.3 is amended as follows:

### **E.3.3 IFRS 9, IAS 39 and IAS 21 Exchange differences arising on translation of foreign entities: other comprehensive income or profit or loss?**

~~IAS 21.32 and IAS 21.48 states that all exchange differences resulting from translating the financial statements of a foreign operation should be recognised in other comprehensive income until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets classified as measured at fair value through profit or loss in accordance with IFRS 9 Financial Instruments and financial assets that are available for sale.~~

~~IAS 39.55 requires that changes in fair value of financial assets classified as at fair value through profit or loss should be recognised in profit or loss and changes in fair value of available-for-sale investments should be recognised in other comprehensive income.~~

~~If the foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are IAS 39.55 IFRS 9 and IAS 21.39 applied?~~

~~IAS 39 IFRS 9 applies in the accounting for financial instruments in the financial statements of a foreign operation and IAS 21 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.~~

~~To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign subsidiary (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which is meets the definition of held for trading and is therefore measured carried at fair value under IAS 39.~~

...

Q&A E.3.4 is amended as follows:

### **E.3.4 IFRS 9, IAS 39 and IAS 21 Interaction between IFRS 9, IAS 39 and IAS 21**

~~IFRS 9 and IAS 39 includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in profit or loss. IAS 21 includes rules about the reporting of foreign currency items and the recognition of exchange differences in profit or loss. In what order are IAS 21, and IFRS 9 and IAS 39 applied?~~

#### *Statement of financial position*

~~Generally, the measurement of a financial asset or financial liability at fair value, cost or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with IFRS 9 and IAS 39. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical~~

rate in accordance with IAS 21 (IAS 39.AG83). For example, if a monetary financial asset (such as a debt instrument) is measured carried at amortised cost in accordance with IFRS 9 under IAS 39, amortised cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognised using the closing rate in the entity's financial statements (IAS 21.23). That applies regardless of whether a monetary item is measured at cost, amortised cost or fair value in the foreign currency (IAS 21.24). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is carried measured at fair value in the foreign currency (IAS 21.23(e)) and at a historical rate if it is not carried at fair value under IAS 39 because its fair value cannot be reliably measured (IAS 21.23(b) and IAS 39.46(e)).

...

### *Profit or loss*

...

Any exchange difference arising on recognising a *monetary item* at a rate different from that at which it was initially recognised during the period, or recognised in previous financial statements, is recognised in profit or loss or in other comprehensive income in accordance with IAS 21 (IAS 39.AG83, IAS 21.28 and IAS 21.32), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95). Differences arising from recognising a monetary item at a foreign currency amount different from that at which it was previously recognised are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognised in profit or loss or in other comprehensive income in accordance with IFRS 9 or IAS 39. For example, although an entity recognises gains and losses on available-for-sale monetary financial assets in other comprehensive income (IAS 39.55(b)), the entity nevertheless recognises the changes in the carrying amount relating to changes in foreign exchange rates in profit or loss (IAS 21.23(a)).

Any changes in the carrying amount of a *non-monetary item* are recognised in profit or loss or in other comprehensive income in accordance with IFRS 9 or IAS 39 (IAS 39.AG83). For example, for available-for-sale financial assets the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognised in other comprehensive income. If the non-monetary item is designated as a cash flow hedge of an unrecognised firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95).

When some portion of the change in carrying amount is recognised in other comprehensive income and some portion is recognised in profit or loss, for example, if the amortised cost of a foreign currency bond classified as available-for-sale has increased in foreign currency (resulting in a gain in profit or loss) but its fair value has decreased in the functional currency (resulting in a loss recognised in other comprehensive income), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognised in profit or loss or in other comprehensive income.

The answer to Question E.4.2 is amended as follows:

~~No. IAS 39.43 Paragraph 5.1 of IFRS 9 requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges). In addition, paragraph 5.2.2 of IFRS 9 requires an entity to apply the impairment requirements in IAS 39. IAS 39.58 requires that an impairment loss is recognised only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with IAS 39.43 paragraph 5.1 of IFRS 9 and IAS 39.58 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.~~

Question E.4.5 is amended as follows:

~~**A financial institution calculates impairment in the unsecured portion of loans and receivables financial assets measured at amortised cost on the basis of a provision matrix that specifies fixed provision rates for the number of days a loan financial asset has been classified as non-performing (zero per cent if less than 90 days, 20 per cent if 90–180 days, 50 per cent if 181–365 days and 100 per cent if more than 365 days). Can the results be considered to be appropriate for the purpose of calculating the impairment loss on the financial assets measured at amortised cost loans and receivables under IAS 39.63?**~~

~~The last sentence of the answer to Question F.1.4 is deleted.~~

The answer to Question F.2.1 is amended as follows:

~~No. Derivative instruments are always meet the definition of deemed held for trading and are measured at fair value with gains and losses recognised in profit or loss unless they are designated and effective hedging instruments (IAS 39.9 and IFRS 9 paragraphs 4.1–4.5, 5.4.1 and 5.4.3). As an exception, IAS 39.AG94 permits the designation of a purchased option as the hedged item in a fair value hedge.~~

The answer to Question F.2.5 is amended as follows:

~~Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under IAS 39 and IFRS 9.~~

~~For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under IAS 39 and IFRS 9 (for example, because the entity has a practice of settling such contracts net in cash 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), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, ...~~

Q&A F.2.13 is amended as follows:

**Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are classified as loans and receivables measured at amortised cost?**

Yes. Under IFRS 9, IAS 39, loans and receivables ~~some fixed rate loans are carried measured at amortised cost. Banking institutions in many countries hold the bulk of their fixed rate loans to collect their contractual cash flows and receivables until maturity. Thus, changes in the fair value of such fixed rate loans and receivables that are due to changes in market interest rates will not affect profit or loss. IAS 39.86 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect profit or loss. Therefore, IAS 39.86 may appear to preclude fair value hedge accounting for fixed rate loans and receivables. However, it follows from IAS 39.79 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held to maturity investments. The entity could sell them and the change in fair values would affect profit or loss. Thus, fair value hedge accounting is permitted for fixed rate loans and receivables.~~

The last paragraph of the answer to Question F.2.17 is amended as follows:

To illustrate: Entity A acquires a 10 per cent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as available for sale measured at amortised cost. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five year pay fixed, receive floating swap. ...

In the answer to Question F.5.6, references to 'IAS 39.55(a)' are replaced with 'IAS 39.55'.

In the answer to Question F.6.4, the reference to 'IAS 39' in the second sentence is amended to 'IAS 39 or IFRS 9'.

Q&A G.1 is amended as follows:

**IAS 39 and IFRS 9 requires financial assets classified as available for sale (AFS) and remeasurement of financial assets and financial liabilities measured at fair value through profit or loss to be remeasured to fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss, and fair value changes for AFS assets financial assets designated at fair value through other comprehensive income are recognised in other comprehensive income. What disclosures are required regarding the amounts of the fair value changes during a reporting period?**

IFRS 7.20 requires items of income, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in other comprehensive income. Further breakdown is provided of changes that relate to:

- ~~(a) — AFS assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount that was reclassified from equity to profit or loss for the period as a reclassification adjustment;~~
- ~~(ba) — financial assets or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) mandatorily classified as such held for trading in accordance with IAS 39 IFRS 9; and~~
- ~~(cb) — hedging instruments.~~

~~In addition, IFRS 7.20A requires an entity to disclose the amount of gain or loss recognised in other comprehensive income for financial assets measured at fair value through other comprehensive income, including any amount transferred within equity.~~

~~IFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with meet the definition of held for trading in IAS 39 it categorises as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.~~

~~In addition, IFRS 7.8 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through profit or loss, showing separately: (i) those designated as such upon initial recognition and (ii) those mandatorily classified as such held for trading in accordance with IAS 39 and IFRS 9.~~

HKAS 40  
Revised June 2010 July 2012

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*Hong Kong Accounting Standard 40*

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# Investment Property



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## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~BCA17~~ The Basis for Conclusions on IAS 40 *Investment Property* is amended as described below.

~~In paragraph BC8 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraph BC9 the reference to 'IAS 39' are footnoted as follows:~~

~~\* In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~BCA18~~ The Basis for Conclusions on IAS 40 (2000) *Investment Property* is amended as described below:

~~In paragraph B35 the reference to 'IAS 39' is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the held-to-maturity category.~~

~~In paragraph B63(a) the reference to 'IAS 39' is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.~~

~~The footnote to paragraph B67(a)(i) is amended as follows (new text underlined):~~

~~† Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003. In 2009 paragraph 46 of IAS 39 was replaced by paragraph 5.2.1 of IFRS 9 *Financial Instruments*.~~

*Basis for Conclusions*  
*Hong Kong Accounting Standard 41*

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# Agriculture



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## Appendix

### Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for IASC's Conclusions on IAS 41 is amended as described below.~~

~~In paragraph B48 the reference to '*IAS 39 Financial Instruments: Recognition and Measurement*' and in paragraph B54 the first reference to '*IAS 39*' are footnoted as follows:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

*Basis for Conclusions on  
Hong Kong Financial Reporting Standard 2*

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# Share-based Payment



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## Appendix

### Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) — effective for annual periods beginning on or after 1 January 2013~~

~~In the Basis for Conclusions on IFRS 2 the heading above paragraph BC25 is footnoted as follows:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

*Hong Kong Financial Reporting Standard 4*

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# Insurance Contracts



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## Appendix E

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009)~~ effective for annual periods beginning on or after 1 January 2013

Paragraphs 3 and 45 are amended and paragraph 41C is added as follows:

- ~~3~~ This HKFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see ~~HKAS 32 *Financial Instruments: Presentation*, HKAS 39 *Financial Instruments: Recognition and Measurement*, and HKFRS 7 and HKFRS 9 *Financial Instruments*~~), except in the transitional provisions in paragraph 45.
- ~~45~~ Notwithstanding paragraph 4.9 of HKFRS 9, ~~w~~When an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as measured 'at fair value through profit or loss'. This reclassification is permitted if an insurer changes accounting policies when it first applies this HKFRS and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and HKAS 8 applies.
- ~~41C~~ HKFRS 9, issued in November 2009, amended paragraphs 3 and 45. An entity shall apply those amendments when it applies HKFRS 9.

HKFRS 4 BC  
Revised February 2010 July 2012

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*Basis for Conclusions on  
Hong Kong Financial Reporting Standards 4*

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# Insurance Contracts



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## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) — effective for annual periods beginning on or after 1 January 2013~~

~~In paragraph BC11 the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’, in paragraphs BC22(e) and BC146 the first reference to ‘IAS 39’ and in paragraphs BC28(b), BC40, BC41(b), BC55, BC73(d) and BC82 the references to ‘IAS 39’ are footnoted as follows:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph discusses matters relevant when IFRS 4 was issued.~~

~~In paragraphs BC47 and BC161 the reference to ‘IAS 39’ is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non financial hosts and financial hosts outside the scope of IFRS 9. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.~~

~~In paragraph BC145(b) ‘available for sale’ is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available for sale financial assets.~~

~~The heading ‘Issues related to IAS 39’ above paragraph BC166 is footnoted as follows:~~

~~\* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC166–BC194 discuss matters relevant when IFRS 4 was issued.~~

~~In the dissenting opinions on IFRS 4 the headings above paragraphs DO7, DO9 and DO18 are footnoted as follows:~~

~~\* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

*Revised Guidance on Implementing HKFRS 4*

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# Insurance Contracts



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## Appendix

### Amendments resulting from other Implementation Guidance

The following sets out amendments required for this guidance resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### **IFRS 9 *Financial Instruments* (issued in November 2009) — effective for annual periods beginning on or after 1 January 2013**

In the table in IG Example 1, the 'Treatment in Phase I' column of contract type 1.18 is amended as follows:

Insurance risk is insignificant. Therefore, the contract is a financial instrument within the scope of IAS 39. Servicing fees are within the scope of IAS 18 (~~recognise as services are provided, subject to various conditions~~).

IG Example 4 in paragraph IG10 is amended as follows:

#### **IG Example 4: Shadow accounting**

##### *Background*

...

At the inception of a contract, insurer A has DAC of CU20 relating to that contract and the present value, at inception, of EGP is CU100. In other words, DAC is 20 per cent of EGP at inception. Thus, for each CU1 of realised gross profits, insurer A amortises DAC by CU0.20. For example, if insurer A sells assets and recognises a gain of CU10, insurer A amortises DAC by CU2 (20 per cent of CU10).

Before adopting IFRSs for the first time in 20X5, insurer A measured financial assets on a cost basis. (Therefore, EGP under those national requirements considers only realised gains and losses.) However, under IFRSs, it classifies its financial assets as measured at fair value through profit or loss, available for sale. Thus, insurer A measures the assets at fair value and recognises changes in their fair value in other comprehensive income.

In 20X5, insurer A recognises unrealised gains of CU10 on the assets backing the contract. and in 20X6, insurer A *it* sells the assets for an amount equal to their fair value at the end of 20X5 and, to comply with IAS 39, reclassifies the now realised gain of CU10 from equity to profit or loss as a reclassification adjustment.

##### *Application of paragraph 30 of the IFRS*

Paragraph 30 of the IFRS permits, but does not require, insurer A to adopt shadow accounting. If insurer A adopts shadow accounting, it amortises DAC in 20X5 by an additional CU2 (20 per cent of CU10) as a result of the change in the fair value of the assets. Because insurer A recognised the change in their fair value in other comprehensive income, it Insurer A recognises the additional amortisation of CU2 in other comprehensive income profit or loss.

When insurer A sells the assets in 20X6, it makes no further adjustment to DAC, but reclassifies DAC amortisation of CU2, relating to the now realised gain, from equity to profit or loss as a reclassification adjustment.

In summary, shadow accounting treats an unrealised gain in the same way as a realised gain, except that the unrealised gain and resulting DAC amortisation are (a) recognised in other comprehensive income rather than in profit or loss and (b) reclassified from equity to profit or loss when the gain on the asset becomes realised. If insurer A does not adopt shadow accounting, unrealised gains on assets do not affect the amortisation of DAC.<sup>1</sup>

HKFRS 5  
Revised February 2010 July 2012

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Effective for annual periods  
beginning on or after 1 January 2005

*Hong Kong Financial Reporting Standard 5*

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# **Non-current Assets Held for Sale and Discontinued Operations**



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## Appendix E

### Amendments resulting from other HKFRSs

*The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) — effective for annual periods beginning on or after 1 January 2013~~

~~In paragraph 5(c), the reference to ‘HKAS 39 *Financial Instruments: Recognition and Measurement*’ is replaced with ‘HKFRS 9 *Financial Instruments*’.~~

*Basis for Conclusions on  
Hong Kong Financial Reporting Standard 5*

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# **Non-current Assets Held for Sale and Discontinued Operations**



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## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### **~~IFRS 9 *Financial Instruments* (issued in November 2009) — effective for annual periods beginning on or after 1 January 2013~~**

~~In paragraph BC8(b) the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~In paragraph BC13 the footnote to 'IAS 39' is deleted and replaced by the following footnote:~~

~~\* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~In paragraph BC54(b) the reference to 'IAS 39' is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of held-for-trading financial assets. Paragraph BC54 discusses matters relevant when IFRS 5 was issued.~~

~~In paragraph BC58 the reference to 'available-for-sale' is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. Paragraph BC58 discusses matters relevant when IFRS 5 was issued.~~

Effective for annual periods  
beginning on or after 1 January 2006

*HK(IFRIC) Interpretation 4*

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# **Determining whether an Arrangement contains a Lease**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013~~

The Basis for Conclusions on IFRIC 4 is amended as described below.

~~In paragraph BC14 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:~~

~~\* In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

Effective for annual periods  
beginning on or after 1 January 2006

*HK(IFRIC) Interpretation 5*

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# **Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds**



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**Certified Public Accountants**  
香港會計師公會

## Appendix

### Amendments resulting from other Basis for Conclusions

*The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.*

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IFRIC 5 is amended as described below.~~

~~In paragraph BC6 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraphs BC12, BC20 and BC24 the first reference in each to 'IAS 39' are footnoted as follows:~~

~~\* In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~In paragraph BC11 a footnote is added to the reference to 'IAS 39' as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.~~

HK(IFRIC)-Int 9  
Revised July 2010<sub>2</sub>

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Effective for annual periods  
beginning on or after 1 June 2006

*HK(IFRIC) Interpretation 9*

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# Reassessment of Embedded Derivatives



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香港會計師公會

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013~~

The Basis for Conclusions on IFRIC 9 is amended as described below.

In paragraph BC2 the reference to '~~IAS 39 *Financial Instruments: Recognition and Measurement*~~' is footnoted as follows:

\* ~~IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.~~

HK(IFRIC)-Int 10  
Revised July 2010<sub>2</sub>

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Effective for annual periods  
beginning on or after 1 November 2006

*HK(IFRIC) Interpretation 10*

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# Interim Financial Reporting and Impairment



Hong Kong Institute of  
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香港會計師公會

## Appendix

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Interpretation resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~HKFRS 9 Financial Instruments (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In the rubric the reference to ‘paragraphs 1–10’ is amended to ‘paragraphs 1–11’. In the ‘References’ section, a reference to HKFRS 9 *Financial Instruments* is added. Paragraphs 1, 2, 7 and 8 are amended, paragraph 11 is added and paragraphs 5 and 6 are deleted as follows:

~~1~~ — An entity is required to assess goodwill for impairment at the end of each reporting period, to assess investments in equity instruments and in financial assets carried at cost for impairment at the end of each reporting period and, if required, to recognise an impairment loss at that date in accordance with HKAS 36 and HKAS 39. However, ...

~~2~~ — The Interpretation addresses the interaction between the requirements of HKAS 34 and the recognition of impairment losses on goodwill in HKAS 36 and certain financial assets in HKAS 39, and the effect of that interaction on subsequent interim and annual financial statements.

~~7~~ — The Interpretation addresses the following issue:

~~Should an entity reverse impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost if a loss would not have been recognised, or a smaller loss would have been recognised, had an impairment assessment been made only at the end of a subsequent reporting period?~~

~~8~~ — An entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

~~11~~ — HKFRS 9, issued in November 2009, amended paragraphs 1, 2, 7 and 8 and deleted paragraphs 5 and 6. An entity shall apply those amendments when it applies HKFRS 9.

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) - effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IFRIC 10 is amended as described below.~~

~~In paragraphs BC2 and BC9 the references to 'IAS 39' are footnoted as follows:~~

~~\* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. Consequently, no financial assets are carried at cost.~~

HK(IFRIC)-Int 12  
Revised August 2010 July 2012

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Effective for annual periods  
beginning on or after 1 January 2008

*HK(IFRIC) Interpretation 12*

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# **Service Concession Arrangements**



Hong Kong Institute of  
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香港會計師公會

## Appendix C

### Amendments resulting from other HKFRSs

The following sets out amendments required for this Interpretation resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~HKFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In the 'References' section, a reference to ~~HKFRS 9 *Financial Instruments*~~ is added. Paragraphs 23–25 are amended and paragraph 28A is added as follows:

~~23~~ HKASs 32 and 39 and ~~HKFRSs 7 and 9~~ apply to the financial asset recognised under paragraphs 16 and 18.

~~24~~ The amount due from or at the direction of the grantor is accounted for in accordance with ~~HKFRS 9 HKAS 39~~ as:

(a) ~~at amortised cost~~ a loan or receivable; ~~or~~

(b) ~~measured at fair value through profit or loss~~ an available-for-sale financial asset; ~~or~~

(c) ~~if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.~~

~~25~~ If the amount due from the grantor is accounted for either as a loan or receivable or as an available-for-sale financial asset ~~at amortised cost~~, ~~HKFRS 9 HKAS 39~~ requires interest calculated using the effective interest method to be recognised in profit or loss.

~~28A~~ HKFRS 9, issued in November 2009, amended paragraphs 23–25. An entity shall apply these amendments when it applies ~~HKFRS 9~~.

## Appendix

### Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

#### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

In the illustrative examples accompanying IFRIC 12, paragraphs IE7 and IE28 are amended as follows:

~~IE7~~ IFRS 9 *Financial Instruments* may require the entity to measure the amounts due from the grantor at amortised cost, unless the entity designates those amounts as measured at fair value through profit or loss meet the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*. ~~If the~~ The receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

~~IE28~~ IFRS 9 *Financial Instruments* may require the entity to measure the amount due from or at the direction of the grantor in exchange for the construction services at amortised cost meets the definition of a receivable in IAS 39 *Financial Instruments: Recognition and Measurement*. ~~If the~~ The receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IFRIC 12 is amended as described below.~~

~~In paragraph BC59 the reference to ‘IAS 39’ is footnoted as follows:~~

~~\* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~The heading above paragraph BC60 is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 for the classification of assets within the scope of IAS 39. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 12 was issued.~~

HK(IFRIC)-Int 17  
Revised August 2010 July 2012

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Effective for annual periods  
beginning on or after 1 July 2009

*HK(IFRIC) Interpretation 17*

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# Distributions of Non-cash Assets to Owners



Hong Kong Institute of  
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香港會計師公會

## Appendix

### Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Interpretation resulting from other newly issued IFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

### ~~IFRS 9 *Financial Instruments* (issued in November 2009) – effective for annual periods beginning on or after 1 January 2013~~

~~The Basis for Conclusions on IFRIC 17 is amended as described below.~~

~~In paragraph BC22 the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ is footnoted as follows:~~

~~\* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.~~

~~Paragraph BC28(a) is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, requires all investments in equity instruments to be measured at fair value.~~

~~In paragraph BC29 the reference to paragraph AG81 is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, amended paragraphs AG80 and AG81 of IAS 39 so that they apply only to derivatives on unquoted equity instruments.~~

~~In paragraph BC32 the reference to ‘IAS 39’ is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the requirement in IAS 39 for some assets to be measured using a historical cost basis.~~

~~In paragraph BC47(e) the reference to ‘available-for-sale’ is footnoted as follows:~~

~~\* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.~~