



**INTERNATIONAL FEDERATION  
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**Agenda Item**  
**5**

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**DATE:** February 20, 2008  
**MEMO TO:** Members of the IPSASB  
**FROM:** Matthew Bohun-Aponte  
**SUBJECT:** Financial Instruments

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**OBJECTIVE OF THIS SESSION**

To **review** the analysis of the presentation and disclosure of Financial Instruments in the context of the “Guidelines for Modifying IASB Documents”.

To **approve** the Exposure Drafts proposing revisions to IPSAS 15, “Financial Instruments: Disclosure and Presentation” and a new IPSAS based on IFRS 7, “Financial Instruments: Disclosures”

**AGENDA MATERIAL:**

**Papers**

- 5.1 Analysis of Public Sector Issues re Financial Instruments
- 5.2 Draft ED XX “Financial Instruments” – Preliminary Material;
- 5.3 Draft ED XX, “Revisions to IPSAS 15, ‘Financial Instruments: Disclosure and Presentation’”
- 5.4 Draft ED XX, Proposed IPSAS XX, “Financial Instruments: Disclosure”

**ACTION REQUIRED**

The IPSASB is asked to:

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

**BACKGROUND**

At the IPSASB meeting in November 2007 in Beijing, China, the IPSASB approved the “Guidelines for Modifying IASB Documents”. These guidelines provide a step analysis for staff to undertake when proposing the development of an IPSAS based on a pronouncement of the International Accounting Standards Board (IASB). At that meeting, it was intended that the IPSASB review an exposure draft proposing amendments to IPSAS 15, “Financial Instruments: Presentation and Disclosure” and proposing a new IPSAS based on IFRS 7, “Financial Instruments: Disclosure”. However, due to time constraints and the necessity to complete high priority projects, the IPSASB deferred its review of the draft Exposure Drafts on Financial Instruments. Instead it asked

staff to prepare an analysis of the financial instruments project in the context of the newly approved Guidelines and to revise the Exposure Draft accordingly.

Staff have provided a revised analysis of the public sector issues related to presentation and disclosure of financial instruments in the public sector. This analysis was developed in the context of the “Guidelines for Modifying IASB Documents” approved by the IPSASB in December 2007. Staff have also provided a revised ED at items 5.2 – 5.4. Staff envisage that one ED would be issued containing a marked-up version of IPSAS 15, and a proposed IPSAS XX, “Financial Instruments: Disclosures”. The documents making up the ED are:

- 5.2 Preliminary material containing the introduction to IPSASs, the reason for issuing the ED and the specific matter for comment.
- 5.3 Proposed amendments to IPSAS 15. This shows the amendments in mark-up. Members will be aware that a number of respondents to ED 26, “Improvements to International Public Sector Accounting Standards” requested that all proposed amendments be included in a markup of the entire ED so that they could easily identify changes. Staff propose that the ED be published with the changes highlighted as markup.
- 5.4 Proposed new IPSAS XX, “Financial Instruments: Disclosures.” The text is shown as markup from the text of IFRS 7, however staff propose that the ED be published in a clean format. The markups are shown so that members may easily identify the changes from IFRS 7.

<b>ACTION: Review and the draft ED and provide staff with directions for finalizing the ED.</b>
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**Matthew Bohun-Aponte  
TECHNICAL MANAGER**

## **Financial Instruments: Presentation and Disclosure**

### **IASB's Rationale for Revising IAS 32 and Issuing IFRS 7**

IFRS 7, "Financial Instruments: Disclosures" replaces disclosure requirements that were previously prescribed in IAS 30, "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" and IAS 32, "Financial Instruments: Disclosure and Presentation". During the late 1990's, the IASB recognized the need for a comprehensive review of IAS 30 and disclosures relating to financial instruments in a variety of other standards. The IASB was also aware of fundamental changes taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures, and their processes for measuring and managing those risks. The IASB initiated a project to revise IAS 30 in 1999, and added a project to develop comprehensive financial instruments disclosures in 2001.

The IASB considered whether its financial instruments disclosures should be limited to banks and similar financial institutions. The IASB observed that increasing competition in the financial services industry meant that a wide variety of entities are now providing services that were once the domain of banks, and therefore the scope of IFRS 7 should not be limited to any particular entities. The IASB also considered exempting insurers, small and medium-sized entities and subsidiaries from the scope of the standard, but concluded that the types of disclosures being proposed were based on the information provided to key management personnel and would not, therefore, be onerous.

#### ***Step One: Are there public sector issues that warrant departure?***

As a reminder, the goal of applying these rules is to assess public sector issues to determine if they warrant a departure in recognition or measurement or in presentation or disclosure.

In determining whether there is a public sector issue that warrants a departure from an IASB document, the following rules would be observed:

1. Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met.
2. Where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders.
3. Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.
4. Where the cost of applying the international accounting standards/interpretations exceeds the benefit.

As has been noted at previous meetings, staff have identified a number of public sector specific financial instruments that do not satisfy the definitions of "financial asset"; "financial liability"; "equity instrument" or "financial instrument" in IAS 32, IFRS 7, or indeed in the current IPSAS 15. These instruments are identified below:

The majority of financial instruments held or issued by public sector entities have the same characteristics, in principle, as those issued or held by private sector entities, consequently for those financial instruments, there are no public sector issues that warrant departure.

There are, however, a small number of financial instruments that are issued and/or held by public sector entities that are not held or issued by private sector entities. Several of these do not meet the definition of “financial instrument” as prescribed by the IFRSs or IPSAS 15.

The public sector specific instruments are:

- Monetary Gold
- Special Drawing Rights (SDRs) in the International Monetary Fund (IMF)
- Reserve Position in the IMF
- Currency issued by the entity
- IPSAS 23: Advance Receipts and Financial Liabilities arising from Conditions

### **Monetary Gold**

Monetary gold is gold bullion or coins of at least 995/1000 purity that is officially designated as being part of a country’s official reserve assets. Ordinarily, monetary gold will be held by a country’s central bank, or other monetary authority. Some countries measure monetary gold at the fair value of the metal, other countries measure monetary gold at its historic cost. The International Monetary Fund (IMF) classifies monetary gold as a financial asset of the central bank, notwithstanding that there is no counterparty, primarily due to gold’s historical role in the monetary system.

Under current IPSASs, monetary gold is not distinguished from other gold, and is recognized as property under IPSAS 17, “Property, Plant and Equipment” and is not presented as a financial instrument.

### **Special Drawing Rights**

Special Drawing Rights (SDRs) are international reserve assets created by the IMF and are an unconditional right to obtain foreign currency from other members of the IMF. SDRs are only held by the monetary authorities of IMF member countries and a limited number of international financial institutions. There is an active secondary market in SDRs and the price of SDRs is quoted in the financial press on a daily basis. SDRs, as currently defined provide an asset for the holder, but there is no corresponding liability recognized by either the IMF or the members of the IMF. At best, IMF members might disclose a contingent liability in respect of a possible call by the IMF to provide foreign currency.

Under current IPSASs, SDRs would be recognized as an asset, principally because they can be sold on the secondary market. If this market did not exist, an entity might interpret an SDR as a contingent asset rather than as an asset. As SDRs do not satisfy the current definition of a financial asset, they would not be presented as a financial instrument, nor would the disclosures required by IFRS 7 be made in respect of them.

### **Reserve Position in the IMF**

A country's reserve position in the IMF has the characteristics of a reserve asset. A reserve tranche position in the IMF arises from (a) the payment of part of a member's subscription in reserve assets and (b) the IMF's net use of the member's currency. Normally a member's reserve tranche position is equal to its "quota" less the adjusted IMF holdings of its currency, less subscriptions receivable, less balances held in the administrative accounts of the IMF to the extent they are not in excess of 0.1 percent of a member's quota, if positive.

When a country joins IMF, it is assigned a quota that fits into the structure of existing quotas considered in the light of the member's economic characteristics relative to those of other members of comparable size. The size of the member's quota determines, among other things, the member's voting power, the size of its potential access to Fund resources, and its share in allocation of SDRs. Quotas are reviewed at intervals of not more than five years to take account of changes in the relative economic positions of members and the growth of the world economy. Initial subscriptions, and normally subscriptions associated with increases in quotas, are paid mainly in the member's own currency, and a smaller portion, not exceeding 25 per cent, are paid in reserve assets (SDRs or other members' currencies that are acceptable to the Fund).

If membership of the IMF is a contractual agreement between the IMF and its member countries, then a country's reserve position would satisfy the definition of an equity instrument. If membership is more in the nature of a binding arrangement, then the definition of equity instrument is not satisfied. If the reserve position in the IMF does not represent a residual interest in the net assets of the IMF then it does not meet the definition of an equity instrument, but would be treated as a financial asset as its value is tied to that of the SDR.

### **Currency Issued by the Entity**

Cash on hand is included within the definition of a financial asset in IPSAS 15. This definition does not, however, take account of the situation of those financial institutions in the private or public sector that issue currency. Currency issued by an entity can be interpreted as a zero coupon, perpetual debt instrument, which might be considered net assets/equity. The general practice for financial institutions issuing currency is to treat it as a liability of the entity. This treatment should be reflected in any standard issued by the IPSASB.

### **IPSAS 23: Advance Receipts and Financial Liabilities arising from Conditions**

Under IPSAS 23, an entity may receive cash or other financial assets prior to a transfer agreement becoming binding. It may also be required to recognize a liability because it will be obligated to return financial assets to a transferor because a condition on transferred assets cannot be fulfilled in any other manner. The current financial instruments standards do not address these financial instruments. An IPSAS on financial instruments will need to address these issues.

## **Other Issues**

Other public sector standard setters have addressed financial reporting of financial issues and have identified a number of issues relating to financial instruments. These are examined below.

## **Binding Arrangements**

One of the key characteristics of the current definition of a financial instrument is the contractual nature of financial assets and financial liabilities. When IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” was being developed, it became clear to the IPSASB that limiting public sector transactions to those that are legally contracted would narrow the scope of public sector transactions significantly. In particular, it was noted that transactions between reporting entities that are subject to joint control may take the form of a binding arrangement rather than a legal contract, this is particularly so when the transacting entities are part of the same legal entity, for example two departments or agencies of the same government. In such cases, rather than being enforced by operation of the law, such as the law of contracts, the agreement may be enforced by an administrative arrangement such as the directive of a minister or adjudication by the ministry of finance. Given that there was extensive debate on this issue during the development of IPSAS 23, staff are of the view that the only choice open is to expand the definition of “financial assets” and “financial liabilities” to include binding arrangements. Staff are of the view that leaving the definition as it is, developing a separate IPSAS addressing binding arrangements, or a separate section within IPSAS 15 and the disclosure IPSAS addressing binding arrangements, would not be consistent with decisions that the IPSASB has taken previously on this issue.

## **Guarantees**

Many entities within the public and private sector provide guarantees for other entities debt instruments. In the private sector guarantees are usually provided for a fee and would be recognized, presented and disclosed as a financial instrument. In the public sector, guarantees may be provided as part of an exchange transaction or a non-exchange transaction. Those that are provided as part of an exchange transaction are not, in principle, different from similar transactions in the private sector, and there is no compelling reason to treat them differently. Where a guarantee is provided through a non-exchange transaction, it is already within the scope of IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” and would be recognized as a contingent liability.

## **Concessional Loans**

Public sector entities often make loans at interest rates that are lower than a borrowing entity might otherwise be able to negotiate. Some have argued that this concessional treatment gives rise to a financial asset for the borrower and a financial liability or expense for the lender. When developing IPSAS 23, the IPSASB, its predecessor, the Public Sector Committee, and the Steering Committee extensively debated the appropriate financial reporting of these types of transaction.

The IPSASB considered whether or not entities should recognize a transfer expense in relation to the difference in the present value of a concessional loan and the present value

of a market rate loan. Some argued that the concession amounted to a grant to the borrower and should be recognized as such in the period in which the loan was agreed. Others argued that these loans are generally part of a legislatively established program and that all eligible borrowers, as defined in the program's legislation, are able to access the same rate and therefore the loans are not concessional.

The IPSASB finally concluded that as these loans were normally negotiated at arm's length, the interest rate really reflected the market rate for that type of loan, and that the loan should be recognized in the same manner as any other loan. Staff would also note that in many cases the government providing the loans may be entitled to be counted as a preferential creditor in any insolvency matter, so that the credit risk to the government is in fact lower. In the case of the present project, staff do not consider that there is any option but to remain consistent with the provisions of IPSAS 23 and not draft specific requirements in relation to concessional loans.

- 1. Where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met.*

As set out in IPSAS 1, the objectives of general purpose financial reporting in the public sector should be to provide information useful for decision making and to demonstrate the accountability of the entity for the resources entrusted to it by:

- a) Providing information about the sources, allocation and uses of financial resources;
- b) Providing information about how the entity financed its activities and met its cash requirements;
- c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
- d) Providing information about the financial condition of the entity and changes in it; and
- e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments. (para 15)

Financial instruments are used extensively by public sector entities for many of the same reasons that they are used by private sector entities. Where transactions in financial instruments in the public sector are substantively identical to transactions in the private sector it is logical to have the same financial reporting requirements for those transactions, positions and cash flows. Providing different financial reporting requirements would make it more difficult for users to assess an entity's financial position, performance and cash flows. Where transactions are substantively different, however, different financial reporting requirements may be indicated.

As noted above, staff have identified a number of public sector specific financial instruments that are not held by private sector entities. These financial instruments are not, however, substantively different from other financial assets and liabilities, therefore

it is not necessary to have different presentation and disclosure requirements for them. It is necessary, however, to ensure that they are included within the definition of financial assets and liabilities to ensure that any ambiguity about their status as financial instruments is removed.

2. *Where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders.*

IPSASB's stakeholders, as stated by IPSASB observers, have a clear preference for ensuring that the presentation and disclosure requirements in respect of financial instruments are consistent in the public and private sectors. This project is not addressing the recognition and measurement of financial instruments, which remains a contentious issue among many stakeholders, particularly those within the European Community. The statistical community has previously asked the IPSASB to ensure that the IPSASs are, to the extent possible, convergent with the statistical standards. Including monetary gold and SDRs within the definition of financial assets and currency issued by the entity within the definition of financial liabilities will ensure consistency with the statistical standards.

3. *Where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.*

The qualitative characteristics of financial reporting in the public sector are set out in IPSAS 1, Appendix B, and are:

- Understandability
- Relevance
- Materiality
- Reliability
- Faithful Representation
- Substance over form
- Neutrality
- Prudence
- Completeness
- Comparability

The qualitative characteristics are constrained by:

- Timeliness
- Balance between Benefit and Cost
- Balance between Qualitative Characteristics.

The use of financial instruments by public sector entities has grown in the public sector over recent years, and is likely to continue. The use of financial instruments has the potential to make significant impacts on a public sector entity's financial position, financial performance and cash flows. It is therefore essential that users of financial statements have access to high quality information about an entity's use of financial instruments. The IASB has provided a benchmark set of presentation and disclosure requirements for financial instruments, financial commentators and analysts are familiar



with these requirements. If the IPSASB developed different requirements, that may pose an impediment to countries adopting IPSASs, or particular IPSASs.

4. *Where the cost of applying the international accounting standards/interpretations exceeds the benefit.*

A consistent criticism of the financial instruments standards issued by the IASB is that they are unduly complex and that this leads to excessive compliance costs that are not warranted by the additional benefits such information provides. The IASB has responded to this concern by establishing disclosure requirements that are consistent with the internal reporting of financial instruments to key management personnel. Staff are of the view that effective internal controls are required in the public sector as well, and therefore it is appropriate that public sector entities adopt the same sorts of internal reporting frameworks with respect to financial instruments that are adopted in the private sector. If they do this, the cost of complying with external reporting requirements is mitigated.

#### *Alternatives Available*

Given the analysis in the rules of the road and considering the divergent views of members, there seem to be a number of alternatives available for the IPSASB to consider:

1. Proceed with the Exposure Draft as proposed by staff. The specific matter for comment focuses on the inclusion of public sector financial instruments within the definitions of financial assets and financial liabilities.
2. Withdraw IPSAS 15 and rely on the hierarchy of guidance in IPSAS 1, “Presentation of Financial Statements” to direct preparers to the IFRSs. The IPSASB specifically rejected this option at its meeting in March 2007.
3. Retain IPSAS 15 as it is and wait for the IASB to conclude its projects on financial instruments. Staff are concerned that if IPSAS 15 is not amended constituents applying IPSAS 15 and IAS 39, may eventually be faced with conflicting requirements. IPSASB considered this option in March 2007, and decided to pursue option 1 further at that point.

#### *Staff Recommendation*

Staff are of the view that option 1 is more consistent with the IPSASB’s strategic objectives to converge with IFRSs and that the project should proceed as per option 1.

Staff have attached a draft ED at item 5.2 – 5.4 that can be adapted should any of options.

#### ***Step Two: Are the departures so significant that a public sector specific project should be initiated?***

The goal of applying these rules is to determine if the public sector issues that warrant a departure from the related IASB document are so significant that a public sector specific project should be initiated. In considering this step the nature of the public sector issues identified and their significance would be considered. It is necessary to assess the issue and the adequacy with which it has been dealt with in the IASB document.

Staff are of the view that the IPSASB should be able to resolve the issues related to the presentation and disclosure of financial instruments without initiating a public sector specific project. Therefore a new public sector specific project is deemed unnecessary.

***Step Three: Modify IASB Documents***

The goal of applying these rules is to set parameters on the modifications that would be made to an IASB documents to address public sector differences.

IPSASB staff have developed a draft exposure draft based on the current IAS 32 and IFRS 7, at attachment 5.2 – 5.4. All changes proposed were developed in the context of the guidelines for modifying IASB documents as set out in step 3.

***Step Four: Issue IPSAS converged (to varying degrees) with IASB Documents***

The goal of applying these rules is to identify changes in style and terminology that are applied to all IPSASs.

Since this is a project to update an existing IPSAS, much of this step has already been undertaken when IPSAS 15 was first developed. Additional changes have been made in line with the guidelines in step 4 and the basis for conclusions modified appropriately. Any additional required aspects of this step will be undertaken after the IPSASB considers responses to any exposure draft it issues as it finalizes the standard.

#### **ACKNOWLEDGMENT**

This Exposure Draft of an amended International Public Sector Accounting Standard (IPSAS) and a proposed new IPSAS is drawn primarily from International Accounting Standard IAS 32, “Financial Instruments: Presentation” and International Financial Reporting Standard IFRS 7 (2005), “Financial Instruments: Disclosures” published by the International Accounting Standards Board (IASB). Extracts from IAS 32 and IFRS 7 are reproduced in this publication of the International Public Sector Accounting Standards Board of the International Federation of Accountants with the permission of the International Accounting Standards Committee Foundation (IASCF).

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

**E-mail: [publications@iasb.org](mailto:publications@iasb.org).**

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

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### REQUEST FOR COMMENTS

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

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

The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West

Toronto Ontario M3A 2L4

Email responses should be sent to: [publicsectorpublishedcomments@ifac.org](mailto:publicsectorpublishedcomments@ifac.org)

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

**PROPOSED AMENDMENTS TO IPSAS 15, “FINANCIAL INSTRUMENTS:  
PRESENTATION”  
AND  
PROPOSED IPSAS XX, “FINANCIAL INSTRUMENTS: DISCLOSURES”**

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## **INTRODUCTION**

### **Introduction to the International Public Sector Accounting Standards**

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

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

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

### **Due Process and Timetable**

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

### **Background and Purpose of the Exposure Draft**

In late 1997, the IPSASB's predecessor – the Public Sector Committee (PSC)\* – commenced a program for the development of IPSASs based on International Accounting Standards (IASs) on issue at August 1997, or their subsequently revised versions, to the extent the requirement of the IASs are relevant for the public sector. The IPSASs maintained the requirements, structure and text of the IASs unless there was a public sector specific reason for a departure. The first phase of the standards development program was completed in late 2002.

In early 2007, the IPSASB, noting that IPSAS 15, "Financial Instruments: Disclosure and Presentation" was no longer convergent with IFRS 7, "Financial Instruments: Disclosure" and IAS 32, "Financial Instruments: Presentation", determined that the IPSASs should be converged with those Standards.

The objective of this Exposure Draft is to update IPSAS 15 to reflect the IASB's amendment to IAS 32, "Financial Instruments: Presentation", and to issue a new IPSAS based on IFRS 7, "Financial Instruments: Disclosure".

Until the proposed IPSAS 15 and the new IPSAS XX become effective, the current version of IPSAS 15 remains in effect.

### **Presentation of the Proposed Amendments to IPSAS 15: Financial Instruments: Presentation**

The Exposure Draft presents a marked-up copy of the full text of IPSAS15, "Financial Instruments: Presentation" with the proposed changes identified in mark-up.

The Exposure Draft presents a clean copy of the full text of proposed IPSAS XX, "Financial Instruments: Disclosure". Any differences between the proposed IPSAS and IFRS 7 are noted in the Comparison with IFRS 7, with reasons for the changes noted in the Basis for Conclusions.

### **Request for Comments**

Comments are invited on any proposals in the Exposure Draft by Month DD, YYYY. The IPSASB would prefer that respondents express a clear overall opinion on whether the Exposure Draft in general is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the specific issues in the Exposure Draft. Respondents are also invited to address any or all of the specific matters for comment outlined below and to provide detailed comments on any other aspects of the Exposure Draft (including materials and examples contained in the implementation guidance) indicating the specific paragraph number or groups

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\* The PSC was reconstituted as the IPSASB by the IFAC Board in November 2004.

of paragraphs to which they relate. It would be helpful to the IPSASB if these comments clearly explained the issue and suggested alternative working with supporting reasoning where this is appropriate.

#### **Specific Matters for Comment**

The IPSASB would particularly value comment on the following:

- It is proposed that monetary gold and Special Drawing Rights be included within the definition of “financial assets” and ~~monetary gold~~, currency issued by the entity and ~~assets and liabilities recognized in obligations to return resources to transferors in~~ accordance with the requirements of IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” ~~be excluded~~ included within the definition of “financial liabilities” from the scope of the IPSASs.



~~December 2004~~ Month 20XX

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

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TO THE IPSAS

International Public Sector Accounting Standard 15, “Financial Instruments: Presentation” is set out in paragraphs 1 – 60. All the paragraphs have equal authority except as noted otherwise. IPSAS 15 should be read in the context of its objective, the Basis for Conclusions, and the “Preface to International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

This is now  
standard text in  
all IPSASs.

## **Introduction**

### **Reasons for revising IPSAS 15**

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

### **The Main Changes**

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

### **Scope**

- IN5. The scope of the IPSAS has been aligned to that of IAS 32.
- IN6. ~~except that it specifically excludes~~ The definition of “financial asset” has been expanded to include Special Drawing Rights in the International Monetary Fund and ~~—~~monetary gold and the definition of “financial liability” has been expanded to include currency issued by the entity and liabilities to return resources to the transferor under the conditions of a transfer agreement recognized in accordance with IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers). These are public sector specific financial instruments that are not addressed in the IFRSs. ~~The limited objective of this project precludes the IPSASB from developing requirements relating to these items at this time.~~

**Principle**

IN7. 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 or other binding arrangement:

(i) To deliver cash or another financial asset to another entity; or

(ii) To exchange financial assets or financial liabilities with another entity under conditions that is potentially unfavorable to the issuer.

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

(i) A non-derivative that includes no contractual obligation or other binding arrangement 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.

IN8. 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.

IN9. 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**

IN10. 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 IN7 above. In particular, when an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a

variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g. a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable instruments

IN11. IPSAS 15 incorporates guidance on financial instruments or rights redeemable by the holder. Consequently, a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset (a ‘puttable instrument’) is a financial liability of the issuer.

Contingent settlement provisions

IN12. 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

IN13. Under IPSAS 15, a derivative financial instrument is a financial asset or a financial liability when it gives one of the parties to it a choice of how it is settled, unless all or the settlement alternatives would result in it being an equity instrument.

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

IN14. The revisions eliminate the option previously in IPSAS 15 to measure the liability component of a compound financial instrument on initial recognition either as a residual amount after separating the net assets/equity component, or by using a relative-fair-value method. Thus, any asset and liability components are separated first and the residual is the amount of any net assets/equity component. These requirements for separating the liability and equity components of a compound financial instrument are conformed to the definition of an equity instrument as a residual.

**Treasury Shares**

IN15. The acquisition or subsequent resale by an entity of its own equity instruments does not result in a gain or loss for the entity. Rather it represents a transfer between those holders of equity instruments who have

given up their equity interest and those who continue to hold an equity instrument.

**Interest, dividends and similar distributions, losses and gains**

IN16. IPSAS 15 incorporates guidance on the costs of a net assets/equity transaction. Transaction costs incurred as a necessary part of completing a net assets/equity transaction are accounted for as part of that transaction and are deducted from net assets/equity.

**Disclosure**

~~IN1-~~IN17. IPSAS 15 no longer incorporates requirements for disclosures relating to financial instruments. Guidance on disclosures relating to disclosures of financial instruments can be found in international or national accounting standards addressing disclosure of financial instruments.

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

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

Deleted in accordance with revised policy established during Improvements

Now paragraph 1, below.

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

## Objective

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

Deleted from IAS 32.

1. Some public sector entities such as national governments and public sector financial institutions may hold a wide range of financial instruments. However, some individual government agencies may not issue or hold a wide range of such instruments. In such cases, the Standard will have limited application and preparers

Previously an unnumbered objective paragraph.



of financial statements will need to identify those aspects of the Standard that apply to them. The purpose of the Implementation Guide located in Appendix 3 is to assist preparers in this task.

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

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

Scope

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

Amended as per IPSASB improvements project.

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

~~3-5.~~ The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements”.

~~4-6.~~ This Standard ~~should~~ **shall** be applied ~~by all entities to in presenting and disclosing information about all types of financial instruments except:~~

- ~~(a) Interests in controlled entities, as defined in International Public Sector Accounting Standard (IPSAS) 6, “Consolidated and Separate Financial Statements”~~
- ~~(b) Interests in associates, as defined in IPSAS 7, “Accounting for Investments in Associates;”~~
- ~~(a) Interests in joint ventures, as defined in Those interests in controlled entities, associates and joint ventures that are accounted for in accordance with IPSAS 6, “Consolidated and Separate Financial Statements”, IPSAS 7, “Investments in Associates” or IPSAS 8, “Interests in Joint Ventures;”. However, in some cases IPSAS 6, IPSAS 7 or IPSAS 8 permits an entity to account for an interest in a controlled entity, associate or joint venture using international or national accounting standards addressing the recognition and measurement of financial instruments as financial instruments; in those cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 or IPSAS 8 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates and joint ventures.~~
- ~~(b) Employers’ rights and obligations under employee benefit plans, to which IPSAS 25, “Employee Benefits” applies.~~
- ~~(c) Contracts for contingent consideration in an entity combination (see international or national standards addressing entity combinations). This exemption only applies to the acquirer.~~
- ~~(d) Obligations arising under insurance contracts. However, this standard applies to derivatives that are embedded in insurance contracts if the international or national accounting standard addressing recognition and measurement of financial instruments applied by the entity requires entity to accounts for them separately. Moreover, an issuer shall apply this Standard~~

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

to financial guarantee contracts if the issuer accounts for the contracts as financial instruments, but shall apply international or national accounting standards addressing insurance contracts if the issuer elects in accordance with the insurance contracts standard it applies, to apply the standard on insurance contracts in recognizing and measuring them;

- (e) Financial instruments that are within the scope of the international or national accounting standard on insurance contracts applied by the entity because they accounted for as insurance contracts because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 0-0 and 0 – AG34 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this standard applies to derivatives that are embedded in these instruments (see international or national accounting standards addressing the recognition and measurement of financial instruments);
- (e) Employers' and plans' obligations for post-employment benefits of all types, including employee benefit plans; and
- (f) Financial instruments, contracts and obligations under share-based payment transactions to which international or national accounting standards addressing share-based payments applied by the entity apply, except for:
  - (i) Contracts within the scope of paragraphs 10 – 12 of this Standard, to which this Standards applies,
  - (ii) Paragraphs 0 and 42 of this Standard, which shall be applied to treasury shares purchased, sold, issued or canceled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.

Monetary gold;

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

Currency (notes and coins) issued by the entity;

- ~~(f)~~(g) Obligations for payments arising under social benefits provided by an entity for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those

**benefits. However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.**

5-7. This Standard does not apply to an entity's net assets/equity interests in controlled entities. However, it does apply to all financial instruments included in the consolidated financial statements of a controlling entity, regardless of whether those instruments are held or issued by the controlling entity or by a controlled entity. Similarly, the Standard applies to financial instruments held or issued by a joint venture and included in the financial statements of a venturer either directly or through proportionate consolidation.

5-8. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard. However, this Standard excludes the insurance contracts themselves from its scope. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks (see paragraph 49), for example, some types of financial reinsurance and guaranteed investment contracts issued by public sector insurance and other entities. Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting and disclosing information about such obligations.

5-9. This Standard does not apply to financial instruments that arise from obligations from employee benefit schemes or obligations of a government to provide social benefits to its citizens for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits (such as old age pensions, unemployment benefits, disability benefits and other forms of financial assistance provided by governments).

~~Monetary gold, Special Drawing Rights in the International Monetary Fund or currency (notes and coins) issued by the entity are normally classified as financial instruments of a national government of a country and its monetary authority. These items have been excluded~~

Added re-scope  
exclusions,  
explains scope  
exclusions.

~~from the scope of this Standard but this does not preclude an entity from presenting them as financial instruments if desired.~~

- ~~10. Additional guidance on the presentation and disclosure of specific types of financial instruments can be found in international and/or national accounting standards. For example, IPSAS 13, "Leases" contains specific disclosure requirements relating to finance leases.~~

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

- 10. 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.**

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

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

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 10

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.

12. 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 11(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entities expected purchase, sale or usage requirements.

## Definitions

- 9-13. The following terms are used in this Standard with the meanings specified:

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

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

Financial asset is any asset that is:

- (a) Cash;
- (b) An equity instrument of another entity; ~~A contractual right to receive cash or another financial asset from another entity;~~
- (c) A contractual right, or other binding arrangement:
  - (i) To receive cash or another financial asset from another entity;
  - (ii) ~~A contractual right to~~ To exchange financial assets or liabilities instruments with another entity under conditions that are potentially favorable to the entity; or
- (d) ~~An equity instrument of another entity~~ A contract or other binding arrangement that will or may be settled in the entity's own equity instruments and is:

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

(i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

(ii) A derivative that will or may be settled other than by the exchange of a fixed number of the entity's own equity instruments do not include instruments that are themselves contracts for the future deliver of the entity's own equity instruments.

(e) Monetary Gold; or

(f) Special Drawing Rights in the International Monetary Fund.

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

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

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

Financial liability is any liability that is:

(a) a contractual obligation, or other binding arrangement:

(i) To deliver cash or another financial asset to another entity; or

(ii) To exchange financial assets or financial liabilities instruments with another entity under conditions that are potentially unfavorable to the entity, or

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

(i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own

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

equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

(c) Currency (notes or coins) issued by the entity; or

(d) A liability recognized in accordance with IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" to return resources to a transferor in accordance with the conditions of a transfer agreement.

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

Inserted to clarify that not all gold is monetary gold.

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

Paragraphs 11 –  
20 deleted as per  
IASB  
improvements  
project.

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

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

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

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

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

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

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

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

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

## PRESENTATION

### Liabilities and Net assets/Equity (see also paragraph 0AG24 to AG28)

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

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

18. ~~When an issuer applies the definitions in paragraph 13 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 or other binding arrangement:~~

(i) ~~To deliver cash or another financial asset to another entity; or~~

(ii) ~~To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.~~

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

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

(i) ~~A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or~~

(ii) ~~A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.~~

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

**No contractual obligation or other binding arrangement to deliver cash or another financial asset (see paragraph 18(a))**

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

21-20. The substance of a financial instrument, rather than its legal form, governs its classification on the issuer's statement of financial position. While substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities.

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

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

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

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

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

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

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

- (a) A restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.
- (b) A contractual obligation or other binding arrangement that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

22. Classification of financial instruments between liabilities and net assets/equity components is required because of the different risks associated with each. Entities with instruments classified as financial liabilities are required to ~~disclose information on interest rate risk exposure in accordance with paragraph 63, and to recognize interest, dividends, or similar distributions, losses or gains as revenue or expense in accordance with paragraph 0036.~~ Paragraph 0036 also specifies that distributions to holders of financial instruments classified as equity instruments should be debited by the issuer directly to net assets/equity.

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

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

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

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



have a contractually provided accelerating dividend or similar distribution such that, within the foreseeable future, the dividend or similar distribution yield is scheduled to be so high that the issuer will be economically compelled to redeem the instrument. In these circumstances, classification as a financial liability is appropriate because the issuer has little, if any, discretion to avoid redeeming the instrument. Similarly, if a financial instrument labeled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. (Refer to Appendix 2, paragraphs ~~00A7–00A8~~ and ~~00A18–00A21~~.)

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

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

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

**Settlement in the entity's own equity instruments (paragraph 18(b))**

28. A contract or other binding arrangement 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.

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

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

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

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).

31. A contract or other binding arrangement 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**

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

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

#### **Settlement Options**

33. **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.**
34. 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 10 to 12). Such contracts are financial assets or financial liabilities and not equity instruments.

**Classification of Compound financial Instruments**~~instruments~~ **by the Issuer**~~(see also paragraphs 00 – AG34 and illustrative examples 9 – 12)~~

~~29.35.~~ **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it that contains both a liability and a net assets/equity element component. should. Such components shall be classify—classified the instrument's component parts separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 0022.**

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

~~30.36.~~ Public sector entities do not commonly issue compound financial instruments. The exceptions include partly-privatized GBEs within an economic entity that issues compound instruments into the financial markets. Where a public sector entity issues a compound instrument, this Standard requires the separate presentation on an issuer's statement of financial position of liability and net assets/equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and net assets/equity interests are created by a single financial instrument rather than two or more separate instruments. An issuer's financial position is more faithfully represented by separate presentation of liability and net assets/equity components contained in a single instrument according to their nature.~~(Refer to Appendix 2, paragraphs A22–A23.)~~

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

~~30.37.~~ ~~For purposes of statement of financial position presentation, a~~An issuer recognizes separately the components of a financial instrument that (a) creates a ~~primary~~ financial liability of the ~~issuer entity~~ and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the ~~issuer entity~~. For example, ~~A—a~~ bond or similar instrument convertible by the holder into a fixed number of ordinary ~~common~~ shares of the ~~issuer entity~~ is an example of such an a compound financial instrument. From the perspective of the ~~issuer entity~~, such an instrument comprises two components: a financial

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

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

- 30-38. Classification of the liability and net assets/equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences (where applicable) resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The ~~issuer's entity's contractual~~ obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument or some other transaction.

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

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

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

~~24. A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument may give the holder the right to receive a non-financial asset such as a right to operate a government owned monopoly or a commodity in settlement and an option to exchange that right for shares of the issuer. The issuer recognizes and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.~~

Paragraphs 22 –  
23 deleted as per  
IASB  
improvements  
project.

~~25. This Standard does not deal with measurement of financial assets, financial liabilities and equity instruments and does not therefore prescribe any particular method for assigning a carrying amount to liability and net assets/equity elements contained in a single instrument. Approaches that might be followed include:~~

~~26. Assigning to the less easily measurable component (often an equity instrument), the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily measurable; and~~

~~27. Measuring the liability and net assets/equity components separately and, to the extent necessary, adjusting these amounts on a pro rata basis so that the sum of the components equals the amount of the instrument as a whole.~~

~~28. The sum of the carrying amounts assigned to the liability and net assets/equity components on initial recognition is always equal to the carrying amount that would be ascribed to the instrument as a whole. No gain or loss arises from recognizing and presenting the components of the instrument separately.~~

~~35-40. Under the first approach described in paragraph 0034, where, for example, a public sector entity issues the issuers of a bond convertible into an equity interest it first determines the carrying amount of the financial liability by discounting the stream of future payments of interest and principal at the prevailing market rate for measuring the fair value of a similar liability (including any embedded non-net assets/equity derivative features) that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into common ordinary shares may is then be determined by deducting the carrying amount fair value of the financial liability from the amount fair value of the compound financial instrument as a whole. Under the second approach, the issuer determines the value of the option directly either by~~

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

~~reference to the fair value of a similar option, if one exists, or by using an option pricing model. The value determined for each component is then adjusted on a pro-rata basis to the extent necessary to ensure that the sum of the carrying amounts assigned to the components equals the amount of the consideration received for the convertible bond. (Refer to Appendix 2, paragraph A24.)~~

**Treasury shares (see also paragraph AG35)**

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

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

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

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

**~~36.43.~~ Interest, dividends or similar distributions, losses and gains relating to a financial instrument, or a component part, classified as component that is a financial liability should shall be reported recognized in the statement of financial performance as expense or revenue in surplus or deficit. Distributions to holders of a financial instrument classified as an equity instrument should shall be debited by the issuer entity directly to net assets/equity net of any related income tax benefit (where applicable). Transaction costs of a net assets/equity transaction shall be accounted for as a deduction from net assets, net of any related income tax benefit (where applicable).**

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

**~~37.44.~~ The classification of a financial instrument as a financial liability or an equity instrument in the statement of financial position determines whether interest, dividends or similar distributions, losses and gains relating to that**

Amended as per IASB improvements project, ref IAS 32. 36.

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

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

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

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

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

~~38-48.~~ Dividends or similar distributions classified as an expense may be presented in the statement of financial performance either with interest on other liabilities or as a separate item. In addition to the requirements of this standard, disclosure of interest and dividends or similar distributions is subject to the requirements of IPSAS 1, "Presentation of Financial



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

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

49. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue or expense in surplus or deficit even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 20(b)). Under IPSAS 1, “Presentation of Financial Statements” the entity presents any gain or loss arising from remeasurement of such an instrument separately on the face of the Statement of Financial Performance when it is relevant in explaining the entity’s performance.

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

**Offsetting of a Financial financial Asset asset and a Financial financial Liability liability (see also paragraphs 00 and 00)**

39:50. A financial asset and a financial liability ~~should~~ shall be offset and the net amount ~~reported~~ presented in the statement of financial position when, and only when, an entity:

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

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

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

40:51. This Standard requires the presentation of financial assets and financial liabilities on a net basis when ~~this doing so~~ reflects an entity’s expected

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

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

~~40-52.~~ Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from ~~ceasing to recognize the derecognition of~~ a financial asset or a financial liability. While offsetting does not give rise to recognition of a gain or a loss, ~~ceasing to recognize the derecognition of~~ a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but may also result in recognition of a gain or a loss.

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

~~40-53.~~ A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. Because ~~the~~ right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and ~~care must be taken to establish which the laws apply applicable~~ to the relationships between the parties need to be considered.

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

~~40-54.~~ The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect significantly an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity does intend to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those

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

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

40-55. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with ~~the standard in paragraph 73 any international or national accounting standard addressing disclosure of financial instruments applied by the entity~~ IPSAS XX, "Financial Instruments: Disclosure".

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

40-56. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are considered simultaneous only when the transactions occur at the same moment.

40-57. The conditions set out in paragraph 0\_939 are generally not satisfied and offsetting is usually inappropriate when:

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

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

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

~~47-58.~~ An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a “master netting arrangement” with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 0.039 are satisfied. ~~When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity’s exposure to credit risk is disclosed in accordance with paragraph 73.~~

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

## Disclosure

~~The purpose of the disclosures required by this Standard is to provide information that will enhance understanding of the significance of on-balance sheet and off-balance sheet financial instruments to an entity's financial position, performance and cash flows and assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments. In addition to providing~~

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

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specific information about particular financial instrument balances and transactions, entities are encouraged to provide a discussion of the extent to which financial instruments are used, the associated risks and the financial purposes served. A discussion of management's policies for controlling the risks associated with financial instruments, including policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risks, provides a valuable additional perspective that is independent of the specific instruments outstanding at a particular time. Some entities provide such information in a commentary that accompanies their financial statements rather than as part of the financial statements.

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

**Price risk**—There are three types of price risk: currency risk, interest rate risk and market risk.

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

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

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

The term "price risk" embodies not only the potential for loss but also the potential for gain.

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

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

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

### **Disclosure of Risk Management Policies**

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

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

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

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

### **Terms, Conditions and Accounting Policies**

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

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

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

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

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

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



~~The date of maturity, expiry or execution;~~

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

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

~~The amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including installment repayments and any sinking fund or similar requirements;~~

~~Stated rate or amount of interest, dividend or other periodic return on principal and the timing of payments;~~

~~Collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;~~

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

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

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

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

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

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

~~The criteria applied in determining when to recognize a financial asset or financial liability on the statement of financial position and when to cease to recognize it;~~

~~The basis of measurement applied to financial assets and financial liabilities both on initial recognition and subsequently; and~~

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

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

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

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

~~Acquisition or issuance of separate financial instruments as part of a series of transactions designed to synthesize the effect of acquiring or issuing a single instrument;~~

~~Acquisition or issuance of financial instruments as hedges of risk exposures, such as an interest rate swap to hedge a finance lease obligation; and~~

~~Acquisition or issuance of monetary financial instruments bearing a stated interest rate that differs from the prevailing market rate at the date of issue, such as the issue of bonds by a central borrowing authority at a discount. (Refer to Appendix 2, paragraph A26)~~

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

~~Costs of acquisition or issuance;~~

~~Premiums and discounts on monetary financial assets and financial liabilities;~~

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

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

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

~~Restructured financial liabilities.~~

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

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

**~~Interest Rate Risk~~**

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

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

~~Effective interest rates, when applicable.~~

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

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

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

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

~~Exposed to interest rate price risk, such as monetary financial assets and financial liabilities with a fixed interest rate;~~

~~Exposed to interest rate cash flow risk, such as monetary financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and~~

~~Not exposed to interest rate risk, such as some investments in equity securities.~~

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

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

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

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

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

~~Within one year of the reporting date;~~

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

~~Five years or more from the reporting date.~~

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

~~Within one month of the reporting date;~~

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

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

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

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

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

### **Credit Risk**

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

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

~~Significant concentrations of credit risk.~~

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

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

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

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

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

~~A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the statement of financial position net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 73. For example, when an entity is due to receive the proceeds from realization of a financial asset before settlement of a financial liability of equal or greater amount against which the entity has a legal right of set-off, the entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform financial statement users of the extent to which exposure to credit risk at a particular point in time has been reduced, the entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.~~



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

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

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

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

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

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

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

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

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

### **Fair Value**

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

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

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

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

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

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

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

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

When disclosure of fair value information is omitted because it is not practicable to determine fair value with sufficient reliability, information is provided to assist users of the financial statements in making their own judgments about the extent of possible differences between the carrying amount of financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for the omission and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 54 may provide sufficient information about the characteristics of the instrument. When it has a reasonable basis for doing so, management may indicate its opinion as to the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value.

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

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

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

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

~~The carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and~~

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

~~Management exercises judgment in determining the amount it expects to recover from a financial asset and whether to write down the carrying amount of the asset when it is in excess of fair value. The information required by paragraph 95 provides users of financial statements with a basis for understanding management's exercise of judgment and assessing the possibility that circumstances may change and lead to a reduction in the asset's carrying amount in the future. When appropriate, the information required by paragraph 95(a) is grouped in a manner that reflects management's reasons for not reducing the carrying amount.~~

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

### **Hedges of Anticipated Future Transactions**

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

~~A description of the anticipated transactions, including the period of time until they are expected to occur;~~

~~A description of the hedging instruments; and~~

~~The amount of any deferred or unrecognized gain or loss and the expected timing of recognition as revenue or expense.~~

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

~~The amount disclosed in accordance with paragraph 98(e) includes all accrued gains and losses on financial instruments designated as hedges of anticipated future transactions, without regard to whether those gains and losses have been recognized in the financial statements. The accrued gain or loss may be unrealized but recorded in the entity's statement of financial position as a result of carrying the hedging instrument at fair value, it may be unrecognized if the hedging instrument is carried on the cost basis, or it may have been realized if the hedging instrument has been sold or settled. In each case, however, the accrued gain or loss on the hedging instrument has not been recognized in the entity's statement of financial performance pending completion of the hedged transaction.~~

## **Other Disclosures**

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

~~The total amount of the change in the fair value of financial assets and financial liabilities that has been recognized as revenue or expense for the period;~~

~~The total amount of deferred or unrecognized gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and~~

~~The average aggregate carrying amount during the year of recognized financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognized financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the reporting date are unrepresentative of amounts on hand during the year.~~

## **Transitional Provision**

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

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

## **Effective Date**

~~103.59.~~ **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2003. Month XX, 20XX. Earlier application is encouraged.**

~~104.60.~~ When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix 21

### **Examples of the Application of the Standard**

#### IPSAS 15, “Financial Instruments: Presentation”

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

#### AG1. This appendix application guidance

explains and illustrates the application of ~~certain particular~~ aspects of the Standard.

~~to various common financial~~

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

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

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

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

### **Definitions**

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

A3-AG3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and reported in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability.

Currency issued by the entity is a financial liability of the entity.

Amended to note that the IPSAS does not address currency issued by the entity is a financial liability.



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

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

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

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

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

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

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

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

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

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

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

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

AG11. Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not

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

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

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

#### *Equity Instruments*

A7-AG13. Equity instruments are not commonly issued by public sector entities except for partly-privatized GBEs. Examples of equity instruments include ~~common~~ non-puttable ordinary shares, certain types of ~~preferred~~ preference shares (see paragraphs 00 and 00), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary ~~common~~ shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity’s obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity. However, if such a contract contains an obligation for the entity to pay cash or another financial assets, it also gives rise to a liability for the present value of the redemption amount (see paragraph 00(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following the declaration of a dividend or similar distribution or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders. ~~of another party is not potentially unfavorable since it results in an increase in net assets/equity and cannot result in a loss to the entity. The possibility that existing holders of a net assets/equity interest in the entity may find the fair value of their interest reduced as a result of the obligation does not make the obligation unfavorable to the entity itself.~~

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

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

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

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

*Derivative Financial Instruments*

A9-AG15. Financial instruments include primary instruments

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

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

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

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

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

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improvements  
project, ref IAS  
32.AG16.

contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally<sup>1</sup> do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a

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

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

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

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improvements  
project, ref IAS  
32.AG17.

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

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project, ref IAS  
32.AG18.

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

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

~~*Commodity Contracts and Commodity-linked Financial Instruments to buy or sell non-financial items (see paragraphs 10 to 12)*~~

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

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improvements  
project, ref IAS  
32.AG20.

for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 10).

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

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

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

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

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

### Presentation

*Liabilities and ~~Net Assets/Equity~~ (see paragraphs 00 to 34)*

*No contractual obligation to deliver cash or another asset (see paragraphs 19 to 00)*

A20. Although it is not common for public sector entities to issue equity instruments, in the event that such instruments are issued, it is relatively easy for issuers to classify certain types of financial instruments as liabilities or net assets/equity. Examples of equity instruments include common (ordinary) shares and options that, if exercised, would require the writer of the option to issue common shares. Common shares do not oblige the issuer to transfer assets to shareholders, except when the issuer formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

Deleted as per IASB improvements project.

### A20. “Perpetual” Debt Instruments

A20. “Perpetual” debt instruments, such as “perpetual” bonds, debentures and capital notes, normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of 1,000. Assuming 8% to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of 1,000. The holder and issuer of the instrument have a financial asset and financial liability, respectively, of 1,000 and corresponding interest revenue and expense of 80 each year in perpetuity.

Relocated to AG6 as per IASB improvements project.

### A20. Preferred Shares

A20:AG24. Preferred-Preference (or preference) shares may be issued with various rights. In classifying-determining whether a preferred

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

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

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

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

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

Settlement in the entity's own equity instruments (see paragraphs 28 to 31)

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

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

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

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

*Contingent settlement provisions (see paragraph 32)*

AG27. Paragraph 32 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

*Treatment in consolidated financial statements*

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

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

*Compound Financial Instruments*

A22-AG29. Paragraph 29-0 of the Standard applies only to issuers of non-derivative a limited group of compound instruments. Paragraph 0029 does not deal with compound financial instruments from the perspective of holders. International and national accounting standards addressing the recognition and measurement of financial instruments deal with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and net assets features.

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

A22-AG30. A common form of a compound financial instrument is a debt security instrument with an embedded conversion option, such as a bond convertible into common ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 0029 of the Standard requires the issuer of such a financial instrument to present the liability component and the net assets/equity instrument component separately on the statement of financial position, from their initial recognition, as follows:

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IASB  
improvements  
project, ref IAS  
32.AG30.

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

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

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

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

AG32. When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and net assets components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 00 to 00.

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

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

AG34. An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favorable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognized as a loss in surplus or deficit.

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Treasury shares

AG35. An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 00 requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets. However, when an entity holds its own net assets on behalf of others, e.g. a financial institution holding its own net assets on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, dividends or similar distributions, losses and gains (see paragraphs 00 to 00)

AG36. The following example illustrates the application of paragraph 00 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends or similar distributions are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognized in surplus or deficit and classified as interest expense. Any dividends or similar distributions paid relate to the net assets component and, accordingly, are recognized as a distribution of surplus or deficit. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (e.g. commodity). However, if any unpaid dividends or similar distributions are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends or similar distributions are classified as interest paid.

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

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IASB  
improvements  
project.

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

**~~When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9%. At the issue date, the market price of one common share is 3. The dividends expected over the three-year term of the~~**

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~~bonds amount to 0.14 per share at the end of each year. The risk-free annual interest rate for a three-year term is 5%.~~

**Residual Valuation of Equity Instrument Component:**

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

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

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

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

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

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

~~This amount relates to the potential for favorable (and unfavorable) changes in the price of the asset underlying the option, in this case the common shares of the entity issuing the convertible bonds. The volatility of the returns on the underlying asset are estimated by the standard deviation of the returns. The higher the standard deviation, the greater the fair value of the option. In this~~

~~example, the standard deviation of the annual returns on the shares is assumed to be 30%. The time to expiry of the conversion rights is three years. The standard deviation of proportionate changes in fair value of the shares multiplied by the square root of the time to expiry of the option is thus determined as:~~

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

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

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

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

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

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

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

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

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

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



Offsetting of a Financial Asset and a Financial Liability

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

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

A25-AG38. The Standard does not provide special treatment for so-called “synthetic instruments,” which are groupings of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the separate components of an individual financial instruments that together constitute a “synthetic instrument” represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each component financial instrument is exposed to risks that may differ from the risks to which other components financial instruments are exposed. Accordingly, when one component financial instrument of in a “synthetic instrument” is an asset and another is a liability, they are not offset and presented on an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 0039 of the Standard. Such is often not the case. Disclosures are provided about the significant terms and conditions of each financial instrument constituting a component of a “synthetic instrument” without regard to the existence of the “synthetic instrument,” although an entity may indicate in addition the nature of the relationship between the components (see paragraph 58 of the Standard).

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

## Disclosure

Paragraphs A26  
– A27 deleted as  
per IASB  
improvements  
project.

**Paragraph 60 of the Standard lists examples of broad categories of matters that, when significant, an entity addresses in its disclosure of accounting policies. In each case, an entity has a choice from among two or more different accounting treatments. The following discussion elaborates on the examples in paragraph 60 and provides further examples of circumstances in which an entity discloses its accounting policies.**

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

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

**An entity may undertake a partial or incomplete transfer of a financial asset. For example, in a securitization, an entity acquires or transfers to another party some, but not all, of the future economic benefits associated with a financial instrument.**

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

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

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

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

~~An entity may acquire or issue a bond, promissory note or other monetary instrument with a stated amount or rate of interest that differs from the prevailing market interest rate applicable to the instrument. Such financial instruments include zero coupon bonds and loans made on apparently favorable terms but involving non-cash consideration, for example, low interest rate loans to employees.~~

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

~~When to reduce the carrying amount of the asset;~~

~~The amount to which it reduces the carrying amount;~~

~~How to recognize any revenue from the asset; and~~

~~Whether the reduction in carrying amount may be reversed in the future if circumstances change.~~

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### **Amendments to Other IPSASs**

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

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

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

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

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

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

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

## Appendix 13

### Implementation Guide

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

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

#### Requirements of IPSAS 15 — Overview

All entities will need to review scope paragraphs 34–128 and consult the definition of a financial instrument and related commentary (paragraphs 9–21–13–00) to determine when the Standard is applicable and whether they hold financial instruments.

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

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

The relevant paragraphs in the Standard for entities with *only* financial liabilities are paragraphs 0022–3428 and 0036–0038 (Presentation), and paragraphs 48–72, 84–94 and 98–101 (Disclosure).

The relevant paragraphs in the Standard for entities with *only* equity instruments are paragraphs 2422–3028 and 0036–0038 (Presentation), and paragraphs 50–62 and 98–101 (Disclosure).

Where entities hold both financial assets and financial liabilities, additional relevant paragraphs are 0039–0047 (Presentation).

Where entities hold both financial liabilities and net assets/equity, additional relevant paragraphs are 3129–0035 (Presentation).

The relevant paragraphs in the Standard for entities that reacquire their own equity instruments are paragraphs 00–42.

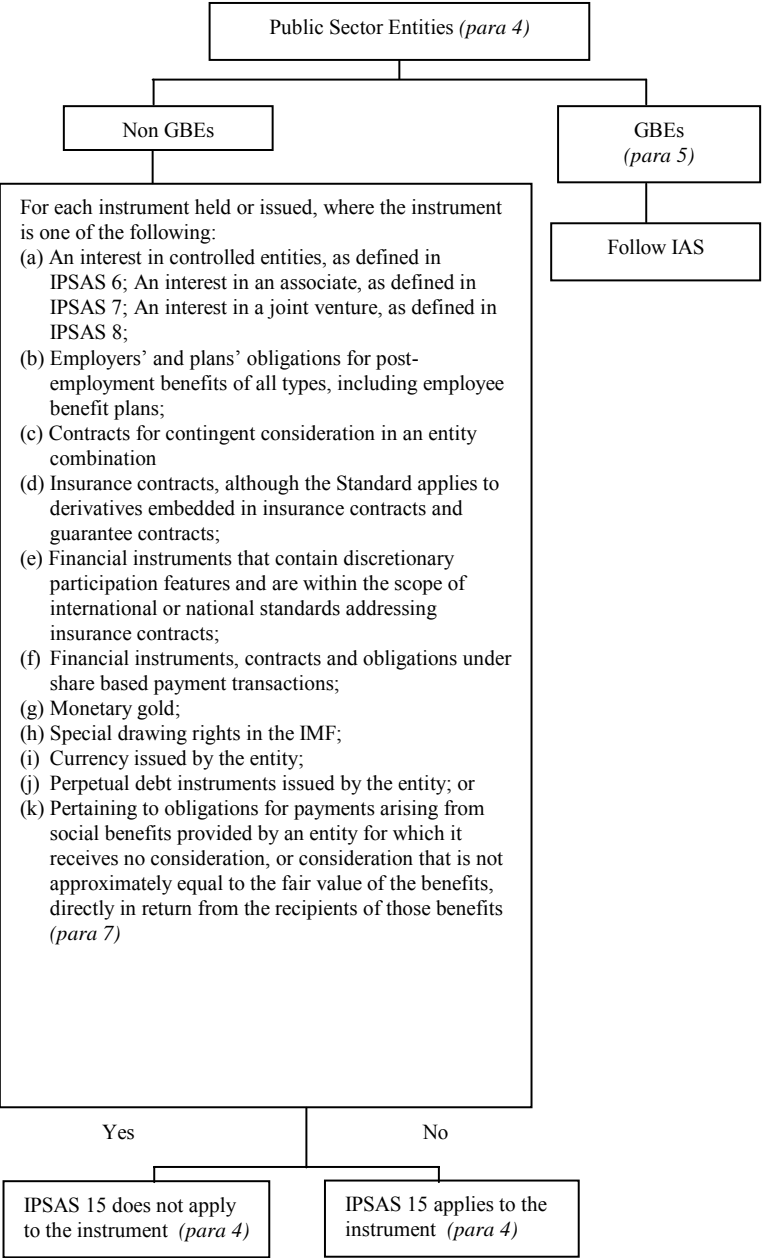
Comparative information is required for all instruments (see IPSAS 1, “Presentation of Financial Statements,” paragraphs 60–63) except, if not available, during the year of first adoption (paragraph 102).

*Summary of Standard ~~Applicability, — and P~~resentation and ~~Disclosure~~  
~~Requirements requirements~~*

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

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Scope of the Standard



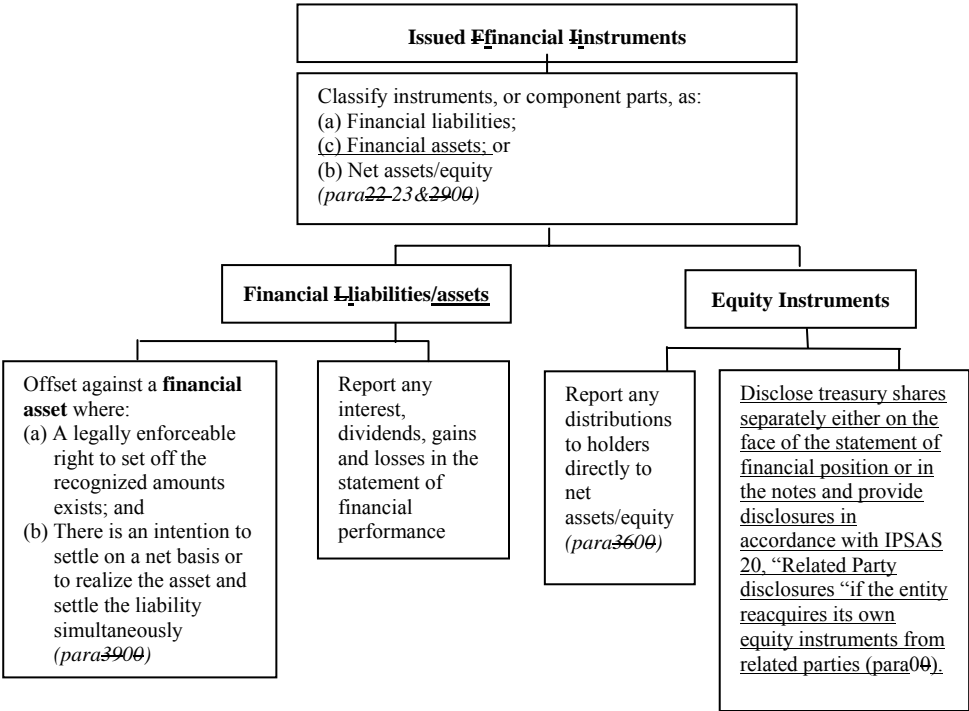
Scope

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

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



Presentation — Issued Financial Instruments



This Standard sets out the requirements for the presentation of financial instruments. Financial instruments can be classified as being financial assets, financial liabilities or equity instruments. These terms are defined in paragraph 9–13 of the Standard. Additional discussion clarifying these defined terms and what constitutes a financial instrument is located in commentary paragraphs 14–24. Examples of financial instruments covered by the Standard are included in Appendix 21, paragraphs 00A3–AG23A16. Appendix 3 contains illustrative examples for the application of paragraphs 00 to 34.

Classification

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

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

It is likely that few public sector entities will issue compound financial instruments (see paragraph 3036). The Standard requires that where such financial instruments are issued, the financial liability, financial liability and net assets/equity components should be separately classified and disclosed (see paragraph 2935). Commentary paragraphs 3437–33–38 and Appendix 21, paragraphs AG22 and AG23, discuss various instances where separate classification is necessary. Paragraphs 3439 and 3540 set out two methods by which preparers could assign a carrying amount to the various components, and Appendix 2, paragraph A24 illustrates an example of how to assign values to the elements.

#### *Treasury shares*

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

Amended as per IASB improvements project (note IAS 32 does not include this appendix).
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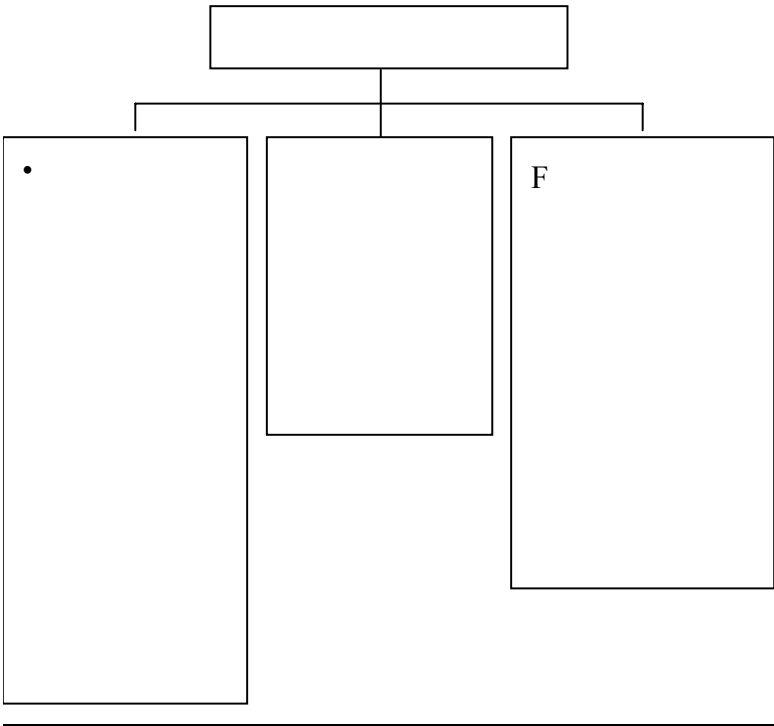
#### *Interest, Dividends and Similar Distributions, Losses and Gains*

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

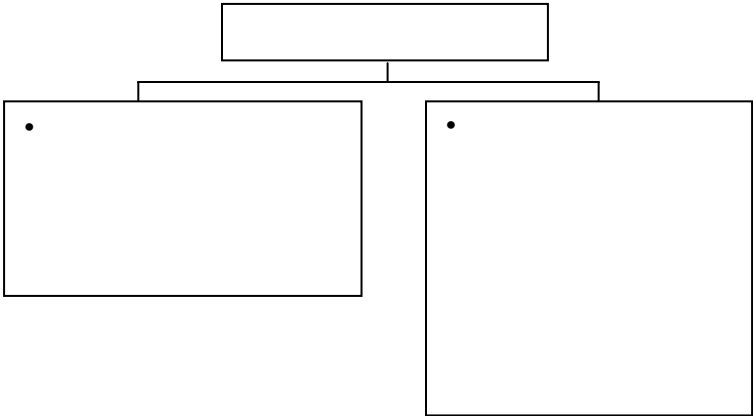
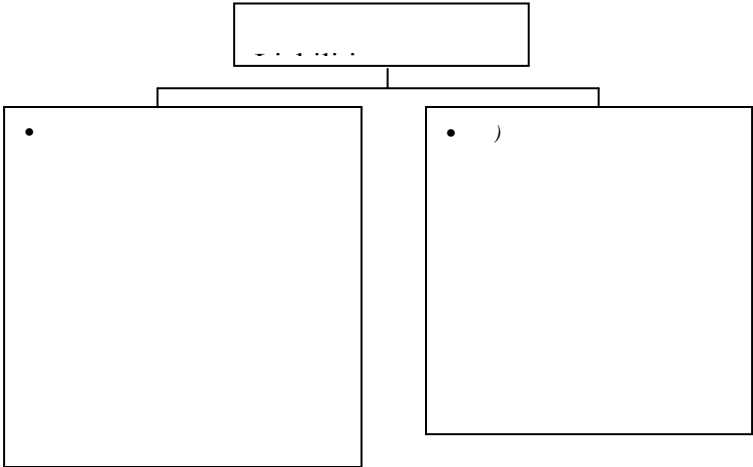
#### *Offsetting*

The Standard prescribes when an entity should offset a financial asset and a financial liability in the statement of financial position (see paragraph 3950). Subsequent commentary includes an explanation of the difference between offsetting instruments and ceasing to recognize an instrument (see paragraph 4152), a discussion of the conditions necessary before an offset is allowable (paragraphs 4253–4556), and provides examples of situations where offsetting would not be allowable (paragraphs 0046 and 0047). Paragraph 5140 provides an example of where instruments should be offset, noting that in other circumstances, separate presentation consistent with the instrument's characteristics as an asset or liability is appropriate. Appendix 2, paragraph 00A25, notes that "synthetic instruments" with financial asset and financial liability components should not be offset unless they meet the criteria for offsetting detailed in paragraph 0039.

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



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appendix).

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

~~Risk~~

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

~~Terms, Conditions and Accounting Policies~~

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

~~Interest Rate Risk~~

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

~~Credit Risk~~

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

~~Fair Value~~

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

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

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

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

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

~~Hedges of Anticipated Future Transactions~~

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

~~Other Disclosure~~

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

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project (note IAS  
32 does not  
include this  
appendix).

These Illustrative Examples are new and has been adapted from the similar appendix in IAS 32.

## Appendix 34

### **Illustrative Examples**

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

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

IE1. The following examples illustrate the application of paragraphs 00 to 30 of this Standard. The examples assume that the entity has adopted accounting policies for the recognition and measurement of financial instruments that are consistent with International Financial Reporting Standard, IAS 39, “Financial Instruments: Recognition and Measurement”. Public sector entities are not typically established as entities with share capital; however, in some situations such a structure may be adopted. For example a public utility may established by a number of different local government entities to supply electricity, gas or water on a subsidized basis, with each local government entity holding shares in the utility and contributing operating funds in proportion to the number of shares they hold. This structure may be used where the entities hold unequal proportions in the utility, and the levels of ownership fluctuate over time. If such an entity satisfied the definition of a Government Business Enterprise, it would not apply this IPSAS, rather it would apply IAS 32, “Financial Instruments: Presentation” issued by the International Accounting Standards Board.

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

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

Assumptions:

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

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

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

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

**February 1, 20X2**

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

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

**December 31, 20X3**

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

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

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



**January 31, 20X4**

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

Dr Loss	CU4,300
Cr Forward asset	CU4,300

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

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:

**January 31, 20X4**

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 Net assets	CU2,000
Cr Forward asset	CU2,000

To record the settlement of the forward contract.

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

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

**February 1, 20X2**

Dr Net assets	CU100,000
Cr Liability	CU100,000

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

**December 31, 20X3**

Dr Interest expense	CU3,660
Cr Liability	CU3,660

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

**January 31, 20X4**

Dr Interest expense	CU340
Cr Liability	CU340

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

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

Dr Liability	CU104,000
Cr Cash	CU104,000

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

(d) Settlement options

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

**Example 2: Forward to sell shares**

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

Assumptions:

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

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

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

**February 1, 20X2**

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

**December 31, 20X3**

Dr Loss	CU3,600
Cr Forward liability	CU3,600

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

**January 31, 20X4**

Dr Forward liability	CU4,300
Cr Gain	CU4,300

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

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

Dr Forward liability	CU2,000
Cr Cash	CU2,000

*To record the settlement of the forward contract.*

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

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

**January 31, 20X4**

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

Dr Financial liability	CU2,000
Cr Net assets	CU2,000

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

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

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

**February 1, 20X2**

No entry is made on February 1, 20X2. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash or another financial asset meets the definition of an equity instrument because it cannot be settled otherwise than through the delivery of shares in exchange for cash.

**December 31, 20X3**

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

**January 31, 20X4**

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

Dr Cash	CU104,000
Cr Net assets	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 recognizes a derivative asset or liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

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

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

**Assumptions:**

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Exercise date</u>	<u>January 31, 20X4</u>
<u>(European terms, i.e. it can be exercised only at maturity)</u>	<u>Reporting entity</u>
<u>Exercise right holder</u>	
<u>(Entity A)</u>	
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU104</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU104</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU102</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>
<u>Fair value of option on December 31, 20X3</u>	<u>CU3,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU2,000</u>

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

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

**February 1, 20X2**

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the

market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

Dr Call option asset CU5,000

Cr Cash CU5,000

*To recognize the purchased call option.*

### **December 31, 20X3**

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

Dr Loss CU2,000

Cr Call option asset CU2,000

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

### **January 31, 20X4**

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

Dr Loss CU1,000

Cr Call option asset CU1,000

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

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

Dr Cash CU2,000

Cr Call option asset CU2,000

*To record the settlement of the option contract.*

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

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

shown in (a) except for recording the settlement of the option contract as follows:

**January 31, 20X4**

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

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

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

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

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

**February 1, 20X2**

Dr Net assets	CU5,000
Cr Cash	CU5,000

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

**December 31, 20X3**

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

**January 31, 20X4**

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

Dr Net assets	CU102,000
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Cr Cash CU102,000

*To record the settlement of the option contract.*

*(d) Settlement options*

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

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

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

*Assumptions:*

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Exercise date</u>	<u>January 31, 20X3</u>
<u>(European terms, i.e. it can be exercised only at maturity)</u>	
<u>Exercise right holder Counterpart (Entity B)</u>	
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU104</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU104</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU102</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>
<u>Fair value of option on December 31, 20X3</u>	<u>CU3,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU2,000</u>

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

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

**February 1, 20X2**

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

To recognize the written call option.

**December 31, 20X3**

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

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

**January 31, 20X4**

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

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

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

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

To record the settlement of the option contract.

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

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

**December 31, 20X3**

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

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

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

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

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

**February 1, 20X2**

Dr Cash	CU5,000
Cr Net assets	CU5,000

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

**December 31, 20X3**

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

**January 31, 20X4**

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

<u>Dr Cash</u>	<u>CU102,000</u>
<u>    Cr Net assets</u>	<u>CU102,000</u>

To record the settlement of the option contract.

**(d) Settlement options**

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

**Example 4: 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:**

<u>Contract date</u>	<u>February 1, 20X2</u>
<u>Exercise date</u>	<u>January 31, 20X4</u>
<u>(European terms, i.e. it can be exercised only at maturity)</u>	
<u>Exercise right holder</u>	<u>Reporting entity</u> <u>(Entity A)</u>
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU95</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU95</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU98</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>

<u>Fair value of option on December 31, 20X3</u>	<u>CU4,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU3,000</u>

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

IE23. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X4 at a strike price of CU98,000 (i.e. CU98 per share) on January 31, 20X4, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

**February 1, 20X2**

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

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

To recognize the purchased put option.

**December 31, 20X3**

On December 31, 20X3 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value  $([CU98 - CU95] \times 1,000)$  and CU1,000 is the remaining time value.

<u>Dr Loss</u>	<u>CU1,000</u>
<u>    Cr Put option asset</u>	<u>CU1,000</u>

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

**January 31, 20X4**

On January 31, 20X4 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value  $([CU98 - CU95] \times 1,000)$  because no time value remains.

<u>Dr Loss</u>	<u>CU1,000</u>
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Cr Put option asset CU1,000

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

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

Dr Cash CU3,000

Cr Put option asset CU3,000

*To record the settlement of the option contract.*

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

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

#### **January 31, 20X4**

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

Dr Net assets CU3,000

Cr Put option asset CU3,000

*To record the settlement of the option contract.*

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

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

#### **February 1, 20X2**

Dr Net assets 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 recognized directly in net assets. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.*

### **December 31, 20X3**

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

### **January 31, 20X4**

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

Dr Cash CU98,000

Cr Net assets 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 recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

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

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

### **Assumptions:**

Contract date

February 1, 20X2

<u>Exercise date</u>	<u>January 31, 20X3</u>
<u>(European terms, i.e. it can be exercised only at maturity)</u>	
<u>Exercise right holder</u>	<u>Counterparty</u>
	<u>(Entity B)</u>
<u>Market price per share on February 1, 20X2</u>	<u>CU100</u>
<u>Market price per share on December 31, 20X3</u>	<u>CU95</u>
<u>Market price per share on January 31, 20X4</u>	<u>CU95</u>
<u>Fixed exercise price to be paid on January 31, 20X4</u>	<u>CU98</u>
<u>Present value of exercise price on February 1, 20X2</u>	<u>CU95</u>
<u>Number of shares under option contract</u>	<u>1,000</u>
<u>Fair value of option on February 1, 20X2</u>	<u>CU5,000</u>
<u>Fair value of option on December 31, 20X3</u>	<u>CU4,000</u>
<u>Fair value of option on January 31, 20X4</u>	<u>CU3,000</u>

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

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

**February 1, 20X2**

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

To recognize the written put option.

**December 31, 20X3**

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

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

**January 31, 20X4**

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

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

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

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

*To record the settlement of the option contract.*

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

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

**January 31, 20X4**

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

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

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

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

IE30. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise

price per share is fixed at CU98. Accordingly, Entity A has an obligation to pay CU98,000 in cash to Entity B ( $CU98 \times 1,000$ ) in exchange for 1,000 of Entity A's outstanding shares, if Entity B exercises its option. Entity A records the following journal entries.

**February 1, 20X2**

Dr Cash	CU5,000
Cr Net assets	CU5,000

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

Dr Net assets	CU95,000
Cr Liability	CU95,000

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

**December 31, 20X3**

Dr Interest expense	CU2,750
Cr Liability	CU2,750

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

**January 31, 20X4**

Dr Interest expense	CU250
Cr Liability	CU250

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

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

Dr Liability	CU98,000
Cr Cash	CU98,000

To record the settlement of the option contract.

(d) Settlement options

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

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

**Example 7: Entities with no net assets**

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

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

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

<b><u>Statement of financial position at December 31,, 20X1</u></b>			
	<b><u>20X1</u></b>	<b><u>20X0</u></b>	
	<b><u>CU</u></b>	<b><u>CU</u></b>	<b><u>CU</u></b>
<b><u>ASSETS</u></b>			
<u>Non-current assets</u> (classified in accordance with IPSAS 1)	<u>91,374</u>	<u>78,484</u>	
<b><u>Total non-current assets</u></b>	<u>91,374</u>	<u>78,484</u>	
<u>Current assets</u> (classified in accordance with IPSAS 1)	<u>1,422</u>	<u>1,769</u>	
<b><u>Total current assets</u></b>	<u>1,422</u>	<u>1,769</u>	
<b><u>Total assets</u></b>	<u>92,796</u>	<u>80,253</u>	
<b><u>LIABILITIES</u></b>			
<u>Current liabilities</u> (classified in accordance With IPSAS 1)	<u>647</u>	<u>66</u>	
<b><u>Total current liabilities</u></b>	<u>(647)</u>	<u>(66)</u>	
<u>Non-current liabilities excluding net assets</u> <u>attributable to unitholders (classified in</u> <u>accordance with IPSAS 1)</u>	<u>280</u>	<u>136</u>	
	<u>(280)</u>	<u>(136)</u>	
<b><u>Net assets attributable to unitholders</u></b>	<u>91,869</u>	<u>80,051</u>	

**Example 8: Entities with some net assets**

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

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

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

<b><u>Statement of financial position at December 31, 20X1</u></b>				
	<b><u>20X1</u></b>		<b><u>20X0</u></b>	
	<u>CU</u>	<u>CU</u>	<u>CU</u>	<u>CU</u>
<b><u>ASSETS</u></b>				
<u>Non-current assets</u>				
(classified in accordance with IPSAS 1)	<u>908</u>		<u>830</u>	
<b><u>Total non-current assets</u></b>		<u>908</u>		<u>830</u>
<u>Current assets</u>				
(classified in accordance with IPSAS 1)	<u>383</u>		<u>350</u>	
<b><u>Total current assets</u></b>		<u>383</u>		<u>350</u>
<b><u>Total assets</u></b>		<u>1,291</u>		<u>1,180</u>
<b><u>LIABILITIES</u></b>				
<u>Current liabilities</u>				
(classified in accordance with IPSAS 1)	<u>372</u>		<u>338</u>	
<b><u>Share capital repayable on demand</u></b>	<u>202</u>		<u>161</u>	
<b><u>Total current liabilities</u></b>		<u>(574)</u>		<u>(499)</u>
<b><u>Total assets less current liabilities</u></b>		<u>717</u>		<u>681</u>
<u>Non-current liabilities</u>				
(classified in accordance with IPSAS 1)	<u>187</u>		<u>196</u>	
		<u>(187)</u>		<u>(196)</u>
<b><u>RESERVES(a)</u></b>				
<u>Reserves e.g. revaluation reserve, retained earnings etc</u>	<u>530</u>		<u>485</u>	
		<u>530</u>		<u>485</u>
		<u>717</u>		<u>681</u>
<b><u>MEMORANDUM NOTE – Total members' interests</u></b>				
<u>Share capital repayable on demand</u>		<u>202</u>		<u>161</u>
<u>Reserves</u>		<u>530</u>		<u>485</u>
		<u>732</u>		<u>646</u>
(a) <u>In this example, the entity has no obligation to deliver a share of its reserves to its members.</u>				

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**Accounting for compound financial instruments**

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

- IE34. Paragraph 00 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.
- IE35. An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.
- IE36. The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

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

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

IE37. The following example illustrates the application of paragraph 00 to the separation of the liability and net assets components of a compound financial instrument with multiple embedded derivative features.

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

**Example 11: Repurchase of a convertible instrument**

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

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

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

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



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

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

IE44. The repurchase price is allocated as follows:

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

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

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

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

*To recognize the repurchase of the liability component.*

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

*To recognize the cash paid for the net assets component.*

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

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

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

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

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

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

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

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

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

*Number of incremental ordinary shares issued upon conversion 10 shares 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 recognized as a loss in surplus or deficit.

**Examples of Disclosure Requirements**

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

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

#### Note X1. Summary of Accounting Policies (Extract)

##### Trade Receivables

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

##### Investments

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

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

##### Borrowings

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

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

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

#### ~~Derivative Financial Instruments~~

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

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

#### ~~Note X2. Financial Risk Management~~

##### ~~Financial Risk Factors~~

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

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

##### ~~Interest Rate Risk~~

~~The entity's revenue and operating cash flows are substantially independent of changes in market interest rates. The entity has no significant interest-bearing assets. The entity's policy is to maintain approximately 80% of its borrowings in fixed rate instruments. At the year end 75% were at fixed rates. The entity sometimes borrows at variable rates and uses interest rate swaps as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from~~

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~~floating rates to fixed rates. The interest rate swaps allow the entity to raise long-term borrowings at floating rates and swap them into fixed rates that are lower than those available if it borrowed at fixed rates directly. Under the interest rate swaps, the entity agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.~~

#### ~~Credit Risk~~

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

#### ~~Liquidity Risk~~

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

#### ~~Fair Value Estimation~~

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

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

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

~~Note X3. Financial Instruments~~

~~(i) Off-balance-sheet Derivative Instruments~~

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

~~Interest Rate Swap Contracts~~

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

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

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

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

	<del>20X2</del>	<del>20X1</del>
	<del>\$'000</del>	<del>\$'000</del>
<del>Less than 1 year</del>	<del>30</del>	<del>20</del>
<del>1–2 years</del>	<del>250</del>	<del>170</del>
<del>2–3 years</del>	<del>250</del>	<del>170</del>
<del>3–4 years</del>	<del>300</del>	<del>80</del>
<del>4–5 years</del>	<del>180</del>	<del>–</del>

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~~1,010~~                      ~~440~~

**Forward Exchange Contracts**

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

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

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

Buy FC <sub>A</sub>	Sell Domestic Currency		Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		

**Maturity**

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

Buy FC <sub>B</sub>	Sell Domestic Currency		Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		

**Maturity**

<del>0–6 months</del>	<del>4,527</del>	<del>2,319</del>	<del>0.6627</del>	<del>0.6467</del>
<del>6–12 months</del>	<del>–</del>	<del>1,262</del>	<del>–</del>	<del>0.6337</del>

~~As these contracts are hedging anticipated future purchases, any unrealized gains and losses on the contracts, together with the cost of the contracts, are~~

~~deferred and will be recognized in the measurement of the underlying transaction. Included in the amounts deferred are any gains and losses on hedging contracts terminated prior to maturity where the related hedged transaction is still expected to occur.~~

~~(ii) Credit Risk Exposures~~

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

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

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

	<del>20X2</del>	<del>20X1</del>
	<del>\$'000</del>	<del>\$'000</del>
<del>Domestic Currency</del>	<del>2,073</del>	<del>1,422</del>
<del>Foreign Currency</del>	<del>11,599</del>	<del>8,613</del>

~~(iii) Interest Rate Risk Exposures~~

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

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



~~(iv) Net Fair Value of Financial Assets and Liabilities~~

~~On-balance-sheet~~

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

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

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

~~Off-balance-sheet~~

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

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

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

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

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

~~The entity has potential financial liabilities which may arise from certain contingencies. No material losses are anticipated in respect of any of those contingencies and the net fair value disclosed below is the Ministry for Finance's~~

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~~estimate of amounts which would be payable by the entity as consideration for the assumption of those contingencies by another party.~~

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

	<del>20X2</del>		<del>20X1</del>	
	<del>Carrying</del>	<del>Net fair</del>	<del>Carrying</del>	<del>Net fair</del>
	<del>amount</del>	<del>value</del>	<del>amount</del>	<del>value</del>
	<del>\$'000</del>	<del>\$'000</del>	<del>\$'000</del>	<del>\$'000</del>
<del>On balance sheet financial instruments</del>				
<del>Financial assets</del>				
Cash	<del>250</del>	<del>250</del>	<del>200</del>	<del>200</del>
Deposits	<del>3,952</del>	<del>3,952</del>	<del>2,881</del>	<del>2,881</del>
Trade debtors	<del>5,374</del>	<del>5,374</del>	<del>3,935</del>	<del>3,935</del>
Bills of exchange	<del>440</del>	<del>437</del>	<del>140</del>	<del>140</del>
Loans to directors	<del>147</del>	<del>121</del>	<del>136</del>	<del>107</del>
Other debtors	<del>424</del>	<del>425</del>	<del>124</del>	<del>124</del>
Loans to related parties	<del>800</del>	<del>800</del>	<del>200</del>	<del>200</del>
Shares in other related parties	<del>200</del>	<del>227</del>	<del>200</del>	<del>227</del>
Shares in other corporations	<del>100</del>	<del>100</del>	<del>200</del>	<del>190</del>
Zero coupon bonds	<del>60</del>	<del>58</del>	<del>–</del>	<del>–</del>

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Non-traded financial assets	11,747	11,744	8,016	8,004
Traded investments				
Shares in non-government corporations	1,100	900	100	60
Debentures	200	215	–	–
	13,047	12,859	8,116	8,064
<b>Financial liabilities</b>				
Trade creditors	2,405	2,405	1,762	1,762
Other creditors	740	740	650	650
Bank overdraft	2,350	2,350	2,250	2,250
Bank loans	530	537	900	898
Bills payable	250	241	130	130
Convertible notes	1,800	1,760	–	–
Redeemable preference shares	1,000	875	1,000	860
Other loans	430	433	150	150
Lease liabilities	575	570	650	643
<b>Non-traded financial liabilities</b>	10,080	9,911	7,492	7,343
Off-balance sheet financial instruments	2,000	2,072	3,000	3,018
<b>Financial assets</b>	12,080	11,983	10,492	10,361

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Indemnity received	<del>—<sup>(i)</sup></del>	<del>200</del>	<del>—<sup>(i)</sup></del>	<del>40</del>
Forward exchange contracts	<del>61<sup>(ii)</sup></del>	<del>61</del>	<del>26</del>	<del>26</del>
Interest rate swaps	<del>2<sup>(ii)</sup></del>	<del>13</del>	<del>1</del>	<del>2</del>
	<del>63</del>	<del>274</del>	<del>27</del>	<del>68</del>
<b>Financial liabilities</b>				
Call options	<del>—</del>	<del>—</del>	<del>—</del>	<del>—</del>
Debentures defeased	<del>—</del>	<del>1,000</del>	<del>—</del>	<del>—</del>
Forward exchange contracts	<del>607<sup>(ii)</sup></del>	<del>402</del>	<del>304</del>	<del>231</del>
Contingencies	<del>—</del>	<del>25</del>	<del>—</del>	<del>30</del>
	<del>607</del>	<del>1,427</del>	<del>304</del>	<del>261</del>

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

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

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

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

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

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

## **Basis for Conclusions**

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

### **Background**

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

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

*Monetary gold*

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

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

*Special Drawing Rights in the International Monetary Fund*

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

*Currency issued by the entity*

BC8. Currency (bank notes and coins) is generally issued by the monetary authority (or central bank) of a national government, however, in some jurisdictions private sector banks are authorized to issue bank notes on behalf of the monetary authority. In some jurisdictions, the central bank

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

does not issue currency, but adopts the currency of another country. Some countries also join together in monetary unions to issue one currency for the several countries.

BC1-BC9. IAS 32 does not address the presentation of currency issued by the entity. This ED proposes that currency issued by the entity be included in the definition of “financial liability”~~Developing specific requirements for the presentation of currency issued by the entity is beyond the limited scope of this project, and the IPSASB has deferred consideration of the issue.~~

*Liabilities related to revenue from non-exchange transactions*

BC10. IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” establishes the requirement to recognize a liability in respect of an obligation to return financial assets to a transferor in the event that a condition on a transferred asset will be breached or otherwise be unfulfilled. The obligation to return cash or other financial assets is a financial liability.

## Comparison with IAS 32

International Public Sector Accounting Standard (IPSAS) 15, “Financial Instruments: Disclosure and Presentation” is drawn primarily from International Accounting Standard (IAS) 32 (revised 1998/2005), “Financial Instruments: Disclosure and Presentation.” The main differences between IPSAS 15 and IAS 32 are as follows:

- ~~IAS 32 was amended in October 2000 to eliminate disclosure requirements that became redundant as a result of Internal Accounting Standard (IAS) 39, “Financial Instruments: Recognition and Measurement.” As yet, there is no IPSAS addressing the issue of the recognition and measurement of financial instruments. Consequently, the sections on Hedges of Anticipated Future Transactions and Other Disclosures have been retained in IPSAS 15.~~

Given the rationale for initiating this project, it is no longer appropriate to include provisions relating to hedges.
- Commentary additional to that in IAS 32 has been included in IPSAS 15 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 15 uses different terminology, in certain instances, from IAS 32. The most significant examples are the use of the terms “entity,” “revenue,” “statement of financial performance,” “statement of financial position” (except for references to “on- and off-balance-sheet”) and “net assets/equity” (except for references to “equity instruments”) in IPSAS 15. The equivalent terms in IAS 32 are “enterprise,” “income,” “income statement,” “balance sheet” and “equity.”
- IPSAS 15 includes within the definition of “financial assets” monetary gold and special drawing rights in the International Monetary Fund. IAS 32 does not include these because they cannot be held by private sector entities.
- IPSAS 15 includes within the definition of “financial liabilities” currency issued by the entity. IAS 32 does not explicitly include this.
- IPSAS 15 includes a definition of an insurance contract; IAS 32 does not include this definition because it is defined in IFRS 4, “Insurance Contracts.” Insurance contracts are only explained in commentary in IAS 32.
- IPSAS 15 includes definitions of special drawing rights in the International Monetary Fund” and monetary gold. IAS 32 does not include these definitions because these items cannot be held by non-public sector entities.
- IPSAS 15 includes liabilities to return resources to transferors recognized in accordance with IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” within the definition of financial liabilities. IFRS 7 does make such an exclusion because there is no IFRS equivalent to IPSAS 23.

ED XX IPSAS 15 COMPARISON WITH IAS 32



- IPSAS 15 includes an implementation guide to assist preparers of financial statements (Appendix 1). IAS 32 does not include such a guide.
- ~~IPSAS 15 includes an illustration of the disclosures required under the Standard (Appendix 3). No example of disclosure requirements is included in IAS 32.~~

**IPSAS XX—FINANCIAL INSTRUMENTS: DISCLOSURE**

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International Public Sector Accounting Standard XX, “Financial Instruments: Disclosure” (IPSAS XX) is set out in paragraphs 1– 48. All the paragraphs have equal authority. IPSAS XX should be read in the context of its objective and the Basis for Conclusions, and the “Preface to the International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

### Reasons for issuing the Standard

- IN1. In recent years, the techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance. In addition, many public and private sector initiatives have proposed improvements to the disclosure framework for risks arising from financial instruments.
- IN2. The International Public Accounting Standards Board believes that users of financial statements need information about an entity's exposure to risks and how those risks are managed. Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows. Greater transparency regarding those risks allows users to make more informed judgments about risk and return.
- IN3. Consequently, the IPSASB concluded that there was a need to revise and enhance the disclosures IPSAS 15, "Financial Instruments: Disclosure and Presentation", in line with the amendments made to IAS 32, "Financial Instruments: Disclosure and Presentation" by the International Accounting Standards Board. Issuing this Standard is part of the IPSASB's ongoing efforts to converge public sector financial reporting with private sector financial reporting to the extent appropriate.

### Main features of the IFRS

- IN4. IPSAS XX applies to all risks arising from all financial instruments, except those instruments listed in paragraph 3. The Standard applies to all entities, including entities that have few financial instruments (e.g. a government department whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (e.g. national government that actively manages its cash flows by trading, holding and issuing a variety of financial instruments). However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

- IN5. The Standard requires disclosure of:
- (a) The significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in IPSAS 15.
  - (b) Qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.
- IN6. The Standard includes mandatory application guidance that explains how to apply the requirements in the Standard. The Standard is accompanied by non-mandatory Implementation Guidance that describes how an entity might provide the disclosures required by the Standard.
- IN7. The Standard supersedes the disclosure requirements previously contained in IPSAS 15. Presentation requirements are included in IPSAS 15.
- IN8. The Standard is effective for annual periods beginning on or after Month DD, 20XX. Earlier application is encouraged.

This Introduction is based on the similar introduction in IFRS 7 and on introductions used in other IPSASs.

## Objective

1. The objective of this ~~IFRS~~-Standard is to require entities to provide in their financial statements that enable users to evaluate:
  - a) the significance of financial instruments for the entity's financial position and performance; and
  - b) ~~the~~The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks.

Some entities such as national governments and public sector financial institutions may hold a wide range of financial instruments. However, some individual government agencies may not issue or hold a wide range of instruments. In such cases, the Standard will have limited application and preparers of financial statements will need to identify those aspects of the Standard that apply to them. The purpose of the application guidance in paragraphs AG1 to AG28 and the implementation guidance in paragraphs IG1 to IG41 is to assist preparers in this task.

Similar to IPSAS 15 new paragraph 1.

2. The principles in this ~~IFRS~~-Standard complement the principles for ~~recognising, measuring and presenting~~ financial assets and financial liabilities in ~~IAS 32~~IPSAS 15, "Financial Instruments: Presentation" and ~~IAS 39, *Financial Instruments: Recognition and Measurement*.~~

## Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard for the presentation of financial instruments.**

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

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

- ~~3.6. This IFRS~~ **This Standard shall be applied by all entities to financial instruments except:**~~shall be applied apply by all entities to all types of financial instruments, except:~~

- (a) ~~those~~**Those interests in subsidiaries controlled entities, associates and joint ventures that are accounted for in accordance with IAS 27**~~IPSAS 6.~~

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

~~“Consolidated and Separate Financial Statements”, IAS 28~~IPSAS 7, “Investments in Associates” or IAS 31~~IPSAS 8 “Interests in Joint Ventures”.~~ However, in some cases, ~~IAS 27~~IPSAS 6, ~~IAS 28~~IPSAS 7 or ~~IAS 31~~IPSAS 8 permits an entity to account for an interest in a ~~subsidiary controlled entity~~, associate or joint venture ~~using IAS 39~~as financial instruments; in those cases, entities shall apply the disclosure requirements in ~~IAS 27~~IPSAS 6, ~~IAS 28~~IPSAS 7 or ~~IAS 31~~IPSAS 8 in addition to those in this ~~IFRS Standard~~. Entities shall also apply this ~~IFRS Standard~~ to all derivatives linked to interests in ~~subsidiaries controlled entities~~, associates or joint ventures unless the derivative meets the definition of an equity instrument in ~~IAS 32~~IPSAS 15.

Sub-paragraphs (f) – (i) and paragraphs 5–7 added to exclude public sector specific financial instruments not addressed by IFRS 7 social policy obligations as per IPSAS 15..

- (b) ~~employers~~Employers’ rights and obligations arising from employee benefit plans, to which ~~IAS 19~~IPSAS XX, “Employee Benefits” applies.
- (c) ~~contracts~~Contracts for contingent consideration in a ~~business an entity combination~~ (see ~~IFRS 3 Business Combinations~~international or national standards addressing entity combinations). This exemption applies only to the acquirer.
- (d) ~~insurance~~Insurance contracts as defined in ~~IFRS 4 Insurance Contracts~~IPSAS 15. However, this ~~IFRS Standard~~ applies to derivatives that are embedded in insurance contracts if ~~IAS 39~~requires the entity to ~~accounts~~ for them separately. Moreover, an issuer shall apply this ~~IFRS Standard~~ to financial guarantee contracts if the issuer ~~applies IAS 39 in recognising and measuring the accounts for the contracts as financial instruments, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.~~
- (e) ~~financial~~Financial instruments, contracts and obligations under share-based payment transactions ~~to which IFRS 2 Share-based Payment applies~~, except that this ~~IFRS Standard~~ applies to those contracts within the scope of paragraphs 5–7 of IAS 39 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 those 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.

This sub-paragraph has been expanded to avoid referring to IAS 39.

(f) —

(f) Obligations for payments arising under social benefits provided by an entity for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits.

4.7. This IFRS—Standard applies to ~~recognised~~recognized and ~~unrecognised~~unrecognized financial instruments. ~~Recognised~~financial instruments include financial assets and financial liabilities that are within the scope of IAS 39. ~~Unrecognised~~financial instruments include some financial instruments that, although outside the scope of IAS 39, are within the scope of this IFRS (such as some loan commitments).

5.8. This IFRS Standard applies to contracts to buy or sell a non-financial item that are within the scope of IAS 39 (see paragraphs 5–7 of IAS 39) 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.

Amended to avoid reference to IAS 39.

## Definitions

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

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

An insurance contract (for the purposes of this Standard) is a contract which one party (the insurer) accepts significant risk, other than financial risk, from another party (the policy holder) by agreeing to compensate the policyholder if a specified future event adversely affects the policyholder.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

Loans payable are financial liabilities, other than short-term payables on normal credit terms.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk

Definitions not in IFRS 7 have been added here. These definitions are drawn from the proposed revisions to IPSAS 15 and from IAS 39 and IFRS 4, "Insurance Contracts".



comprises three types of risk: currency risk, interest rate risk and other price risk.

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

Past due A financial asset is past due when a counterparty has failed to make a payment when contractually due.

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

## **Classes of financial instruments and level of disclosure**

- ~~6.10.~~ When this ~~IFRS~~ Standard requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the ~~balance sheet~~ statement of financial position.

## **Significance of financial instruments for financial position and performance**

- ~~7.11.~~ An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

## **Statement of financial position**

### **Categories of financial assets and financial liabilities**

- ~~8.12.~~ The carrying amounts of each of the following categories, as defined in ~~IAS 39~~ IPSAS 15, shall be disclosed either on the face of the balance sheet or in the notes:

- (a) ~~financial~~ Financial assets at fair value through ~~profit~~ surplus or loss ~~deficit~~, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading ~~in accordance with IAS 39~~;
- (b) ~~held~~ Held-to-maturity investments;

- (c) ~~loans~~ Loans and receivables;
- (d) ~~available~~ Available-for-sale financial assets;
- (e) ~~financial~~ Financial liabilities at fair value through ~~profit or loss~~ surplus or deficit, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading ~~in accordance with IAS 39~~; and
- (f) ~~financial~~ Financial liabilities measured at ~~amortised~~ amortized cost

Amended to avoid  
reference to IAS  
39.

**Financial assets or financial liabilities at fair value through surplus or deficit**

~~9.13.~~ If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through ~~profit or loss~~ surplus or deficit, it shall disclose:

- (a) ~~the~~ The maximum exposure to credit risk (see paragraph 40(a)~~36(a)~~) of the loan or receivable (or group of loans or receivables) at the reporting date.
- (b) ~~the~~ The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.
- (c) ~~the~~ The amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:
  - (i) ~~as~~ As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
  - (ii) ~~using~~ Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.
- (d) Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.
- (e) ~~the~~ The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

~~10.14.~~ If the entity has designated a financial liability as at fair value through ~~profit or loss~~ surplus or deficit ~~in accordance with paragraph 9 of IAS 39~~, it shall disclose:

- (a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:

- (i) ~~as~~ As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix B, paragraph B4); or
- (ii) ~~using~~ Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.
- (b) Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.
- (c) ~~the~~ The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

~~11.15.~~ The entity shall disclose:

- (a) ~~the~~ The methods used to comply with the requirements in paragraphs 13(c) ~~9(e)~~ and 14(a) ~~10(a)~~.
- (b) ~~if~~ If the entity believes that the disclosure it has given to comply with the requirements in paragraph 13(c) ~~9(e)~~ or 14(a) ~~10(a)~~ does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

### **Reclassification**

~~12.16.~~ If the entity has reclassified a financial asset as one measured:

- (a) at cost or ~~amortised~~ amortized cost, rather than at fair value; or
- (b) at fair value, rather than at cost or ~~amortised~~ amortized cost,

~~It~~ It shall disclose the amount reclassified into and out of each category and the reason for that reclassification (~~see paragraphs 51–54 of IAS 39~~).

### **Derecognition**

~~13.17.~~ An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (~~see paragraphs 15–37 of IAS 39~~). The entity shall disclose for each class of such financial assets:

- (a) the nature of the assets;
- (b) the nature of the risks and rewards of ownership to which the entity remains exposed;

- (c) when the entity continues to ~~recognise~~recognize all of the assets, the carrying amounts of the assets and of the associated liabilities; and
- (d) when the entity continues to ~~recognise~~recognize the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to ~~recognise~~recognize, and the carrying amount of the associated liabilities

### Collateral

~~14.18.~~ An entity shall disclose:

- (a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified because the entity has the right by contract or custom to sell or repledge the collateral in accordance with paragraph 37(a) of IAS 39; and
- (b) ~~the~~The terms and conditions relating to its pledge.

First sentence added to clarify that this is not a common transaction for most public sector entities.

~~15.19.~~ When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:

- (a) the fair value of the collateral held;
- (b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
- (c) ~~the~~The terms and conditions associated with its use of the collateral.

Amended to avoid reference to IAS 39. Additional text brought in from IAS 39.37(a).

### Allowance account for credit losses

~~16.20.~~ When financial assets are impaired by credit losses and the entity records the impairment in a separate account (e.g. an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

### Compound financial instruments with multiple embedded derivatives

~~17.21.~~ Public sector entities do not commonly issue compound financial instruments. However, this Standard requires that if an entity has issued an instrument that contains both a liability and ~~an~~ a net assets/equity component (see paragraph 28 36 of IAS 32IPSAS 15) and the instrument has multiple embedded derivatives

whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

### Defaults and breaches

~~18-22.~~ For loans payable ~~recognised~~recognized at the reporting date, an entity shall disclose:

- (a) ~~details~~Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
- (b) ~~the~~The carrying amount of the loans payable in default at the reporting date; and
- (c) ~~whether~~Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were ~~authorised~~authorized for issue.

~~19-23.~~ If, during the period, there were breaches of loan agreement terms other than those described in paragraph 22~~48~~, an entity shall disclose the same information as required by paragraph 22~~48~~ if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the reporting date).

## Statement of financial performance and net assets

### Items of revenue, expense, gains or losses

~~20-24.~~ An entity shall disclose the following items of income, expense, gains or losses either on the face of the financial statements or in the notes:

- (a) ~~net~~Net gains or net losses on:
  - (i) ~~financial~~Financial assets or financial liabilities at fair value through ~~profit or loss~~surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading ~~in accordance with IAS 39~~;
  - (ii) ~~available~~Available-for-sale financial assets, showing separately the amount of gain or loss ~~recognised~~recognized directly in net assets/equity during the period and the amount removed from net assets/equity and ~~recognised~~recognized in profit or loss~~surplus or deficit~~ for the period;
  - (iii) ~~held~~Held-to-maturity investments;
  - (iv) ~~loans~~Loans and receivables; and
  - (v) ~~financial~~Financial liabilities measured at ~~amortised~~amortized cost;

- (b) ~~total~~ Total interest ~~income-revenue~~ and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through ~~profit or loss~~ surplus or deficit;
- (c) ~~Fee income-revenue~~ and expense (other than amounts included in determining the effective interest rate) arising from:
  - (i) ~~financial~~ Financial assets or financial liabilities that are not at fair value through ~~profit-surplus or loss~~ deficit; and
  - (ii) ~~trust~~ Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;
- (d) ~~Interest income-revenue~~ on impaired financial assets ~~accrued in accordance with paragraph AG93 of IAS 39~~; and
- (e) ~~the~~ The amount of any impairment loss for each class of financial asset.

## Other disclosures

### Accounting policies

- ~~21-25.~~ In accordance with paragraph ~~108-132~~ of ~~IAS-IPSAS 1~~, “Presentation of Financial Statements”, an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

### Hedge accounting

- ~~22-26.~~ An entity shall disclose the following separately for each type of hedge ~~described in IAS 39 (i.e. fair value hedges, cash flow hedges, and hedges of net investments in foreign operations)~~:
- (a) ~~a~~ A description of each type of hedge;
  - (b) ~~a~~ A description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and
  - (c) ~~the~~ The nature of the risks being hedged.
- ~~23-27.~~ For cash flow hedges, an entity shall disclose:
- (a) ~~the~~ The periods when the cash flows are expected to occur and when they are expected to affect ~~profit or loss~~ surplus or deficit;
  - (b) ~~a~~ A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;
  - (c) ~~the~~ The amount that was ~~recognised~~ recognized in net assets/equity during the period;

- (d) ~~the~~ The amount that was removed from net assets/equity and included in profit or loss—surplus or deficit for the period, showing the amount included in each line item in the income statement of financial performance; and
- (e) ~~the~~ The amount that was removed from net assets/equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.
- ~~24-28.~~ An entity shall disclose separately:
- (a) in fair value hedges, gains or losses:
- (i) on the hedging instrument; and
- (ii) ~~on~~ On the hedged item attributable to the hedged risk.
- (b) the ineffectiveness ~~recognised~~ recognized in profit or loss—surplus or deficit that arises from cash flow hedges; and
- (c) the ineffectiveness ~~recognised~~ recognized in profit or loss—surplus or deficit that arises from hedges of net investments in foreign operations

**Fair value**

- ~~25-29.~~ Except as set out in paragraph 33~~29~~, for each class of financial assets and financial liabilities (see paragraph 106), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
- ~~26-30.~~ In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the balance sheet ~~statement of financial position~~.
- ~~27-31.~~ An entity shall disclose:
- (a) ~~the~~ The methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates.
- (b) ~~whether~~ Whether fair values are determined, in whole or in part, directly by reference to published price quotations in an active market or are estimated using a valuation technique ~~(see paragraphs AG71–AG79 of IAS 39)~~.
- (c) ~~whether~~ Whether the fair values ~~recognised~~ recognized or disclosed in the financial statements are determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same

- instrument (~~ie i.e.~~ without modification or repackaging) and not based on available observable market data. For fair values that are ~~recognised~~recognized in the financial statements, if changing one or more of those assumptions to reasonably possible alternative assumptions would change fair value significantly, the entity shall state this fact and disclose the effect of those changes. For this purpose, significance shall be judged with respect to ~~profit or loss~~surplus or deficit, and total assets or total liabilities, or, when changes in fair value are ~~recognised~~recognized in net assets/equity, total net assets/equity.
- (d) ~~if~~ (c) applies, the total amount of the change in fair value estimated using such a valuation technique that was ~~recognised~~recognized in ~~profit or loss~~surplus or deficit during the period.
- ~~28-32.~~ If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (~~see paragraphs AG74-AG79 of IAS 39~~). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (~~ie i.e.~~ the fair value of the consideration given or received); ~~unless conditions described in paragraph AG76 of IAS 39 are met~~. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:
- (a) ~~its~~Its accounting policy for ~~recognising~~recognizing that difference in ~~profit or loss~~surplus or deficit to reflect a change in factors (including time) that market participants would consider in setting a price (~~see paragraph AG76A of IAS 39~~); and
- (b) ~~the~~The aggregate difference yet to be ~~recognised~~recognized in ~~profit or loss~~surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
- ~~29-33.~~ Disclosures of fair value are not required:
- (a) ~~when~~When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
- (b) ~~for~~For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost ~~in accordance with IAS 39~~ because its fair value cannot be measured reliably; or
- (c) ~~for~~For a contract containing a discretionary participation feature (~~as described in IFRS 4~~) if the fair value of that feature cannot be measured reliably.
- ~~30-34.~~ In the cases described in paragraph 33(b)~~29(b)~~ and 33(c)~~(e)~~, an entity shall disclose information to help users of the financial statements make their own ~~judgements~~judgments about the extent of possible differences between the



carrying amount of those financial assets or financial liabilities and their fair value, including:

- (a) ~~the~~ The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
- (b) ~~a~~ A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
- (c) ~~information~~ Information about the market for the instruments;
- (d) ~~information~~ Information about whether and how the entity intends to dispose of the financial instruments; and
- (e) ~~if~~ If financial instruments whose fair value previously could not be reliably measured are ~~derecognised~~ derecognized, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss ~~recognised~~ recognized.

### **Nature and extent of risks arising from financial instruments**

~~31.35.~~ **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date.**

~~32.36.~~ The disclosures required by paragraphs 37~~33~~–46~~42~~ focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk.

### **Qualitative disclosures**

~~33.37.~~ For each type of risk arising from financial instruments, an entity shall disclose:

- (a) ~~the~~ The exposures to risk and how they arise;
- (b) ~~its~~ Its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- (c) ~~any~~ Any changes in (a) or (b) from the previous period.

### **Quantitative disclosures**

~~34.38.~~ For each type of risk arising from financial instruments, an entity shall disclose:

- (a) ~~summary~~ Summary quantitative data about its exposure to that risk at the reporting date. This disclosure shall be based on the information provided internally to key management personnel of the entity (as defined in ~~IAS 24~~ IPSAS 20, “Related Party Disclosures”), for example the entity’s board of directors or chief executive officer.

- (b) ~~the~~The disclosures required by paragraphs 40~~36–46~~42, to the extent not provided in (a), unless the risk is not material (see paragraphs 29~~–31~~45–47 of ~~IAS 1~~IPSAS 1 for a discussion of materiality).
- (c) ~~concentrations~~Concentrations of risk if not apparent from (a) and (b).
- ~~35.39.~~ If the quantitative data disclosed as at the reporting date are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

### **Credit risk**

- ~~36.40.~~ An entity shall disclose by class of financial instrument:
- (a) ~~the~~The amount that best represents its maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements (~~eg~~e.g. netting agreements that do not qualify for offset in accordance with ~~IAS 32~~IPSAS 15);
- (b) ~~in~~In respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;
- (c) ~~information~~Information about the credit quality of financial assets that are neither past due nor impaired; and
- (d) ~~the~~The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

#### *Financial assets that are either past due or impaired*

- ~~37.41.~~ An entity shall disclose by class of financial asset:
- (a) ~~an~~An analysis of the age of financial assets that are past due as at the reporting date but not impaired;
- (b) ~~an~~An analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired; and
- (c) ~~for~~For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

#### *Collateral and other credit enhancements obtained*

- ~~38.42.~~ When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (~~eg~~e.g. guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose:
- (a) ~~the~~The nature and carrying amount of the assets obtained; and

- (b) ~~when~~When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

**Liquidity risk**

~~39-43.~~ An entity shall disclose:

- (a) ~~a~~A maturity analysis for financial liabilities that shows the remaining contractual maturities; and
- (b) ~~a~~A description of how it manages the liquidity risk inherent in (a).

**Market risk**

*Sensitivity analysis*

~~40-44.~~ Unless an entity complies with paragraph 4541, it shall disclose:

- (a) ~~a~~A sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing how ~~profit or loss~~surplus or deficit and net assets/equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) ~~the~~The methods and assumptions used in preparing the sensitivity analysis; and
- (c) ~~changes~~Changes from the previous period in the methods and assumptions used, and the reasons for such changes.

~~41-45.~~ If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (~~e.g.g.~~ interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 40. The entity shall also disclose:

- (a) ~~an~~An explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
- (b) ~~an~~An explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

*Other market risk disclosures*

~~42-46.~~ When the sensitivity analyses disclosed in accordance with paragraph 4440 or 4541 are unrepresentative of a risk inherent in a financial instrument (for example because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

**Effective date~~Date~~ and transitional~~Transitional~~  
provisions~~Provisions~~**

~~43.47.~~ An entity shall apply this ~~IFRS Standard~~ for annual periods beginning on or after ~~1 January 2007~~ Month DD, YYYY. Earlier application is encouraged. If an entity applies this ~~IFRS Standard~~ for an earlier period, it shall disclose that fact.

~~44.48.~~ If an entity applies this ~~IFRS Standard~~ for annual periods beginning before ~~1 January 2006~~ Month DD, YYYY, it need not present comparative information for the disclosures required by paragraphs ~~3531–4642~~ about the nature and extent of risks arising from financial instruments.

**Withdrawal of IAS 30**

~~45.~~ This IFRS supersedes IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions.

## **Appendix A** **Defined terms**

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

**credit risk** The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

**currency risk** The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

**interest rate risk** The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

**liquidity risk** The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

**loans payable** Loans payable are financial liabilities, other than short term trade payables on normal credit terms.

**market risk** The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: **currency risk**, **interest rate risk** and **other price risk**.

**other price risk** The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from **interest rate risk** or **currency risk**), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

**past due** A financial asset is past due when a counterparty has failed to make a payment when contractually due.

The following terms are defined in paragraph 11 of IAS 32 ~~IPSAS 15~~ or paragraph 9 of IAS 39 and are used in the IFRS with the meaning specified in IAS 32 ~~IPSAS 15~~ and IAS 39.

- ~~amortised cost of a financial asset or financial liability~~
- ~~available for sale financial assets~~
- ~~derecognition~~
- ~~derivative~~
- ~~effective interest method~~
- ~~equity instrument~~
- ~~fair value~~

- ~~financial asset~~
- ~~financial instrument~~
- ~~financial liability~~
- ~~financial asset or financial liability at fair value through profit or loss~~
- ~~financial guarantee contract~~
- ~~financial asset or financial liability held for trading~~
- ~~forecast transaction~~
- ~~hedging instrument~~
- ~~held to maturity investments~~
- ~~loans and receivables~~
- ~~regular way purchase or sale~~

**Appendix B**  
**Appendix**  
**Amendments to other IPSASs**

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

A1. IPSAS 1, “Presentation of Financial Statements” is amended as described below.

In paragraph 75, “IPSAS 15, “Financial Instrument: Disclosure and Presentation” is replaced by ‘IPSAS XX, “Financial Instruments: Disclosures”,’ and in paragraphs 129(d)(ii) and 148, “IPSAS 15” is replaced by “IPSAS XX”.

## Application guidance

*This ~~appendix~~ application guidance is an integral part of the ~~IFRS~~ Standard.*

### Classes of financial instruments and level of disclosure (paragraph 106)

- AG1. ~~B1~~——Paragraph 106 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 106 are determined by the entity and are, ~~thus,~~ distinct from the categories of financial instruments specified in ~~IAS 39—international and national accounting standards addressing the recognition and measurement of financial instruments that may have been adopted by the entity~~ (which determine how financial instruments are measured and where changes in fair value are ~~recognised~~ recognized).
- AG2. ~~B2~~——In determining classes of financial instrument, an entity shall, at a minimum:
- (a) ~~distinguish~~ Distinguish instruments measured at ~~amortised~~ amortized cost from those measured at fair value.
  - (b) ~~treat~~ Treat as a separate class or classes those financial instruments outside the scope of this ~~IFRS~~ Standard.
- AG3. ~~B3~~——An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this ~~IFRS~~ Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

## Significance of financial instruments for financial position and performance

### Financial liabilities at fair value through ~~profit surplus~~ or ~~loss deficit~~ (paragraphs 1410 and 1511)

- AG4. ~~B4~~——If an entity designates a financial liability as at fair value through ~~profit surplus~~ or ~~loss deficit~~, paragraph 14(a)10(a) requires it to disclose the amount of



change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 14(a)14(a)10(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 14(a)10(a).

#### **Other disclosure – accounting policies (paragraph 2521)**

AG5. ~~B5~~ Paragraph 2521 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

- (a) ~~for~~ For financial assets or financial liabilities designated as at fair value through ~~profit or loss~~ surplus or deficit:
  - (i) ~~the~~ The nature of the financial assets or financial liabilities the entity has designated as at fair value through ~~profit or loss~~ surplus or deficit; and
  - (ii) ~~the~~ The criteria for so designating such financial assets or financial liabilities on initial recognition; and
  - (iii) ~~how the entity has satisfied the conditions in paragraph 9, 11A or 12 of IAS 39 for such designation. For instruments designated in~~

~~accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.~~

Sub-paragraph (iii) refers to the conditions required to satisfy the designation of a financial instrument as one through the profit or loss. Omitting this guidance does not detract from the Standard and simplifies it somewhat. If entities apply IAS 39, they need to ensure that they comply with the requirements relating to such a designation.

- (b) ~~the~~The criteria for designating financial assets as available for sale.
- (c) ~~whether~~Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date ~~(see paragraph 38 of IAS 39).~~
- (d) ~~when~~When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
  - (i) ~~the~~The criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and
  - (ii) ~~the~~The criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 20~~4~~6).
- (e) ~~how~~How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)~~20(a)~~), for example, whether the net gains or net losses on items at fair value through ~~profit surplus or loss deficit~~ include interest or dividend income.
- (f) ~~the~~The criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 24(c)~~20(c)~~).
- (g) ~~when~~When the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 40(d)~~36(d)~~).

Paragraph ~~413-137~~ of ~~IAS 4~~IPSAS 1 also requires entities to disclose, in the summary of significant accounting policies or other notes, the ~~judgements~~judgments, apart from those involving estimations, that management

has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts ~~recognised~~recognized in the financial statements.

### **Nature and extent of risks arising from financial instruments (paragraphs 3531–4642)**

- AG6. ~~B6~~—The disclosures required by paragraphs 3531–4642 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

### **Quantitative disclosures (paragraph 3834)**

- AG7. ~~B7~~—Paragraph 38(a)~~34(a)~~ requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information. ~~IAS 8~~IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" discusses relevance and reliability.

- AG8. ~~B8~~—Paragraph 38(c)~~34(c)~~ requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires ~~judgement~~judgment taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

- (a) a description of how management determines concentrations;
- (b) a description of the shared characteristic that identifies each concentration (~~e.g.~~e.g. counterparty, geographical area, currency or market); and
- (c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

### **Maximum credit risk exposure (paragraph~~40(a)~~–~~36(a)~~)**

- AG9. ~~B9~~—Paragraph 40(a)~~36(a)~~ requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

- (a) any amounts offset in accordance with ~~IAS 32~~IPSAS 15IPSAS 15; and
- (b) any impairment losses ~~recognised~~recognized in accordance with ~~IAS 39~~.

- AG10. ~~B10~~—Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:
- (a) ~~granting~~Granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.
  - (b) ~~entering~~Entering into derivative contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk at the reporting date will equal the carrying amount.
  - (c) ~~granting~~Granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount ~~recognised~~recognized as a liability.
  - (d) ~~making~~Making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount ~~recognised~~recognized as a liability.

**Contractual maturity analysis (paragraph 43(a)~~39(a)~~)**

- AG11. ~~B11~~—In preparing the contractual maturity analysis for financial liabilities required by paragraph 43(a)~~39(a)~~, an entity uses its ~~judgement~~judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
- (a) ~~not~~Not later than one month;
  - (b) ~~later~~Later than one month and not later than three months;
  - (c) ~~later~~Later than three months and not later than one year; and
  - (d) ~~later~~Later than one year and not later than five years.
- AG12. ~~B12~~—When a counterparty has a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (eg demand deposits) are included in the earliest time band.
- AG13. ~~B13~~—When an entity is committed to make amounts available in ~~instalments~~installments, each ~~instalment~~installment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.
- AG14. ~~B14~~—The amounts disclosed in the maturity analysis are the contractual undiscounted cash flows, for example:

- (a) ~~G~~gross finance lease obligations (before deducting finance charges);
- (b) ~~prices-Prices~~ specified in forward agreements to purchase financial assets for cash;
- (c) ~~net-Net~~ amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) ~~contractual-Contractual~~ amounts to be exchanged in a derivative financial instrument (~~eg~~e.g. a currency swap) for which gross cash flows are exchanged; and
- (e) ~~gross~~Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows.

AG15. ~~B15~~—If appropriate, an entity shall disclose the analysis of derivative financial instruments separately from that of non-derivative financial instruments in the contractual maturity analysis for financial liabilities required by paragraph 43(a)~~39(a)~~. For example, it would be appropriate to distinguish cash flows from derivative financial instruments and non-derivative financial instruments if the cash flows arising from the derivative financial instruments are settled gross. This is because the gross cash outflow may be accompanied by a related inflow.

AG16. ~~B16~~—When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the reporting date. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

#### **Market risk – sensitivity analysis (paragraphs ~~4440~~ and ~~4541~~)**

AG17. ~~B17~~—Paragraph 44(a)~~40(a)~~ requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph AG3~~B3~~, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

- (a) ~~an~~An entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.
- (b) ~~an~~An entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

AG18. ~~B18~~—Paragraph 44(a)~~40(a)~~ requires the sensitivity analysis to show the effect on ~~profit-surplus or loss-deficit~~ and net assets/equity of reasonably possible

- changes in the relevant risk variable (~~eg~~e.g. prevailing market interest rates, currency rates, equity prices or commodity prices). For this purpose:
- (a) ~~entities~~Entities are not required to determine what the ~~profit or loss surplus or deficit~~ for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on ~~profit or loss surplus or deficit~~ and net assets/equity at the ~~balance sheet reporting~~ date assuming that a reasonably possible change in the relevant risk variable had occurred at the balance sheet date and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on ~~profit surplus or loss deficit~~ (i.e. interest expense) for the current year if interest rates had varied by reasonably possible amounts.
  - (b) ~~entities~~Entities are not required to disclose the effect on ~~profit or loss surplus or deficit~~ and net assets/equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.
- |AG19. ~~B19~~—In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:
- (a) ~~the~~The economic environments in which it operates. A reasonably possible change should not include remote or ‘worst case’ scenarios or ‘stress tests’. Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 per cent and an entity determines that a fluctuation in interest rates of  $\pm 50$  basis points is reasonably possible. It would disclose the effect on ~~profit surplus or loss deficit~~ and net assets/equity if interest rates were to change to 4.5 per cent or 5.5 per cent. In the next period, interest rates have increased to 5.5 per cent. The entity continues to believe that interest rates may fluctuate by  $\pm 50$  basis points (i.e. that the rate of change in interest rates is stable). The entity would disclose the effect on ~~profit surplus or loss deficit~~ and net assets/equity if interest rates were to change to 5 per cent or 6 per cent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by  $\pm 50$  basis points, unless there is evidence that interest rates have become significantly more volatile.
  - (b) ~~the~~The time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.
- |AG20. ~~B20~~—Paragraph 4541—permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk

methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 45(a)41(a) by disclosing the type of value-at-risk model used (eg.g. whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (eg.g. the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

- AG21. B21—An entity shall provide sensitivity analyses for the whole of its business, but may provide different types of sensitivity analysis for different classes of financial instruments.

#### **Interest rate risk**

- AG22. B22—Interest rate risk arises on interest-bearing financial instruments ~~recognised~~recognized in the balance sheet (eg.g. loans and receivables and debt instruments issued) and on some financial instruments not ~~recognised~~recognized in the balance sheet (eg.g. some loan commitments).

#### **Currency risk**

- AG23. B23—Currency risk (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency, ~~ie i.e.~~ in a currency other than the functional currency in which they are measured. For the purpose of this ~~IFRS Standard~~, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.
- AG24. B24—A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

#### **Other price risk**

- AG25. B25—Other price risk arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 4440, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.
- AG26. B26—Two examples of financial instruments that give rise to equity price risk are a (a) holding of equities in another entity, and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such

financial instruments are affected by changes in the market price of the underlying equity instruments.

AG27. ~~B27~~—In accordance with paragraph 44(a)~~40(a)~~, the sensitivity of ~~profit surplus or loss-deficit~~ (that arises, for example, from instruments classified as at fair value through ~~profit or loss~~surplus or deficit and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of net assets/equity (that arises, for example, from instruments classified as available for sale).

AG28. ~~B28~~—Financial instruments that an entity classifies as equity instruments are not remeasured. Neither ~~profit or loss~~surplus or deficit nor net assets/equity will be affected by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.



## **Appendix C**

### **Amendments to other IFRSs**

~~The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2007. If an entity applies this IFRS for an earlier period, these amendments shall be applied for that earlier period.~~

~~\*\*\*\*\*~~

~~The amendments contained in this appendix when this IFRS was issued in 2005 have been incorporated into the text of the relevant pronouncements included in this volume.~~

## **Appendix D**

### **Amendments to IFRS 7 if the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option* have not been applied**

*In June 2005 the Board issued Amendments to IAS 39 Financial Instruments: Recognition and Measurement—The Fair Value Option, to be applied for annual periods beginning on or after 1 January 2006. If an entity applies IFRS 7 for annual periods beginning before 1 January 2006 and it does not apply these amendments to IAS 39, it shall amend IFRS 7 for that period, as follows. In the amended paragraphs, new text is underlined and deleted text is struck through.*

D1 — The heading above paragraph 9 and paragraph 11 are amended as follows, and paragraph 9 is deleted.

#### **Financial assets or financial liabilities at fair value through profit or loss**

11 — The entity shall disclose:

- (a) — the methods used to comply with the requirements in paragraphs 9(c) and paragraph 10(a).
- (b) — if the entity believes that the disclosure it has given to comply with the requirements in paragraphs 9(c) or paragraph 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Paragraph B5(a) is amended as follows:

- (a) — the criteria for designating, on initial recognition, for financial assets or financial liabilities designated as at fair value through profit or loss;
  - (i) — the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;
  - (ii) — the criteria for so designating such financial assets or financial liabilities on initial recognition; and
  - (iii) — how the entity has satisfied the conditions in paragraph 9, 11A or 12 of IAS 39 for such designation. For

~~instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.~~

## **Approval of IFRS 7 by the Board**

~~International Financial Reporting Standard 7 *Financial Instruments: Disclosures* was approved for issue by the fourteen members of the International Accounting Standards Board.~~

~~Sir David Tweedie~~

~~Chairman~~

~~Thomas E Jones~~

~~Vice Chairman~~

~~Mary E Barth~~

~~Hans Georg Bruns~~

~~Anthony T Cope~~

~~Jan Engström~~

~~Robert P Garnett~~

~~Gilbert Gélard~~

~~James J Leisenring~~

~~Warren J McGregor~~

~~Patricia L O'Malley~~

~~John T Smith~~

~~Geoffrey Whittington~~

~~Tatsumi Yamada~~

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## **Basis for Conclusions on ~~IFRS 7~~IPSAS XX Financial Instruments: Disclosures**

*This Basis for Conclusions accompanies, but is not part of, ~~IFRS 7~~ IPSAS XX, “Financial Instruments: Presentation.” This Basis for Conclusions only notes the IPSASB’s reasons for departing from the provisions of the related International Financial Reporting Standard.*

### **Background**

- BC1. The IPSASB’s policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board where convergence is appropriate for public sector entities.
- BC2. Accrual Basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the “comparison with IFRS” included in each IPSAS.
- BC3. IPSAS 15, “Financial Instruments: Disclosure and Presentation” issued in December 2001 was based on IAS 32 (revised 1998), “Financial Instruments: Disclosure and Presentation.” IAS 32 was reissued in 2003 and subsequently amended by the issuance of IFRS 2, “Share-based Payment” (issued February 2004); IFRS 3, “Business Combinations” (issued March 2004); IFRS 4, “Insurance Contracts” (issued March 2004); and IFRS 7, “Financial Instruments: Disclosure”. IAS 32 has also been amended by amendments to IAS 39, “Financial Instruments: Recognition and Measurement” in June and August 2005, and by an amendment to IFRS 4 issued August 2005.
- BC4. A major consequence of the amendments to IAS 32 is that the disclosure requirements previously included in that Standard have been removed, and new disclosure requirements established in IFRS 7. This means that IPSAS 15 is no longer consistent with IAS 32 and, therefore, under the IPSASB’s policy to converge where appropriate, IPSAS 15 needs to be updated to reflect the revised IAS 32, and a new IPSAS XX, “Financial Instruments: Disclosures” needs to be issued. In issuing this IPSAS the IPSASB has retained public sector differences that were included in the disclosure requirements in the superseded IPSAS 15.
- BC5. The IPSASB reviewed IFRS 7 and generally concurred with the IASB’s reasons for issuing the IFRS. (The IASB’s Basis for Conclusions is not reproduced here. Subscribers to the IASB’s *Comprehensive Subscription Service* can view the Basis for Conclusions on the IASB’s website at [www.iasb.org](http://www.iasb.org)). The scope of

IPSAS XX is slightly different to that of IAS 32, to account for several public sector specific financial instruments that the IASB has not considered. This Basis for Conclusions explains the public sector specific reasons for departure.

BC1.—

## Introduction

BC1— ~~This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 7 *Financial Instruments: Disclosures*. Individual Board members gave greater weight to some factors than to others.~~

BC2— ~~During the late 1990s, the need for a comprehensive review of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* became apparent. The Board's predecessor, the International Accounting Standards Committee (IASC), issued a number of Standards that addressed, more comprehensively, some of the topics previously addressed only for banks in IAS 30. Also, fundamental changes were taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures, and their processes for measuring and managing those risks.~~

BC3— ~~In 1999 IASC added a project to its agenda to revise IAS 30 and in 2000 it appointed a steering committee.~~

BC4— ~~In 2001 the Board added this project to its agenda. To assist and advise it, the Board retained the IAS 30 steering committee, renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members had experience and expertise in banks, finance companies and insurance companies and included auditors, financial analysts, preparers and regulators. The FAAC's role was:~~

- ~~(a) — to provide input from the perspective of preparers and auditors of financial statements of entities that have significant exposures to financial instruments; and~~
- ~~(b) — to assist the Board in developing a standard and implementation guidance for risk disclosures arising from financial instruments and for other related disclosures.~~

BC5— ~~The Board published its proposals in July 2004 as ED 7 *Financial Instruments: Disclosures*. The deadline for comments was 27 October 2004. The Board received 105 comment letters. After reviewing the responses, the Board issued IFRS 7 in August 2005.~~



## **Scope (paragraphs 3–5)**

### **The entities to which the IFRS applies**

- ~~BC6~~ Although IFRS 7 arose from a project to revise IAS 30 (a Standard that applied only to banks and similar financial institutions), it applies to all entities that have financial instruments. The Board observed that the reduction in regulatory barriers in many countries and increasing competition between banks, non bank financial services firms, and financial conglomerates have resulted in many entities providing financial services that were traditionally provided only by entities regulated and supervised as banks. The Board concluded that this development would make it inappropriate to limit this project to banks and similar financial institutions.
- ~~BC7~~ The Board considered whether entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit taking, lending and securities activities, face unique risks that would require a standard specific to them. However, the Board decided that the scope of this project should include disclosures about risks arising from financial instruments in all entities for the following reasons:
- ~~(a)~~ disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities.
  - ~~(b)~~ the Board found it could not satisfactorily define deposit taking, lending, and securities activities. In particular, it could not satisfactorily differentiate an entity with securities activities from an entity holding a portfolio of financial assets for investment and liquidity management purposes.
  - ~~(c)~~ responses to the Exposure Draft of Improvements to IAS 32~~IPSAS 15~~ *Financial Instruments: Disclosure and Presentation*, published in June 2002, indicated that IAS 32~~IPSAS 15~~'s risk disclosure requirements, applicable to all entities, could be improved.
  - ~~(d)~~ the exclusion of some financial instruments would increase the danger that risk disclosures could be incomplete and possibly misleading. For example, a debt instrument issued by an entity could significantly affect its exposures to liquidity risk, interest rate risk and currency risk even if that instrument is not held as part of deposit taking, lending and securities activities.
  - ~~(e)~~ users of financial statements need to be able to compare similar activities, transactions and events of different entities on a consistent basis. Hence, the disclosure principles that apply to regulated entities should not differ from those that apply to non-regulated, but otherwise similar, entities.
- ~~BC8~~ The Board decided that the scope of the IFRS should be the same as that of IAS 32~~IPSAS 15~~ with one exception. The Board concluded that the IFRS should not apply to derivatives based on interests in subsidiaries, associates or joint ventures if the derivatives meet the definition of an equity instrument in IAS 32~~IPSAS 15~~. This is because equity instruments are not remeasured and hence:

- (a) ~~they do not expose the issuer to balance sheet and income statement risk; and~~
- (b) ~~the disclosures about the significance of financial instruments for financial position and performance are not relevant to equity instruments.~~

~~Although these instruments are excluded from the scope of IFRS 7, they are within the scope of IAS 32/IPSAS 15 for the purpose of determining whether they meet the definition of equity instruments.~~

## **Exemptions considered by the Board**

### **Insurers**

~~BC9 The Board considered whether the IFRS should apply to entities that both have financial instruments and issue insurance contracts. The Board did not exempt these entities because financial instruments expose all entities to risks regardless of what other assets and liabilities they have. Accordingly, an entity that both issues insurance contracts and has financial instruments applies IFRS 4 *Insurance Contracts* to its insurance contracts and IFRS 7 to its financial assets and financial liabilities. However, many of the disclosure requirements in IFRS 4 were applications of, or relatively straightforward analogies with, existing requirements in IAS 32/IPSAS 15. Therefore, the Board also updated the disclosures required by IFRS 4 to make them consistent with IFRS 7, with modifications that reflect the interim nature of IFRS 4.~~

### **Small and medium-sized entities**

~~BC10 The Board considered whether it should exempt small and medium-sized entities from the scope of the IFRS. The Board noted that the extent of disclosures required by the IFRS will depend on the extent to which the entity uses financial instruments and the extent to which it has assumed associated risks. The IFRS requires entities with few financial instruments and few risks to give few disclosures. Also, many of the requirements in the IFRS are based on information provided internally to the entity's key management personnel. This helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to exempt such entities from the scope of IFRS 7. However, it will keep this decision under review in its project on financial reporting for small and medium-sized entities.~~

### **Subsidiaries**

~~BC11 Some respondents to ED 7 stated that there is little public interest in the financial statements of some entities, such as a wholly owned subsidiary whose parent issues publicly available financial statements. These respondents stated that such subsidiaries should be exempt from some of the requirements of IFRS 7 in their individual financial statements. However, deciding whether such an entity should prepare general purpose financial statements is a matter for the entity and local~~

~~legislators and regulators. If such an entity prepares financial statements in accordance with IFRSs, users of those statements should receive information of the same quality as users of any general purpose financial statements prepared in accordance with IFRSs. The Board confirmed its view that no exemptions from the general requirements of any Standard should be given for the financial statements of subsidiaries.~~

## **~~Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)~~**

~~BC12 The Board relocated disclosures from IAS 32/IPSAS 15 to IFRS 7, so that all disclosure requirements for financial instruments are in one Standard. Many of the disclosure requirements about the significance of financial instruments for an entity's financial position and performance were previously in IAS 32/IPSAS 15. For these disclosures, the relevant paragraphs from the Basis for Conclusions on IAS 32/IPSAS 15 have been incorporated into this Basis for Conclusions. This Basis for Conclusions does not discuss requirements that the Board did not reconsider either in revising IAS 32/IPSAS 15 in 2003 or in developing IFRS 7.~~

### **~~The principle (paragraph 7)~~**

~~BC13 The Board decided that the disclosure requirements of IFRS 7 should result from the explicit disclosure principle in paragraph 7. The Board also decided to specify disclosures to satisfy this principle. In the Board's view, entities could not satisfy the principle in paragraph 7 unless they disclose the information required by paragraphs 8–30.~~

## **~~Balance sheet disclosures (paragraphs 8–19 and B4)~~**

### **~~Categories of financial assets and financial liabilities (paragraph 8)~~**

~~BC14 Paragraph 8 requires entities to disclose financial assets and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. The Board concluded that the disclosure for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.~~

~~BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss is useful because such designation is at the discretion of the entity.~~

**~~Financial assets or financial liabilities at fair value through profit or loss (paragraphs 9–11, B4 and B5)~~**

- ~~BC16 IAS 39 permits entities to designate a non-derivative financial liability as at fair value through profit or loss, if specified conditions are met. If entities do so, they are required to provide the disclosures in paragraphs 10 and 11. The Board's reasons for these disclosures are set out in the Basis for Conclusions on IAS 39, paragraphs BC87–BC92.~~
- ~~BC17 The requirements in paragraphs 9, 11 and B5(a) are related to the Amendments to IAS 39 Financial Instruments: Recognition and Measurement – *The Fair Value Option*, issued in June 2005. The reasons for those requirements are discussed in the Basis for Conclusions on those Amendments.~~
- ~~BC18 Paragraph 10(a) requires disclosure of the change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the liability's credit risk. The Board previously considered this disclosure in its deliberations on the fair value measurement of financial liabilities in IAS 39.~~
- ~~BC19 Although quantifying such changes might be difficult in practice, the Board concluded that disclosure of such information would be useful to users of financial statements and would help alleviate concerns that users may misinterpret the profit or loss effects of changes in credit risk, especially in the absence of disclosures. Therefore, in finalising the revisions to IAS 32/IPSAS 15 in 2003, it decided to require disclosure of the change in fair value of the financial liability that is not attributable to changes in a benchmark interest rate. The Board believed that this is often a reasonable proxy for the change in fair value that is attributable to changes in the liability's credit risk, in particular when such changes are large, and would provide users with information with which to understand the profit or loss effect of such a change in credit risk.~~
- ~~BC20 However, some respondents to ED 7 stated that they did not agree that the IAS 32/IPSAS 15 disclosure provided a reasonable proxy, except for straightforward debt instruments. In particular, there could be other factors involved in the change in an instrument's fair value unrelated to the benchmark interest rate, such as the effect of an embedded derivative. Respondents also cited difficulties for unit-linked insurance contracts, for which the amount of the liability reflects the performance of a defined pool of assets. The Board noted that the proxy that was developed in IAS 32/IPSAS 15 assumed that it is not practicable for entities to determine directly the change in fair value arising from changes in credit risk. However, the Board acknowledged and shared these concerns.~~
- ~~BC21 As a result, the Board amended this requirement to focus directly on the objective of providing information about the effects of changes in credit risk:~~
- ~~(a) by permitting entities to provide a more faithful representation of the amount of change in fair value that is attributable to changes in credit risk if they could do so. However, such entities are also required to disclose the methods used and provide their justification for concluding that those methods give a more faithful representation than the proxy in paragraph 10(a)(i).~~

(b) ~~by amending the proxy disclosure to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. For example, some entities may be able to identify part of the change in the fair value of the liability as attributable to a change in an index. In these cases, the proxy disclosure would exclude the amount of change attributable to a change in an index. Similarly, excluding the amount attributable to a change in an internal or external investment fund makes the proxy more suitable for unit linked insurance contracts.~~

BC22 ~~The Board decided that when an entity has designated a financial liability as at fair value through profit or loss, it should disclose the difference between the carrying amount and the amount the entity would contractually be required to pay at maturity to the holders of the liability (see paragraph 10(b)). The fair value may differ significantly from the settlement amount, in particular for financial liabilities with a long duration when an entity has experienced a significant deterioration in creditworthiness since their issue. The Board concluded that knowledge of this difference would be useful to users of financial statements. Also, the settlement amount is important to some financial statement users, particularly creditors.~~

### **Reclassification (paragraph 12)**

BC23 ~~IAS 32/IPSAS 15 required disclosure of the reason for reclassification of financial assets at cost or amortised cost rather than at fair value. The Board extended this requirement to include disclosure of the reason for reclassifications and of the amount reclassified into and out of each category. As noted in paragraph BC14, the Board regards such information as useful because the categorisation of financial instruments has a significant effect on their measurement.~~

### **Derecognition (paragraph 13)**

BC24 ~~An entity may have transferred financial assets in such a way that part or all of them do not qualify for derecognition (see paragraphs 15–37 of IAS 39). If the entity either continues to recognise all of the assets or continues to recognise the assets to the extent of its continuing involvement, paragraph 13 requires disclosure of the nature of the financial assets, the extent of the entity's continuing involvement, and any associated liabilities. Such disclosure helps users of the financial statements evaluate the significance of the risks retained.~~

### **Collateral (paragraphs 14 and 15)**

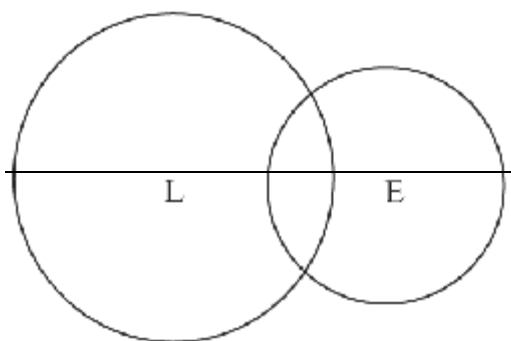
BC25 ~~Paragraph 15 requires disclosures about collateral that the entity holds if it is permitted to sell or repledge the collateral in the absence of default by the owner. Some respondents to ED 7 argued for an exemption from this disclosure if it is impracticable to obtain the fair value of the collateral held. However, the Board concluded that it is reasonable to expect an entity to know the fair value of collateral that it holds and can sell even if there is no default.~~

**~~Allowance account for credit losses (paragraph 16)~~**

- ~~BC26—When a separate account is used to record impairment losses (such as an allowance account or similar account used to record a collective impairment of assets), paragraph 16 requires a reconciliation of that account to be disclosed. The Board was informed that analysts and other users find this information useful in assessing the adequacy of the allowance for impairment losses for such entities and when comparing one entity with another. However, the Board decided not to specify the components of the reconciliation. This allows entities flexibility in determining the most appropriate format for their needs.~~
- ~~BC27—Respondents to ED 7 asked the Board to require entities to provide equivalent information if they do not use an allowance account. The Board decided not to add this disclosure in finalising the IFRS. It concluded that, for virtually all entities, IAS 39's requirement to consider impairment on a group basis would necessitate the use of an allowance or similar account. The accounting policy disclosures required by paragraph B5(d) also include information about the use of direct adjustments to carrying amounts of financial assets.~~

**~~Compound financial instruments with multiple embedded derivatives (paragraph 17)~~**

- ~~BC28—IAS 32/IPSAS 15 requires the separation of the liability and equity components of a compound financial instrument. The Board notes that this is more complicated for compound financial instruments with multiple embedded derivative features whose values are interdependent (for example, a convertible debt instrument that gives the issuer a right to call the instrument back from the holder, or the holder a right to put the instrument back to the issuer) than for those without such features. If the embedded equity and non equity derivative features are interdependent, the sum of the separately determined values of the liability and equity components will not equal the value of the compound financial instrument as a whole.~~
- ~~BC29—For example, the values of an embedded call option feature and an equity conversion option feature in a callable convertible debt instrument depend in part on each other if the holder's equity conversion option is extinguished when the entity exercises the call option or vice versa. The following diagram illustrates the joint value arising from the interaction between a call option and an equity conversion option in a callable convertible bond. Circle L represents the value of the liability component, ie the value of the straight debt and the embedded call option on the straight debt, and Circle E represents the value of the equity component, ie the equity conversion option on the straight debt. The total area of the two circles represents the value of the callable convertible bond. The difference between the value of the callable convertible bond as a whole and the sum of the separately determined values for the liability and equity components is the joint value attributable to the interdependence between the call option feature and the equity conversion feature. It is represented by the intersection between the two circles.~~



~~BC30 Under the approach in IAS 32/IPSAS 15, the joint value attributable to the interdependence between multiple embedded derivative features is included in the liability component. A numerical example is set out as Illustrative Example 10 accompanying IAS 32/IPSAS 15.~~

~~BC31 Even though this approach is consistent with the definition of equity as a residual interest, the Board recognises that the allocation of the joint value to either the liability component or the equity component is arbitrary because it is, by its nature, joint. Therefore, the Board concluded that it is important to disclose the existence of issued compound financial instruments with multiple embedded derivative features that have interdependent values. Such disclosure highlights the effect of multiple embedded derivative features on the amounts recognised as liabilities and equity.~~

### **~~Defaults and breaches (paragraphs 18 and 19)~~**

~~BC32 Paragraphs 18 and 19 require disclosures about defaults and breaches of loans payable and other loan agreements. The Board concluded that such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.~~

### **Income statement and equity (paragraph 20)**

#### **Items of income, expenses, gains or losses (paragraph 20(a))**

~~BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement categories in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC14). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39.~~

~~BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities held for trading and others do not. To assist users in comparing income arising from financial instruments across different entities, the Board decided that an entity should disclose how the income statement amounts are~~

determined. For example, an entity should disclose whether net gains and losses on financial assets or financial liabilities held for trading include interest and dividend income (see Appendix B, paragraph B5(e)).

### **Fee income and expense (paragraph 20(c))**

- BC35—Paragraph 20(c) requires disclosure of fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets or financial liabilities and from trust and other fiduciary activities that result in the entity holding or placing assets on behalf of individuals, trusts, retirement benefit plans, and other institutions. This information indicates the level of such activities and helps users to estimate possible future income of the entity.

### **Other disclosures—fair value (paragraphs 25–30)**

- BC36—Many entities use fair value information internally in determining their overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets about the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of why they are held and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. The Board decided that when an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it should provide fair value information through supplementary disclosures to assist users to compare entities on a consistent basis.
- BC37—Disclosure of fair value is not required for investments in unquoted equity instruments and derivatives linked to such equity instruments if their fair value cannot be measured reliably. Similarly, IFRS 4 does not specify the accounting required for contracts containing a discretionary participation feature pending phase II of the Board's project on insurance contracts. Accordingly, disclosure of fair value is not required for contracts containing a discretionary participation feature, if the fair value of that feature cannot be measured reliably. For all other financial assets and financial liabilities, it is reasonable to expect that fair value can be determined with sufficient reliability within constraints of timeliness and cost. Therefore, the Board concluded that there should be no other exception from the requirement to disclose fair value information for financial assets or financial liabilities.
- BC38—To provide users of financial statements with a sense of the potential variability of fair value estimates, the Board decided that information about the use of valuation techniques should be disclosed, in particular the sensitivities of fair value estimates to the main valuation assumptions. In forming this conclusion, the Board considered the view that disclosure of sensitivities could be difficult, particularly when there are many assumptions to which the disclosure would apply and these assumptions are interdependent. However, the Board noted that a detailed quantitative disclosure of



~~sensitivity to all assumptions is not required (only those that could result in a significantly different estimate of fair value are required) and that the disclosure does not require the entity to reflect interdependencies between assumptions when making the disclosure. Additionally, the Board considered whether this disclosure might imply that a fair value established by a valuation technique is less reliable than one established by other means. However, the Board noted that fair values estimated by valuation techniques are more subjective than those established from an observable market price, and concluded that users need information to help them assess the extent of this subjectivity.~~

~~BC39 Paragraph 28 requires disclosure about the difference that arises if the transaction price differs from the fair value of a financial instrument that is determined in accordance with paragraph AG76 of IAS 39. Those disclosures relate to matters addressed in the December 2004 amendment to IAS 39 *Transition and Initial Recognition of Financial Assets and Financial Liabilities*. That amendment does not specify how entities should account for those initial differences in subsequent periods. The disclosures required by paragraph 28 inform users about the amount of gain or loss that will be recognised in profit or loss in future periods. The Board noted that the information required to provide these disclosures would be readily available to the entities affected.~~

### **~~Disclosures about the nature and extent of risks arising from financial instruments (paragraphs 31–42 and B6–B28)~~**

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~~BC40 The Board was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed, and the techniques used to identify, measure, monitor and control those risks. Therefore, the Board decided to require disclosure of this information. The Board also decided to balance two objectives:~~

- ~~(a) consistent requirements should apply to all entities so that users receive comparable information about the risks to which entities are exposed.~~
- ~~(b) the disclosures provided should depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks. Entities with many financial instruments and related risks should provide more disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks may provide less extensive disclosure.~~

~~BC41 The Board decided to balance these two objectives by developing an IFRS that sets out principles and minimum requirements applicable to all entities, supported by guidance on implementing the IFRS. The requirements in paragraphs 33–42 combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way in which management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments. The extent of disclosure depends on the extent of the entity's exposure to risks arising from financial instruments. The guidance on implementing the IFRS~~

~~illustrates how an entity might apply the IFRS. This guidance is consistent with the disclosure requirements for banks developed by the Basel Committee (known as Pillar 3), so that banks can prepare, and users receive, a single co-ordinated set of disclosures about financial risk.~~

~~BC42 The Board noted that because entities view and manage risk in different ways, disclosures based on how an entity manages risk are unlikely to be comparable between entities. In addition, for an entity that undertakes limited management of risks arising from financial instruments, such disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify disclosures about risk exposures applicable to all entities. These disclosures provide a common benchmark for financial statement users when comparing risk exposures across different entities and are expected to be relatively easy for entities to prepare. Entities with more developed risk management systems would provide more detailed information.~~

### **Location of disclosures of risks arising from financial instruments (paragraph B6)**

~~BC43 Many respondents to ED 7 argued that disclosures about risks in paragraphs 31–42 should not be part of the financial statements for the following reasons:~~

- ~~(a) the information would be difficult and costly to audit.~~
- ~~(b) the information is different from information generally included in financial statements because it is subjective, forward looking and based on management's judgement. Thus, the information does not meet the criteria of comparability, faithful representation and completeness.~~
- ~~(c) inclusion of such information in a management commentary section outside the financial statements would be consistent with practice in other jurisdictions, including the US. Having this information in the financial statements would put IFRS preparers at a disadvantage relative to their US peers.~~

~~BC44 Respondents raised concerns that the disclosure of sensitivity analysis in particular should not be part of the financial statements. Respondents stated that sensitivity analysis cannot be prepared with the degree of reliability expected of information in the financial statements, and that the subjectivity in the sensitivity analysis and the hypothetical alternative values could undermine the credibility of the fair values recognised in the financial statements.~~

~~BC45 The Board considered whether the disclosures should be part of the information provided by management outside the financial statements. The Board noted that respondents generally regarded the disclosures proposed in ED 7 as useful, even if they did not agree that they should be located in the financial statements. The Board's view is that financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments. Hence, it concluded that such disclosures should be part of the financial statements. The Board rejected the argument that increased transparency puts an entity at a~~

~~disadvantage; greater certainty on the part of investors can provide a significant advantage by lowering the entity's cost of capital.~~

~~BC46 The Board also noted that some entities might prefer to present the information required by the IFRS together with material such as a management commentary or risk report that is not part of the financial statements. Some entities might be required by regulatory authorities to provide in a separate report information similar to that required by the IFRS. Accordingly, the Board decided these disclosures should be given in the financial statements or incorporated by cross reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time.~~

## **Quantitative disclosures (paragraphs 34–42 and B7–B28)**

### **Information based on how the entity manages risk (paragraphs 34 and B7)**

~~BC47 The Board concluded that disclosures about an entity's exposure to risks arising from financial instruments should be required, and should be based on how the entity views and manages its risks, ie using the information provided to key management personnel (for example, its board of directors or chief executive officer). This approach:~~

- ~~(a) provides a useful insight into how the entity views and manages risk;~~
- ~~(b) results in information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity's ability to react to adverse situations;~~
- ~~(c) is more effective in adapting to changes in risk measurement and management techniques and developments in the external environment;~~
- ~~(d) has practical advantages for preparers of financial statements, because it allows them to use the data they use in managing risk; and~~
- ~~(e) is consistent with the approach used in IAS 14 *Segment Reporting*.<sup>\*</sup>~~

### **Information on averages**

~~BC48 The Board considered whether it should require quantitative information about average risk exposures during the period. It noted that information about averages is more informative if the risk exposure at the reporting date is not typical of the exposure during the period. However, information about averages is also more onerous to prepare. On balance, the Board decided to require disclosure of the exposures at the reporting date in all cases and to require additional information only~~

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<sup>\*</sup> In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

~~if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.~~

## **~~Credit risk (paragraphs 36–38, B9 and B10)~~**

### **~~Maximum exposure to credit risk (paragraphs 36(a), B9 and B10)~~**

~~BC49 Paragraph 36(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date. Some respondents to ED 7 stated that these disclosures would not provide useful information when there are no identified problems in a loan portfolio, and it is not likely that collateral would be called on. However, the Board disagreed because it believes that such information:~~

- ~~(a) provides users of financial statements with a consistent measure of an entity's exposure to credit risk; and~~
- ~~(b) takes into account the possibility that the maximum exposure to loss may differ from the amount recognised in the balance sheet.~~

~~BC50 Some respondents to ED 7 questioned whether the maximum exposure to credit risk for a derivative contract is its carrying amount because fair value does not always reflect potential future exposure to credit risk (see paragraph B10(b)). However, the Board noted that paragraph 36(a) requires disclosure of the amount that best represents the maximum exposure to credit risk at the reporting date, which is the carrying amount.~~

### **~~Collateral held as security and other credit enhancements (paragraphs 36(b) and 37(c))~~**

~~BC51 ED 7 proposed that, unless impracticable, the entity should disclose the fair value of collateral held as security and other credit enhancements, to provide information about the loss the entity might incur in the event of default. However, many respondents to ED 7 disagreed with this proposal on cost/benefit grounds. Respondents indicated that fair value information might not be available for:~~

- ~~(a) small entities and entities other than banks, which may find it onerous to acquire information about collateral;~~
- ~~(b) banks that collect precise information on the value of collateral only on origination, for loans whose payments are made on time and in full (for example a mortgage portfolio secured by properties, for which valuations are not kept up to date on an asset by asset basis);~~
- ~~(c) particular types of collateral, such as a floating charge on all the assets of an entity; and~~
- ~~(d) insurers that hold collateral for which fair value information is not readily available.~~

~~BC52 The Board also noted respondents' concerns that an aggregate disclosure of the fair value of collateral held would be misleading when some loans in a portfolio are over collateralised, and other loans have insufficient collateral. In these circumstances, netting the fair value of the two types of collateral would under report the amount of credit risk. The Board agreed with respondents that the information useful to users is not the total amount of credit exposure less the total amount of collateral, but rather is the amount of credit exposure that is left after available collateral is taken into account.~~

~~BC53 Therefore, the Board decided not to require disclosure of the fair value of collateral held, but to require disclosure of only a description of collateral held as security and other credit enhancements. The Board noted that such disclosure does not require an entity to establish fair values for all its collateral (in particular when the entity has determined that the fair value of some collateral exceeds the carrying amount of the loan) and, thus, would be less onerous for entities to provide than fair values.~~

### **~~Credit quality of financial assets that are neither past due nor impaired (paragraph 36(c))~~**

~~BC54 The Board noted that information about credit quality gives a greater insight into the credit risk of assets and helps users assess whether such assets are more or less likely to become impaired in the future. Because this information will vary between entities, the Board decided not to specify a particular method for giving this information, but rather to allow each entity to devise a method that is appropriate to its circumstances.~~

### **~~Financial assets that are either past due or impaired (paragraph 37)~~**

~~BC55 The Board decided to require separate disclosure of financial assets that are past due or impaired to provide users with information about financial assets with the greatest credit risk (paragraph 37). This includes:~~

- ~~(a) an analysis of the age of financial assets, including trade receivables, that are past due at the reporting date, but not impaired (paragraph 37(a)). This information provides users with information about those financial assets that are more likely to become impaired and helps users to estimate the level of future impairment losses.~~
- ~~(b) an analysis of financial assets that are individually determined to be impaired at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 37(b)). The Board concluded that an analysis of impaired financial assets by factors other than age (eg nature of the counterparty, or geographical analysis of impaired assets) would be useful because it helps users to understand why the impairment occurred.~~

### **~~Collateral and other credit enhancements obtained (paragraph 38)~~**

~~BC56 Paragraph 38 requires the entity to disclose the nature and carrying amount of assets obtained by taking possession of collateral held as security or calling on other credit enhancements and its policy for disposing of such assets. The Board concluded that this information is useful because it provides information about the frequency of such activities and the entity's ability to obtain and realise the value of the collateral. ED 7 had proposed that the entity should disclose the fair value of the assets obtained less the cost of selling them, rather than the carrying amount. The Board noted that this amount might be more relevant in the case of collateral obtained that is expected to be sold. However, it also noted that such an amount would be included in the impairment calculation that is reflected in the amount recognised in the balance sheet and the purpose of the disclosure is to indicate the amount recognised in the balance sheet for such assets.~~

### **~~Liquidity risk (paragraphs 39 and B11–B16)~~**

~~BC57 The Board decided to require disclosure of a maturity analysis for financial liabilities showing the remaining earliest contractual maturities (paragraph 39(a) and paragraphs B11–B16 of Appendix B). Liquidity risk, ie the risk that the entity will encounter difficulty in meeting commitments associated with financial liabilities, arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities earlier than expected. The Board decided to require disclosure based on the earliest contractual maturity date because this disclosure shows a worst case scenario.~~

~~BC58 Some respondents expressed concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities, which, for some entities eg banks with many demand deposits may be very different. They suggested that a contractual maturity analysis alone does not provide information about the conditions expected in normal circumstances or how the entity manages deviations from expected maturity. Therefore, the Board decided to require a description of how the entity manages the liquidity risk portrayed by the contractual maturity analysis.~~

### **~~Market risk (paragraphs 40–42 and B17–B28)~~**

~~BC59 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 40) because:~~

- ~~(a) users have consistently emphasised the fundamental importance of sensitivity analysis;~~
- ~~(b) a sensitivity analysis can be disclosed for all types of market risk and by all entities, and is relatively easy to understand and calculate; and~~
- ~~(c) it is suitable for all entities including non financial entities that have financial instruments. It is supported by disclosures of how the entity manages the risk. Thus, it is a simpler and more suitable disclosure than~~

~~other approaches, including the disclosures of terms and conditions and the gap analysis of interest rate risk previously required by IAS 32/IPSAS 15.~~

~~The Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. This is because the methodologies used to prepare the sensitivity analysis and the resulting disclosures would vary according to the nature of the entity and the complexity of its risk management systems.~~

~~BC60 The Board acknowledged that a simple sensitivity analysis that shows a change in only one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or the effects of interdependencies between variables. The Board decided to meet the first concern by requiring additional disclosure when the sensitivity analysis is unrepresentative of a risk inherent in a financial instrument (paragraph 42). The Board noted that it could meet the second concern by requiring a more complex sensitivity analysis that takes into account the interdependencies between risks. Although more informative, such an analysis is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure as an alternative to the minimum requirement when it is used by management to manage risk.~~

~~BC61 Respondents to ED 7 noted that a value at risk amount would not show the effect on profit or loss or equity. However, entities that manage on the basis of value at risk would not want to prepare a separate sensitivity analysis solely for the purpose of this disclosure. The Board's objective was to require disclosures about sensitivity, not to mandate a particular form of sensitivity disclosure. Therefore, the Board decided not to require disclosure of the effects on profit or loss and equity if an alternative disclosure of sensitivity is made.~~

~~BC62 Respondents to ED 7 requested the Board to provide more guidance and clarification about the sensitivity analysis, in particular:~~

- ~~(a) what is a reasonably possible change in the relevant risk variable?~~
- ~~(b) what is the appropriate level of aggregation in the disclosures?~~
- ~~(c) what methodology should be used in preparing the sensitivity analysis?~~

~~BC63 The Board concluded that it would not be possible to provide comprehensive guidance on the methodology to be used in preparing the sensitivity analysis. The Board noted that more comparable information would be obtained if it imposed specific requirements about the inputs, process and methodology of the analysis, for example disclosure of the effects of a parallel shift of the yield curve by 100 basis points. However, the Board decided against such a specific requirement because a reasonably possible change in a relevant risk variable (such as interest rates) in one economic environment may not be reasonably possible in another (such as an economy with higher inflation). Moreover, the effect of a reasonably possible change will vary depending on the entity's risk exposures. As a result, entities are required to judge what those reasonably possible changes are.~~

~~BC64 However, the Board decided that it would provide high level application guidance about how the entity should assess what is a reasonably possible change and on the appropriate level of aggregation in the disclosures. In response to comments received on ED 7, the Board also decided to clarify that:~~

- (a) ~~an entity should not aggregate information about material exposures to risk from significantly different economic environments. However, if it has exposure to only one type of market risk in only one economic environment, it might not show disaggregated information.~~
- (b) ~~the sensitivity analysis does not require entities to determine what the profit or loss for the period would have been had the relevant risk variable been different. The sensitivity analysis shows the effect on current period profit or loss and equity if a reasonably possible change in the relevant risk variable had been applied to the risk exposures in existence at the balance sheet date.~~
- (c) ~~a reasonably possible change is judged relative to the economic environments in which the entity operates, and does not include remote or 'worst case' scenarios or 'stress tests'.~~
- (d) ~~entities are required to disclose only the effects of the changes at the limits of the reasonably possible range of the relevant risk variable, rather than all reasonably possible changes.~~
- (e) ~~the time frame for which entities should make an assessment about what is reasonably possible is the period until the entity next presents these disclosures, usually its next annual reporting period.~~

The Board also decided to add a simple example of what a sensitivity analysis might look like.

### **Operational risk**

~~BC65 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that the definition and measurement of operational risk are in their infancy and are not necessarily related to financial instruments. It also decided that such disclosures would be more appropriately located outside the financial statements. Therefore, the Board decided to defer this issue to its research project on management commentary.~~

### **Effective date and transition (paragraphs 43 and 44)**

~~BC66 The Board is committed to maintaining a 'stable platform' of substantially unchanged Standards for annual periods beginning on or before 1 January 2005, when many entities will adopt IFRSs for the first time. In addition, some preparers will need time to make the system changes necessary to comply with the IFRS. Therefore, the Board decided that the effective date of IFRS 7 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.~~

~~BC67 The Board noted that entities that apply IFRS 7 only when it becomes mandatory will have sufficient time to prepare comparative information. This conclusion does not apply to entities that apply IFRS 7 early. In particular, the time would be extremely short for those entities that would like to apply IFRS 7 when they first adopt IFRSs in 2005, to avoid changing from local GAAP to IAS 32 IPSAS 15 and~~



~~IAS 30 when they adopt IFRSs and then changing again to IFRS 7 only one or two years later. Therefore, the Board gave an exemption from providing comparative disclosure in the first year of application of IFRS 7 to any entity that both (a) is a first time adopter of IFRSs and (b) applies IFRS 7 before 1 January 2006. The Board noted that such an exemption for first time adopters exists in IAS 32/IPSAS 15 and IFRS 4 and that the reasons for providing the exemption apply equally to IFRS 7.~~

~~BC68—The Board also considered whether it should provide an exemption from presenting all or some of the comparative information to encourage early adoption of IFRS 7 by entities that already apply IFRSs.~~

~~BC69—The Board noted that IFRS 7 contains two types of disclosures: accounting disclosures (in paragraphs 7–30) that are based on requirements previously in IAS 32/IPSAS 15 and new risk disclosures (in paragraphs 31–42). The Board concluded that existing users of IFRSs already will have complied with the requirements of IAS 32/IPSAS 15 and will not encounter difficulty in providing comparative information for the accounting disclosures.~~

~~BC70—The Board noted that most of the risk disclosures, in particular those about market risk, are based on information collected at the end of the reporting period. The Board concluded that although IFRS 7 was published in August 2005, it will still be possible for entities to collect the information that they require to comply with IFRS 7 for accounting periods beginning in 2005. However, it would not always be possible to collect the information needed to provide comparative information about accounting periods that began in 2004. As a result, the Board decided that entities that apply IFRS 7 for accounting periods beginning in 2005 (ie before 1 January 2006) need not present comparative information about the risk disclosures.~~

~~BC71—The Board also noted that comparative disclosures about risk are less relevant because these disclosures are intended to have predictive value. As a result information about risk loses relevance more quickly than other types of disclosure, and any disclosures required by previous GAAP are unlikely to be comparable with those required by IFRS 7. Accordingly, the Board decided that an entity that is not a first time adopter and applies IFRS 7 for annual periods beginning before 1 January 2006 need not present comparative disclosures about the nature and extent of risks arising from financial instruments. In reaching this conclusion, the Board noted that the advantages of encouraging more entities to apply IFRS 7 early outweighed the disadvantage of the reduced information provided.~~

~~BC72—The Board considered and rejected arguments that it should extend the exemption:~~

- ~~(a) — from providing comparative information to first time adopters that applied IFRS 7 before 1 January 2007 (rather than only those that applied IFRS 7 before 1 January 2006). The Board concluded that an entity that intends to adopt IFRSs for the first time on or after 1 January 2006 will have sufficient time to collect information for its accounting period beginning on or after 1 January 2005 and, thus, should not have difficulty in providing the comparative disclosures for accounting periods beginning on or after 1 January 2006.~~
- ~~(b) — from providing comparative disclosures about the significance of financial instruments to all entities adopting the IFRS for annual periods beginning before 1 January 2006 (rather than only to first time adopters). The Board~~

~~concluded that only first time adopters warranted special relief so that they would be able to adopt IFRS 7 early without first having to adopt IAS 32/IPSAS 15 and IAS 30 for only one period. Entities that are not first time adopters already apply IAS 32/IPSAS 15 and IAS 30 and have no particular need to adopt IFRS 7 before 1 January 2007.~~

- ~~(e) from providing comparative disclosures about risk to periods beginning before 1 January 2007 (rather than 2006). The Board noted that entities adopting IFRS 7 after 1 January 2006 would have a full calendar year to prepare after the publication of the IFRS.~~

## **Summary of main changes from the Exposure Draft**

~~BC73 The main changes to the proposals in ED 7 are:~~

- ~~(a) ED 7 proposed disclosure of the amount of change in the fair value of a financial liability designated as at fair value through profit or loss that is not attributable to changes in a benchmark interest rate as a proxy for the amount of change in fair value attributable to changes in the instrument's credit risk. The IFRS permits entities to determine the amount of change in fair value attributable to changes in the instrument's credit risk using an alternative method if the entity believes that its alternative method gives more faithful representation. The proxy disclosure has been amended to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. As a result, entities may exclude factors other than a change in a benchmark interest rate when calculating the proxy.~~
- ~~(b) a requirement has been added for disclosures about the difference between the transaction price at initial recognition (used as fair value in accordance with paragraph AG76 of IAS 39) and the results of a valuation technique that will be used for subsequent measurement.~~
- ~~(c) no disclosure is required of the fair value of collateral pledged as security and other credit enhancements as was proposed in ED 7.~~
- ~~(d) the sensitivity analysis requirements have been clarified.~~
- ~~(e) the exemption from presenting comparatives has been widened.~~
- ~~(f) the capital disclosures are a stand alone amendment to IAS 1, rather than part of the IFRS. No disclosure is required of whether the entity has complied with capital targets set by management and of the consequences of any non compliance with those targets.~~
- ~~(g) the amendments to IFRS 4 related to IFRS 7 have been modified to reduce systems changes for insurers.~~

## **Appendix**

### **Amendments to Basis for Conclusions on other IFRSs**

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*This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 7. In the amended paragraphs, new text is underlined and deleted text is struck through.*

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*The amendments contained in this appendix when IFRS 7 was issued in 2005 have been incorporated into the text of the Basis of Conclusions on IFRS 4 and on IASs 32, 39 and 41 as issued at 18 August 2005.*

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## **Guidance on implementing ~~IFRS 7~~IPSAS XX, “Financial Instruments: Disclosures”**

*This guidance accompanies, but is not part of, ~~IFRS 7~~IPSAS XX.*

### **Introduction**

- IG1. This guidance suggests possible ways to apply some of the disclosure requirements in ~~IFRS 7~~IPSAS XX. The guidance does not create additional requirements.
- IG2. For convenience, each disclosure requirement in the ~~IFRS Standard~~ is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

### **Materiality**

- IG3. ~~IAS 1~~IPSAS 1, “Presentation of Financial Statements” notes that a specific disclosure requirement in a Standard or an Interpretation need not be satisfied if the information is not material. ~~IAS 1~~IPSAS 1 defines materiality as follows:

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

- IG4. ~~IAS 1~~IPSAS 1 also explains that definition as follows:

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. ~~The Framework for the Preparation and Presentation of Financial Statements states in paragraph 25 that ‘Users are assumed to have a reasonable knowledge of business—the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence.’~~<sup>2</sup> Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

### **Classes of financial instruments and level of disclosure (paragraphs 106 and AG1B1–AG3B3)**

- IG5. Paragraph AG3B3 states that ‘an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this ~~IFRS Standard~~.’

how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics.’ To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.

- IG6. Paragraph ~~4529~~(c) of ~~IAS 4~~IPSAS 1 requires an entity to ‘provide additional disclosures when compliance with the specific requirements in ~~IFRSs~~IPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.’

**Significance of financial instruments for financial position and performance**  
**(paragraphs 117–3430, AG4B4 and AG5B5)**

**Financial liabilities at fair value through ~~profit surplus~~ or ~~loss deficit~~**  
**(paragraphs 1414(a)14(a)~~10(a)(i)~~ and AG4B4)**

- IG7. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG4B4 of ~~Appendix B of the IFRS~~the Application Guidance to the Standard.
- IG8. On ~~4~~January, 1 20X1, an entity issues a 10-year bond with a par value of CU150,000 and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- IG9. The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:
- (a) LIBOR has decreased to 4.75 per cent.
  - (b) ~~the~~The fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.<sup>2</sup>
- IG10. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.
- IG11. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<del>[paragraph AG4(a)B4(a)]</del>	
First, the entity computes the liability’s internal rate of return at the start of the period	At the start of the period of a 10-year bond with a coupon of 8 per cent,

<sup>2</sup> This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

<p>using the observed market price of the liability and the liability's contractual cash flows at the start of the period.</p> <p>It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.</p>	<p>the bond's internal rate of return is 8 per cent.</p> <p>Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.</p>
<p>[paragraph AG4(b)<del>B4(b)</del>]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph AG4(a)<del>B4(a)</del>.</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> <li>• interest: CU12,000<sup>(a)</sup> per year for each of years 2–10.</li> <li>• principal: CU150,000 in year 10.</li> </ul> <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period LIBOR rate, plus the 3 per cent instrument-specific component.</p> <p>This gives a present value of CU152,367.<sup>(b)</sup></p>
<p>[paragraph AG4(c)<del>B4(c)</del>]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG4(b)<del>B4(b)</del> is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.</p>	<p>The market price of the liability at the end of the period is CU153,811.<sup>(c)</sup></p> <p>Thus, the entity discloses CU1,444, which is CU153,811–CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>
<p>(a) <math>CU150,000 \times 8\% = CU12,000</math></p> <p>(b) <math>PV = [CU12,000 \times (1 - (1 + 0.0775)^{-9}) / 0.0775] + CU150,000 \times (1 + 0.0775)^{-9}</math></p> <p>(c) <math>market\ price = [CU12,000 \times (1 - (1 + 0.076)^{-9}) / 0.076] + CU150,000 \times (1 + 0.076)^{-9}</math></p>	

### Defaults and breaches (paragraphs 2248 and 2349)

- IG12. Paragraphs 2248 and 2349 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with ~~IAS 1~~ IPSAS 1.

### Total interest income and total interest expense (paragraph 24(b)20(b))

- IG13. The total interest income and total interest expense disclosed in accordance with paragraph 24(b)20(b) is a component of the finance costs, which paragraph 84102(b) of ~~IAS 1~~ IPSAS 1 requires to be presented separately on the face of the income statement. The line item for finance costs may also include amounts that arise on non-financial assets or non-financial liabilities.

### Fair value (paragraph 3228)

- IG14. The fair value at initial recognition of financial instruments that are not traded in active markets is determined ~~in accordance with paragraph AG76 of IAS 39 by means of a valuation technique. A valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.~~ However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be ~~recognised~~ recognized in ~~profit or loss surplus or deficit~~ in subsequent periods in accordance with ~~IAS 39~~ and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price ~~(see paragraph AG76A of IAS 39)~~. Paragraph 3228 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 3228:

This section has been inserted from paragraph AG76 of IAS 39 to avoid referring to the IAS, whilst still retaining the intent of IFRS 7. This Implementation Guidance is not binding, therefore this does not impose an additional requirement on entities.



**Background**

On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at 1 January 20X1.

**Application of requirements**

The entity's 20X2 disclosure would include the following:

*Accounting policies*

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, ~~in accordance with IAS 39~~, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

*In the notes to the financial statements*

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, ~~in accordance with IAS 39~~, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be ~~recognised~~recognized in ~~profit or loss~~ surplus or deficit are as follows:

	<b>31 Dec X2</b>	<b>31 Dec X1</b>
	CU million	CU million
Balance at beginning of year	5.3	5.0
New transactions	—	1.0

Amounts <del>recognised</del> recognized in profit surplus or loss deficit during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	4.5	5.3

## **Nature and extent of risks arising from financial instruments (paragraphs ~~3531–4642~~ and ~~AG6B6–AG28B28~~)**

### **Qualitative disclosures (paragraph ~~3733~~)**

- IG15. The type of qualitative information an entity might disclose to meet the requirements in paragraph ~~3733~~ includes, but is not limited to, a narrative description of:
- (a) the entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.
  - (b) the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:
    - (i) the structure and organisation of the entity's risk management function(s), including a discussion of independence and accountability;
    - (ii) the scope and nature of the entity's risk reporting or measurement systems;
    - (iii) the entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and
    - (iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.
  - (c) the entity's policies and procedures for avoiding excessive concentrations of risk.
- IG16. Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.

- IG17. In accordance with paragraph 37(c)~~33(c)~~, entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

**Quantitative disclosures (paragraphs ~~3834–4642~~ and ~~AG7B7–AG28B28~~)**

- IG18. Paragraph ~~3834~~ requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:

- (a) ~~industry~~Industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (b) ~~credit~~Credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (c) ~~geographical~~Geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (d) ~~a~~A limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realise liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

- IG19. In accordance with paragraph ~~AG8B8~~, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.
- IG20. When quantitative information at the reporting date is unrepresentative of the entity's exposure to risk during the period, paragraph ~~3935~~ requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest and average exposures.

**Credit risk (paragraphs ~~4036–4238~~, AG9B9 and AG10B10)**

- IG21. Paragraph ~~4036~~ requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

*Collateral and other credit enhancements pledged (paragraph 40(b)~~36(b)~~)*

- IG22. Paragraph 40(b)~~36(b)~~ requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:
- (a) ~~the~~The policies and processes for valuing and managing collateral and other credit enhancements obtained;
  - (b) ~~a~~A description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with ~~IAS 32~~IPSAS 15);
  - (c) ~~the~~The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
  - (d) ~~information~~Information about risk concentrations within the collateral or other credit enhancements.

*Credit quality (paragraph 40(c)~~36(c)~~)*

- IG23. Paragraph 40(c)~~36(c)~~ requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:
- (a) ~~an~~An analysis of credit exposures using an external or internal credit grading system;
  - (b) ~~the~~The nature of the counterparty;
  - (c) ~~historical~~Historical information about counterparty default rates; and
  - (d) ~~any~~Any other information used to assess credit quality.
- IG24. When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:
- (a) ~~the~~The amounts of credit exposures for each external credit grade;
  - (b) ~~the~~The rating agencies used;
  - (c) ~~the~~The amount of an entity's rated and unrated credit exposures; and
  - (d) ~~the~~The relationship between internal and external ratings.

- IG25. When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:
- (a) ~~the~~ The internal credit ratings process;
  - (b) ~~the~~ The amounts of credit exposures for each internal credit grade; and
  - (c) ~~the~~ The relationship between internal and external ratings.

*Financial assets that are either past due or impaired (paragraph 41~~37~~)*

- IG26. A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.
- IG27. When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.
- IG28. Paragraph 41(a)~~37(a)~~ requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its ~~judgement~~ judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
- (a) ~~not~~ Not more than three months;
  - (b) ~~more~~ More than three months and not more than six months;
  - (c) ~~more~~ More than six months and not more than one year; and
  - (d) ~~more~~ More than one year.
- IG29. Paragraph 41(b)~~37(b)~~ requires an analysis of impaired financial assets by class. This analysis might include:
- (a) ~~the~~ The carrying amount, before deducting any impairment loss;
  - (b) ~~the~~ The amount of any related impairment loss; and
  - (c) ~~the~~ The nature and fair value of collateral available and other credit enhancements obtained.

**Liquidity risk (paragraphs 43~~39~~ and AG11B~~11~~)**

*Liquidity management (paragraph 43(b)~~39(b)~~)*

- IG30. If an entity manages liquidity risk on the basis of expected maturity dates, it might disclose a maturity analysis of the expected maturity dates of both financial liabilities and financial assets. If an entity discloses such an expected maturity analysis, it might clarify that expected dates are based on estimates made by management, and explain how the estimates are determined and the

- principal reasons for differences from the contractual maturity analysis that is required by paragraph 43(a)~~39(a)~~.
- IG31. Paragraph 43(b)~~39(b)~~ requires the entity to describe how it manages the liquidity risk inherent in the maturity analysis of financial liabilities required in paragraph 43(a)~~39(a)~~. The factors that the entity might consider in providing this disclosure include, but are not limited to, whether the entity:
- (a) ~~expects~~Expects some of its liabilities to be paid later than the earliest date on which the entity can be required to pay (as may be the case for customer deposits placed with a bank);
  - (b) ~~expects~~Expects some of its undrawn loan commitments not to be drawn;
  - (c) ~~holds~~Holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs;
  - (d) ~~has~~Has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;
  - (e) ~~holds~~Holds financial assets for which there is not a liquid market, but which are expected to generate cash inflows (principal or interest) that will be available to meet cash outflows on liabilities;
  - (f) ~~holds~~Holds deposits at central banks to meet liquidity needs;
  - (g) ~~has~~Has very diverse funding sources; or
  - (h) ~~has~~Has significant concentrations of liquidity risk in either its assets or its funding sources.

**Market risk (paragraphs ~~4440–4642~~ and ~~AG17B17–AG28B28~~)**

- IG32. Paragraph 43(a)~~40(a)~~ requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (~~ie i.e.~~ the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (~~eg e.g.~~ a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:
- (a) ~~the~~The yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
  - (b) ~~foreign~~Foreign exchange rates.
  - (c) ~~prices~~Prices of equity instruments.
  - (d) ~~market~~Market prices of commodities.
- IG33. Paragraph 44(a)~~40(a)~~ requires the sensitivity analysis to show the effect on ~~profit or loss~~surplus or deficit and net assets/equity of reasonably possible

- changes in the relevant risk variable. For example, relevant risk variables might include:
- (a) ~~prevailing~~Prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan; or
  - (b) ~~currency~~Currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.
- IG34. For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:
- (a) ~~interest~~Interest income and expense;
  - (b) ~~other~~Other line items of ~~profit or loss~~surplus or deficit (such as trading gains and losses); and
  - (c) ~~when~~When applicable, net assets/equity.
- An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.
- IG35. Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.
- IG36. The following example illustrates the application of the disclosure requirement in paragraph 44(a)~~40(a)~~:

**Interest rate risk**

At ~~31~~December, 31 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, ~~post-tax profits~~surplus for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other components of net assets/equity would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, ~~post-tax profits~~surplus would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, and other components of net assets/equity would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Profit Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).<sup>(a)</sup>

**Foreign currency exchange rate risk**

At ~~31~~ December, 31 20X2, if the CU had weakened 10 per cent against the US dollar with all other variables held constant, ~~post-tax profit surplus~~ for the year would have been CU2.8 million (20X1—CU6.4 million) lower, and other components of net assets/equity would have been CU1.2 million (20X1—CU1.1 million) higher. Conversely, if the CU had strengthened 10 per cent against the US dollar with all other variables held constant, ~~post-tax profit surplus~~ would have been CU2.8 million (20X1—CU6.4 million) higher, and other components of net assets/equity would have been CU1.2 million (20X1—CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in ~~profit surplus~~ in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Net assets/Equity is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 39(a) requires disclosure of a maturity analysis of liabilities.

*Other market risk disclosures (paragraph 42)*

IG37. Paragraph 46~~42~~—requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

- (a) ~~a~~A financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis, e.g. options that remain out of (or in) the money for the chosen change in the risk variable;
- (b) ~~financial~~Financial assets are illiquid, e.g. when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty; or
- (c) ~~an~~An entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38. In the situation in paragraph IG37(a), additional disclosure might include:

- (a) ~~the~~The terms and conditions of the financial instrument (e.g. the options);
- (b) ~~the~~The effect on ~~profit surplus~~ or ~~loss deficit~~ if the term or condition were met (i.e. if the options were exercised); and
- (c) ~~a~~A description of how the risk is hedged.

For example, an entity may acquire a zero-cost interest rate collar that includes an out-of-the-money leveraged written option (e.g. the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger



payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39. In the situation described in paragraph IG37(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40. In the situation described in paragraph IG37(c), additional disclosure might include:

- (a) ~~the~~ The nature of the security (~~eg~~ e.g. entity name);
- (b) ~~the~~ The extent of holding (~~eg~~ e.g. 15 per cent of the issued shares);
- (c) ~~the~~ The effect on ~~profit surplus~~ or ~~loss deficit~~; and
- (d) ~~how~~ How the entity hedges the risk.

### Transition (paragraph 4844)

IG41. The following table ~~summarises~~ summarizes the effect of the exemption from presenting comparative accounting and risk disclosures for accounting periods beginning before ~~1 January 2006~~ Month DD, YYYY, before ~~1 January 2007~~ Month DD, YYYY, and on or after ~~1 January 2007~~ Month DD, YYYY. In this table:

- (a) a **first-time adopter** is an entity preparing its first ~~IFRS~~ IPSAS financial statements (~~see IFRS 1 First-time Adoption of International Financial Reporting Standards~~).
- (b) an **existing ~~IFRS~~ IPSAS user** is an entity preparing its second or subsequent IFRS financial statements.

	Accounting disclosures (paragraphs 117– <del>323</del> <del>0</del> )	Risk disclosures (paragraphs 31–42)
<b>Accounting periods beginning before 1 January 1, 2006</b>		
First-time adopter not applying <del>IFRS 7</del> <u>IPSAS XX</u> early	<i>Applies <del>IAS 32</del> <u>IPSAS 15</u> but exempt from providing <del>IAS 32</del> <u>IPSAS 15</u> comparative information</i>	<i>Applies <del>IAS 32</del> <u>IPSAS 15</u> but exempt from providing <del>IAS 32</del> <u>IPSAS 15</u> comparative information</i>
First-time adopter	<b>Exempt from</b>	<b>Exempt from presenting <u>IPSAS XX</u></b>

applying <del>IFRS 7</del> <del>IPSAS XX</del> early	<b>presenting <del>IPSAS XX</del> comparative information<sup>(a)</sup></b>	<b><del>IFRS 7</del> comparative information<sup>(a)</sup></b>
Existing <del>IFRS</del> <del>IPSAS</del> user not applying <del>IPSAS XX</del> early	Applies <del>IAS</del> <del>32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information	Applies <del>IAS 32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information
Existing <del>IFRS</del> <del>IPSAS</del> user applying <del>IFRS 7</del> <del>IPSAS XX</del> early	Provides full <del>IFRS</del> <del>7</del> <del>IPSAS XX</del> comparative information	<b>Exempt from presenting <del>IFRS 7</del> <del>IPSAS XX</del> comparative information<sup>(b)</sup></b>
<b>Accounting periods beginning on or after 1 January 1, 2006 and before 1 January 1, 2007</b>		
First-time adopter not applying <del>IFRS</del> <del>7</del> <del>IPSAS XX</del> early	Applies <del>IAS</del> <del>32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information	Applies <del>IAS 32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information
First-time adopter applying <del>IFRS 7</del> <del>IPSAS XX</del> early	Provides full <del>IFRS</del> <del>7</del> <del>IPSAS XX</del> comparative information	Provides full <del>IFRS 7</del> <del>IPSAS XX</del> comparative information
Existing IFRS user not applying <del>IFRS 7</del> <del>IPSAS XX</del> early	Applies <del>IAS</del> <del>32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information	Applies <del>IAS 32</del> <del>IPSAS 15</del> . Provides full <del>IAS 32</del> <del>IPSAS 15</del> comparative information
Existing IFRS user applying <del>IFRS 7</del> <del>IPSAS XX</del> early	Provides full <del>IFRS</del> <del>7</del> <del>IPSAS XX</del> comparative information	Provides full <del>IFRS 7</del> <del>IPSAS XX</del> comparative information
<b>Accounting periods beginning on or after 1 January 2007 (mandatory application of <del>IFRS 7</del> <del>IPSAS XX</del>)</b>		

First-time adopter	Provides full <del>IFRS</del> <u>IPSAS XX</u> comparative information	Provides full <del>IFRS</del> <u>IPSAS XX</u> comparative information
Existing IFRS user	Provides full <del>IFRS</del> <u>IPSAS XX</u> comparative information	Provides full <del>IFRS</del> <u>IPSAS XX</u> comparative information
(a) See paragraph 36A of IFRS 1 as amended by <del>IFRS</del> <u>IPSAS XX</u>		
(b) See paragraph 44 of <del>IFRS</del> <u>IPSAS XX</u>		

### **Comparison with IFRS 7**

International Public Sector Accounting Standard (IPSAS) XX, “Financial Instruments: Disclosures” is drawn primarily from International Financial Reporting Standard (IFRS) 32 (issued 2005), “Financial Instruments: Disclosures.”  
The main differences between IPSAS XX and IFRS 7 are as follows:

- Commentary additional to that in IFRS 7 has been included in IPSAS XX to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS XX uses different terminology, in certain instances, from IFRS 7. The most significant examples are the use of the terms “revenue,” “statement of financial performance,” “statement of financial position” (except for references to “on- and off-balance-sheet”) and “net assets/equity” (except for references to “equity instruments”) in IPSAS XX. The equivalent terms in IFRS 7 are “income,” “income statement,” “balance sheet” and “equity.”
- IPSAS XX includes a definition of an insurance contract; IFRS 7 does not include this definition because it is defined in IFRS 4, “Insurance Contracts”.