

**Statement of
Financial Accounting Standards
No. 36**

23 June 2005

Translated by

**Da-Bai Shen, Professor
(Soochow University)**

Financial Accounting Standards Committee

Statement of Financial Accounting Standards No.36

Financial Instruments: Disclosure and Presentation

I Introduction

- (1) This Statement establishes the accounting standards for disclosure and presentation of financial instruments (including derivatives).
- (2) The objective of this Standard is to enhance financial statement users' understanding of the significance of on-balance-sheet (recognized) and off-balance-sheet (unrecognized) financial instruments to an entity's financial position, performance, and cash flows.
- (3) This Standard contains the following requirements for the presentation of financial instruments (a) the classification of financial instruments, from the perspective of issuer, into financial assets, liabilities and equity instruments. (b) the classification of related interest, dividends, losses, and gains. (c) the offset of financial assets and financial liabilities.
This Standard contains the following requirements for the disclosure of financial instruments (a) the factors that affect the amount, timing and uncertainty of an entity's future cash flow relating to financial instruments. (b) the accounting policies of an entity's financial instruments. (c) the nature, extent and purposes of an entity's use of financial instruments, the risks associated with them, and management's policies for controlling those risks.
- (4) This Standard shall be applied to all types of financial instruments, except:
 - (a) Long-term Investments under Equity Method (follow the

principles set out in the Statement of Financial Accounting Standards No. 5, *Long-term Investments under Equity Method*, No. 7, *Consolidated Financial Statements*, and No.31, *Interests in Joint Ventures*). However, entities shall apply this Standard to those investments that according to those Standards described above is accounted for under this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in the Statement of Financial Accounting Standards No. 36, *Financial Instruments: Disclosure and Presentation*.

- (b) Employers' rights and obligations under employee pension plans (follow the principles set out in the Statement of Financial Accounting Standards No. 18, *Accounting for Pensions*).
- (c) Contracts for contingent consideration in a business combination (follow the principles set out in the Statement of Financial Accounting Standards No. 25, *Business Combinations*). This exemption applies only to the acquirer.
- (d) The rights and obligations under insurance contracts. However, this Standard applies to derivatives that are embedded in insurance contracts if the entity applies Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement* to account for them separately.
- (e) Financial instruments, contracts and obligations under share-based payment transactions, including transactions in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options) or in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the equity instruments of the entity, except for contracts within the scope of paragraphs 7–8 of this Standard. A share option is a

contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

- (f) Treasury Stocks (follow the principles set out in the Statement of Financial Accounting Standards No. 30, *Accounting for Treasury Stocks*).
- (5) 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 and provides the insurer economical protects, including death, sickness, disability, property damage, injury to others and business interruption. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance (or reinsurance) contract but principally involves the transfer of financial risks (see paragraph94), for example, some types of financial reinsurance and guaranteed investment contracts issued by 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.
 - (6) This Standard applies to on-balance-sheet and off-balance-sheet financial instruments. On-balance-sheet financial instruments include equity instruments issued by the entity, loans and receivables originated by the entity and financial assets and financial liabilities that are with the scope of Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*. Off-balance-sheet financial instruments include some financial instruments that, although outside the scope of Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*, are within the scope of this Standard (such as some loan commitments).
 - (7) 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.

- (8) 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 (for example, 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 delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
 - (d) when the non-financial item that is the subject of the contract is readily convertible to cash.

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

are within the scope of this Standard.

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 (a) or (d) described above is within the scope of this Standard. Such a contract cannot be entered into for the entity's expected purchase, sale or usage requirements.

II Definitions

- (9) The definitions of the terms used in this Statement are as follows:
- (a) *Financial instrument*: any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
 - (b) *Financial asset*: any asset that is:
 - (i) cash;
 - (ii) an equity instrument of another entity;
 - (iii) a contractual right:
 - ① to receive cash or another financial asset from another entity; or
 - ② to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity;
 - (iv) a contract that will or may be settled in the entity's own equity instruments and is:
 - ① 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

- ② a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

(c) *Financial liability*: any liability that is:

(i) a contractual obligation:

- ① to deliver cash or another financial asset to another entity; or
- ② to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

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

- ① 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
- ② a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity

instruments

- (d) *Equity instrument*: any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities
- (e) *Fair value*: the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- (f) *Market risk*: there are three types of market risk: currency risk, fair value interest rate risk, and price risk.
- (i) Currency risk is the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates.
- (ii) Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates.
- (iii) Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.

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

- (g) *Credit risk*: 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.
- (h) *Liquidity risk*: also referred to as funding risk, 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.

- (i) *Cash flow interest rate risk*: the risk that the future cash flows of a financial instrument will fluctuate because of changes in interest rates. 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.

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

(11) In this Standard, 'entity' includes individuals, solely owned enterprise, enterprises, partnerships, trusts and government agencies

III Explanation

Presentation

Assets, liabilities and equity

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

(13) An issuer determines the financial instrument is an equity

instrument if, and only if, both conditions (a) and (b) below are met.

- (a) The instrument includes no contractual obligation:
- (i) to deliver cash or another financial asset to another entity; or

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

Equity instrument: any contract that evidences a residual interest in the assets of an entity

- (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, 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 to deliver cash or another financial asset

(14) A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or

another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

- (15) The substance of a financial instrument, rather than its legal form, governs its classification on the entity's balance sheet. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:
- (a) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability
 - (b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability. This is so even when:
 - (i) the amount of cash or other financial assets is determined on the basis of an index other item that has the potential to increase or decrease, or
 - (ii) 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 equity (such as some mutual funds and unit trusts) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not.

- (16) If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability. For example:
- (a) restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.
 - (b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.
- (17) A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions, which financial instrument is a financial liability. For example:
- (a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid

a transfer of cash or another financial asset only by settling the non-financial obligation, a financial instrument is a financial liability.

- (b) a financial instrument 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 from (i).

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

Settlement in the entity's own equity instruments

- (18) A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (eg an interest rate, a commodity price or a financial instrument price). For example, a contract to deliver as many of the entity's own equity instruments as are equal in value to NTD 10,000,000 or 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.

- (19) A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.
- (20) A contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redeem option 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 Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is remeasured in accordance with Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*. If the contract

expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (eg 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).

- (21) A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold

Contingent settlement provisions

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

- (23) When a derivative financial instrument gives one party a choice over how it is settled (eg 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. 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.
- (24) 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 if they can be settled either by delivery of the non-financial item or net in cash or another financial instrument (see paragraphs 7-8). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound financial instruments

- (25) An entity recognizes separately the components of a financial instrument that creates a financial liability of the entity and grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components (a) a financial liability (a contractual arrangement to deliver cash or another financial asset) and (b) an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or

issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately on its balance sheet.

- (26) Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.
- (27) Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement* deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.
- (28) Under the approach described in paragraph 27, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a

similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Interest, dividends, losses and gains

- (29) The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognized as income or expense in profit or loss. Thus, dividend payments on shares wholly recognized as liabilities are recognized as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognized in profit or loss, whereas redemptions or refinancings of equity instruments are recognized as changes in equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.
- (30) An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognized as an expense.
- (31) Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions

using a basis of allocation that is rational and consistent with similar transactions.

- (32) Dividends classified as an expense may be presented in the income statement either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of Financial Accounting Standards No. 1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements*. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the income statement. Disclosures of the tax effects are made in accordance with Financial Accounting Standards No. 22, *Income Tax*.
- (33) Gains and losses related to changes in the carrying amount of a financial liability are recognized as income or expense in profit or loss even when they relate to a financial instrument that includes a right to the interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 15(b)). Under Financial Accounting Standards No. 1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements* the entity presents any gain or loss arising from remeasurement of such an instrument separately on the face of the income statement when it is relevant in explaining the entity's performance.
- (34) Assume that a non-cumulative preference share is mandatory redeemable for cash in specific years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognized in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognized as a distribution of profit or loss.

A similar treatment would apply if the redemption was not

mandatory but at the option of the holder, or if the share was mandatory convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (eg commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense

Offsetting a financial asset and a financial liability

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

In accounting for a transfer of a financial asset that does not qualify for derecognition under Financial Accounting Standards No. 33, *Accounting for Transfers of Financial Assets and Extinguishments of Liabilities*, the entity shall not offset the transferred asset and the associated liability.

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

- (37) This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in substance, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.
- (38) Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognized item from the balance sheet but also may result in recognition of a gain or loss.
- (39) A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.
- (40) The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected.

When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

- (41) An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 109.
- (42) The conditions set out in paragraph 92 are generally not satisfied and offsetting is usually inappropriate when:
- (a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');
 - (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
 - (c) financial or other assets are pledged as collateral for non-recourse financial liabilities;
 - (d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for

example, a sinking fund arrangement); or

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

(43) An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 92 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 109.

Disclosure

(44) The purpose of the disclosures required by this Standard is to provide information to enhance understanding of the significance of financial instruments to an entity's financial position, performance, and cash flows and assist in assessing the amounts, timing, and uncertainty of future cash flows associated with those instruments.

Format, location and classes of financial instruments

(45) Determination of the level of detail to be disclosed about particular

financial instruments is requires the exercise of judgement taking into account the relative significance of those instruments. It is necessary to strike a balance between overburdening financial statements with excessive detail and too much aggregation. For example, when an entity is party to a large numbers of financial instruments with similar characteristics and no single contract is individually significant, summarised information by reference to particular classes of instruments is appropriate. On the other hand, specific information about an individual instrument may be important when that instrument represents, for example, a significant component of an entity's capital structure.

Risk management policies and hedging activities

(46) In addition to providing specific information about particular financial instrument balances and transactions, an entity provides a discussion of the extent to which financial instruments are used, the associated risks, and the business purposes served. A discussion of management's policies for controlling the risks associated with financial instruments includes policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk, and requirements for collateral to mitigate credit risk.

Terms, conditions, and accounting policies

several different financial instruments are used to emulate the features of a single financial instrument.

(47) The contractual terms and conditions of a financial instrument are an important factor affecting the amount, timing and uncertainty of future cash receipts and payments by the parties to the instrument. When financial instruments are significant, either individually or as a class, in relation to the 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 the entity, the essential characteristics of the instruments are described by reference to appropriate groupings of like instruments.

(48) The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relation between individual instruments that can affect the amount, timing,

or uncertainty of the future cash flows of an entity. For example, it is important to disclose hedging relationships such as one that might exist when an entity holds an investment in shares for which it has purchased a put option. The extent to which a risk exposure is altered by the relation among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 102, but in some circumstances further disclosure is necessary.

- (49) In accordance with Financial Accounting Standards No. 1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements* and Financial Accounting Standards No. 15, *Disclosure of Accounting Policies*, an entity provides disclosure of all significant accounting policies, including the general principles adopted and the method of applying those principles to transactions, other events and conditions arising in the entity's business.

Interest rate risk

- (50) An entity provides information about its exposure to the effects of future changes in the prevailing level of interest rates. Changes in market interest rates have a direct effect on the contractually determined cash flows associated with some financial assets and financial liabilities (cash flow interest rate risk) and on the fair value of others (fair value interest rate risk).
- (51) Information about maturity dates (or repricing dates when they are earlier), indicates the length of time for which interest rates are fixed, and information about effective interest rates indicates the levels at which they are fixed. Disclosure of this information provides financial statement users with a basis for evaluating the fair value interest rate risk to which an entity is exposed and, thus, the potential for gain or loss. For instruments that are repriced 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.
- (52) When an entity is able to predict, with reasonable reliability about

expected repricing or maturity dates are differ significantly from the contractual dates, an entity shall disclose additional information includes:

- (a) the expected repricing or maturity dates, and an explanation of that it is based on management's expectations of future events;
- (b) an explanation of the assumptions made about repricing or maturity dates;
- (c) an explanation of the differences from expected dates to the contractual dates.

Such information may be particularly relevant for an entity to disclose 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 information as the basis for managing its interest rate risk exposure.

- (53) An entity indicates which of its financial assets and financial liabilities are:
- (a) exposed to fair value interest rate risk, such as financial assets and financial liabilities with a fixed interest rate;
 - (b) exposed to cash flow interest rate risk, such as financial assets and financial liabilities with a floating interest rate that resets as market rates change; and
 - (c) not directly exposed to interest rate risk, such as some investments in equity securities.
- (54) The requirement in paragraph 105(b) applies to bonds, notes, loans, and similar financial instruments. The requirement does not apply to financial instruments such as investments in equity securities and derivative instruments that do not bear a determinable effective interest rate. For example, even though instruments such as interest rate derivatives (including swaps, forward rate agreements, and options) are exposed to fair value or cash flow risk from changes in

market interest rates, while such instruments does not bear an effective interest rate, disclosure of an effective interest rate is not required. However, when providing effective interest rate information, an entity discloses the effect on its interest rate risk exposure of hedging transactions such as interest rate swaps.

(55) An entity may become exposed to interest rate risk as a result of a transaction in which no financial asset or financial liability is recognized on its balance sheet. In such circumstances, the entity discloses information that permits users of its financial statements to understand the nature and extent of its exposure. For example, when an entity has a commitment to lend funds at a fixed interest rate, the disclosure normally includes the stated principal, interest rate and term to begin and maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to interest rate risk.

(56) When an entity has financial instruments exposed to fair value or cash flow interest rate risk, it may adopt one or more of the following approaches to presenting information:

- (a) The carrying amounts of financial instruments exposed to interest rate risk may be presented in tabular form, grouped by those that are contracted to mature or be repriced in the following periods after the balance sheet date:
 - (i) in one year or less;
 - (ii) in more than one year but not more than two years;
 - (iii) in more than two years but not more than three years;
 - (iv) in more than three years but not more than four years;

- (v) in more than four years but not more than five years; and
- (vi) in more than five years from the balance sheet date to the mature or repriced date.

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

- (i) within one month of the balance sheet date from the balance sheet date to the mature or repriced date;
 - (ii) more than one month and less than three months from the balance sheet date to the mature or repriced date ; and
 - (iii) more than three and less than twelve months from the balance sheet date to the mature or repriced date.
- (b) An entity may indicate its exposure to cash flow interest rate cash flow risk through a table indicating the aggregate carrying amount of groups of floating rate financial assets and financial liabilities maturing within various future time periods.
 - (c) 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

(57) 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 market interest rates on the fair value of its financial instruments and future earnings and cash flows. Such interest rate sensitivity information may be based on, for example, an assumed one percentage point (100 basis points) change in market interest rates occurring at the balance sheet date. The effects of a change in interest rates includes changes in interest income and expense relating to floating rate financial instruments and gains or losses resulting from changes in the fair values of fixed rate instruments. The reported interest rate sensitivity may be restricted to the direct effects of an interest rate change on interest-bearing financial instruments recognized at the balance sheet date because 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

(58) 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 recognized at the balance sheet date or require a cash outflow from other credit exposures (such as a credit derivative or an issued guarantee of the obligations of a third party). Such failures give rise to a loss recognized in an entity's income statement.

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

- (a) to provide users of financial statements with a consistent measure of the amount exposed to credit risk for financial assets and other credit exposures; and

- (b) to take into account the possibility that the maximum exposure to loss may differ from the carrying amount of financial assets recognized at the balance sheet date.

(60) In the case of financial assets exposed to credit risk, the carrying amount of the assets in the balance sheet, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the balance sheet date is normally the carrying amount because it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the balance sheet is necessary. On the other hand, an entity's maximum potential loss from some financial instruments may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 109(a).

(61) A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the balance sheet net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 109. For example, when an entity is due to receive the proceeds from realisation of a financial asset before settlement of a financial liability of equal or greater amount against which the 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.

- (62) An entity may have entered into 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 disclosures indicates that:
- (a) the credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realised; and
 - (b) the extent to which an entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the balance sheet date because the exposure is affected by each transaction subject to the arrangement.

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

- (63) An entity may be exposed to credit risk as a result of a transaction in which no financial asset is recognized on its balance sheet, such as for a financial guarantee contract. Guaranteeing an obligation of another party creates a liability and exposes the guarantor to credit risk that is taken into account in making the disclosures required by paragraph 109.
- (64) Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature of the business and

financial position of the entity and result in a significant exposure to loss in the event of default by other parties. Identification of significant concentrations requires judgement by management taking into account the circumstances of the entity and its debtors. Financial Accounting Standards No. 20, *Segment Reporting* provides guidance in identifying industry and geographical segments within which credit risk concentrations may arise.

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

Fair value

- (67) Fair value information is widely used for business purposes in determining an enterprise's entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets as to the present value of expected future cash

flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur maintain or discharge financial liabilities. When an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it provides fair value information through supplementary disclosures except for the fair value of financial instruments cannot be measured reliably.

- (68) In disclosing fair values, an entity groups financial assets and financial liabilities into classes and offsets them only to the extent that their related carrying amounts are offset in the balance sheet.
- (69) If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*, because their fair values cannot be measured reliably, the information about fair value set out in paragraphs 115-119 is not required to be disclosed. Instead information is provided to assist users of the financial statements in making their own judgements about the extent of possible differences between the carrying amount of such financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for not disclosing fair values 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 100 may provide sufficient information. When it has a reasonable basis for doing so, management may indicate its opinion on the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value reliably.

Other disclosures

- (70) For the purposes of disclosing information on breaches of loan agreements in accordance with paragraph 121(i), loans payable include issued debt securities and financial liabilities other than short-term trade payables on normal credit terms. When such a breach occurred during the period, and the breach has not been remedied or the terms of the loan payable have not been renegotiated by the balance sheet date, the effect of the breach on the classification of the liability as current or non-current is determined under Financial Accounting Standards No.1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements*.

IV Accounting standards

Presentation

Assets, liabilities and equity

- (71) The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.
- (72) An issuer determines the financial instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met .
- (a) The instrument includes no contractual obligation:
- (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity

instruments, it is:

- (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose 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.

No contractual obligation to deliver cash or another financial asset

- (73) A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the issuer either to deliver cash or another financial asset to the holder or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer.
- (74) The substance of a financial instrument, rather than its legal form, governs its classification on the entity's balance sheet. 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.
- (75) If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability.
- (76) Some financial instruments that do not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions, the financial instrument is a financial liability.

Settlement in the entity's own equity instruments

- (77) A contract is a financial asset or liability solely because it may result in the receipt or delivery of the entity's own equity instruments to settle the contract. 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 to receive or deliver a various number of its own equity instruments.
- (78) A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. Any consideration received is added directly to equity. Any consideration paid is deducted directly from equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.
- (79) A contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount. This is the case even if the contract itself is an equity instrument. The financial liability is remeasured in accordance with Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem.
- (80) A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability.

Contingent settlement provisions

- (81) 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.

Settlement options

- (82) When a derivative financial instrument gives one party a choice over how it is settled, it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.

Compound financial instruments

- (83) The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains an asset, a liability and an equity component at the same time. Such components shall be classified separately as financial assets, financial liabilities or equity instruments in accordance with paragraph 71.
- (84) Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders.
- (85) When the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features embedded in the compound financial instrument other than the equity component is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole.

No gain or loss arises from initially recognising the components of the instrument separately.

Interest, dividends, losses and gains

- (86) Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognized as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit. Gains and losses associated with redemptions or refinancings of financial liabilities are recognized in profit or loss, whereas redemptions or refinancings of equity instruments are recognized as changes in equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

Transaction costs of an equity transaction, other than costs of issuing an equity instrument that are directly attributable to the acquisition of a business (which shall be accounted for under Statement of Financial Accounting Standards No. 25, *Business Combinations*), shall be accounted for as a deduction from equity, net of any related income tax benefit.

- (87) While an entity issues or acquires its own equity instruments, the transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognized as an expense.
- (88) Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

- (89) The amount of transaction costs accounted for as a deduction from equity in the period shall disclose separately. The related amount of income taxes recognized directly in equity that is followed the principles set out in the Financial Accounting Standards No. 22, *Income Taxes*.
- (90) Dividends classified as an expense may be presented in the income statement either with interest on other liabilities or as a separate item.
- (91) Gains and losses related to changes in the carrying amount of a financial liability are recognized as income or expense in profit or loss. Under Financial Accounting Standards No. 1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements* the entity presents any gain or loss arising from remeasurement of such an instrument separately on the face of the income statement when it is relevant in explaining the entity's performance.

Offsetting a financial asset and a financial liability

- (92) A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:
- currently has a legally enforceable right to set off the recognized amounts; and
 - intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability.

- (93) When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, or when financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 109.

Disclosure

- (94) The entity is required to provide information that to assist users of financial statements in assessing the extent of risk related to financial instruments.
- Market risk -There are three types of market risk: currency risk, fair value interest rate risk, and price risk.
 - Credit risk.
 - Liquidity risk
 - Cash flow interest rate risk.

Format, location and classes of financial instruments

- (95) This Standard does not prescribe either the format of the information required to be disclosed or its location within the financial statements. To the extent that the required information is presented on the face of the financial statements, it is not necessary for it to be repeated in the notes to the financial statements. 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.
- (96) The management of an entity groups financial instruments into classes, taking into account matters such as the characteristics of the instruments and the measurement basis that has been applied. In general, classes distinguish items measured at cost or amortized cost from items measured at fair value. Sufficient information is provided to permit a reconciliation to relevant line items on the balance sheet. When an entity is a party to financial instruments not within the scope of this Standard, those instruments constitute a class or classes of financial assets or financial liabilities separate from those within the scope of this Standard. Disclosures about those financial

instruments are dealt with by other Standard.

Risk management policies and hedging activities

- (97) An entity shall describe its financial risk management objectives and policies, including its policy for hedging each major type of forecast transaction for which hedge accounting is used.
- (98) An entity shall disclose the following separately for designated fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation:
- (a) a description of the hedge;
 - (b) a description of the financial instruments designated as hedging instruments and their fair values at the balance sheet date;
 - (c) the nature of the risks being hedged; and
 - (d) for hedges of forecast transactions, the periods in which the forecast transactions are expected to occur, when they are expected to enter into the determination of profit or loss, and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur
- (99) When a gain or loss on a hedging instrument in a cash flow hedge has been recognized directly in equity, through the statement of changes in equity, an entity shall disclose:
- (a) the amount that was so recognized in equity during the period;
 - (b) the amount that was removed from equity and included in profit or loss for the period; and
 - (c) the amount that was removed from equity during the period and

included other carrying amount of a non-financial asset or non-financial liability in a hedged highly probable forecast transaction.

Terms, conditions, and accounting policies

- (100) For each class of financial asset, financial liability, and equity instrument, an entity shall disclose:
- (a) information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and uncertainty of future cash flows; and
 - (b) the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.
- (101) As part of the disclosure of an entity's accounting policies an entity shall disclose whether purchases and sales of financial assets are accounted for at trade date or at settlement date.
- (102) 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 94, terms and conditions that warrant disclosure include:
- (a) the principal, stated, face, or other similar amount which, for some derivative instruments, such as interest rate swaps, might be the amount (referred to as the notional amount) on which future payments are based;
 - (b) the date of maturity, expiry, or execution;
 - (c) early settlement options held by either party to the instrument, including the period in which, or date at which, the options can be exercised and the exercise price or range of prices;

- (d) options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options can be exercised and the conversion or exchange ratio(s);
 - (e) the amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including instalment repayments and any sinking fund or similar requirements;
 - (f) stated rate or amount of interest, dividend, or other periodic return on principal and the timing of payments;
 - (g) collateral held, in the case of a financial asset, or pledged, in the case of a financial liability, and if there are any characteristics in its nature, such as repleged the collateral;
 - (h) in the case of an instrument for which cash flows are denominated in a currency other than the entity's presentation currency, the currency in which receipts or payments are required;
 - (i) in the case of an instrument that provides for an exchange, information described in items (a)-(h) for the instrument to be acquired in the exchange; and
 - (j) any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt-to-equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).
- (103) When the balance sheet 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.

- (104) An entity provides disclosure of all significant accounting policies of financial instrument, includes:
- (a) the criteria applied in determining when to recognize a financial asset or financial liability and when to cease to derecognize it;
 - (b) the basis of measurement applied to financial assets and financial liabilities on initial recognition and subsequently; and
 - (c) the basis on which income and expense arising from financial assets and financial liabilities are recognized and measured.

Interest rate risk

- (105) For each class of financial assets and financial liabilities, an entity shall disclose information about its exposure to interest rate risk, including:
- (a) contractual repricing or maturity dates, whichever dates are earlier; and
 - (b) effective interest rates, when applicable.
- (106) When an entity is able to predict, with reasonable reliability about expected repricing or maturity dates are differ significantly from the contractual dates, an entity shall disclose additional information includes:
- (a) the expected repricing or maturity dates, and an explanation of that it is based on management's expectations of future events;
 - (b) an explanation of the assumptions made about repricing or maturity dates;
 - (c) an explanation of the differences from expected dates to the contractual dates.
- (107) The nature of an entity's business and the extent of its activity in

financial instruments determine whether information about interest rate risk is presented in narrative form, in tables, or by using a combination of the two.

- (108) Entities that are encouraged to consider the appropriateness of applying the provisions of this Standard in disclosing information about the interest rate sensitivity. When disclosing interest rate sensitivity information, an entity indicates the basis on which it has prepared the information, including any significant assumptions.

Credit risk

- (109) For each class of financial assets and other credit exposures, unrecognized, an entity shall disclose information about its exposure to credit risk, including:
- (a) the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event of other parties failing to perform their obligations under financial instruments; and
 - (b) significant concentrations of credit risk.
- (110) In the case of financial assets exposed to credit risk, the carrying amount of the assets in the balance sheet, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. In these circumstances, no additional disclosure beyond that provided on the balance sheet is necessary. On the other hand, an entity's maximum potential loss from some financial instruments may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 109(a).
- (111) A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the balance sheet net of the liability unless settlement is intended to take place on a net

basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 109.

- (112) An entity may have entered into 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 disclosures indicates that:
- (a) the credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realised; and
 - (b) the extent to which an entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the balance sheet date because the exposure is affected by each transaction subject to the arrangement.

An entity shall also disclose the terms of its master netting arrangements that determine the extent of the reduction in its credit risk.

- (113) Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature of the business and financial position of the entity and result in a significant exposure to loss in the event of default by other parties.
- (114) 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 financial assets sharing that characteristic.

Fair value

- (115) For each class of financial assets and financial liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the balance sheet (Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*, provides guidance for determining fair value) except for the fair value of financial instruments cannot be measured reliably.
- (116) When an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it provides fair value information through supplementary disclosures except for the fair value of financial instruments cannot be measured reliably.
- (117) In disclosing fair values, an entity groups financial assets and financial liabilities into classes and offsets them only to the extent that their related carrying amounts are offset in the balance sheet.
- (118) An entity shall disclose :
- (a) the methods and significant assumptions applied in determining fair values of financial assets and financial liabilities separately for significant classes of financial assets and financial liabilities (paragraph 96 provides guidance for determining classes of financial assets);
 - (b) whether fair values of financial assets and financial liabilities are determined directly, in full or in part, by reference to published price quotations in an active market or are estimated using a valuation technique;
 - (c) whether its financial statements include financial instruments measured at fair values that are determined in full or in part using a valuation technique based on assumptions that are not supported by observable market prices. If changing any such assumption to a reasonably possible alternative would result in a significantly different fair value, the entity shall state this fact

- and disclose the effect on the fair value of a range of reasonably possible alternative assumptions. For this purpose, significance shall be judged with respect to profit or loss and total assets or total liabilities.
- (d) the total amount of the change in fair value estimated using a valuation technique that was recognized in profit or loss during the reporting period.
- (119) Disclosure of fair value information includes disclosure of the method used in determining fair value and any significant assumptions made in its application. For example, an entity discloses information about prepayment rates, rates of estimated credit losses, and interest or discount rates.
- (120) If investments in unquoted equity instruments or derivatives linked to such equity instruments are measured at cost under Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement* because their fair values cannot be measured reliably, that fact shall be disclosed together with a description of the financial instruments, their carrying amount, and explanation of why fair value cannot be measured reliably and, if possible, the range of estimates within which fair value is highly likely to lie. Furthermore, if financial assets whose fair value previously could not be measured are sold, that fact, the carrying amount of such financial assets at the time of sale and the amount of gain or loss recognized shall be disclosed.

Other disclosures

- (121) An entity shall disclose the following relating to its financial instruments:

Collateral

- (a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, and (consistently with paragraphs 100(a) and 102(g)) any material terms and conditions

relating to assets pledged as collateral.

- (b) When an entity holds collateral and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
- (i) the fair value of the collateral held (financial and non-financial assets);
 - (ii) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
 - (iii) any material the terms and conditions associated with its use of this collateral (consistently with paragraphs 100(a) and 102(g)).

Compound financial instruments with multiple embedded derivatives

- (c) If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 83) and the instrument has multiple embedded derivative features whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features and the effective interest rate on the liability component (excluding any embedded derivatives that are accounted for separately).

Financial assets and financial liabilities at fair value through profit or loss

- (d) An entity shall disclose the carrying amounts of financial assets and financial liabilities that:
- (i) are classified as held for trading; and
 - (ii) were, upon initial recognition, designated by the entity as financial assets and financial liabilities at fair value

through profit or loss (ie those that are not financial instruments classified as held for trading).

- (e) If the entity has designated a financial liability as at fair value through profit or loss, it shall disclose:
- (i) the amount of change in its fair value that is not attributable to changes in a benchmark interest rate; and
 - (ii) the difference between its carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

Reclassification

- (f) If the entity has reclassified a financial asset as one measured at cost or amortized cost rather than at fair value, it shall disclose the reason for that reclassification.

Income statement and equity

- (g) An entity shall disclose material items of income, expense and gains and losses resulting from financial assets and financial liabilities, whether included in profit or loss or as a separate component of equity. For this purpose, the disclosure shall include at least the following items:
- (i) total interest income and total interest expense for financial assets and financial liabilities that are not at fair value through profit or loss;
 - (ii) for available-for-sale financial assets, the amount of any gain or loss recognized directly in equity during the period and the amount that was removed from equity and recognized in profit or loss for the period; and
 - (iii) the amount of interest income accrued on impaired financial assets, in accordance with Financial

Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*, which is calculated and recognized by the rate discounted the future cash flows.

Impairment

- (h) An entity shall disclose the nature and amount of any impairment loss recognized in profit or loss for a financial asset, separately for each significant class of financial asset (paragraph 96 provides guidance for determining classes of financial assets).

Defaults and breaches

- (i) With respect to any defaults of principal, interest, sinking fund or redemption provisions during the period on loans payable recognized as at the balance sheet date, and any other breaches during the period of loan agreements when those breaches can permit the lender to demand repayment (except for breaches that are remedied, or in response to which the terms of the loan are renegotiated, on or before the balance sheet date), an entity shall disclose:
- (i) details of those breaches;
 - (ii) the amount recognized as at the balance sheet date in respect of the loans payable on which the breaches occurred; and
 - (iii) with respect to amounts disclosed under (ii), whether the default has been remedied or the terms of the loans payable renegotiated before the date the financial statements were authorised for issue.
- (122) For the purpose of disclosing information on breaches of loan agreements in accordance with paragraph 121 (i) loans payable include issued debt instruments and financial liabilities other than short-term trade payables on normal credit terms. When such a breach occurred during the period, and the breach has not been

remedied or the terms of the loan payable have not been renegotiated by the balance sheet date, the effect of the breach on the classification of the liability as current or non-current is determined under Financial Accounting Standards No. 1, *Conceptual Framework for Financial Accounting and Preparation of Financial Statements*.

V Notes

- (123) This Statement was issued on June 23, 2005. This Statement shall be effective for financial statements with fiscal years beginning on or after January 1, 2006. Earlier adoption is prohibited.
- (124) If an entity has issued a compound financial instrument that contains equity component before the financial year in which this Standard is initially applied, it shall not account that equity component separately; neither accounts a cumulative effect resulting from the change to a new accounting principle.
- (125) If an entity has issued financial instruments that take the legal form of equity but are liabilities in substance (such as a preference share that provides for mandatory redemption by the issuer) before the financial year in which this Standard is initially applied, do not need to apply this Standard, with the exception of an entity changes initial contractual terms and conditions materially, for which is regarded as the first time issuing.
- (126) This Statement supersedes the Statement of Financial Accounting Standards No. 27, *Financial Instruments: Disclosure*.

The provisions of this Statement need not be applied to immaterial items.