Compiled AASB Standard **AASB 132**

Financial Instruments: Presentation

This compiled Standard applies to annual reporting periods beginning on or after 1 February 2010. Early application is permitted. It incorporates relevant amendments made up to and including 20 October 2009.

Prepared on 4 December 2009 by the staff of the Australian Accounting Standards Board.

Australian Government
Australian Accounting Standards Board

Obtaining Copies of Accounting Standards

Compiled versions of Standards, original Standards and amending Standards (see Compilation Details) are available on the AASB website: www.aasb.gov.au.

Printed copies of original Standards and amending Standards are available for purchase by contacting:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Postal address:
PO Box 204 Collins Street West
Victoria 8007
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aasb.gov.au
Website: www.aasb.gov.au

Other Enquiries

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aasb.gov.au

CONTENTS

Australian Accounting Standard AASB 132 *Financial Instruments: Presentation* (as amended) is set out in paragraphs 2 – 97E and the Appendix. All the paragraphs have equal authority. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 132 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

COMPILATION DETAILS

Accounting Standard AASB 132 *Financial Instruments: Presentation* as amended

This compiled Standard applies to annual reporting periods beginning on or after 1 February 2010. It takes into account amendments made up to and including 20 October 2009 and was prepared on 4 December 2009 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 132 (July 2004) as amended by other Accounting Standards, which are listed in the Table below.

Table of Standards

Standard	**Date made**	**Application date (*annual reporting periods … on or after …*)**	**Application, saving or transitional provisions**
AASB 132	15 Jul 2004	*(beginning)* 1 Jan 2005	
AASB 2005-4	9 Jun 2005	*(beginning)* 1 Jan 2006	see (a) below
AASB 2005-9	6 Sep 2005	*(beginning)* 1 Jan 2006	see (b) below
AASB 2005-10	5 Sep 2005	*(beginning)* 1 Jan 2007	see (c) below
AASB 2005-11	8 Sep 2005	*(ending)* 31 Dec 2005	see (d) below
Erratum	24 Feb 2006	*(ending)* 24 Feb 2006	see (e) below
AASB 2007-4	30 Apr 2007	*(beginning)* 1 Jul 2007	see (f) below
AASB 2007-8	24 Sep 2007	*(beginning)* 1 Jan 2009	see (g) below
AASB 2008-2	5 Mar 2008	*(beginning)* 1 Jan 2009	see (h) below
AASB 2008-3	6 Mar 2008	*(beginning)* 1 Jul 2009	see (i) below
AASB 2008-5	24 Jul 2008	*(beginning)* 1 Jan 2009	see (j) below
AASB 2009-6	25 Jun 2009	*(beginning)* 1 Jan 2009 and *(ending)* 30 Jun 2009	see (k) below
AASB 2009-10	20 Oct 2009	*(beginning)* 1 Feb 2010	see (l) below

(a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2006. Entities that elect to apply the amendments in AASB 2005-4 in respect of AASB 139 *Financial Instruments: Recognition and Measurement* to such periods must also apply the amendments made to AASB 132 by AASB 2005-4.

(b) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2006.

(c) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2007.

(d) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 that end before 31 December 2005.

(e) Entities may elect to apply this Erratum to annual reporting periods beginning on or after 1 January 2005 that end before 24 February 2006.

(f) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 July 2007.

(g) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods.

(h) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009.

(i) Entities may elect to apply this Standard to annual reporting periods beginning on or after 30 June 2007 but before 1 July 2009, provided that AASB 3 *Business Combinations* (March 2008) and AASB 127 *Consolidated and Separate Financial Statements* (March 2008) are also applied to such periods.

(j) Entities may elect to apply this Standard, or its amendments to individual Standards, to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009.

(k) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods, and to annual reporting periods beginning on or after 1 January 2009 that end before 30 June 2009.

(l) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 February 2010.

Table of Amendments to Standard

Paragraph affected	How affected	By … [paragraph]
Title	amended	AASB 2005-10 [6]
1	deleted	AASB 2005-10 [7]
2	amended amended	AASB 2005-10 [7] AASB 2007-4 [89]
3	amended	AASB 2005-10 [7]
Aus3.1	amended	AASB 2007-8 [7, 8]
Aus3.4	amended	AASB 2007-8 [8]
Aus3.5	deleted	AASB 2005-10 [8]
4	amended amended amended amended amended	AASB 2005-9 [23] AASB 2005-10 [9] Erratum, Feb 2006 AASB 2008-5 [52] AASB 2008-3 [55]
5	deleted	AASB 2005-10 [10]
7	deleted	AASB 2005-10 [10]
11 (preceding heading)	amended	AASB 2007-4 [89]

Paragraph affected	**How affected**	**By … [paragraph]**
11	amended amended	AASB 2008-2 [13-15] AASB 2009-10 [6]
12	amended	AASB 2005-9 [24]
15 (preceding heading)	amended	AASB 2008-2 [16]
16	amended amended	AASB 2008-2 [17] AASB 2009-10 [6]
16A (and preceding heading)	added amended	AASB 2008-2 [18] AASB 2009-6 [65]
16B	added	AASB 2008-2 [18]
16C (and preceding heading)	added amended	AASB 2008-2 [18] AASB 2009-6 [65]
16D	added	AASB 2008-2 [18]
16E (and preceding heading)	added amended	AASB 2008-2 [18] AASB 2009-6 [66]
16F	added amended	AASB 2008-2 [18] AASB 2009-6 [66]
17	amended	AASB 2008-2 [19]
18	amended amended	AASB 2007-8 [93] AASB 2008-2 [19]
19	amended	AASB 2008-2 [19]
22	amended	AASB 2008-2 [20]
22A	added amended	AASB 2008-2 [21] AASB 2009-6 [66]
23	amended	AASB 2008-2 [22]
25	amended amended	AASB 2008-2 [23] AASB 2009-6 [66]
29	amended	AASB 2007-8 [94]
34	amended	AASB 2007-8 [6]
35	amended	AASB 2005-11 [10]
40	amended amended	AASB 2005-10 [11] AASB 2007-8 [95]
41-42	amended	AASB 2007-8 [6]
44	amended	AASB 2007-8 [6]
47	amended	AASB 2005-10 [12]
50	amended	AASB 2005-10 [13]
51-95	deleted	AASB 2005-10 [14]
66	amended	AASB 2005-4 [15]
94	amended amended	AASB 2005-4 [16] Erratum, Feb 2006
96 (preceding heading)	amended	AASB 2008-2 [24]
96A	note added	AASB 2008-2 [25]
96B-96C	added	AASB 2008-2 [26]
97A	note added	AASB 2007-8 [96]

Paragraph affected	How affected	By … [paragraph]
97B	note added	AASB 2008-3 [56]
97C	added	AASB 2008-2 [27]
97D	added	AASB 2008-5 [54]
97E	added	AASB 2009-10 [6]
AG2	amended	AASB 2007-4 [89]
AG8	amended	AASB 2005-11 [11]
AG12	amended	AASB 2007-4 [89]
AG13-AG14	amended	AASB 2008-2 [28]
AG14A-AG14E (and preceding headings)	added	AASB 2008-2 [29]
AG14F (and preceding heading)	added amended	AASB 2008-2 [29] AASB 2009-6 [67]
AG14G-AG14I	added	AASB 2008-2 [29]
AG14J (and preceding heading)	added	AASB 2008-2 [29]
AG24	deleted	AASB 2005-10 [15]
AG27	amended	AASB 2008-2 [30]
AG29	amended amended	AASB 2007-4 [89] AASB 2008-3 [8]
AG29A	added	AASB 2008-2 [31]
AG31	amended	AASB 2007-8 [97]
AG36	amended	AASB 2007-8 [6]
AG39	amended amended	AASB 2005-10 [15] AASB 2007-8 [98]
AG40	amended amended deleted	AASB 2005-4 [17] AASB 2005-11 [12] AASB 2005-10 [15]

Table of Amendments to Illustrative Examples

Paragraph affected	How affected	By … [paragraph]
IE1	amended	AASB 2008-2 [32]
IE10	amended	AASB 2009-6 [68]
IE32	amended amended	AASB 2007-8 [6] AASB 2009-6 [69]
IE33	amended amended amended	AASB 2007-8 [6] AASB 2008-2 [33] AASB 2009-6 [70]
IE45	amended amended	AASB 2007-8 [6] AASB 2009-6 [71]

COMPARISON WITH IAS 32

AASB 132 and IAS 32

AASB 132 *Financial Instruments: Presentation* as amended incorporates IAS 32 *Financial Instruments: Presentation* as issued and amended by the International Accounting Standards Board (IASB). Paragraphs that have been added to this Standard (and do not appear in the text of IAS 32) are identified with the prefix "Aus", followed by the number of the preceding IASB paragraph and decimal numbering.

Compliance with IAS 32

Entities that comply with AASB 132 as amended will simultaneously be in compliance with IAS 32 as amended.

ACCOUNTING STANDARD AASB 132

The Australian Accounting Standards Board made Accounting Standard AASB 132 *Financial Instruments: Disclosure and Presentation* under section 334 of the *Corporations Act 2001* on 15 July 2004.

This compiled version of AASB 132 applies to annual reporting periods beginning on or after 1 February 2010. It incorporates relevant amendments contained in other AASB Standards made by the AASB and other decisions of the AASB up to and including 20 October 2009 (see Compilation Details).

ACCOUNTING STANDARD AASB 132

FINANCIAL INSTRUMENTS: PRESENTATION

Objective

1 [Deleted by the IASB]

2 The objective of this Standard is to establish principles for presenting *financial instruments* as liabilities or equity and for offsetting *financial assets* and *financial liabilities*. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and *equity instruments*; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in AASB 139 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in AASB 7 *Financial Instruments: Disclosures*.

Application

Aus3.1 This Standard applies to:

(a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;

(b) general purpose financial statements of each other reporting entity; and

(c) financial statements that are, or are held out to be, general purpose financial statements.

Aus3.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.
[Note: For application dates of paragraphs changed or added by an amending Standard, see Compilation Details.]

Aus3.3 This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.

Aus3.4 The requirements specified in this Standard apply to the financial statements where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

Aus3.5 [Deleted by the AASB]

Aus3.6 When applicable, this Standard supersedes:

(a) AASB 1033 *Presentation and Disclosure of Financial Instruments* as notified in the *Commonwealth of Australia Gazette* No S 516, 29 October 1999; and

(b) AAS 33 *Presentation and Disclosure of Financial Instruments* as issued in October 1999.

Aus3.7 Both AASB 1033 and AAS 33 remain applicable until superseded by this Standard.

Aus3.8 Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

Scope

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates, or joint ventures that are accounted for in accordance with AASB 127 *Consolidated and Separate Financial Statements*, AASB 128 *Investments in Associates* or AASB 131 *Interests in Joint Ventures*. However, in some cases, AASB 127, AASB 128 or AASB 131 permits an entity to account for an interest in a subsidiary, associate or joint venture using AASB 139; in those cases, entities shall apply the requirements of this

Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures;

(b) **employers' rights and obligations under employee benefit plans, to which AASB 119 *Employee Benefits* applies;**

(c) [deleted by the IASB]

(d) **insurance contracts as defined in AASB 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if AASB 139 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies AASB 139 in recognising and measuring the contracts, but shall apply AASB 1023 *General Insurance Contracts* if the issuer elects, in accordance with paragraph 2.2(f) of AASB 1023, to apply AASB 1023 in recognising and measuring them;**

(e) **financial instruments that are within the scope of AASB 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see AASB 139); and**

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

(i) **contracts within the scope of paragraphs 8-10 of this Standard, to which this Standard applies; or**

(ii) **paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

5 [Deleted by the IASB]

6 [Deleted by the IASB]

7 [Deleted by the IASB]

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

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

(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(d) when the non-financial item that is the subject of the contract is readily convertible to cash.

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

10 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial

instruments, in accordance with paragraph 9(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions (see also paragraphs AG3-AG23)

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

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

A *financial asset* is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

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

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

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

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

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to

another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

A *financial liability* is any liability that is:

(a) a contractual obligation:

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

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

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

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

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

the future receipt or delivery of the entity's own equity instruments.

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

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

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

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

12 The following terms are defined in paragraph 9 of AASB 139 and are used in this Standard with the meaning specified in AASB 139:

(a) amortised cost of a financial asset or financial liability;

(b) available-for-sale financial assets;

(c) derecognition;

(d) derivative;

(e) effective interest method;

(f) financial asset or financial liability at fair value through profit or loss;

(g) financial guarantee contract;

(h) firm commitment;

(i) forecast transaction;

(j) hedge effectiveness;

(k) hedged item;

(l) hedging instrument;

(m) held-to-maturity investments;

(n) loans and receivables;

(o) regular way purchase or sale; and

(p) transaction costs.

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

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

Presentation

Liabilities and Equity (see also paragraphs AG13-AG14J and AG25-AG29A)

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

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) The instrument includes no contractual obligation:

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

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

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

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

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

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

Puttable Instruments

16A A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the entity's net assets on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation; and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.

(d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

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

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract); and

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

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

Instruments, or Components of Instruments, that Impose on the Entity an Obligation to Deliver to Another Party a Pro Rata Share of the Net Assets of the Entity Only on Liquidation

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

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the net assets of the entity on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation; and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

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

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract); and

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

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

Reclassification of Puttable Instruments and Instruments that Impose on the Entity an Obligation to Deliver to Another Party a Pro Rata Share of the Net Assets of the Entity Only on Liquidation

16E An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all the features and meet all the conditions in paragraphs 16A and 16B, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

16F An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 16E:

(a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognise in equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

(b) It shall reclassify a financial liability as equity from the date when the instrument has all the features and meets the conditions set out in paragraphs 16A and 16B or paragraphs 16C and 16D. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraph 16(a))

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

18 The substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

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

(b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).

19 If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example:

(a) a restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument; and

(b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

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

(a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability; and

(b) a financial instrument is a financial liability if it provides that on settlement the entity will deliver either:

(i) cash or another financial asset; or

(ii) its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

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

Settlement in the Entity's Own Equity Instruments (paragraph 16(b))

21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the *fair value* of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g. an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100,[1] and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

---

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

22 Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

22A If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all the features and meeting the conditions described in paragraphs 16A and 16B, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all the features and meeting the conditions described in paragraphs 16C and 16D, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

23 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised initially under AASB 139, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with AASB 139. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on

the counterparty exercising a right to redeem (e.g. a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

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

Contingent Settlement Provisions

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

(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) the instrument has all the features and meets the conditions in paragraphs 16A and 16B.

Settlement Options

26 When a derivative financial instrument gives one party a choice over how it is settled (e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.

27 An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the non-financial item or net in cash or another financial instrument (see paragraphs 8-10). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound Financial Instruments (see also paragraphs AG30-AG35 and Illustrative Examples 9-12)

28 The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.

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

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

make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument, or some other transaction.

31 AASB 139 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

32 Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Treasury Shares (see also paragraph AG36) [2]

33 If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognised in the profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.

34 The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with

---

2 The Corporations Act prohibits a company from acquiring shares (or units of shares) in itself except in limited circumstances, and an entity subject to the Corporations Act cannot have treasury shares.

AASB 101 *Presentation of Financial Statements*. An entity provides disclosure in accordance with AASB 124 *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

Interest, Dividends, Losses and Gains (see also paragraph AG37)

35 **Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, net of any related income tax benefit.**

36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

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

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

39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under AASB 101. The

related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under AASB 112 *Income Taxes*.

40 Dividends classified as an expense may be presented in the statement of comprehensive income or separate income statement (if presented) either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of AASB 101 and AASB 7. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement of comprehensive income or separate income statement (if presented). Disclosures of the tax effects are made in accordance with AASB 112.

41 Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under AASB 101 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of comprehensive income when it is relevant in explaining the entity's performance.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG38 and AG39)

42 A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

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

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

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see AASB 139, paragraph 36).

43 This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net

amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.

44 Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.

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

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

47 An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right

on the entity's credit risk exposure is disclosed in accordance with paragraph 36 of AASB 7.

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

49 The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:

(a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');

(b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (e.g. 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 (e.g. a sinking fund arrangement); or

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

50 An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of

bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 36 of AASB 7.

Disclosure

51-95 [Deleted by the IASB]

Effective Date and Transition

96 [Deleted by the AASB]

96A [Deleted by the AASB]

96B AASB 2008-2 *Amendments to Australian Accounting Standards – Puttable Financial Instruments and Obligations arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy.

96C The classification of instruments under this exception shall be restricted to the accounting for such an instrument under AASB 7, AASB 101, AASB 132 and AASB 139. The instrument shall not be considered an equity instrument under other guidance, for example AASB 2 *Share-based Payment*.

97 [Deleted by the AASB]

97A [Deleted by the AASB]

97B [Deleted by the AASB]

97C When applying the amendments made in AASB 2008-2, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to AASB 132 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.

97D Paragraph 4 was amended by AASB 2008-5 *Amendments to Australian Accounting Standards arising from the Annual Improvements Project* issued in July 2008. An entity shall apply that amendment for annual reporting periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact and apply for that earlier period the amendments to paragraph 3 of AASB 7, paragraph 1 of AASB 128 and paragraph 1 of AASB 131 issued in July 2008. An entity is permitted to apply the amendment prospectively.

97E Paragraphs 11 and 16 were amended by AASB 2009-10 *Amendments to Australian Accounting Standards – Classification of Rights Issues* issued in October 2009. An entity shall apply that amendment for annual reporting periods beginning on or after 1 February 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period, it shall disclose that fact.

Withdrawal of Other Pronouncements

98 [Deleted by the AASB]

99 [Deleted by the AASB]

100 [Deleted by the AASB]

APPENDIX

APPLICATION GUIDANCE

The Appendix is an integral part of AASB 132.

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

AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in AASB 139.

Definitions (paragraphs 11-14)

Financial Assets and Financial Liabilities

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

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

(a) trade accounts receivable and payable;

(b) notes receivable and payable;

(c) loans receivable and payable; and

(d) bonds receivable and payable.

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

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

AG6 'Perpetual' debt instruments (such as 'perpetual bonds', debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.[3] Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

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

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

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

statements. Some of these contingent rights and obligations may be insurance contracts within the scope of AASB 4 *Insurance Contracts*.

AG9 Under AASB 117 *Leases* a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).

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

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

AG12 Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes is dealt with in AASB 112. Similarly, constructive obligations, as defined in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, do not arise from contracts and are not financial liabilities.

Equity Instruments

AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

AG14 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 22A). Instead, any consideration paid for such a contract is deducted from equity.

The Class of Instruments that is Subordinate to All Other Classes (paragraphs 16A(b) and 16C(b))

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

AG14B When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.

AG14C An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.

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

Total Expected Cash Flows Attributable to the Instrument over the Life of the Instrument (paragraph 16A(e))

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

Transactions Entered into by an Instrument Holder Other than as Owner of the Entity (paragraphs 16A and 16C)

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

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

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

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

No Other Financial Instrument or Contract with Total Cash Flows that Substantially Fixes or Restricts the Residual Return to the Instrument Holder (paragraphs 16B and 16D)

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

(a) instruments with total cash flows substantially based on specific assets of the entity;

(b) instruments with total cash flows based on a percentage of revenue;

(c) contracts designed to reward individual employees for services rendered to the entity;

(d) contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

Derivative Financial Instruments

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

AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract.[4] Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favourable or unfavourable.

AG17 A put or call option to exchange financial assets or financial liabilities (i.e. financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a

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

financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favourable conditions and the writer's obligation to exchange the financial asset under potentially unfavourable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

AG18 Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

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

Contracts to Buy or Sell Non-Financial Items (paragraphs 8-10)

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

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

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

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

AG24 [Deleted by the IASB]

Presentation

Liabilities and Equity (paragraphs 15-27)

No Contractual Obligation to Deliver Cash or Another Financial Asset (paragraphs 17-20)

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

AG26 When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them.

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

(a) a history of making distributions;

(b) an intention to make distributions in the future;

(c) a possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);

(d) the amount of the issuer's reserves;

(e) an issuer's expectation of a profit or loss for a period; or

(f) an ability or inability of the issuer to influence the amount of its profit or loss for the period.

Settlement in the Entity's Own Equity Instruments (paragraphs 21-24)

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

(a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 22A). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.

(b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.

(c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is a net cash-settled share option.

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

Contingent Settlement Provisions (paragraph 25)

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

Treatment in Consolidated Financial Statements

AG29 In consolidated financial statements, an entity presents non-controlling interests – that is, the interests of other parties in the equity and income of its subsidiaries – in accordance with AASB 101 and AASB 127. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a subsidiary in a group issues a financial instrument and a parent or other group entity agrees additional terms directly with the holders of the instrument (e.g. a guarantee), the group may not have discretion over distributions or redemption. Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the group.

Compound Financial Instruments (paragraphs 28-32)

AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. AASB 139 deals with the separation of embedded derivates from the perspective of holders of compound financial instruments that contain debt and equity features.

AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the statement of financial position, as follows.

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

(b) The equity instrument is an embedded option to convert the liability into equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.

AG32 On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.

AG33 When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and equity components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 28-32.

AG34 Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

(a) the amount of gain or loss relating to the liability component is recognised in profit or loss; and

(b) the amount of consideration relating to the equity component is recognised in equity.

AG35 An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favourable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognised as a loss in profit or loss.

Treasury Shares (paragraphs 33 and 34)

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

Interest, Dividends, Losses and Gains (paragraphs 35-41)

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

Offsetting a Financial Asset and a Financial Liability (paragraphs 42-50)

AG38 To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.

AG39 The Standard does not provide special treatment for so-called ‘synthetic instruments’, which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate long-term debt. Each of the individual financial instruments that together constitute a synthetic instrument represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a synthetic instrument is an asset and another is a liability, they are not offset and presented in an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 42.

Disclosure

Financial Assets and Financial Liabilities at Fair Value Through Profit or Loss (paragraph 94(f))

AG40 [Deleted by the IASB]

ILLUSTRATIVE EXAMPLES

CONTENTS

ILLUSTRATIVE EXAMPLES

The examples accompany, but are not part of, AASB 132.

Accounting for Contracts on Equity Instruments of an Entity

IE1 The following examples[1] illustrate the application of paragraphs 15-27 and AASB 139 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

Example 1: Forward to buy shares

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

Assumptions:

Contract date	1 February 2002
Maturity date	31 January 2003
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU110
Market price per share on 31 January 2003	CU106
Fixed forward price to be paid on 31 January 2003	CU104
Present value of forward price on 1 February 2002	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 2002	CU0

1 In these examples, monetary amounts are denominated in 'currency units' (CU).

Fair value of forward on 31 December 2002	CU6,300
Fair value of forward on 31 January 2003	CU2,000

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

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

On 1 February 2002, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 2003 in exchange for a payment of CU104,000 in cash (i.e. CU104 per share) on 31 January 2003. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 2002

The price per share when the contract is agreed on 1 February 2002 is CU100. The initial fair value of the forward contract on 1 February 2002 is zero.

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

31 December 2002

On 31 December 2002, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr	Forward asset	CU6,300	
Cr	Gain		CU6,300

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

31 January 2003

On 31 January 2003, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ([CU106 × 1,000] – CU104,000).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 1,000) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr	Loss	CU4,300	
Cr	Forward asset		CU4,300

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

Dr	Cash	CU2,000	
Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

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

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

31 January 2003

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 (CU104 × 1,000) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 (CU106 × 1,000) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 (CU106,000 – CU104,000) worth of shares to Entity A, that is, 18.9 shares (CU2,000 ÷ CU106).

Dr	Equity	CU2,000	
Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

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

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

1 February 2002

Dr	Equity	CU100,000	
Cr	Liability		CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see AASB 139, paragraph AG64).

31 December 2002

Dr	Interest expense	CU3,660	
Cr	Liability		CU3,660

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

31 January 2003

Dr	Interest expense	CU340	
Cr	Liability		CU340

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

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

Dr	Liability	CU104,000	
Cr	Cash		CU104,000

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

(d) Settlement options

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

Example 2: Forward to sell shares

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

Assumptions:

Contract date	1 February 2002
Maturity date	31 January 2003
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU110
Market price per share on 31 January 2003	CU106
Fixed forward price to be received on 31 January 2003	CU104
Present value of forward price on 1 February 2002	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 2002	CU0
Fair value of forward on 31 December 2002	CU(6,300)
Fair value of forward on 31 January 2003	CU(2,000)

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

IE8 On 1 February 2002, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 2003 in exchange for CU104,000 in cash (i.e. CU104 per share) on 31 January 2003. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 2002

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

31 December 2002

Dr	Loss	CU6,300	
Cr	Forward liability		CU6,300

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

31 January 2003

Dr	Forward liability	CU4,300	
Cr	Gain		CU4,300

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

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

Dr	Forward liability	CU2,000	
Cr	Cash		CU2,000

To record the settlement of the forward contract.

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

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

31 January 2003

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

Dr	Forward liability	CU2,000	
Cr	Equity		CU2,000

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

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

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

1 February 2002

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

31 December 2002

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

31 January 2003

On 31 January 2003, Entity A receives CU104,000 in cash and delivers 1,000 shares.

Dr	Cash	CU104,000	
Cr	Equity		CU104,000

To record the settlement of the forward contract.

(d) Settlement options

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

Example 3: Purchased call option on shares

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

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, i.e. it can be exercised only at maturity)

Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU104
Market price per share on 31 January 2003	CU104
Fixed exercise price to be paid on 31 January 2003	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	CU5,000
Fair value of option on 31 December 2002	CU3,000
Fair value of option on 31 January 2003	CU2,000

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

IE13 On 1 February 2002, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 2003 in exchange for CU102,000 in cash (i.e. CU102 per share) on 31 January 2003, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 2002

The price per share when the contract is agreed on 1 February 2002 is CU100. The initial fair value of the option contract on 1 February 2002 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

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

To recognise the purchased call option.

31 December 2002

On 31 December 2002, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ([CU104 – CU102] × 1,000), and CU1,000 is the remaining time value.

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

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

31 January 2003

On 31 January 2003, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ([CU104 – CU102] × 1,000) because no time value remains.

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 2003

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

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

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

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

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

1 February 2002

Dr	Equity	CU5,000	
Cr	Cash		CU5,000

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

31 December 2002

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

31 January 2003

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

Dr	Equity	CU102,000	
Cr	Cash		CU102,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 4: Written call option on shares

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

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU104
Market price per share on 31 January 2003	CU104

Fixed exercise price to be received on 31 January 2003	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	CU5,000
Fair value of option on 31 December 2002	CU3,000
Fair value of option on 31 January 2003	CU2,000

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

IE18 Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on 1 February 2002 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 2003 in exchange for CU102,000 in cash (i.e. CU102 per share) on 31 January 2003, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 2002

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

To recognise the written call option.

31 December 2002

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

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

31 January 2003

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 2003

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

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

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

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

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

1 February 2002

Dr	Cash	CU5,000	
Cr	Equity		CU5,000

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

31 December 2002

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

31 January 2003

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

Dr	Cash	CU102,000	
Cr	Equity		CU102,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 5: Purchased put option on shares

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

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU95
Market price per share on 31 January 2003	CU95
Fixed exercise price to be received on 31 January 2003	CU98
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	CU5,000
Fair value of option on 31 December 2002	CU4,000
Fair value of option on 31 January 2003	CU3,000

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

IE23 On 1 February 2002, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 2003 at a strike price of CU98,000 (i.e. CU98 per share) on 31 January 2003, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 2002

The price per share when the contract is agreed on 1 February 2002 is CU100. The initial fair value of the option contract on 1 February 2002 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

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

To recognise the purchased put option.

31 December 2002

On 31 December 2002 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value ([CU98 – CU95] × 1,000) and CU1,000 is the remaining time value.

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

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

31 January 2003

On 31 January 2003 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value ([CU98 – CU95] × 1,000) because no time value remains.

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 2003

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

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

To record the settlement of the option contract.

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

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

1 February 2002

Dr	Equity	CU5,000	
Cr	Cash		CU5,000

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

31 December 2002

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

31 January 2003

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

Dr	Cash	CU98,000	
Cr	Equity		CU98,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 6: Written put option on shares

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

Assumptions:

Contract date	1 February 2002
Exercise date	31 January 2003 (European terms, i.e. it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 2002	CU100
Market price per share on 31 December 2002	CU95
Market price per share on 31 January 2003	CU95
Fixed exercise price to be paid on 31 January 2003	CU98
Present value of exercise price on 1 February 2002	CU95
Number of shares under option contract	1,000
Fair value of option on 1 February 2002	CU5,000
Fair value of option on 31 December 2002	CU4,000
Fair value of option on 31 January 2003	CU3,000

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

IE28 Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on 1 February 2002, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of 31 January 2003 in exchange for CU98,000 in cash (i.e. CU98 per share) on 31 January 2003, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 2002

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

To recognise the written put option.

31 December 2002

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

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

31 January 2003

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 2003

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

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

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

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

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

1 February 2002

Dr	Cash	CU5,000	
Cr	Equity		CU5,000

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

Dr	Equity	CU95,000	
Cr	Liability		CU95,000

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

31 December 2002

Dr	Interest expense	CU2,750	
Cr	Liability		CU2,750

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

31 January 2003

Dr	Interest expense	CU250	
Cr	Liability		CU250

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

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

Dr	Liability	CU98,000	
Cr	Cash		CU98,000

To record the settlement of the option contract.

(d) Settlement options

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

Entities such as Mutual Funds and Co-operatives whose Share Capital is not Equity as Defined in AASB 132

Example 7: Entities with no equity

IE32 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have equity as defined in AASB 132. Other formats are possible.

Statement of comprehensive income for the year ended 31 December 20x1

		20x1	***20x0***
		CU	CU
Revenue		2,956	1,718
Expenses (classified by nature or function)		(644)	(614)
Profit from operating activities		2,312	1,104
Finance costs	– other finance costs	(47)	(47)
	– distributions to unitholders	(50)	(50)
Change in net assets attributable to unitholders		2,215	1,007

Statement of financial position at 31 December 20x1

		20x1		***20x0***
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with AASB 101 *Presentation of Financial Statements*)	91,374		78,484	
Total non-current assets		91,374		78,484
Current assets (classified in accordance with AASB 101)	1,422		1,769	
Total current assets		1,422		1,769
Total assets		92,796		80,253
LIABILITIES				
Current liabilities (classified in accordance with AASB 101)	647		66	
Total current liabilities		(647)		(66)
Non-current liabilities excluding net assets attributable to unitholders (classified in accordance with AASB 101)	280		136	
		(280)		(136)
Net assets attributable to unitholders		91,869		80,051

Example 8: Entities with some equity

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in AASB 132 because the entity has an obligation to repay the share capital on demand but does not have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. Other formats are possible.

Statement of comprehensive income for the year ended 31 December 20x1

	20x1	***20x0***
	CU	CU
Revenue	472	498
Expenses (classified by nature or function)	(367)	(396)
Profit from operating activities	105	102
Finance costs – other finance costs	(4)	(4)
– distributions to members	(50)	(50)
Change in net assets attributable to members	51	48

Statement of financial position at 31 December 20x1

		20x1		***20x0***
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with AASB 101)	908		830	
Total non-current assets		908		830
Current assets (classified in accordance with AASB 101)	383		350	
Total current assets		383		350
Total assets		1,291		1,180
LIABILITIES				
Current liabilities (classified in accordance with AASB 101)	372		338	
Share capital repayable on demand	202		161	
Total current liabilities		(574)		(499)
Total assets less current liabilities		717		681
Non-current liabilities (classified in accordance with AASB 101)	187		196	
		187		196

OTHER COMPONENTS OF EQUITY[2]				
Reserves for example, revaluation surplus, retained earnings etc	530		485	
		530		485
		717		681

MEMORANDUM NOTE – Total Members' Interests

Share capital repayable on demand	202	161
Reserves	530	485
	732	646

Accounting for Compound Financial Instruments

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

IE34 Paragraph 28 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.

IE35 An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.

IE36 The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market

2 In this example, the entity has no obligation to deliver a share of its reserves to its members.

interest rate for similar bonds having no conversion rights, as shown below.

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

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

IE37 The following example illustrates the application of paragraph 31 to the separation of the liability and equity components of a compound financial instrument with multiple embedded derivative features.

IE38 Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 31 is CU55 (CU57 – CU2) and the value allocated to the equity component is CU5 (CU60 – CU55).

Example 11: Repurchase of a convertible instrument

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

IE40 On 1 January 1999, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December 2008. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued nonconvertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

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

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

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

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

IE44 The repurchase price is allocated as follows:

	Carrying Value	**Fair Value**	**Difference**
Liability component:	CU	CU	CU
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	962	1,081	(119)

	Carrying Value	Fair Value	Difference
Equity component	60	619[3]	(559)
Total	1,022	1,700	(678)

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

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

To recognise the repurchase of the liability component.

Dr	Equity	CU619	
Cr	Cash		CU619

To recognise the cash paid for the equity component.

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

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

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

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

3 This amount represents the differences between the fair value amount allocated to the liability component and the repurchase price of CU1,700.

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

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

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

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

Face amount	CU1,000	
Original conversion price	/CU25	per share
Number of ordinary shares issued upon conversion	40	shares
*Number of **incremental** ordinary shares issued upon conversion*	10	shares

Value of incremental ordinary shares issued upon conversion

CU40 per share × 10 incremental shares	CU400	

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