

IPSAS 15—FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 32 (Revised 1998), *Financial Instruments: Disclosure and Presentation* published by the International Accounting Standards Board (IASB). Extracts from IAS 32 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

The approved text of the International Financial Reporting Standards (IFRSs) is that published by the IASB in the English language, and copies may be obtained directly from IFRS Publications Department, First Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

**IPSAS 15—FINANCIAL INSTRUMENTS:
DISCLOSURE AND PRESENTATION**

CONTENTS

	Paragraph
Objective	
Scope	1–8
Definitions	9–21
Presentation	22–47
Liabilities and Net Assets/Equity	22–28
Classification of Compound Instruments by the Issuer	29–35
Interest, Dividends, Losses and Gains	36–38
Offsetting of a Financial Asset and a Financial Liability	39–47
Disclosure	48–101
Disclosure of Risk Management Policies	50–53
Terms, Conditions and Accounting Policies	54–62
Interest Rate Risk	63–72
Credit Risk	73–83
Fair Value	84–94
Financial Assets Carried at an Amount in Excess of Fair Value	95–97
Hedges of Anticipated Future Transactions	98–100
Other Disclosures	101
Transitional Provision	102
Effective Date	103–104
Implementation Guidance	
Illustrative Examples	
Comparison with IAS 32	

International Public Sector Accounting Standard 15, *Financial Instruments: Disclosure and Presentation* is set out in the objective and paragraphs 1–104. All the paragraphs have equal authority. IPSAS 15 should be read in the context of its objective and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Please note that International Public Sector Accounting Standard (IPSAS) 15, *Financial Instruments: Presentation and Disclosure* has been superseded by IPSAS 28, *Financial Instruments: Presentation*; IPSAS 29, *Financial Instruments: Recognition and Measurement*; and IPSAS 30, *Financial Instruments: Disclosures*. These Standards apply for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. IPSAS 15 remains applicable until these Standards are applied or become effective, whichever is earlier.

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

Objective

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

The objective of this Standard is to enhance financial statement users' understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to a government's or other public sector entity's financial position, performance and cash flows. In this Standard, references to balance sheet in the context of on-balance-sheet and off-balance-sheet have the same meaning as statement of financial position.

The Standard prescribes certain requirements for presentation of on-balance-sheet financial instruments and identifies the information that should be disclosed about both on-balance-sheet (recognized) and off-balance-sheet (unrecognized) financial instruments. The presentation standards deal with the classification of financial instruments between liabilities and net assets/equity, the classification of related interest, dividends, revenues and expenses, and the circumstances in which financial assets and financial liabilities should be offset. The disclosure standards deal with information about factors that affect the amount, timing and certainty of an entity's

future cash flows relating to financial instruments and the accounting policies applied to the instruments. In addition, the Standard encourages disclosure of information about the nature and extent of an entity's use of financial instruments, the financial purposes that they serve, the risks associated with them and management's policies for controlling those risks.

Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard for the presentation and disclosure of financial instruments.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.
4. **This Standard shall be applied in presenting and disclosing information about all types of financial instruments, both recognized and unrecognized, other than:**
 - (a) Interests in controlled entities, as defined in IPSAS 6, *Consolidated and Separate Financial Statements*;
 - (b) Interests in associates, as defined in IPSAS 7, *Investments in Associates*;
 - (c) Interests in joint ventures, as defined in IPSAS 8, *Interests in Joint Ventures*;
 - (d) Obligations arising under insurance contracts;
 - (e) Employers' and plans' obligations for post-employment benefits of all types, including employee benefit plans; and
 - (f) Obligations for payments arising under social benefits provided by an entity for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits. However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.
5. This Standard does not apply to an entity's net assets/equity interests in controlled entities. However, it does apply to all financial instruments

included in the consolidated financial statements of a controlling entity, regardless of whether those instruments are held or issued by the controlling entity or by a controlled entity. Similarly, the Standard applies to financial instruments held or issued by a joint venture and included in the financial statements of a venturer either directly or through proportionate consolidation.

6. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard. However, this Standard excludes the insurance contracts themselves from its scope. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks (see paragraph 49), for example, some types of financial reinsurance and guaranteed investment contracts issued by public sector insurance and other entities. Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting and disclosing information about such obligations.
7. This Standard does not apply to financial instruments that arise from obligations from employee benefit schemes or obligations of a government to provide social benefits to its citizens for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits (such as old age pensions, unemployment benefits, disability benefits and other forms of financial assistance provided by governments).
8. Additional guidance on the presentation and disclosure of specific types of financial instruments can be found in international and/or national accounting standards. For example, IPSAS 13, “Leases” contains specific disclosure requirements relating to finance leases.

Definitions

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

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

Financial asset is any asset that is:

- (a) **Cash;**
- (b) **A contractual right to receive cash or another financial asset from another entity;**

- (c) A contractual right to exchange financial instruments with another entity under conditions that are potentially favorable; or
- (d) An equity instrument of another entity.

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

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

Financial liability is any liability that is a contractual obligation:

- (a) To deliver cash or another financial asset to another entity; or
- (b) To exchange financial instruments with another entity under conditions that are potentially unfavorable.

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

An **insurance contract** (for the purposes of this Standard) is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations.

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

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

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

10. In this Standard, the terms contract and contractual refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable at law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.
11. For purposes of the definitions in paragraph 9, the term entity includes public sector bodies, individuals, partnerships and incorporated bodies.
12. Parts of the definitions of a financial asset and a financial liability include the terms financial asset and financial instrument, but the definitions are not circular. When there is a contractual right or obligation to exchange financial instruments, the instruments to be exchanged give rise to financial assets, financial liabilities, or equity instruments. A chain of contractual rights or obligations may be established but it ultimately leads to the receipt or payment of cash or to the acquisition or issuance of an equity instrument.
13. Financial instruments include both primary instruments, such as receivables, payables and equity securities, and derivative instruments, such as financial options, futures and forwards, interest rate swaps and currency swaps. Derivative financial instruments, whether recognized or unrecognized, meet the definition of a financial instrument and, accordingly, are subject to this Standard.
14. Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. Derivative instruments do not result in a transfer of the underlying primary financial instrument on inception of the contract and such a transfer does not necessarily take place on maturity of the contract.
15. Physical assets such as inventories, property, plant and equipment, leased assets and intangible assets such as radio spectrum, patents and trademarks are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or other assets but it does not give rise to a present right to receive cash or other financial assets.
16. Assets, such as prepaid expenses, for which the future economic benefit is the receipt of goods or services rather than the right to receive cash or another financial asset are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the probable outflow of economic benefits associated with them is the delivery of goods and services rather than cash or another financial asset.
17. Liabilities or assets that are not contractual in nature, such as income taxes or tax equivalents that are created as a result of statutory requirements imposed on public sector entities by governments, are not financial liabilities or

financial assets. International Accounting Standard (IAS) 12, *Income Taxes* provides guidance on accounting for income taxes.

18. Contractual rights and obligations that do not involve the transfer of a financial asset do not fall within the scope of the definition of a financial instrument. For example, some contractual rights (obligations), such as those that arise under a commodity futures contract, can be settled only by the receipt (delivery) of non-financial assets. Similarly, contractual rights (obligations) such as those that arise under an operating lease or build-own-operate arrangement for use of a physical asset, such as a hospital, can be settled only by the receipt (delivery) of services. In both cases, the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. (Refer to Illustrative Examples, paragraphs IE13–IE17.)
19. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though many such assets and liabilities do not qualify for recognition in financial statements. For example, a national government may provide a private sector operator of an infrastructure facility protection against demand risk by guaranteeing a minimum level of revenue. The guarantee is a contingent obligation of the government until it becomes probable that the operator's revenue will fall below the guaranteed minimum.
20. An obligation of an entity to issue or deliver its own equity instruments, such as a share option or warrant, is itself an equity instrument, not a financial liability, since the entity is not obliged to deliver cash or another financial asset. Similarly, the cost incurred by an entity to purchase a right to re-acquire its own equity instruments from another party is a deduction from its net assets/equity, not a financial asset.
21. The minority interest that may arise on an entity's statement of financial position from consolidating a controlled entity is not a financial liability or an equity instrument of the entity. In consolidated financial statements, an entity presents the interests of other parties in the net assets/equity and the net surplus or deficit of its controlled entities in accordance with IPSAS 6. Accordingly, a financial instrument classified as an equity instrument by a controlled entity is eliminated on consolidation when held by the controlling

entity, or presented by the controlling entity in the consolidated statement of financial position as a minority interest separate from the net assets/equity of its own shareholders. A financial instrument classified as a financial liability by a controlled entity remains a liability in the controlling entity's consolidated statement of financial position unless eliminated on consolidation as an intra-economic entity balance. The accounting treatment by the controlling entity on consolidation does not affect the basis of presentation by the controlled entity in its financial statements.

Presentation

Liabilities and Net assets/Equity

22. **The issuer of a financial instrument shall classify the instrument, or its component parts, as a liability or as net assets/equity in accordance with the substance of the contractual arrangement on initial recognition and the definitions of a financial liability and an equity instrument.**
23. The substance of a financial instrument, rather than its legal form, governs its classification on the issuer's statement of financial position. While substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. The classification of an instrument is made on the basis of an assessment of its substance when it is first recognized. That classification continues at each subsequent reporting date until the financial instrument is removed from the entity's statement of financial position. The classification of financial instruments as either liabilities or net assets/equity are not likely to be a significant issue for many reporting entities in the public sector.
24. Classification of financial instruments between liabilities and net assets/equity is required because of the different risks associated with each. Entities with instruments classified as financial liabilities are required to disclose information on interest rate risk exposure in accordance with paragraph 63, and to recognize interest, dividends, losses or gains as revenue or expense in accordance with paragraph 36. Paragraph 36 also specifies that distributions to holders of financial instruments classified as equity instruments should be debited by the issuer directly to net assets/equity.
25. While public sector entities will often hold an equity instrument as an investment (financial assets) it is not common for a public sector entity to issue equity instruments to parties outside the economic entity except where a controlled entity is partly-privatized. Nevertheless, the use of financial instruments in the public sector continues to evolve and classification by the issuer needs to be guided by their substance and not necessarily their form.

26. The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation on one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavorable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled. A restriction on the ability of the issuer to satisfy an obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the issuer's obligation or the holder's right under the instrument.
27. When a financial instrument does not give rise to a contractual obligation on the part of the issuer to deliver cash or another financial asset or to exchange another financial instrument under conditions that are potentially unfavorable, it is an equity instrument. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions out of net assets/equity, the issuer does not have a contractual obligation to make such distributions.
28. A public sector entity may issue instruments with particular rights, such as preferred shares. When a preferred share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A preferred share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. For example, a preferred share that does not provide for mandatory redemption or redemption at the option of the holder may have a contractually provided accelerating dividend such that, within the foreseeable future, the dividend yield is scheduled to be so high that the issuer will be economically compelled to redeem the instrument. In these circumstances, classification as a financial liability is appropriate because the issuer has little, if any, discretion to avoid redeeming the instrument. Similarly, if a financial instrument labeled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. (Refer to Illustrative Examples, paragraphs IE7–IE8 and IE18–IE21.)

Classification of Compound Instruments by the Issuer

29. **The issuer of a financial instrument that contains both a liability and a net assets/equity element shall classify the instrument's component parts separately in accordance with paragraph 22.**
30. Public sector entities do not commonly issue compound financial instruments. The exceptions include partly-privatized GBEs within an economic entity that issues compound instruments into the financial markets. Where a public sector entity issues a compound instrument, this Standard requires the separate presentation on an issuer's statement of financial position of liability and net assets/equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and net assets/equity interests are created by a single financial instrument rather than two or more separate instruments. An issuer's financial position is more faithfully represented by separate presentation of liability and net assets/equity components contained in a single instrument according to their nature. (Refer to Illustrative Examples, paragraphs IE22–IE23.)
31. For purposes of statement of financial position presentation, an issuer recognizes separately the component parts of a financial instrument that creates a primary financial liability of the issuer and grants an option to the holder of the instrument to convert it into an equity instrument of the issuer. A bond or similar instrument convertible by the holder into common shares of the issuer is an example of such an instrument. From the perspective of the issuer, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or other financial assets) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert into common shares of the issuer). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase common shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the issuer presents the liability and net assets/equity elements separately on its statement of financial position.
32. Classification of the liability and net assets/equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The issuer's obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument or some other transaction.

33. A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument may give the holder the right to receive a non-financial asset such as a right to operate a government owned monopoly or a commodity in settlement and an option to exchange that right for shares of the issuer. The issuer recognizes and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.
34. This Standard does not deal with measurement of financial assets, financial liabilities and equity instruments and does not therefore prescribe any particular method for assigning a carrying amount to liability and net assets/equity elements contained in a single instrument. Approaches that might be followed include:
- (a) Assigning to the less easily measurable component (often an equity instrument), the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily measurable; and
 - (b) Measuring the liability and net assets/equity components separately and, to the extent necessary, adjusting these amounts on a pro rata basis so that the sum of the components equals the amount of the instrument as a whole.

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

35. Under the first approach described in paragraph 34, where, for example, a public sector entity issues a bond convertible into an equity interest it first determines the carrying amount of the financial liability by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into common shares may then be determined by deducting the carrying amount of the financial liability from the amount of the compound instrument as a whole. Under the second approach, the issuer determines the value of the option directly either by reference to the fair value of a similar option, if one exists, or by using an option pricing model. The value determined for each component is then adjusted on a pro-rata basis to the extent necessary to ensure that the sum of the carrying amounts assigned to the components equals the amount of the consideration received for the convertible bond. (Refer to Illustrative Examples, paragraph IE24.)

Interest, Dividends, Losses and Gains

36. **Interest, dividends, losses and gains relating to a financial instrument, or a component part, classified as a financial liability shall be reported in**

the statement of financial performance as expense or revenue. Distributions to holders of a financial instrument classified as an equity instrument shall be debited by the issuer directly to net assets/equity.

37. The classification of a financial instrument in the statement of financial position determines whether interest, dividends, losses and gains relating to that instrument are classified as expenses or revenue and reported in the statement of financial performance. Thus, dividend payments on shares classified as liabilities are classified as expenses in the same way as interest on a bond and reported in the statement of financial performance. Similarly, gains and losses associated with redemptions or refinancings of instruments classified as liabilities are reported in the statement of financial performance, while redemptions or refinancings of instruments classified as net assets/equity of the issuer are reported as movements in net assets/equity.
38. Dividends classified as an expense may be presented in the statement of financial performance either with interest on other liabilities or as a separate item. Disclosure of interest and dividends is subject to the requirements of IPSAS 1. In some circumstances, because of significant differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately within the statement of financial performance. For entities subject to income taxes, guidance on the disclosure of the amounts of tax effects can be found in IAS 12.

Offsetting of a Financial Asset and a Financial Liability

39. **A financial asset and a financial liability shall be offset and the net amount reported in the statement of financial position when an entity:**
- (a) **Has a legally enforceable right to set off the recognized amounts; and**
 - (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**
40. This Standard requires the presentation of financial assets and financial liabilities on a net basis when this reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. For example, a state government settles a financial liability to a national government on a net basis (that is, after deducting a financial asset it was owed by the national government). In other circumstances, financial assets and financial liabilities are presented separately from each other consistent with their characteristics as assets or liabilities of the entity. (Refer to Illustrative Examples, paragraph IE25.)
41. Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from ceasing to recognize a financial asset or a financial liability. While offsetting does not give rise to recognition of a

gain or a loss, ceasing to recognize a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but may also result in recognition of a gain or a loss.

42. A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. Since the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and care must be taken to establish which laws apply to the relationships between the parties.
43. The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect significantly an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity does intend to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting since the rights and obligations associated with the individual financial asset and financial liability remain unaltered.
44. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with the standard in paragraph 73.
45. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial

liability are considered simultaneous only when the transactions occur at the same moment.

46. The conditions set out in paragraph 39 are generally not satisfied and offsetting is usually inappropriate when:
- (a) Several different financial instruments are used to emulate the features of a single financial instrument (that is, a synthetic instrument);
 - (b) Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
 - (c) Financial or other assets are pledged as collateral for non-recourse financial liabilities;
 - (d) Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or
 - (e) Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance policy.
47. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a “master netting arrangement” with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 39 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity’s exposure to credit risk is disclosed in accordance with paragraph 73.

Disclosure

48. The purpose of the disclosures required by this Standard is to provide information that will enhance understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to an entity’s financial position, performance and cash flows and assist in assessing the amounts,

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

49. Transactions in financial instruments may result in an entity assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information that assists users of financial statements in assessing the extent of risk related to both recognized and unrecognized financial instruments.
- (a) Price risk—There are three types of price risk: currency risk, interest rate risk and market risk.
 - (i) Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.
 - (ii) Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.
 - (iii) Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.

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

- (b) Credit risk—Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.
- (c) Liquidity risk—Liquidity risk, also referred to as funding risk, is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. For some public sector entities, such as a national government, liquidity risks may be mitigated by raising taxes or other charges levied by the entity.

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

Disclosure of Risk Management Policies

50. **An entity shall describe its financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used.**
51. The standards do not prescribe either the format of the information required to be disclosed or its location within the financial statements. With regard to recognized financial instruments, to the extent that the required information is presented on the face of the statement of financial position, it is not necessary for it to be repeated in the notes to the financial statements. With regard to unrecognized financial instruments, however, information in notes or supplementary schedules is the primary means of disclosure. Disclosures may include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the instruments and their relative significance to the entity.
52. Determination of the level of detail to be disclosed about particular financial instruments is a matter for the exercise of judgment taking into account the relative significance of those instruments. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring significant information as a result of too much aggregation. For example, when an entity is party to large numbers of financial instruments with similar characteristics and no one contract is individually significant, summarized information by reference to particular classes of instruments is appropriate. On the other hand, specific information about an individual instrument may be important when that instrument represents, for example, a significant element in an entity's capital structure.
53. Management of an entity group's financial instruments into classes that are appropriate to the nature of the information to be disclosed, taking into account matters such as the characteristics of the instruments, whether they are recognized or unrecognized and, if they are recognized, the measurement basis that has been applied. In general, classes are determined on a basis that distinguishes items carried on a cost basis from items carried at fair value. When amounts disclosed in notes or supplementary schedules relate to recognized assets and liabilities, sufficient information is provided to permit a reconciliation to relevant line items on the statement of financial position. When an entity is a party to financial instruments not dealt with by this Standard, such as obligations under retirement benefit plans or insurance contracts, these instruments constitute a class or classes of financial assets or financial liabilities disclosed separately from those dealt with by this Standard.

Terms, Conditions and Accounting Policies

54. **For each class of financial asset, financial liability and equity instrument, both recognized and unrecognized, an entity shall disclose:**
- (a) **Information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and**
 - (b) **The accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.**
55. The contractual terms and conditions of a financial instrument are an important factor affecting the amount, timing and certainty of future cash receipts and payments by the parties to the instrument. When recognized and unrecognized instruments are important, either individually or as a class, in relation to the current financial position of an entity or its future operating results, their terms and conditions are disclosed. If no single instrument is individually significant to the future cash flows of a particular entity, the essential characteristics of the instruments are described by reference to appropriate groupings of like instruments.
56. When financial instruments held or issued by an entity, either individually or as a class, create a potentially significant exposure to the risks described in paragraph 49, terms and conditions that may warrant disclosure include:
- (a) The principal, stated, face or other similar amount which, for some derivative instruments, such as interest rate swaps, may be the amount (referred to as the notional amount) on which future payments are based;
 - (b) The date of maturity, expiry or execution;
 - (c) Early settlement options held by either party to the instrument, including the period in which, or date at which, the options may be exercised and the exercise price or range of prices;
 - (d) Options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options may be exercised and the conversion or exchange ratio(s);
 - (e) The amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including installment repayments and any sinking fund or similar requirements;
 - (f) Stated rate or amount of interest, dividend or other periodic return on principal and the timing of payments;
 - (g) Collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;

- (h) In the case of an instrument for which cash flows are denominated in a currency other than the entity's reporting currency, the currency in which receipts or payments are required;
 - (i) In the case of an instrument that provides for an exchange, information described in items (a) to (h) for the instrument to be acquired in the exchange; and
 - (j) Any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt-to-net assets/equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).
57. When the statement of financial position presentation of a financial instrument differs from the instrument's legal form, it is desirable for an entity to explain in the notes to the financial statements the nature of the instrument.
58. The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relationships between individual instruments that may affect the amount, timing or certainty of the future cash flows of an entity. For example, it is important to disclose hedging relationships such as might exist when a central borrowing authority holds an investment in shares for which it has purchased a put option. Similarly, it is important to disclose relationships between the components of "synthetic instruments" such as fixed rate debt created by borrowing at a floating rate and entering into a floating to fixed interest rate swap. In each case, an entity presents the individual financial assets and financial liabilities in its statement of financial position according to their nature, either separately or in the class of financial asset or financial liability to which they belong. The extent to which a risk exposure is altered by the relationships among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 56 but in some circumstances further disclosure is necessary.
59. In accordance with IPSAS 1, an entity provides clear and concise disclosure of all significant accounting policies, including both the general principles adopted and the method of applying those principles to significant transactions and circumstances arising in the entity's operations. In the case of financial instruments, such disclosure includes:
- (a) The criteria applied in determining when to recognize a financial asset or financial liability on the statement of financial position and when to cease to recognize it;
 - (b) The basis of measurement applied to financial assets and financial liabilities both on initial recognition and subsequently; and
 - (c) The basis on which revenue and expense arising from financial assets and financial liabilities is recognized and measured.

60. Types of transactions for which it may be necessary to disclose the relevant accounting policies include:
- (a) Transfers of financial assets when there is a continuing interest in, or involvement with, the assets by the transferor, such as securitizations of financial assets, repurchase agreements and reverse repurchase agreements;
 - (b) Transfers of financial assets to a trust for the purpose of satisfying liabilities when they mature without the obligation of the transferor being discharged at the time of the transfer, such as an in-substance defeasance trust;
 - (c) Acquisition or issuance of separate financial instruments as part of a series of transactions designed to synthesize the effect of acquiring or issuing a single instrument;
 - (d) Acquisition or issuance of financial instruments as hedges of risk exposures, such as an interest rate swap to hedge a finance lease obligation; and
 - (e) Acquisition or issuance of monetary financial instruments bearing a stated interest rate that differs from the prevailing market rate at the date of issue, such as the issue of bonds by a central borrowing authority at a discount. (Refer to Illustrative Examples, paragraph IE26).
61. To provide adequate information for users of financial statements to understand the basis on which financial assets and financial liabilities have been measured, disclosures of accounting policies indicate not only whether cost, fair value or some other basis of measurement has been applied to a specific class of asset or liability but also the method of applying that basis. For example, for financial instruments carried on the cost basis, an entity may be required to disclose how it accounts for:
- (a) Costs of acquisition or issuance;
 - (b) Premiums and discounts on monetary financial assets and financial liabilities;
 - (c) Changes in the estimated amount of determinable future cash flows associated with a monetary financial instrument such as a bond indexed to a commodity price;
 - (d) Changes in circumstances that result in significant uncertainty about the timely collection of all contractual amounts due from monetary financial assets;
 - (e) Declines in the fair value of financial assets below their carrying amount; and
 - (f) Restructured financial liabilities.

For financial assets and financial liabilities carried at fair value, an entity indicates whether carrying amounts are determined from quoted market prices, independent appraisals, discounted cash flow analysis or another appropriate method, and discloses any significant assumptions made in applying those methods. (Refer to Illustrative Examples, paragraph IE27.)

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

Interest Rate Risk

63. **For each class of financial asset and financial liability, both recognized and unrecognized, an entity shall disclose information about its exposure to interest rate risk, including:**
- (a) **Contractual repricing or maturity dates, whichever dates are earlier; and**
 - (b) **Effective interest rates, when applicable.**
64. An entity provides information concerning its exposure to the effects of future changes in the prevailing level of interest rates. Changes in market interest rates have a direct effect on the contractually determined cash flows associated with some financial assets and financial liabilities (cash flow risk) and on the fair value of others (price risk).
65. Information about maturity dates, or repricing dates when they are earlier, indicates the length of time for which interest rates are fixed and information about effective interest rates indicates the levels at which they are fixed. Disclosure of this information provides financial statement users with a basis for evaluating the interest rate price risk to which an entity is exposed and thus the potential for gain or loss. For instruments that reprice to a market rate of interest before maturity, disclosure of the period until the next repricing is more important than disclosure of the period to maturity.
66. To supplement the information about contractual repricing and maturity dates, an entity may elect to disclose information about expected repricing or maturity dates when those dates differ significantly from the contractual dates. Such information may be particularly relevant when, for example, an entity is able to predict, with reasonable reliability, the amount of fixed rate mortgage loans that will be repaid prior to maturity and it uses this data as the basis for

managing its interest rate risk exposure. The additional information includes disclosure of the fact that it is based on management's expectations of future events and explains the assumptions made about repricing or maturity dates and how those assumptions differ from the contractual dates.

67. An entity indicates which of its financial assets and financial liabilities are:
- (a) Exposed to interest rate price risk, such as monetary financial assets and financial liabilities with a fixed interest rate;
 - (b) Exposed to interest rate cash flow risk, such as monetary financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and
 - (c) Not exposed to interest rate risk, such as some investments in equity securities.
68. The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The present value calculation applies the interest rate to the stream of future cash receipts or payments from the reporting date to the next repricing (maturity) date and to the expected carrying amount (principal amount) at that date. The rate is a historical rate for a fixed rate instrument carried at amortized cost and a current market rate for a floating rate instrument or an instrument carried at fair value. The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the instrument for that period.
69. The requirement in paragraph 63(b) applies to bonds, notes and similar monetary financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement does not apply to financial instruments such as non-monetary and derivative instruments that do not bear a determinable effective interest rate. For example, while instruments such as interest rate derivatives, including swaps, forward rate agreements and options, are exposed to price or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not relevant. However, when providing effective interest rate information, an entity discloses the effect on its interest rate risk exposure of hedging or conversion transactions such as interest rate swaps.
70. An entity may retain an exposure to the interest rate risks associated with financial assets removed from its statement of financial position as a result of a transaction such as a securitization. Similarly, it may become exposed to interest rate risks as a result of a transaction in which no financial asset or financial liability is recognized on its statement of financial position, such as a commitment to lend funds at a fixed interest rate, or loans to be provided to primary producers during times of drought or other disaster relief. In such circumstances, the entity discloses information that will permit financial

statement users to understand the nature and extent of its exposure. In the case of a securitization or similar transfer of financial assets, this information normally includes the nature of the assets transferred, their stated principal, interest rate and term to maturity, and the terms of the transaction giving rise to the retained exposure to interest rate risk. In the case of a commitment to lend funds, the disclosure normally includes the stated principal, interest rate and term to maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to risk.

71. The nature of an entity's operations and the extent of its activity in financial instruments will determine whether information about interest rate risk is presented in narrative form, in tables, or by using a combination of the two. When an entity has a significant number of financial instruments exposed to interest rate price or cash flow risks, it may adopt one or more of the following approaches to presenting information.
- (a) The carrying amounts of financial instruments exposed to interest rate price risk may be presented in tabular form, grouped by those that are contracted to mature or be repriced:
 - (i) Within one year of the reporting date;
 - (ii) More than one year and less than five years from the reporting date; and
 - (iii) Five years or more from the reporting date.
 - (b) When the performance of an entity is significantly affected by the level of its exposure to interest rate price risk or changes in that exposure, more detailed information is desirable. An entity such as a central borrowing authority may disclose, for example, separate groupings of the carrying amounts of financial instruments contracted to mature or be repriced:
 - (i) Within one month of the reporting date;
 - (ii) More than one and less than three months from the reporting date; and
 - (iii) More than three and less than twelve months from the reporting date.
 - (c) Similarly, an entity may indicate its exposure to interest rate cash flow risk through a table indicating the aggregate carrying amount of groups of floating rate financial assets and financial liabilities maturing within various future time periods.
 - (d) Interest rate information may be disclosed for individual financial instruments or weighted average rates or a range of rates may be presented for each class of financial instrument. An entity groups

instruments denominated in different currencies or having substantially different credit risks into separate classes when these factors result in instruments having substantially different effective interest rates.

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

Credit Risk

73. **For each class of financial asset, both recognized and unrecognized, an entity shall disclose information about its exposure to credit risk, including:**
- (e) **The amount that best represents its maximum credit risk exposure at the reporting date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and**
 - (f) **Significant concentrations of credit risk.**
74. An entity provides information relating to credit risk to permit users of its financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the reporting date. Such failures give rise to a financial loss recognized in an entity's statement of financial performance. Paragraph 73 does not require an entity to disclose an assessment of the probability of losses arising in the future.
75. The purposes of disclosing amounts exposed to credit risk without regard to potential recoveries from realization of collateral (an entity's maximum credit risk exposure) are:
- (g) To provide users of financial statements with a consistent measure of the amount exposed to credit risk for both recognized and unrecognized financial assets; and

- (h) To take into account the possibility that the maximum exposure to loss may differ from the carrying amount of a recognized financial asset or the fair value of an unrecognized financial asset that is otherwise disclosed in the financial statements.
76. In the case of recognized financial assets exposed to credit risk, the carrying amount of the assets in the statement of financial position, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the reporting date is normally the carrying amount since it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the statement of financial position is necessary. On the other hand, as illustrated by the examples in paragraphs 77 and 78, an entity's maximum potential loss from some recognized financial assets may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 73(a).
77. A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the statement of financial position net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 73. For example, when an entity is due to receive the proceeds from realization of a financial asset before settlement of a financial liability of equal or greater amount against which the entity has a legal right of set-off, the entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform financial statement users of the extent to which exposure to credit risk at a particular point in time has been reduced, the entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.
78. An entity may have entered into one or more master netting arrangements that serve to mitigate its exposure to credit loss but do not meet the criteria for offsetting. When a master netting arrangement significantly reduces the credit risk associated with financial assets not offset against financial liabilities with

the same counterparty, an entity provides additional information concerning the effect of the arrangement. Such disclosure indicates that:

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

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

79. When there is no credit risk associated with an unrecognized financial asset or the maximum exposure is equal to the principal, stated, face or other similar contractual amount of the instrument disclosed in accordance with paragraph 54 or the fair value disclosed in accordance with paragraph 84, no additional disclosure is required to comply with paragraph 73(a). However, with some unrecognized financial assets, the maximum loss that would be recognized upon default by the other party to the underlying instrument may differ substantially from the amounts disclosed in accordance with paragraphs 54 and 84. For example, an entity may have a right to mitigate the loss it would otherwise bear by setting off an unrecognized financial asset against an unrecognized financial liability. In such circumstances, paragraph 73(a) requires disclosure in addition to that provided in accordance with paragraphs 54 and 84.
80. Guaranteeing an obligation of another party exposes the guarantor to credit risk that would be taken into account in making the disclosures required by paragraph 73. This situation may arise as a result of, for example, a securitization transaction in which an entity remains exposed to credit risk associated with financial assets that have been removed from its statement of financial position. If the entity is obligated under recourse provisions of the transaction to indemnify the purchaser of the assets for credit losses, it discloses the nature of the assets removed from its statement of financial position, the amount and timing of the future cash flows contractually due from the assets, the terms of the recourse obligation and the maximum loss that could arise under that obligation. Similarly, where a local government guarantees the obligations of a private sector provider of public infrastructure, the maximum loss that could arise under that obligation in the event of default of the provider should be disclosed.
81. Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature and financial position of the entity and they result in a significant exposure to loss in the event of default by other parties. Identification of significant concentrations is a matter for the exercise of judgment by management taking into account the circumstances of the entity and its debtors.

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

Fair Value

84. **For each class of financial asset and financial liability, both recognized and unrecognized, an entity shall disclose information about fair value. When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability, that fact shall be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.**
85. Fair value information is widely used for financial purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements since, in many circumstances, it reflects the judgment of the financial markets as to the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. When an entity does not carry a financial asset or financial liability in its statement of financial position at fair value, it provides fair value information through supplementary disclosures.
86. The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods. Disclosure of fair value information

includes disclosure of the method adopted and any significant assumptions made in its application.

87. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, an entity takes its current circumstances into account in determining the fair values of its financial assets and financial liabilities. For example, the fair value of a financial asset that an entity has decided to sell for cash in the immediate future is determined by the amount that it expects to receive from such a sale. The amount of cash to be realized from an immediate sale will be affected by factors such as the current liquidity and depth of the market for the asset.
88. When a financial instrument is traded in an active and liquid market, its quoted market price provides the best evidence of fair value. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction may provide evidence of the current fair value provided that there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an entity has matching asset and liability positions, it may appropriately use mid-market prices as a basis for establishing fair values.
89. When there is infrequent activity in a market, the market is not well established (for example, some over the counter markets) or small volumes are traded relative to the number of trading units of a financial instrument to be valued, quoted market prices may not be indicative of the fair value of the instrument. In these circumstances, as well as when a quoted market price is not available, estimation techniques may be used to determine fair value with sufficient reliability to satisfy the requirements of this Standard. Techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. In applying discounted cash flow analysis, an entity uses a discount rate equal to the prevailing market rate of interest for financial instruments having substantially the same terms and characteristics, including the creditworthiness of the debtor, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.
90. The fair value to an entity of a financial asset or financial liability, whether determined from market value or otherwise, is determined without deduction for the costs that would be incurred to exchange or settle the underlying financial instrument. The costs may be relatively insignificant for instruments traded in organized, liquid markets but may be substantial for other instruments.

Transaction costs may include taxes and duties, fees and commissions paid to agents, advisers, brokers or dealers and levies by regulatory agencies or securities exchanges.

91. When an instrument is not traded in an organized financial market, it may not be appropriate for an entity to determine and disclose a single amount that represents an estimate of fair value. Instead, it may be more useful to disclose a range of amounts within which the fair value of a financial instrument is reasonably believed to lie.
92. When disclosure of fair value information is omitted because it is not practicable to determine fair value with sufficient reliability, information is provided to assist users of the financial statements in making their own judgments about the extent of possible differences between the carrying amount of financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for the omission and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 54 may provide sufficient information about the characteristics of the instrument. When it has a reasonable basis for doing so, management may indicate its opinion as to the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value.
93. The historical cost carrying amount of receivables and payables subject to normal trade credit terms usually approximates fair value. Similarly, the fair value of a deposit liability without a specified maturity is the amount payable on demand at the reporting date.
94. Fair value information relating to classes of financial assets or financial liabilities that are carried on the statement of financial position at other than fair value is provided in a way that permits comparison between the carrying amount and the fair value. Accordingly, the fair values of recognized financial assets and financial liabilities are grouped into classes and offset only to the extent that their related carrying amounts are offset. Fair values of unrecognized financial assets and financial liabilities are presented in a class or classes separate from recognized items and are offset only to the extent that they meet the offsetting criteria for recognized financial assets and financial liabilities.

Financial Assets Carried at an Amount in Excess of Fair Value

95. **When an entity carries one or more financial assets at an amount in excess of their fair value, the entity should disclose:**
 - (a) **The carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and**
 - (b) **The reasons for not reducing the carrying amount, including the**

nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.

96. Management exercises judgment in determining the amount it expects to recover from a financial asset and whether to write down the carrying amount of the asset when it is in excess of fair value. The information required by paragraph 95 provides users of financial statements with a basis for understanding management's exercise of judgment and assessing the possibility that circumstances may change and lead to a reduction in the asset's carrying amount in the future. When appropriate, the information required by paragraph 95(a) is grouped in a manner that reflects management's reasons for not reducing the carrying amount.
97. An entity's accounting policies with respect to recognition of declines in value of financial assets, disclosed in accordance with paragraph 54, assist in explaining why a particular financial asset is carried at an amount in excess of fair value. In addition, the entity provides the reasons and evidence specific to the asset that provide management with the basis for concluding that the asset's carrying amount will be recovered. For example, the fair value of a fixed rate loan intended to be held to maturity may have declined below its carrying amount as a result of an increase in interest rates. In such circumstances, the lender may not have reduced the carrying amount because there is no evidence to suggest that the borrower is likely to default.

Hedges of Anticipated Future Transactions

98. **When an entity has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:**
- (a) **A description of the anticipated transactions, including the period of time until they are expected to occur;**
 - (b) **A description of the hedging instruments; and**
 - (c) **The amount of any deferred or unrecognized gain or loss and the expected timing of recognition as revenue or expense.**
99. An entity's accounting policies indicate the circumstances in which a financial instrument is accounted for as a hedge and the nature of the special recognition and measurement treatment applied to the instrument. The information required by paragraph 98 permits the users of an entity's financial statements to understand the nature and effect of a hedge of an anticipated future transaction. The information may be provided on an aggregate basis when a hedged position comprises several anticipated transactions or has been hedged by several financial instruments.
100. The amount disclosed in accordance with paragraph 98(c) includes all accrued gains and losses on financial instruments designated as hedges of anticipated future transactions, without regard to whether those gains and losses have

been recognized in the financial statements. The accrued gain or loss may be unrealized but recorded in the entity's statement of financial position as a result of carrying the hedging instrument at fair value, it may be unrecognized if the hedging instrument is carried on the cost basis, or it may have been realized if the hedging instrument has been sold or settled. In each case, however, the accrued gain or loss on the hedging instrument has not been recognized in the entity's statement of financial performance pending completion of the hedged transaction.

Other Disclosures

101. Additional disclosures are encouraged when they are likely to enhance financial statement users' understanding of financial instruments. It may be desirable to disclose such information as:
- (a) The total amount of the change in the fair value of financial assets and financial liabilities that has been recognized as revenue or expense for the period;
 - (b) The total amount of deferred or unrecognized gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and
 - (c) The average aggregate carrying amount during the year of recognized financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognized financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the reporting date are unrepresentative of amounts on hand during the year.

Transitional Provision

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

Effective Date

103. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2003. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2003, it shall disclose that fact.**
104. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 15.

Requirements of IPSAS 15—Overview

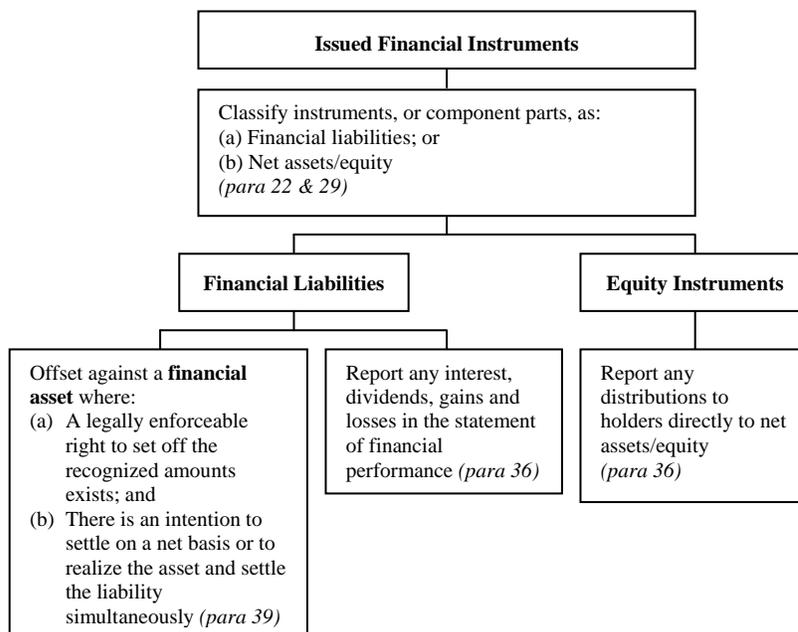
- IG1. All entities will need to review scope paragraphs 1–8 and consult the definition of a financial instrument and related commentary (paragraphs 9–21) to determine when the Standard is applicable and whether they hold financial instruments.
- IG2. The relevant paragraphs in the Standard for entities with only financial assets are paragraphs 48–101 (Disclosure).
- IG3. The relevant paragraphs in the Standard for entities with only financial liabilities are paragraphs 22–28 and 36–38 (Presentation), and paragraphs 48–72, 84–94 and 98–101 (Disclosure).
- IG4. The relevant paragraphs in the Standard for entities with only equity instruments are paragraphs 22–28 and 36–38 (Presentation), and paragraphs 50–62 and 98–101 (Disclosure).
- IG5. Where entities hold both financial assets and financial liabilities, additional relevant paragraphs are 39–47 (Presentation).
- IG6. Where entities hold both financial liabilities and net assets/equity, additional relevant paragraphs are 29–35 (Presentation).
- IG7. Comparative information is required for all instruments (see IPSAS 1, *Presentation of Financial Statements*, paragraphs 60–63) except, if not available, during the year of first adoption (paragraph 102).

Summary of Standard Applicability, Presentation and Disclosure Requirements

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

Scope

- IG8. This Standard applies to public sector entities reporting under the accrual basis of accounting. Government Business Enterprises (GBEs) are excluded from the scope of these IPSASs (paragraph 2), however, the *Preface to International Public Sector Accounting Standards* explains that GBEs apply with IFRSs. This IPSAS also exempts financial instruments of the types identified in paragraph 4 of the Standard from having to comply with the disclosure and presentation rules set out within the Standard. Commentary on these excluded financial instruments can be found in paragraphs 5–8.

Presentation: Issued Financial Instruments

- IG9. This Standard sets out the requirements for the presentation of financial instruments. Financial instruments can be classified as being financial assets, financial liabilities or equity instruments. These terms are defined in paragraph 9 of the Standard. Additional discussion clarifying these defined terms and what constitutes a financial instrument is located in commentary paragraphs 10–21. Examples of financial instruments covered by the Standard are included in Illustrative Examples, paragraphs IE3–IE16.

Classification

- IG10. The Standard requires that the issuer of a financial instrument classify the instrument, or its component parts, as a financial liability or as net assets/equity (paragraph 22). Commentary in paragraphs 23–28 provides users with guidance in distinguishing the nature of the instrument to facilitate consistency in classification across users. The Illustrative Examples, paragraphs IE18–IE21, provides examples of instruments which should be classified as liabilities or as net assets/equity.
- IG11. It is likely that few public sector entities will issue compound financial instruments (paragraph 30). The Standard requires that where such instruments are issued, the financial liability and net assets/equity components should be separately classified and disclosed (paragraph 29). Commentary paragraphs 31–33 and Illustrative Examples, paragraphs IE22

and IE23, discuss various instances where separate classification is necessary. Paragraphs 34 and 35 set out two methods by which preparers could assign a carrying amount to the various components, and Illustrative Examples, paragraph IE24 illustrates an example of how to assign values to the elements.

Interest, Dividends, Losses and Gains

IG12. The Standard sets out when such items should be classified as revenue or expense, or as a direct debit to net assets/equity (paragraph 36). Further guidance and clarifying comments made regarding these classifications is located within paragraphs 37 and 38.

Offsetting

IG13. The Standard prescribes when an entity should offset a financial asset and a financial liability in the statement of financial position (paragraph 39). Subsequent commentary includes an explanation of the difference between offsetting instruments and ceasing to recognize an instrument (paragraph 41), a discussion of the conditions necessary before an offset is allowable (paragraphs 42–45), and provides examples of situations where offsetting would not be allowable (paragraphs 46 and 47). Paragraph 40 provides an example of where instruments should be offset, noting that in other circumstances, separate presentation consistent with the instrument's characteristics as an asset or liability is appropriate. Illustrative Examples, paragraph IE25, notes that “synthetic instruments” with financial asset and financial liability components should not be offset unless they meet the criteria for offsetting detailed in paragraph 39.

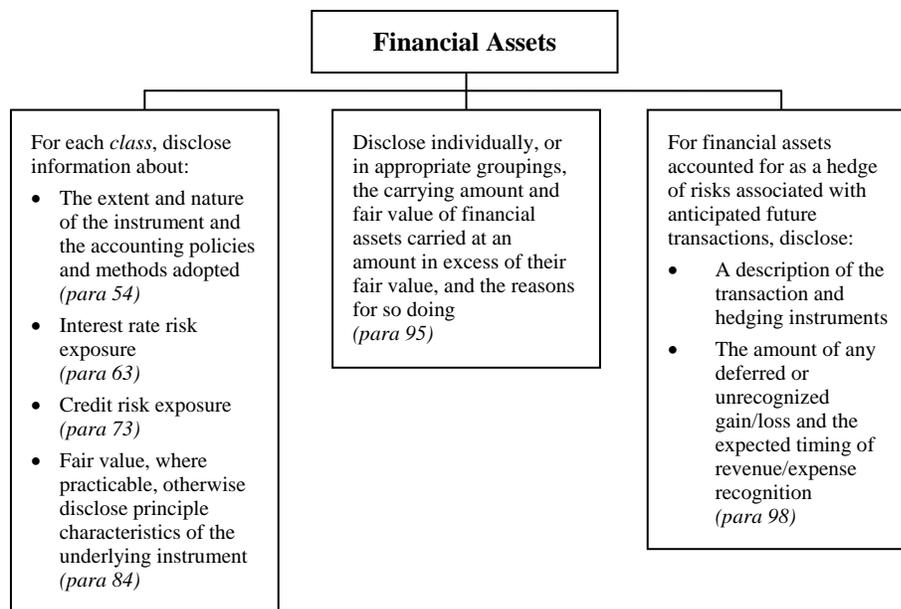
IG14. Further discussion pertaining to offsetting and disclosures warranted in those instances is located within paragraphs 77, 78 and 94 of the Standard.

Disclosure

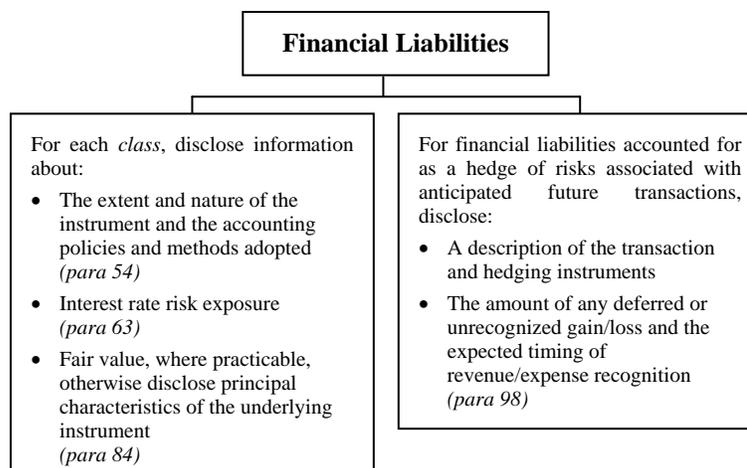
Risk Management Policies

The entity should describe its financial risk management objectives and policies (para 50).

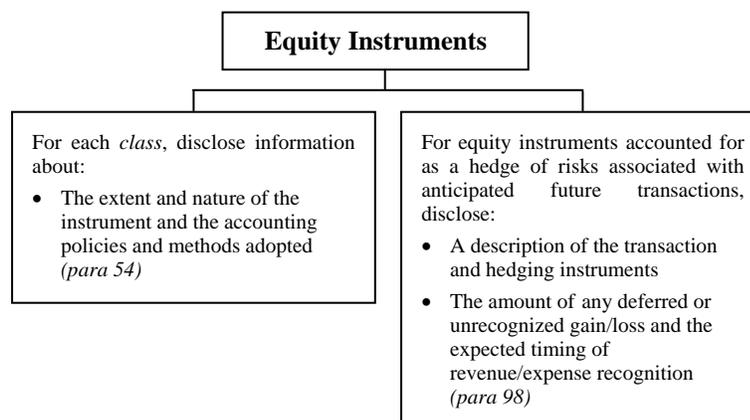
Financial Asset Disclosures



Financial Liability Disclosures



Equity Instrument Disclosures



IG15. A comprehensive example of the disclosures required of financial instruments under this Standard appears in Illustrative Examples, paragraph IE31.

Risk

IG16. A discussion on various forms of risk associated with financial instruments is located in paragraph 49 of the Standard. While the Standard requires disclosure of risk management objectives and policies (paragraph 50), the associated commentary paragraphs 51–53 indicate that aside from the specific inclusion required under paragraph 50, the format, location and level of detail is subject to management’s judgement.

Terms, Conditions and Accounting Policies

IG17. The Standard requires disclosure of the extent and nature of financial instruments, and the accounting policies and methods employed (paragraph 54). Commentary paragraphs 55–62, and Illustrative Examples, paragraphs IE26 and IE27, provide guidance on the types of information that may be appropriate and instances where disclosure of information is warranted.

Interest Rate Risk

IG18. The reasons for the disclosures about interest rate risk exposure required by paragraph 63 and guidance on the types of information that should be disclosed is located in commentary paragraphs 64–70. Guidance on the presentation of this information is presented in paragraphs 71 and 72.

Credit Risk

- IG19. The reasons for the disclosures about credit risk information for the financial assets of the entity are located at paragraph 74 and 75 of the Standard. Commentary paragraphs 76–83 provide readers with examples and discussion of instances where additional credit risk information is desirable or warranted.

Fair Value

- IG20. Paragraph 85 explains why the Standard requires the disclosure of fair value information. Discussion regarding the determination of a fair value amount is located at paragraphs 86–91, and at paragraph 93 of the Standard.
- IG21. Paragraph 84 of the Standard provides preparers with relief from having to disclose fair value information for each class of financial asset and financial liability where it is not practicable with regard to time or cost. Discussion regarding this relief, and the information to be disclosed is found in commentary paragraph 92.
- IG22. Where classes of financial assets or financial liabilities are carried at other than at their fair value, paragraph 94 notes that information should be provided in a manner that permits comparison between the carrying value and the fair value.

Financial Assets Carried at an Amount in Excess of Fair Value

- IG23. In some instances, management decides not to write down the carrying amount of financial assets to their fair value. Paragraph 95 requires certain disclosures to be made when this occurs. Paragraph 96 and 97 provide discussion of the issue.

Hedges of Anticipated Future Transactions

- IG24. Paragraph 98 requires certain disclosures to be made in respect of financial instruments used for hedging risks related to an anticipated future transaction. Paragraph 99 explains why these disclosures are important. It also explains when such information may be provided on an aggregate basis. Paragraph 100 clarifies the types of items that would be included within paragraph 98(c) pertaining to the disclosure of any deferred or unrecognized gain or loss.

Other Disclosure

- IG25. The Standard encourages preparers to disclose information that would be expected to enhance users' understanding of financial instruments. Examples of such disclosures are included in paragraph 101.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 15.

- IE1. This appendix explains and illustrates the application of certain aspects of the Standard to various common financial instruments. The detailed examples are illustrative only and do not necessarily represent the only basis for applying the Standard in the specific circumstances discussed. Changing one or two of the facts assumed in the examples can lead to substantially different conclusions concerning the appropriate presentation or disclosure of a particular financial instrument. This appendix does not discuss the application of all requirements of the Standard in the examples provided. In all cases, the provisions of the Standard prevail.
- IE2. The Standard does not deal with the recognition or measurement of financial instruments. Certain recognition and measurement practices may be assumed for purposes of illustration but they are not required.

Definitions

Common Types of Financial Instruments, Financial Assets and Financial Liabilities

- IE3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and reported in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability.
- IE4. 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).

- IE5. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in highly rated bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver bonds, not cash. The bonds are financial assets because they represent obligations of the issuer

to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

- IE6. Under IPSAS 13, a finance lease is accounted for as a sale with delayed payment terms. The lease contract is considered to be primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is considered to be primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is considered to be a financial instrument and an operating lease is considered not to be a financial instrument (except as regards individual payments currently due and payable).

Equity Instruments

- IE7. Equity instruments are not commonly issued by public sector entities except for partly-privatized GBEs. Examples of equity instruments include common shares, certain types of preferred shares, and warrants or options to subscribe for or purchase common shares in the issuing entity. An entity's obligation to issue its own equity instruments in exchange for financial assets of another party is not potentially unfavorable since it results in an increase in net assets/equity and cannot result in a loss to the entity. The possibility that existing holders of a net assets/equity interest in the entity may find the fair value of their interest reduced as a result of the obligation does not make the obligation unfavorable to the entity itself.
- IE8. An option or other similar instrument acquired by an entity that gives it the right to reacquire its own equity instruments is not a financial asset of the entity. The entity will not receive cash or any other financial asset through exercise of the option. Exercise of the option is not potentially favorable to the entity since it results in a reduction in net assets/equity and an outflow of assets. Any change in net assets/equity recorded by the entity from reacquiring and canceling its own equity instruments represents a transfer between those holders of equity instruments who have given up their net assets/equity interest and those who continue to hold a net assets/equity interest, rather than a gain or loss by the entity.

Derivative Financial Instruments

- IE9. On inception, derivative financial instruments give one party a contractual right to exchange financial assets with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets

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

- IE10. A put or call option to exchange financial instruments gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forego potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability respectively. The financial instrument underlying an option contract may be any financial asset, including shares and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would still constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the assets under potentially favorable conditions and the writer's obligation to exchange the assets under potentially unfavorable conditions are distinct from the underlying assets to be exchanged upon exercise of the option. The nature of the holder's right and the writer's obligation is not affected by the likelihood that the option will be exercised. An option to buy or sell an asset other than a financial asset (such as a commodity) does not give rise to a financial asset or financial liability because it does not fit the requirements of the definitions for the receipt or delivery of financial assets or exchange of financial instruments.
- IE11. Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver 1,000,000 cash in exchange for 1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver 1,000,000 face amount of fixed rate government bonds in exchange for 1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above 1,000,000, the conditions will be favorable to the purchaser and unfavorable to the seller; if the market price falls below 1,000,000, the effect will be the opposite. The purchaser has both a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). The significant

difference between a forward contract and an option contract is that 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.

- IE12. Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

Commodity Contracts and Commodity-linked Financial Instruments

- IE13. As indicated by paragraph 18 of the Standard, contracts that provide for settlement by receipt or delivery of a physical asset only (for example, an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardized in form and traded on organized markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be readily bought and sold for cash because it is listed 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.
- IE14. 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.
- IE15. Some contracts are commodity-linked but do not involve settlement through physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price but is settled only in cash. Such a contract constitutes a financial instrument.

- IE16. The definition of a financial instrument encompasses also a contract that gives rise to a non-financial asset or liability in addition to a financial asset or liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time based 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.
- IE17. Although the Standard was not developed to apply to commodity or other contracts that do not satisfy the definition of a financial instrument, entities may consider whether it is appropriate to apply the relevant portions of the disclosure standards to such contracts.

Liabilities and Net Assets/Equity

- IE18. Although it is not common for public sector entities to issue equity instruments, in the event that such instruments are issued, it is relatively easy for issuers to classify certain types of financial instruments as liabilities or net assets/equity. Examples of equity instruments include common (ordinary) shares and options that, if exercised, would require the writer of the option to issue common shares. Common shares do not oblige the issuer to transfer assets to shareholders, except when the issuer formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

“Perpetual” Debt Instruments

- IE19. “Perpetual” debt instruments, such as “perpetual” bonds, debentures and capital notes, normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of 1,000. Assuming 8% to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of 1,000. The holder and issuer of the instrument have a

financial asset and financial liability, respectively, of 1,000 and corresponding interest revenue and expense of 80 each year in perpetuity.

Preferred Shares

- IE20. Preferred (or preference) shares may be issued with various rights. In classifying a preferred share as a liability or net assets/equity, an entity assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preferred share that provides for redemption on a specific date or at the option of the holder meets the definition of a financial liability if the issuer has an obligation to transfer financial assets to the holder of the share. The inability of an issuer to satisfy an obligation to redeem a preferred share when contractually required to do so, whether due to a lack of funds or a statutory restriction, does not negate the obligation. An option of the issuer to redeem the shares does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. Redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.
- IE21. When preferred shares are non-redeemable, the appropriate classification is determined by the other rights that may attach to them. When distributions to holders of the preferred shares whether, cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments.

Compound Financial Instruments

- IE22. Paragraph 29 of the Standard applies only to a limited group of compound instruments for the purpose of having the issuers present liability and equity instrument components separately on their statements of financial position. Paragraph 29 does not deal with compound instruments from the perspective of holders.
- IE23. A common form of compound financial instrument is a debt security with an embedded conversion option, such as a bond convertible into common shares of the issuer. Paragraph 29 of the Standard requires the issuer of such a financial instrument to present the liability component and the equity instrument component separately on the statement of financial position from their initial recognition.
- (a) The issuer's obligation to make scheduled payments of interest and principal constitutes a financial liability which exists as long as the instrument is not converted. On inception, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied by the market at that time to instruments of comparable credit status and

providing substantially the same cash flows, on the same terms, but without the conversion option.

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

- IE24. Paragraph 34 of the Standard describes how the components of a compound financial instrument may be valued on initial recognition. The following example illustrates in greater detail how such valuations may be made.

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

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

Residual Valuation of Equity Instrument Component:

- IE25. Under this approach, the liability component is valued first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets/equity component. The present value of the liability component is calculated using a discount rate of 9%, the market interest rate for similar bonds having no conversion rights, as shown.

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

Option Pricing Model Valuation of Net Assets/Equity Component:

IE26. Option pricing models may be used to determine the fair value of conversion options directly rather than by deduction as illustrated above. Option pricing models are often used by financial institutions for pricing day-to-day transactions. There are a number of models available, of which the Black-Scholes model is one of the most well-known, and each has a number of variants. The following example illustrates the application of a version of the Black-Scholes model that utilizes tables available in finance textbooks and other sources. The steps in applying this version of the model are set out below.

IE27. This model first requires the calculation of two amounts that are used in the option valuation tables:

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

This amount relates to the potential for favorable (and unfavorable) changes in the price of the asset underlying the option, in this case the common shares of the entity issuing the convertible bonds. The volatility of the returns on the underlying asset are estimated by the standard deviation of the returns. The higher the standard deviation, the greater the fair value of the option. In this example, the standard deviation of the annual returns on the shares is assumed to be 30%. The time to expiry of the conversion rights is three years. The standard deviation of proportionate changes in fair value of the shares multiplied by the square root of the time to expiry of the option is thus determined as:

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

- (b) Ratio of the fair value of the asset underlying the option to the present value of the option exercise price.

This amount relates the present value of the asset underlying the option to the cost that the option holder must pay to obtain that asset, and is associated with the intrinsic value of the option. The higher this amount, the greater the fair value of a call option. In this example, the market value of each share on issuance of the bonds is 3. The present value of the expected dividends over the term of the option is deducted from the market price, since the payment of dividends reduces the fair value of the shares and thus the fair value of the option. The present

value of a dividend of 0.14 per share at the end of each year, discounted at the risk-free rate of 5%, is 0.3813. The present value of the asset underlying the option is therefore:

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

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

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

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

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

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

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

Offsetting of a Financial Asset and a Financial Liability

IE28. The Standard does not provide special treatment for so-called “synthetic instruments,” which are groupings of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the separate components of a “synthetic instrument” represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each component is exposed to risks that may differ from the risks to which other components are exposed. Accordingly, when one component of a “synthetic instrument” is an asset and another is a liability, they are not offset and presented on an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 39 of the Standard. Such is often not the case. Disclosures are provided about the significant terms and conditions of each financial instrument constituting a component of a “synthetic instrument” without regard to the existence of the “synthetic instrument.”

although an entity may indicate in addition the nature of the relationship between the components (see paragraph 58 of the Standard).

Disclosure

IE29. Paragraph 60 of the Standard lists examples of broad categories of matters that, when significant, an entity addresses in its disclosure of accounting policies. In each case, an entity has a choice from among two or more different accounting treatments. The following discussion elaborates on the examples in paragraph 60 and provides further examples of circumstances in which an entity discloses its accounting policies.

- (a) An entity may acquire or issue a financial instrument under which the obligations of each party are partially or completely unperformed (sometimes referred to as an unexecuted or executory contract). Such a financial instrument may involve a future exchange and performance may be conditional on a future event. For example, neither the right nor the obligation to make an exchange under a forward contract results in any transaction in the underlying financial instrument until the maturity of the contract but the right and obligation constitute a financial asset and a financial liability, respectively. Similarly, a financial guarantee does not require the guarantor to assume any obligation to the holder of the guaranteed debt until an event of default has occurred. The guarantee is, however, a financial liability of the guarantor because it is a contractual obligation to exchange one financial instrument (usually cash) for another (a receivable from the defaulted debtor) under conditions that are potentially unfavorable.
- (b) An entity may undertake a transaction that, in form, constitutes a direct acquisition or disposition of a financial instrument but does not involve the transfer of the economic interest in it. Such is the case with some types of repurchase and reverse repurchase agreements. Conversely, an entity may acquire or transfer to another party an economic interest in a financial instrument through a transaction that, in form, does not involve an acquisition or disposition of legal title. For example, in a non-recourse borrowing, an entity may pledge accounts receivable as collateral and agree to use receipts from the pledged accounts solely to service the loan.
- (c) An entity may undertake a partial or incomplete transfer of a financial asset. For example, in a securitization, an entity acquires or transfers to another party some, but not all, of the future economic benefits associated with a financial instrument.
- (d) An entity may be required, or intend, to link two or more individual financial instruments to provide specific assets to satisfy specific obligations. Such arrangements include, for example, “in substance”

defeasance trusts in which financial assets are set aside for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation, non-recourse secured financing and sinking fund arrangements.

- (e) An entity may use various risk management techniques to minimize exposures to financial risks. Such techniques include, for example, hedging, interest rate conversion from floating rate to fixed rate or fixed rate to floating rate, risk diversification, risk pooling, guarantees and various types of insurance (including sureties and “hold harmless” agreements). These techniques generally reduce the exposure to loss from only one of several different financial risks associated with a financial instrument and involve the assumption of additional but only partially offsetting risk exposures.
- (f) An entity may link two or more separate financial instruments together notionally in a “synthetic instrument” or for some purposes other than those described in items (d) and (e) above.
- (g) An entity may acquire or issue a financial instrument in a transaction in which the amount of the consideration exchanged for the instrument is uncertain. Such transactions may involve non-cash consideration or an exchange of several items.
- (h) An entity may acquire or issue a bond, promissory note or other monetary instrument with a stated amount or rate of interest that differs from the prevailing market interest rate applicable to the instrument. Such financial instruments include zero coupon bonds and loans made on apparently favorable terms but involving non-cash consideration, for example, low interest rate loans to employees.

IE30. Paragraph 61 of the Standard lists several issues that an entity addresses in its disclosure of accounting policies when the issues are significant to the application of the cost basis of measurement. In the case of uncertainty about the collectibility of amounts realizable from a monetary financial asset or a decline in the fair value of a financial asset below its carrying amount due to other causes, an entity indicates its policies for determining:

- (a) When to reduce the carrying amount of the asset;
- (b) The amount to which it reduces the carrying amount;
- (c) How to recognize any revenue from the asset; and
- (d) Whether the reduction in carrying amount may be reversed in the future if circumstances change.

Disclosure Requirements

IE31. The example illustrates an economic entity which includes a number of partly-privatized GBEs that have issued convertible notes and preference shares.

Note XI. Summary of Accounting Policies (Extract)

Trade Receivables

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

Investments

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

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

Borrowings

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

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

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

Derivative Financial Instruments

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

The net amount receivable or payable under interest rate swap agreements is progressively recognized over the period to settlement. The amount recognized is

accounted for as an adjustment to interest and finance charges during the period and included in other debtors or other creditors at each reporting date.

Note X2. Financial Risk Management

Financial Risk Factors

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

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

Interest Rate Risk

The entity's revenue and operating cash flows are substantially independent of changes in market interest rates. The entity has no significant interest-bearing assets. The entity's policy is to maintain approximately 80% of its borrowings in fixed rate instruments. At the year end 75% were at fixed rates. The entity sometimes borrows at variable rates and uses interest rate swaps as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps allow the entity to raise long-term borrowings at floating rates and swap them into fixed rates that are lower than those available if it borrowed at fixed rates directly. Under the interest rate swaps, the entity agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

Credit Risk

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

Liquidity Risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit

facilities and the ability to close out market positions. Treasury Corporation aims at maintaining flexibility in funding by keeping committed credit lines available.

Fair Value Estimation

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

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

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

Note X3. Financial Instruments

(i) Off-Balance-Sheet Derivative Instruments

The entity is party to derivative financial instruments in the normal course of its operations in order to hedge exposure to fluctuations in interest and foreign exchange rates.

Interest Rate Swap Contracts

Loans of the entity currently bear an average variable interest rate of 8.5%. It is policy to protect part of the loans from exposure to increasing interest rates. Accordingly, the entity has entered into interest rate swap contracts under which it is obliged to receive interest at variable rates and to pay interest at fixed rates. The contracts are settled on a net basis and the net amount receivable or payable at the reporting date is included in other debtors or other creditors.

The contracts require settlement of net interest receivable or payable each 90 days. The settlement dates coincide with the dates on which interest is payable on the underlying debt.

Swaps currently in place cover approximately 60% (20X1–40%) of the loan principal outstanding and are timed to expire as each loan repayment falls due. The fixed interest rates range between 7.8% and 8.3% (20X1–9.0% and 9.6%) and the

variable rates are between 0.5% and 1.0% above the 90 day bank bill rate which at the reporting date was 8.2% (20X1–9.4%).

At 30 June 20X2, the notional principal amounts and periods of expiry of the interest rate swap contracts are as follows:

	20X2	20X1
	\$'000	\$'000
Less than 1 year	30	20
1–2 years	250	170
2–3 years	250	170
3–4 years	300	80
4–5 years	180	–
	1,010	440

Forward Exchange Contracts

The passenger rail system is being substantially upgraded. New rolling stock is being purchased from Country A and Country B. In order to protect against exchange rate movements, the entity has entered into forward exchange contracts to purchase Foreign Currency A (FCA) and Foreign Currency B (FCB).

The contracts are timed to mature when major shipments of rolling stock are scheduled to arrive and cover anticipated purchases for the ensuing financial year.

At the reporting date, the details of outstanding contracts are:

Buy FC_A	Sell		Average exchange rate	
	Domestic	Currency		
	20X2	20X1	20X2	20X1
	\$'000	\$'000		
Maturity				
0–6 months	2,840	3,566	0.7042	0.7010
6–12 months	4,152	1,466	0.7225	0.6820
Buy FC_B	Sell		Average exchange rate	
	Domestic	Currency		
	20X2	20X1	20X2	20X1
	\$'000	\$'000		
Maturity				
0–6 months	4,527	2,319	0.6627	0.6467
6–12 months	–	1,262	–	0.6337

As these contracts are hedging anticipated future purchases, any unrealized gains and losses on the contracts, together with the cost of the contracts, are deferred and will

be recognized in the measurement of the underlying transaction. Included in the amounts deferred are any gains and losses on hedging contracts terminated prior to maturity where the related hedged transaction is still expected to occur.

(ii) Credit Risk Exposures

The credit risk on financial assets of the entity which have been recognized on the statement of financial position, other than investments in shares, is generally the carrying amount, net of any provisions for doubtful debts.

Bills of exchange and zero coupon bonds which have been purchased at a discount to face value, are carried on the statement of financial position at an amount less than the amount realizable at maturity. The total credit risk exposure of the entity could also be considered to include the difference between the carrying amount and the realizable amount.

The recognized financial assets of the consolidated entity include amounts receivable arising from unrealized gains on derivative financial instruments. For off-balance-sheet financial instruments, including derivatives, which are deliverable, credit risk also arises from the potential failure of counterparties to meet their obligations under the respective contracts at maturity. A material exposure arises from forward exchange contracts and the consolidated entity is exposed to loss in the event that counterparties fail to deliver the contracted amount. At the reporting date the following amounts are receivable (domestic currency equivalents):

	20X2	20X1
	\$'000	\$'000
Domestic Currency	2,073	1,422
Foreign Currency	11,599	8,613

(iii) Interest Rate Risk Exposures

The entity's exposure to interest rate risk and the effective weighted average interest rate by maturity periods is set out in the following table. For interest rates applicable to each class of asset or liability refer to individual notes to the financial statements [not shown here].

Exposures arise predominantly from assets and liabilities bearing variable interest rates as the entity intends to hold fixed rate assets and liabilities to maturity.

(iv) Net Fair Value of Financial Assets and Liabilities

On-balance-sheet

The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of the entity approximates their carrying amounts.

The net fair value of other monetary financial assets and financial liabilities is based upon market prices where a market exists or by discounting the expected future cash flows by the current interest rates for assets and liabilities with similar risk profiles.

Equity investments traded on organized markets have been valued by reference to market prices prevailing at the reporting date. For non-traded equity investments, the net fair value is an assessment by the Treasury Corporation based on the underlying net assets, future maintainable earnings and any special circumstances pertaining to a particular investment.

Off-balance-sheet

The entity has been indemnified against any losses which might be incurred in relation to shares in certain non-government corporations. The net fair value of the indemnity has been taken to be the difference between the carrying amount and the net fair value of the shares.

The call option granting an unrelated party an option to acquire the entity's interest Inter-Provincial Airlines is out-of-the money and the net fair value is immaterial.

Debentures which were the subject of an in-substance defeasance and for which the entity has guaranteed repayment have a net fair value equal to their face value.

The net fair value of financial assets or financial liabilities arising from interest rate swap agreements has been determined as the carrying amount, which represents the amount currently receivable or payable at the reporting date, and the present value of the estimated future cash flows which have not been recognized as an asset or liability.

For forward exchange contracts, the net fair value is taken to be the unrealized gain or loss at the reporting date calculated by reference to the current forward rates for contracts with similar maturity profiles.

The entity has potential financial liabilities which may arise from certain contingencies. No material losses are anticipated in respect of any of those contingencies and the net fair value disclosed below is the Ministry for Finance's estimate of amounts which would be payable by the entity as consideration for the assumption of those contingencies by another party.

The carrying amount and net fair values of financial assets and financial liabilities at the reporting date are:

	20X2		20X1	
	Carrying amount \$'000	Net fair value \$'000	Carrying amount \$'000	Net fair value \$'000
On-balance-sheet financial instruments				
Financial assets				
Cash	250	250	200	200
Deposits	3,952	3,952	2,881	2,881
Trade debtors	5,374	5,374	3,935	3,935
Bills of exchange	440	437	140	140
Loans to directors	147	121	136	107
Other debtors	424	425	124	124
Loans to related parties	800	800	200	200
Shares in other related parties	200	227	200	227
Shares in other corporations	100	100	200	190
Zero coupon bonds	60	58	–	–
Non-traded financial assets	11,747	11,744	8,016	8,004
Traded investments				
Shares in non-government corporations	1,100	900	100	60
Debentures	200	215	–	–
	13,047	12,859	8,116	8,064
Financial liabilities				
Trade creditors	2,405	2,405	1,762	1,762
Other creditors	740	740	650	650
Bank overdraft	2,350	2,350	2,250	2,250
Bank loans	530	537	900	898
Bills payable	250	241	130	130
Convertible notes	1,800	1,760	–	–
Redeemable preference shares	1,000	875	1,000	860
Other loans	430	433	150	150
Lease liabilities	575	570	650	643
Non-traded financial liabilities	10,080	9,911	7,492	7,343
Off-balance-sheet financial instruments	2,000	2,072	3,000	3,018
Financial assets	12,080	11,983	10,492	10,361

FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

Indemnity received	– ⁽ⁱ⁾	200	– ⁽ⁱ⁾	40
Forward exchange contracts	61⁽ⁱⁱ⁾	61	26	26
Interest rate swaps	2⁽ⁱⁱ⁾	13	1	2
	63	274	27	68
Financial liabilities				
Call options	–	–	–	–
Debentures defeased	–	1,000	–	–
Forward exchange contracts	607⁽ⁱⁱ⁾	402	304	231
Contingencies	–	25	–	30
	607	1,427	304	261

(i) Included in the carrying amount of traded investments above.

(ii) The carrying amounts are unrealized gains or losses which have been included in the on-balance-sheet financial assets and liabilities disclosed above.

Other than those classes of assets and liabilities denoted as “traded,” none of the classes of financial assets and liabilities are readily traded on organized markets in standardized form.

Although certain financial assets are carried at an amount above net fair value, the Governing Board has not caused those assets to be written down as it is intended to retain those assets to maturity.

Net fair value is exclusive of costs which would be incurred on realization of an asset, and inclusive of costs which would be incurred on settlement of a liability.

Comparison with IAS 32

IPSAS 15, *Financial Instruments: Disclosure and Presentation* is drawn primarily from IAS 32 (Revised 1998), *Financial Instruments: Disclosure and Presentation*. The main differences between IPSAS 15 and IAS 32 are as follows:

- IAS 32 was amended in October 2000 to eliminate disclosure requirements that became redundant as a result of Internal Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*. As yet, there is no IPSAS addressing the issue of the recognition and measurement of financial instruments. Consequently, the sections on Hedges of Anticipated Future Transactions and Other Disclosures have been retained in IPSAS 15.
- Commentary additional to that in IAS 32 has been included in IPSAS 15 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 15 uses different terminology, in certain instances, from IAS 32. The most significant examples are the use of the terms revenue, statement of financial performance, and net assets/equity (except for references to equity instruments) in IPSAS 15. The equivalent terms in IAS 32 are income, income statement, and equity.
- IPSAS 15 includes a definition of an insurance contract. Insurance contracts are only explained in commentary in IAS 32.
- IPSAS 15 includes implementation guidance to assist preparers of financial statements. IAS 32 does not include such guidance.
- IPSAS 15 includes an illustration of the disclosures required under the Standard. No example of disclosure requirements is included in IAS 32.