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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**January 2009, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Draft of Section 11B – Additional Financial Instruments Issues (Attachment B to Agenda Paper 12A)**

Section 11B
Additional Financial Instruments Issues

Overview

11B.1 Section 11 has two parts, Section 11A and Section 11B. Section 11A applies to basic **financial instruments** and will be relevant to all entities. Section 11B (this section) applies to other, more complex financial instruments. If an entity enters into only basic financial instrument transactions then this section will not be applicable. However, even entities with only basic financial instruments shall consider the scope of this section to ensure they are exempt.

Scope

11B.2 A financial instrument is a contract that gives rise to a **financial asset** of one entity and a **financial liability** or equity instrument of another entity.

11B.3 This section applies to all financial instruments except the following:

(a) those covered by Section 11A;

(b) interests in subsidiaries (covered by Section 9 *Consolidated and Separate Financial Statements*), associates (see Section 13 *Investments in Associates*) and joint ventures (see Section 14 *Investments in Joint Ventures*);

(c) employers' rights and obligations under employee benefit plans (see Section 27 *Employee Benefits*);

(d) rights under insurance contracts unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:

  (i) changes in the insured risk,

  (ii) changes in foreign exchange rates, or

  (iii) a default by one of the counterparties;

(e) financial instruments that meet the definition of an entity's own equity (see Sections 21 *Equity* and 25 *Share-based Payment*); and

(f) leases (see Section 19 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:

  (i) changes in the price of the leased asset,

  (ii) changes in foreign exchange rates, or

  (iii) a default by one of the counterparties.

11B.4 Most contracts to buy or sell a non-financial item such as a commodity, inventory, property, plant or equipment are excluded from this section because they are not financial instruments. However, this section applies to all contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties.

11B.5 In addition to the contracts described in paragraph 11B.4, this section applies to contracts to buy or sell non-financial items if the contract can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the following exception: contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements are not financial instruments for the purposes of this section.

Initial recognition of financial assets and liabilities

11B.6 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Initial measurement

11B.7 When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value, which is normally the transaction price.

Subsequent Measurement

11B.8 At each reporting date, an entity shall measure all financial instruments within the scope of Section 11B at fair value, without any deduction for transaction costs the entity may incur on sale or other disposal, and recognise changes in fair value in profit or loss, except as follows: equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment.

11B.9 If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, its fair value at the last date the instrument was reliably measurable is treated as the cost of the instrument. The entity shall measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.

Fair value

11B.10 An entity shall apply the guidance on fair value in paragraphs 11A.25 to 11A.31 to fair value measurements in accordance with this section as well as fair value measurements in accordance with Section 11A.

11B.11 The fair value of a financial liability that is due on demand is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

11B.12 An entity shall not include transaction costs in the initial measurement of financial assets and liabilities measured at fair value through profit or loss. If payment for the asset is deferred or is financed at a rate of interest that is not a market rate, the entity shall measure cost at the present value of the future payments discounted at a market rate of interest.

Impairment of financial instruments measured at cost or amortised cost

11B.13 An entity shall apply the guidance on impairment of a financial instrument measured at cost in paragraphs 11A.19 to 11A.24 to financial instruments measured at cost in accordance with this section.

Derecognition of a financial asset or financial liability

11B.14 An entity shall apply the derecognition requirements in paragraphs 11A.32 to 11A.40 to financial assets and financial liabilities to which this section applies.

Hedge accounting

11B.15 An entity may designate a hedging relationship between a **hedging instrument** and a **hedged item** in such a way as to qualify for hedge accounting. If specified criteria are met, hedge accounting permits the gain or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.

11B.16 To qualify for hedge accounting, an entity shall comply with all of the following conditions:

(a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.

(b) the hedged risk is one of the risks specified in paragraph 11B.17.

(c) the hedging instrument is as specified in paragraph 11B.18.

(d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

11B.17 This standard permits hedge accounting only for:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a firm commitment or a **highly probable forecast transaction**;

(c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

(d) foreign exchange risk in a net investment in a foreign operation.

11B.18 This standard permits hedge accounting only if the hedging instrument has all of following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 11B.19 that is designated as being the hedged risk.

(b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on).

(c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item.

(d) it has a specified maturity date not later than

(i) the maturity of the financial instrument being hedged,

(ii) the expected settlement of the commodity purchase commitment, or

(iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

Hedge of fixed interest rate risk of a recognised financial instrument or commodity price risk of a commodity held

11B.19 If the conditions in paragraph 11B.16 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:

(a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss; and

(b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.

11B.20 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

11B.21 The entity shall discontinue the hedge accounting specified in paragraph 11B.19 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 11B.16; or

(c) the entity revokes the designation.

11B.22 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged instrument.

Hedge of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation

11B.23 If the conditions in paragraph 11B.16 are met and the hedged risk is

(a) the variable interest rate risk in a debt instrument measured at amortised cost,

(b) the foreign exchange risk in a **firm commitment** or a highly probable forecast transaction,

(c) the commodity price risk in a firm commitment or highly probable forecast transaction, or

(d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise directly in equity the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows in profit or loss. The hedging relationship ends for (a), (b) and (c) when the hedged transaction occurs and for (d) when the net investment in the foreign operation is sold. The hedging gain or loss recognised in equity shall be reclassified to profit and loss when the hedged item is recognised in profit and loss.

11B.24 If the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost, the entity shall subsequently recognise the periodic net cash settlements from the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

11B.25 The entity shall discontinue the hedge accounting specified in paragraph 11B.24 or 11B.25 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the criteria for hedge accounting in paragraph 11B.16;

(c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or

(d) the entity revokes the designation.

If the forecast transaction is no longer expected to take place or if the hedged debt instrument measured at amortised cost is derecognised, any gain or loss on the hedging instrument that was recognised directly in equity shall be removed from equity and recognised in profit or loss.

Disclosure

11B.26 An entity applying this section shall make all of the disclosures required in Section 11A incorporating in those disclosures financial instruments that are within the scope of this section as well as those within in the scope of Section A. In addition, if the entity uses hedge accounting, it shall make the additional disclosures in paragraphs 11B.27-11B.29 below).

11B.27 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 11B.17:

(a) a description of the hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and

(c) the nature of the risks being hedged, including a description of the hedged item.

11B.28 For a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 11B.19–11B.22) it shall disclose:

(a) the amount of the change in fair value of the hedging instrument recognised in profit or loss and

(b) the amount of the change in fair value of the hedged item recognised in profit or loss.

11B.29 If For a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 11B.23–11B.25) it shall disclose:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

(c) the amount of the change in fair value of the hedging instrument that was recognised in equity during the period (paragraph 11B.23);

(d) the amount that was removed from equity and recognised in profit or loss for the period, showing the amount included in each line item in the income statement (paragraphs 11B.24 and 11B.25).