International Accounting Standard 39

Financial Instruments: Recognition and Measurement

This version includes amendments resulting from IFRSs issued up to 31 December 2008.

IAS 39 *Financial Instruments: Recognition and Measurement* was issued by the International Accounting Standards Committee (IASC) in March 1999. In November 2000 IASC issued five limited revisions to IAS 39.

In March 2000 IASC approved an approach to publishing implementation guidance on IAS 39 in the form of Questions and Answers. Subsequently the IAS 39 Implementation Guidance Committee (IGC), which was established by IASC for that purpose, published a series of Questions and Answers on IAS 39. The guidance was not considered by IASC and did not necessarily represent its views.

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In June 2003, the IASB made a limited amendment to IAS 39 when it issued IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

In December 2003 the IASB issued a revised IAS 39, accompanied by Implementation Guidance replacing that published by the former IGC.

Since 2003, the IASB has issued the following amendments to IAS 39:

- *Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk* (issued March 2004)
- *Transition and Initial Recognition of Financial Assets and Financial Liabilities* (issued December 2004)
- *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (issued April 2005)
- *The Fair Value Option* (issued June 2005)
- *Financial Guarantee Contracts* (issued August 2005)
- *Eligible Hedged Items* (issued July 2008)*
- *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7) (issued October 2008)†
- *Reclassification of Financial Assets—Effective Date and Transition* (Amendments to IAS 39 and IFRS 7) (issued November 2008).†

* effective date 1 July 2009

† effective date 1 July 2008

IAS 39 and its accompanying documents have also been amended by the following IFRSs:

- IFRS 2 *Share-based Payment* (issued February 2004)
- IFRS 3 *Business Combinations* (issued March 2004)
- IFRS 4 *Insurance Contracts* (issued March 2004)
- IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (issued December 2004)
- IFRS 7 *Financial Instruments: Disclosures* (issued August 2005)
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007)*
- IFRS 3 *Business Combinations* (as revised in January 2008)†
- IAS 27 *Consolidated and Separate Financial Statements* (as amended in January 2008)†
- *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1) (issued February 2008)*
- *Improvements to IFRSs* (issued May 2008).*

As well as IFRIC 5, the following Interpretations refer to IAS 39:

- SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (issued December 2001; the Basis for Conclusions has subsequently been amended)
- IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* (issued November 2004)
- IFRIC 9 *Reassessment of Embedded Derivatives* (issued March 2006)
- IFRIC 10 *Interim Financial Reporting and Impairment* (issued July 2006)
- IFRIC 12 *Service Concession Arrangements* (issued November 2006 and subsequently amended)
- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (issued July 2008).§

* effective date 1 January 2009

† effective date 1 July 2009

§ effective date 1 October 2008

CONTENTS

International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39) is set out in paragraphs 1–110 and Appendices A and B. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 39 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for revising IAS 39

IN1 International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39) replaces IAS 39 *Financial Instruments: Recognition and Measurement* (revised in 2000) and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is permitted. Implementation Guidance accompanying this revised IAS 39 replaces the Questions and Answers published by the former Implementation Guidance Committee (IGC).

IN2 The International Accounting Standards Board has developed this revised IAS 39 as part of its project to improve IAS 32 *Financial Instruments: Disclosure and Presentation*[*] and IAS 39. The objective of this project was to reduce complexity by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the Standard elements of Standing Interpretations Committee (SIC) Interpretations and Questions and Answers published by the IGC.

IN3 For IAS 39, the Board's main objective was a limited revision to provide additional guidance on selected matters such as derecognition, when financial assets and financial liabilities may be measured at fair value, how to assess impairment, how to determine fair value and some aspects of hedge accounting. The Board did not reconsider the fundamental approach to the accounting for financial instruments contained in IAS 39.

The main changes

IN4 The main changes from the previous version of IAS 39 are described below.

Scope

IN5 A scope exclusion has been made for loan commitments that are not designated as at fair value through profit or loss, cannot be settled net, and do not involve a loan at a below-market interest rate. A commitment to provide a loan at a below-market interest rate is initially recognised at fair value, and subsequently measured at the higher of (a) the amount that would be recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

IN6 The scope of the Standard includes financial guarantee contracts issued. However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 4 *Insurance Contracts* to such financial guarantee contracts. Under this Standard, a financial guarantee contract is initially recognised at fair value and is subsequently measured at the higher of (a) the amount determined

[*] In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

in accordance with IAS 37 and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18. Different requirements apply for the subsequent measurement of financial guarantee contracts that prevent derecognition of financial assets or result in continuing involvement. Financial guarantee contracts held are not within the scope of the Standard because they are insurance contracts and are therefore outside the scope of the Standard because of the general scope exclusion for such contracts.

IN7 The Standard continues to require that a contract to buy or sell a non-financial item is within the scope of IAS 39 if it can be settled net in cash or another financial instrument, unless it is entered into and continues to be held for the purpose of receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, the Standard clarifies that there are various ways in which a contract to buy or sell a non-financial asset can be settled net. These include: when the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments; when the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and when the non-financial item that is the subject of the contract is readily convertible to cash. The Standard also clarifies that a written option that can be settled net in cash or another financial instrument, or by exchanging financial instruments, is within the scope of the Standard.

Definitions

IN8 The Standard amends the definition of 'originated loans and receivables' to become 'loans and receivables'. Under the revised definition, an entity is permitted to classify as loans and receivables purchased loans that are not quoted in an active market.

Reclassifications

IN8A An amendment to the Standard, issued in October 2008, permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. A further amendment, issued in November 2008, clarified the effective date and transition requirements of that earlier amendment.

Derecognition of a financial asset

IN9 Under the original IAS 39, several concepts governed when a financial asset should be derecognised. Although the revised Standard retains the two main concepts of *risks and rewards* and *control*, it clarifies that the evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for all derecognition transactions.

IN10 Under the Standard, an entity determines what asset is to be considered for derecognition. The Standard requires a part of a larger financial asset to be considered for derecognition if, and only if, the part is one of:

(a) specifically identified cash flows from a financial asset; or

(b) a fully proportionate (pro rata) share of the cash flows from a financial asset; or

(c) a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset.

In all other cases, the Standard requires the financial asset to be considered for derecognition in its entirety.

IN11 The Standard introduces the notion of a 'transfer' of a financial asset. A financial asset is derecognised when (a) an entity has transferred a financial asset and (b) the transfer qualifies for derecognition.

IN12 The Standard states that an entity has transferred a financial asset if, and only if, it either:

(a) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay those cash flows to one or more recipients in an arrangement that meets three specified conditions; or

(b) transfers the contractual rights to receive the cash flows of a financial asset.

IN13 Under the Standard, if an entity has transferred a financial asset, it assesses whether it has transferred substantially all the risks and rewards of ownership of the transferred asset. If an entity has retained substantially all such risks and rewards, it continues to recognise the transferred asset. If it has transferred substantially all such risks and rewards, it derecognises the transferred asset.

IN14 The Standard specifies that if an entity has neither transferred nor retained substantially all the risks and rewards of ownership of the transferred asset, it assesses whether it has retained control over the transferred asset. If it has retained control, the entity continues to recognise the transferred asset to the extent of its continuing involvement in the transferred asset. If it has not retained control, the entity derecognises the transferred asset.

IN15 The Standard provides guidance on how to apply the concepts of risks and rewards and of control.

Measurement: fair value option

IN16 An amendment to the Standard, issued in June 2005, permits an entity to designate a financial asset or financial liability (or a group of financial assets, financial liabilities or both) on initial recognition as one(s) to be measured at fair value, with changes in fair value recognised in profit or loss. To impose discipline on this categorisation, an entity is precluded from reclassifying financial instruments into or out of this category. The fair value option that was available in IAS 39 (as revised in 2003) permitted an entity to designate any financial asset or financial liability on initial recognition as one to be measured at fair value, with changes in fair value recognised in profit or loss.

IN17 The option previously contained in IAS 39 (as revised in 2000) to recognise in profit or loss gains and losses on available-for-sale financial assets has been eliminated. Such an option is no longer necessary because under the amendments made to IAS 39 in December 2003 and June 2005, an entity is permitted by designation to measure a financial asset or financial liability at fair value with gains and losses recognised in profit or loss.

How to determine fair value

IN18 The Standard provides the following additional guidance about how to determine fair values using valuation techniques.

- The objective is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.
- A valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments.
- In applying valuation techniques, an entity uses estimates and assumptions that are consistent with available information about the estimates and assumptions that market participants would use in setting a price for the financial instrument.
- The best estimate of fair value at initial recognition of a financial instrument that is not quoted in an active market is the transaction price unless the fair value of the instrument is evidenced by other observable market transactions or is based on a valuation technique whose variables include only data from observable markets.

IN19 The Standard also clarifies that the fair value of a liability with a demand feature, eg a demand deposit, is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Impairment of financial assets

IN20 The Standard clarifies that an impairment loss is recognised only when it has been incurred. It also provides additional guidance on what events provide objective evidence of impairment for investments in equity instruments.

IN21 The Standard provides additional guidance about how to evaluate impairment that is inherent in a group of loans, receivables or held-to-maturity investments, but cannot yet be identified with any individual financial asset in the group, as follows:

- An asset that is individually assessed for impairment and found to be impaired should not be included in a group of assets that are collectively assessed for impairment.
- An asset that has been individually assessed for impairment and found *not* to be individually impaired should be included in a collective assessment of impairment. The occurrence of an event or a combination of events should not be a precondition for including an asset in a group of assets that are collectively evaluated for impairment.

- When performing a collective assessment of impairment, an entity groups assets by similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms.
- Contractual cash flows and historical loss experience provide the basis for estimating expected cash flows. Historical loss rates are adjusted on the basis of relevant observable data that reflect current economic conditions.
- The methodology for measuring impairment should ensure that an impairment loss is not recognised on the initial recognition of an asset.

IN22 The Standard requires that impairment losses on available-for-sale equity instruments cannot be reversed through profit or loss, ie any subsequent increase in fair value is recognised in other comprehensive income.

Hedge accounting

IN23 Hedges of firm commitments are now treated as fair value hedges rather than cash flow hedges. However, the Standard clarifies that a hedge of the foreign currency risk of a firm commitment can be treated as either a cash flow hedge or a fair value hedge.

IN24 The Standard requires that when a hedged forecast transaction occurs and results in the recognition of a *financial* asset or a *financial* liability, the gain or loss recognised in other comprehensive income does not adjust the initial carrying amount of the asset or liability (ie basis adjustment is prohibited), but remains in equity and is reclassified from equity to profit or loss consistently with the recognition of gains and losses on the asset or liability as a reclassification adjustment. For hedges of forecast transactions that result in the recognition of a *non-financial* asset or a *non-financial* liability, the entity has a choice of whether to apply basis adjustment or retain the hedging gain or loss in equity and reclassify it from equity to profit or loss when the asset or liability affects profit or loss as a reclassification adjustment.

IN24A This Standard permits fair value hedge accounting to be used more readily for a portfolio hedge of interest rate risk than previous versions of IAS 39. In particular, for such a hedge, it allows:

(a) the hedged item to be designated as an amount of a currency (eg an amount of dollars, euro, pounds or rand) rather than as individual assets (or liabilities).

(b) the gain or loss attributable to the hedged item to be presented either:

  (i) in a single separate line item within assets, for those repricing time periods for which the hedged item is an asset; or

  (ii) in a single separate line item within liabilities, for those repricing time periods for which the hedged item is a liability.

(c) prepayment risk to be incorporated by scheduling prepayable items into repricing time periods based on expected, rather than contractual, repricing dates. However, when the portion hedged is based on expected repricing dates, the effect that changes in the hedged interest rate have on those expected repricing dates are included when determining the change in the fair value of the hedged item. Consequently, if a portfolio that contains prepayable items is hedged with a non-prepayable derivative, ineffectiveness arises if the dates on which items in the hedged portfolio are expected to prepay are revised, or actual prepayment dates differ from those expected.

IN24B In July 2008 the Board amended the Standard, by *Eligible Hedged Items*, to clarify how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations.

Disclosure

IN25 The disclosure requirements previously in IAS 39 have been moved to IAS 32.*

Amendments to and withdrawal of other pronouncements

IN26 As a consequence of the revisions to this Standard, the Implementation Guidance developed by IASC's IAS 39 Implementation Guidance Committee is superseded by this Standard and its accompanying Implementation Guidance.

Potential impact of proposals in exposure drafts

IN27 [Deleted]

* In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

International Accounting Standard 39
Financial Instruments: Recognition and Measurement

Objective

1 The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in IAS 32 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in IFRS 7 *Financial Instruments: Disclosures*.

Scope

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

(a) those interests in subsidiaries, associates and joint ventures that are accounted for under IAS 27 *Consolidated and Separate Financial Statements,* IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures.* However, entities shall apply this Standard to an interest in a subsidiary, associate or joint venture that according to IAS 27, IAS 28 or IAS 31 is accounted for under this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in IAS 32.

(b) rights and obligations under leases to which IAS 17 *Leases* applies. However:

(i) lease receivables recognised by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 15–37, 58, 59, 63–65 and Appendix A paragraphs AG36–AG52 and AG84–AG93);

(ii) finance lease payables recognised by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 39–42 and Appendix A paragraphs AG57–AG63); and

(iii) derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 10–13 and Appendix A paragraphs AG27–AG33).

(c) employers' rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits* applies.

(d) financial instruments issued by the entity that meet the definition of an equity instrument in IAS 32 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.

(e) **rights and obligations arising under (i) an insurance contract as defined in IFRS 4 *Insurance Contracts*, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 9, or (ii) a contract that is within the scope of IFRS 4 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in a contract within the scope of IFRS 4 if the derivative is not itself a contract within the scope of IFRS 4 (see paragraphs 10–13 and Appendix A paragraphs AG27–AG33 of this Standard). Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 4 to such financial guarantee contracts (see paragraphs AG4 and AG4A). The issuer may make that election contract by contract, but the election for each contract is irrevocable.**

(f) [deleted]

(g) **contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date.**

(h) **loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 15–42 and Appendix A paragraphs AG36–AG63).**

(i) **financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies, except for contracts within the scope of paragraphs 5–7 of this Standard, to which this Standard applies.**

(j) **rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognises as a provision in accordance with IAS 37, or for which, in an earlier period, it recognised a provision in accordance with IAS 37.**

3 [Deleted]

4 The following loan commitments are within the scope of this Standard:

(a) **loan commitments that the entity designates as financial liabilities at fair value through profit or loss. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**

(b) **loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).**

(c) **commitments to provide a loan at a below-market interest rate. Paragraph 47(d) specifies the subsequent measurement of liabilities arising from these loan commitments.**

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

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

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

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

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

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

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 5 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements and, accordingly, whether they are within the scope of this Standard.

7 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 6(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions

8 The terms defined in IAS 32 are used in this Standard with the meanings specified in paragraph 11 of IAS 32. IAS 32 defines the following terms:

- financial instrument
- financial asset
- financial liability
- equity instrument

and provides guidance on applying those definitions.

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

Definition of a derivative

A *derivative* **is a financial instrument or other contract within the scope of this Standard (see paragraphs 2–7) with all three of the following characteristics:**

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(c) it is settled at a future date.

Definitions of four categories of financial instruments

A *financial asset or financial liability at fair value through profit or loss* **is a financial asset or financial liability that meets either of the following conditions.**

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:

(i) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

(ii) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

(iii) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either

(i) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or

(ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures* (as revised in 2003)), for example the entity's board of directors and chief executive officer.

In IFRS 7, paragraphs 9–11 and B4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions. For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.

It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69–AG82, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

Held-to-maturity investments **are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG16–AG25) other than:**

(a) those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity designates as available for sale; and

(c) those that meet the definition of loans and receivables.

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

(i) are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;

(ii) **occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or**

(iii) **are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.**

Loans and receivables **are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:**

(a) **those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;**

(b) **those that the entity upon initial recognition designates as available for sale; or**

(c) **those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.**

An interest acquired in a pool of assets that are not loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable.

Available-for-sale financial assets **are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.**

Definition of a financial guarantee contract

A *financial guarantee contract* **is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.**

Definitions relating to recognition and measurement

The *amortised cost of a financial asset or financial liability* **is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.**

The *effective interest method* **is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options)**

but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see IAS 18 *Revenue*), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Derecognition **is the removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.**

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

A *regular way purchase or sale* **is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.**

Transaction costs **are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see Appendix A paragraph AG13). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.**

Definitions relating to hedge accounting

A *firm commitment* **is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.**

A *forecast transaction* **is an uncommitted but anticipated future transaction.**

A *hedging instrument* **is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (paragraphs 72–77 and Appendix A paragraphs AG94–AG97 elaborate on the definition of a hedging instrument).**

A *hedged item* **is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged (paragraphs 78–84 and Appendix A paragraphs AG98–AG101 elaborate on the definition of hedged items).**

Hedge effectiveness **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 (see Appendix A paragraphs AG105–AG113).**

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* Paragraphs 48–49 and AG69–AG82 of Appendix A contain requirements for determining the fair value of a financial asset or financial liability.

Embedded derivatives

10 An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

11 An embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract (see Appendix A paragraphs AG30 and AG33);

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).

If an embedded derivative is separated, the host contract shall be accounted for under this Standard if it is a financial instrument, and in accordance with other appropriate Standards if it is not a financial instrument. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.

11A Notwithstanding paragraph 11, if a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:

(a) the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or

(b) it is clear with little or no analysis when a similar hybrid (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

12 If an entity is required by this Standard to separate an embedded derivative from its host contract, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid (combined) contract as at fair value through profit or loss.