

**Financial Instruments:
Presentation
Illustrative Examples**

This Guidance is applicable for annual reporting period beginning on
1 January 2021.

CONTENTS

	<i>from paragraph</i>
ACCOUNTING FOR CONTRACTS ON EQUITY INSTRUMENTS OF AN ENTITY	IE1
Example 1: Forward to buy shares	IE2
Example 2: Forward to sell shares	IE7
Example 3: Purchased call option on shares	IE12
Example 4: Written call option on shares	IE17
Example 5: Purchased put option on shares	IE22
Example 6: Written put option on shares	IE27
ENTITIES SUCH AS MUTUAL FUNDS AND CO-OPERATIVES WHOSE SHARE CAPITAL IS NOT EQUITY AS DEFINED IN SB-FRS 32	IE32
Example 7: Entities with no equity	IE32
Example 8: Entities with some equity	IE33
ACCOUNTING FOR COMPOUND FINANCIAL INSTRUMENTS	IE34
Example 9: Separation of a compound financial instrument on initial recognition	IE34
Example 10: Separation of a compound financial instrument with multiple embedded derivative features	IE37
Example 11: Repurchase of a convertible instrument	IE39
Example 12: Amendment of the terms of a convertible instrument to induce early conversion	IE47

Illustrative examples

These examples accompany, but are not part of, SB-FRS 32.

Accounting for contracts on equity instruments of an entity

IE1 The following examples¹ illustrate the application of paragraphs 15–27 and SB-FRS 109 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

Example 1: Forward to buy shares

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

Assumptions:

Contract date	1 February 20X2
Maturity date	31 January 20X3
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU110
Market price per share on 31 January 20X3	CU106
Fixed forward price to be paid on 31 January 20X3	CU104
Present value of forward price on 1 February 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 20X2	CU0
Fair value of forward on 31 December 20X2	CU6,300
Fair value of forward on 31 January 20X3	CU2,000

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

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

On 1 February 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for a

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

payment of CU104,000 in cash (ie CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the forward contract on 1 February 20X2 is zero.

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

31 December 20X2

On 31 December 20X2, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr	Forward asset	CU6,300	
Cr	Gain		CU6,300

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

31 January 20X3

On 31 January 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ($[\text{CU}106 \times 1,000] - \text{CU}104,000$).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU}106 \times 1,000$) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr	Loss	CU4,300	
Cr	Forward asset		CU4,300

To record the decrease in the fair value of the forward contract (ie $\text{CU}4,300 = \text{CU}6,300 - \text{CU}2,000$).

Dr	Cash	CU2,000	
Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

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

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

31 January 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($\text{CU}104 \times 1,000$) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU}106 \times 1,000$) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 ($\text{CU}106,000 - \text{CU}104,000$) worth of shares to Entity A, ie 18.9 shares ($\text{CU}2,000/\text{CU}106$).

Dr	Equity	CU2,000	
Cr	Forward asset		CU2,000

To record the settlement of the forward contract.

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

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

1 February 20X2

Dr	Equity	CU100,000	
Cr	Liability		CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see SB-FRS 109, paragraph B5.1.1).

31 December 20X2

Dr	Interest expense	CU3,660	
Cr	Liability		CU3,660

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

31 January 20X3

Dr	Interest expense	CU340	
Cr	Liability		CU340

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

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

Dr	Liability	CU104,000	
Cr	Cash		CU104,000

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

(d) Settlement options

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

Example 2: Forward to sell shares

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

Assumptions:

Contract date	1 February 20X2
Maturity date	31 January 20X3
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU110
Market price per share on 31 January 20X3	CU106
Fixed forward price to be paid on 31 January 20X3	CU104
Present value of forward price on 1 February 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 20X2	CU0
Fair value of forward on 31 December 20X2	(CU6,300)
Fair value of forward on 31 January 20X3	(CU2,000)

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

IE8 On 1 February 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for CU104,000 in cash (ie CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 20X2

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

31 December 20X2

Dr	Loss	CU6,300	
Cr	Forward liability		CU6,300

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

31 January 20X3

Dr	Forward liability	CU4,300	
Cr	Gain		CU4,300

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

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

Dr	Forward liability	CU2,000	
Cr	Cash		CU2,000

To record the settlement of the forward contract.

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

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

31 January 20X3

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

Dr	Forward liability	CU2,000	
Cr	Equity		CU2,000

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

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

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

1 February 20X2

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

31 December 20X2

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

31 January 20X3

On 31 January 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

Dr	Cash	CU104,000	
Cr	Equity		CU104,000

To record the settlement of the forward contract.

(d) Settlement options

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

Example 3: Purchased call option on shares

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

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

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

IE13 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 20X3 in exchange for CU102,000 in cash (ie CU102 per share) on 31 January 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the option contract on 1 February 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

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

To recognise the purchased call option.

31 December 20X2

On 31 December 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ($[\text{CU}104 - \text{CU}102] \times 1,000$), and CU1,000 is the remaining time value.

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

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

31 January 20X3

On 31 January 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ($[\text{CU}104 - \text{CU}102] \times 1,000$) because no time value remains.

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

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

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver CU104,000 ($\text{CU}104 \times 1,000$) to Entity A in exchange for CU102,000 ($\text{CU}102 \times 1,000$) from Entity A, so Entity A receives a net amount of CU2,000.

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

To record the settlement of the option contract.

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

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

31 January 20X3

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver CU104,000 ($\text{CU}104 \times 1,000$) worth of Entity A's shares to Entity A in exchange for CU102,000 ($\text{CU}102 \times 1,000$) worth of Entity A's shares. Thus, Entity B delivers the net amount of CU2,000 worth of shares to Entity A, ie 19.2 shares ($\text{CU}2,000/\text{CU}104$).

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

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

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

- IE15 Assume the same facts as in (a) except that settlement will be made by receiving a fixed number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity A has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 ($\text{CU}102 \times 1,000$) in cash, if Entity A exercises its option. Entity A records the following journal entries.

1 February 20X2

Dr	Equity	CU5,000	
Cr	Cash		CU5,000

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

31 December 20X2

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

31 January 20X3

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

Dr	Equity	CU102,000	
Cr	Cash		CU102,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 4: Written call option on shares

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

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

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

IE18 Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on 1 February 20X2 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 20X3 in exchange for CU102,000 in cash (ie CU102 per share) on 31 January 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

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

To recognise the written call option.

31 December 20X2

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

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

31 January 20X3

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

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

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

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

To record the settlement of the option contract.

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

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

31 December 20X3

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

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

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

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

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

1 February 20X2

Dr	Cash	CU5,000	
Cr	Equity		CU5,000

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

31 December 20X2

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

31 January 20X3

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

Dr	Cash	CU102,000	
Cr	Equity		CU102,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 5: Purchased put option on shares

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

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU95
Market price per share on 31 January 20X3	CU95
Fixed exercise price to be paid on 31 January 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU4,000
Fair value of option on 31 January 20X3	CU3,000

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

IE23 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 at a strike price of CU98,000 (ie CU98 per share) on 31 January 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the option contract on 1 February 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

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

To recognise the purchased put option.

31 December 20X2

On 31 December 20X2 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value $([CU98 - CU95] \times 1,000)$ and CU1,000 is the remaining time value.

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

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

31 January 20X3

On 31 January 20X3 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value $([CU98 - CU95] \times 1,000)$ because no time value remains.

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 20X3

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

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

To record the settlement of the option contract.

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

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

1 February 20X2

Dr	Equity	CU5,000	
Cr	Cash		CU5,000

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

31 December 20X2

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

31 January 20X3

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

Dr	Cash	CU98,000	
Cr	Equity		CU98,000

To record the settlement of the option contract.

(d) Settlement options

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

Example 6: Written put option on shares

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

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU95
Market price per share on 31 January 20X3	CU95
Fixed exercise price to be paid on 31 January 20X3	CU98
Present value of exercise price on 1 February 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU4,000
Fair value of option on 31 January 20X3	CU3,000

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

IE28 Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of 31 January 20X3 in exchange for CU98,000 in cash (ie CU98 per share) on 31 January 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

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

To recognise the written put option.

31 December 20X2

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

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

31 January 20X3

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

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

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

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

To record the settlement of the option contract.

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

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

31 January 20X3

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

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

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

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

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

1 February 20X2

Dr	Cash	CU5,000	
Cr	Equity		CU5,000

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

Dr	Equity	CU95,000	
Cr	Liability		CU95,000

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

31 December 20X2

Dr	Interest expense	CU2,750	
Cr	Liability		CU2,750

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

31 January 20X3

Dr	Interest expense	CU250	
Cr	Liability		CU250

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

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

Dr	Liability	CU98,000	
Cr	Cash		CU98,000

To record the settlement of the option contract.

(d) Settlement options

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

Entities such as mutual funds and co-operatives whose share capital is not equity as defined in SB-FRS 32

Example 7: Entities with no equity

IE32 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have equity as defined in SB-FRS 32. Other formats are possible.

Statement of comprehensive income for the year ended 31 December 20X1

	20X1	20X0
	CU	CU
Revenue	2,956	1,718
Expenses (classified by nature or function)	<u>(644)</u>	<u>(614)</u>
Profit from operating activities	2,312	1,104
Finance costs		
– other finance costs	(47)	(47)
– distributions to unitholders	<u>(50)</u>	<u>(50)</u>
Change in net assets attributable to unitholders	<u><u>2,215</u></u>	<u><u>1,007</u></u>

Statement of financial position at 31 December 20X1

	20X1		20X0	
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with SB-FRS 1)	<u>91,374</u>		<u>78,484</u>	
Total non-current assets		91,374		78,484
Current assets (classified in accordance with SB-FRS 1)	<u>1,422</u>		<u>1,769</u>	
Total current assets		<u>1,422</u>		<u>1,769</u>
Total assets		<u>92,796</u>		<u>80,253</u>
LIABILITIES				
Current liabilities (classified in accordance with SB-FRS 1)	<u>647</u>		<u>66</u>	
Total current liabilities		(647)		(66)
Non-current liabilities excluding net assets attributable to unitholders (classified in accordance with SB-FRS 1)	<u>280</u>		<u>136</u>	
		<u>(280)</u>		<u>(136)</u>
Net assets attributable to unitholders		<u><u>91,869</u></u>		<u><u>80,051</u></u>

Example 8: Entities with some equity

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in SB-FRS 32 because the entity has an obligation to repay the share capital on demand but does not have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. Other formats are possible.

Statement of comprehensive income for the year ended 31 December 20X1

	20X1	20X0
	CU	CU
Revenue	472	498
Expenses (classified by nature or function)	<u>(367)</u>	<u>(396)</u>
Profit from operating activities	105	102
Finance costs		
– other finance costs	(4)	(4)
– distributions to members	<u>(50)</u>	<u>(50)</u>
Change in net assets attributable to members	<u><u>51</u></u>	<u><u>48</u></u>

Statement of financial position at 31 December 20X1

	20X1		20X0	
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with SB-FRS 1)	<u>908</u>		<u>830</u>	
Total non-current assets		908		830
Current assets (classified in accordance with SB-FRS 1)	<u>383</u>		<u>350</u>	
Total current assets		<u>383</u>		<u>350</u>
Total assets		<u><u>1,291</u></u>		<u><u>1,180</u></u>
LIABILITIES				
Current liabilities (classified in accordance with SB-FRS 1)	372		338	
Share capital repayable on demand	<u>202</u>		<u>161</u>	
Total current liabilities		<u>(574)</u>		<u>(499)</u>
Total assets less current liabilities		<u><u>717</u></u>		<u><u>681</u></u>
Non-current liabilities (classified in accordance with SB-FRS 1)	<u>187</u>		<u>196</u>	
		(187)		(196)

continued...

continued...

OTHER COMPONENTS OF EQUITY²

Reserves eg revaluation surplus, retained earnings etc	<u>530</u>	<u>485</u>
	530	485
	<u>717</u>	<u>681</u>

MEMORANDUM NOTE – Total members' interests

Share capital repayable on demand	<u>202</u>	<u>161</u>
Reserves	530	485
	<u>732</u>	<u>646</u>

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

Accounting for compound financial instruments

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

- IE34 Paragraph 28 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.
- IE35 An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.
- IE36 The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

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

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

- IE37 The following example illustrates the application of paragraph 31 to the separation of the liability and equity components of a compound financial instrument with multiple embedded derivative features.
- IE38 Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 31 is CU55 (CU57 – CU2) and the value allocated to the equity component is CU5 (CU60 – CU55).

Example 11: Repurchase of a convertible instrument

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

IE40 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

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

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

IE42 On 1 January 20X5, the convertible debenture has a fair value of CU1,700.

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

IE44 The repurchase price is allocated as follows:

	Carrying value	Fair value	Difference
	CU	CU	CU
Liability component:			
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	962	1,081	(119)
Equity component	60	619 ³	(559)
Total	1,022	1,700	(678)

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

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

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

To recognise the repurchase of the liability component.

Dr	Equity	CU619	
Cr	Cash		CU619

To recognise the cash paid for the equity component.

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

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

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

IE48 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 11. On 1 January 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before 1 March 20X1 (ie within 60 days).

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

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

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

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

Face amount	CU1,000	
Original conversion price	<u>CU25</u>	per share
Number of ordinary shares to be issued on conversion	<u>40</u>	shares
<i>Number of incremental ordinary shares issued upon conversion</i>	<u>10</u>	shares

*Value of **incremental** ordinary shares issued upon conversion*

CU40 per share x 10 incremental shares	<u>CU400</u>
--	--------------

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