SPECIFIC ITEMS
SECTION 3856
financial instruments

Basis for Conclusions

Financial Instruments, Section 3856 (February 2022)

Accounting for Related Party Financial Instruments and Significant Risk Disclosures (December 2018)

Retractable or Mandatorily Redeemable Shares Issued in a Tax Planning Arrangement (December 2018)

PURPOSE AND SCOPE

.01 This Section establishes standards for:

(a) recognizing and measuring financial assets, financial liabilities and specified contracts to buy or sell non-financial items;

(b) the classification of financial instruments, from the perspective of the issuer, between liabilities and equity;

(c) the classification of related interest, dividends, losses and gains;

(d) the circumstances in which financial assets and financial liabilities are offset;

(e) when and how hedge accounting may be applied; and

(f) disclosures about financial assets and financial liabilities.

.02 Common examples of financial instruments include:

(a) cash;

(b) demand and fixed-term deposits;

(c) commercial paper, bankers' acceptances, treasury notes and bills;

(d) accounts, notes and loans receivable and payable;

(e) bonds and similar debt instruments, both issued and held as investments;

(f) common and preferred shares and similar equity instruments, both issued and held as investments; and

(g) options, warrants, futures contracts, forward contracts, and swaps.

.03 An enterprise applies this Section to all financial instruments except the following:

(a) interests in subsidiaries, enterprises subject to significant influence, and joint arrangements that are accounted for in accordance with SUBSIDIARIES, Section 1591, INVESTMENTS, Section 3051, and INTERESTS IN JOINT ARRANGEMENTS, Section 3056, although this Section applies to a derivative that is based on such an interest;

(b) leases (see LEASES, Section 3065), although Appendix B applies to transfers of lease receivables;

(c) employer's rights and obligations for employee future benefits and related plan assets (see EMPLOYEE FUTURE BENEFITS, Section 3462);

(d) insurance contracts, including the cash surrender value of a life insurance policy;

(e) investments held by an investment company that are accounted for at fair value in accordance with ACCOUNTING GUIDELINE AcG-18, Investment Companies, although the disclosure requirements in paragraphs 3856.37-.54 apply to an investment company;

(f) contracts and obligations for stock-based compensation to employees and stock-based payments to non-employees (see STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS, Section 3870);

(g) guarantees, other than guarantees that replace financial liabilities as described in paragraph 3856.A58 (see also ACCOUNTING GUIDELINE AcG-14, Disclosure of Guarantees);

(h) contracts based on revenues of a party to the contract;

(i) loan commitments (see CONTRACTUAL OBLIGATIONS, Section 3280, and CONTINGENCIES, Section 3290);

(j) contractual arrangements that prevent sale treatment (for example, an option to repurchase transferred receivables); and

(k) contracts issued by an acquirer (but not the seller) for contingent consideration in a business combination until such time as the contingency is resolved (see BUSINESS COMBINATIONS, paragraphs 1582.41-.42). This exception applies only to the acquirer (the enterprise that is accounting for the combination) and not to the seller.

.04 This Section does not apply to:

(a) contracts to buy or sell non-financial items except for:

(i) exchange-traded futures contracts; and

(ii) contracts that are designated in a qualifying hedging relationship in accordance with paragraphs 3856.30-.36;

(b) non-financial assets and non-financial liabilities; and

(c) initial measurement of financial assets acquired or financial liabilities assumed in a transaction when a combination involving a business under common control occurs (see paragraph 3840.44).

[Former paragraph 3856.04, amended by amendments to Section 3840 (September 2023), retained in Archived Pronouncements] [Former paragraph 3856.04, amended by amendments to Section 3840 (December 2025), retained in Archived Pronouncements]

.04A Not-for-profit organizations do not apply paragraphs 3856.19AA, 3856.28A, 3856.42A, 3856.47A, 3856.A37A-.A37C and 3856.A60A.

DEFINITIONS

.05 The following terms are used in this Section with the meanings specified:

(a) **Amortized cost** is the amount at which a financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization 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 (see paragraphs 3856.A3-.A6).

(b) An **anticipated transaction** is any transaction expected to occur in the future that has not yet given rise to a recognized asset or liability.

(ba)For the purposes of applying paragraph 3856.08B, **carrying amount** is the amount of an item transferred, or cost of services provided, as recorded in the accounts of the transferor, after adjustment, if any, for amortization or impairment in value.

(bb)The **cost method** is a basis of accounting for financial instruments whereby the instrument is initially recorded at cost; earnings from such instruments are recognized only to the extent received or receivable.

(c) **Derecognition** is the removal of a previously recognized financial asset or financial liability from an enterprise's balance sheet.

(d) A **derivative** is a contract with all three of the following characteristics:

(i) 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, a credit rating or credit index, or other variable (sometimes called the "underlying"), provided in the case of a non-financial variable that the variable is not specific to a party to the contract;

(ii) 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

(iii) it is settled at a future date.

(da)An **economic interest** in another not-for-profit organization exists if:

(i) the other organization holds resources that must be used to produce revenue or provide services for the reporting organization; or

(ii) the reporting organization is responsible for the liabilities of the other organization.

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

(ea) **Exchange amount** is the amount of consideration paid or received as established and agreed to by related parties.

(f) **Fair value** is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. (Paragraph 3856.A7 provides related application guidance.)

(g) **Financing fees** are amounts that compensate the lender for the risk of providing funds to the borrower. Financing fees, sometimes referred to as fees in lieu of interest, loan fees or financing costs, include:

- (i) fees charged to originate, arrange or syndicate a loan or debt financing;
- (ii) commitment, standby and guarantee fees; and
- (iii) refinancing, restructuring and renegotiation fees.

Financing fees may be refundable or non-refundable. Financing fees do not include transaction costs.

(h) A **financial asset** is any asset that is:

- (i) cash;
- (ii) a contractual right to receive cash or another financial asset from another party;
- (iii) a contractual right to exchange financial instruments with another party under conditions that are potentially favourable; or
- (iv) an equity instrument of another enterprise.

The cost incurred by an enterprise to purchase a right to reacquire its own equity instruments from another party is a deduction from its equity, not a financial asset.

(i) A **financial instrument** is a contract that creates a financial asset for one enterprise and a financial liability or equity instrument of another enterprise.

(j) A **financial liability** is any liability that is a contractual obligation:

- (i) to deliver cash or another financial asset to another party; or
- (ii) to exchange financial instruments with another party under conditions that are potentially unfavourable to the enterprise.

(k) **Hedge accounting** is a method of recognizing the gains, losses, revenues and expenses associated with the items in a hedging relationship such that those gains, losses, revenues and expenses are recognized in net income in the same period when they would otherwise be recognized in different periods.

(l) A **hedged item** is a recognized asset, a recognized liability, an anticipated transaction or a net investment in a self-sustaining foreign operation having an identified risk exposure that an enterprise has taken steps to modify.

(m) A **hedging item** is:

- (i) a derivative offsetting a risk exposure identified in the hedged item; or
- (ii) a non-derivative financial asset or a non-derivative financial liability offsetting the foreign currency risk exposure in the net investment in a self-sustaining foreign operation.

(n) A **hedging relationship** is a relationship established by an enterprise's management between a hedged item and a hedging item that satisfies all of the conditions in this Section.

(o) An **insurance contract** is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. Insurance contracts include any contract based on climatic, geological or other physical variables.

(oa) **Observable inputs** are developed using market data, such as publicly available information about actual events or transactions, and reflect the assumptions that knowledgeable, willing parties that are under no compulsion to act would use when valuing the asset or liability. Examples of markets in which inputs might be observable for financial assets or financial liabilities include exchange markets, dealer markets, brokered markets and principal-to-principal markets.

(ob) **Related parties** exist when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two or more parties are related when they are subject to common control, joint control or common significant influence. Two not-for-profit organizations are related parties if one has an economic interest in the other. Related parties also include management and immediate family members (see RELATED PARTY TRANSACTIONS, paragraph 3840.04 or DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4460.04 in Part III of the Handbook, as applicable).

(oc) A **related party financial instrument** is a contract between related parties that creates a financial asset for one enterprise and a financial liability or equity instrument of another enterprise.

(od)A **related party transaction** is a transfer of economic resources or obligations between related parties, or the provision of services by one party to a related party, regardless of whether any consideration is exchanged. The parties to the transaction are related prior to the transaction. When the relationship arises as a result of the transaction, the transaction is not one between related parties.

(p) **Transaction costs** are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the enterprise had not acquired, issued or disposed of the financial instrument. Transaction costs include expenditures such as legal fees, reimbursement of the lender's administrative costs and appraisal costs associated with a loan. Transaction costs do not include financing fees, debt premiums or discounts.

RECOGNITION

.06 *An enterprise shall recognize a financial asset or a financial liability when the enterprise becomes a party to the contractual provisions of the financial instrument.*

MEASUREMENT

Initial measurement

(Paragraphs 3856.A7A and 3856.A8K provide related application guidance.)

.06A *Except as specified in this Section, transaction costs shall be recognized in net income in the period incurred.*

Arm's length transactions

.07 *Except as specified in paragraph* 3856.09A*, when a financial asset is originated or acquired or a financial liability is issued or assumed in an arm's length transaction, an enterprise shall measure it at its fair value adjusted by, in the case of a financial asset or financial liability that will not be measured subsequently at fair value, financing fees and transaction costs that are directly attributable to its origination, acquisition, issuance or assumption.* (Paragraphs 3856.A8 and 3856.A9-.A13 provide related application guidance.)

.07A For the purpose of this Section, parties whose sole relationship with the enterprise is in the capacity of management, as defined in RELATED PARTY TRANSACTIONS, paragraph 3840.04(d) or DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NOT-FOR-PROFIT ORGANIZATIONS, paragraph 4460.04(e), as an individual, group or by contract, and members of the immediate family of any individual to which this paragraph applies, are deemed to be unrelated third parties. The requirements of paragraph 3856.07 apply to transactions with such parties.

Related party transactions

.08 *Except as specified in paragraphs* 3856.04*(c)* 3856.08C-*.08D and* 3856.09A*, when a financial asset is originated or acquired or a financial liability is issued or assumed in a related party transaction, an enterprise shall initially measure it at cost. The cost of a financial instrument in a related party transaction shall depend on whether the instrument has repayment terms. When the financial asset originated or acquired or the financial liability issued or assumed:*

(a) has repayment terms, the cost of the instrument shall be determined using the undiscounted cash flow(s), excluding interest and dividend payments, of the instrument less any impairment losses previously recognized by the transferor;

(b) does not have repayment terms, the cost of the instrument shall be determined using the consideration transferred or received by the enterprise in the transaction (see paragraph 3856.08A).

(Paragraphs 3856.A8A-.A8B provide related application guidance.) [Former paragraph 3856.08, amended by amendments to Section 3840, retained in Archived Pronouncements]

.08A *As required by paragraph* 3856.08*(b), when the consideration transferred by the enterprise in the transaction:*

(a) is a financial instrument that has repayment terms, the cost of the financial asset originated or acquired or the financial liability issued or assumed is determined using the undiscounted cash flow(s), excluding interest and dividend payments, of the financial instrument transferred as consideration less any impairment losses previously recognized by the transferor;

(b) is an asset or liability that does not have repayment terms, the cost of the financial asset originated or acquired or the financial liability issued or assumed is the carrying or exchange amount of the consideration transferred or received (see paragraph 3856.08B).

(Paragraph 3856.A8C provides related application guidance.)

.08B *As required by paragraph* 3856.08A*(b), the cost of a financial asset originated or acquired or financial liability issued or assumed in a related party transaction is the exchange amount of the consideration transferred or received when:*

(a) the transaction is in the normal course of operations; or

(b) the transaction is not in the normal course of operations and:

(i) the transaction is a monetary transaction or a non-monetary transaction that has commercial substance;

(ii) the change in the ownership interests in the related financial item transferred is substantive; and

(iii) the amount of consideration paid or received is established and agreed to by related parties and is supported by independent evidence.

Otherwise, the cost of the financial asset originated or acquired or the financial liability issued or assumed in a related party transaction is the carrying amount of the consideration transferred or received.

(Paragraphs 3856.A8D-A8I provide related application guidance.)

.08C *An enterprise shall initially measure the following financial instruments originated or acquired or issued or assumed in a related party transaction at fair value without any adjustments:*

(a) *investments in equity instruments that are quoted in an active market;*

(b) *debt instruments that are quoted in an active market;*

(c) *debt instruments when the inputs significant to the determination of the fair value of the instrument are observable, either directly or indirectly* (Paragraph 3856.A8J provides related application guidance.)*; and*

(d) *derivative contracts.*

(Paragraphs 3856.A9-.A10 provide related application guidance.)

.08D *Except for financial instruments to which paragraph* 3856.14A *applies, an enterprise shall not initially measure the variable or contingent portion of a related party financial instrument. Instead, the enterprise shall disclose the terms of the instrument and remeasure the financial asset or financial liability at fair value when the contingency or variability is resolved, with any gain or loss recognized in net income.*

Gains or losses or measurement differences arising in a related party transaction

.08E *Except for retractable or mandatorily redeemable shares issued in a tax planning arrangement to which paragraph* 3856.23 *applies, on initial measurement, when a related party transaction includes a financial instrument and is in the normal course of operations, or is not in the normal course of operations and:*

(a) *the transaction is a monetary transaction or a non-monetary transaction that has commercial substance;*

(b) *the change in the ownership interests in the items transferred is substantive; and*

(c) *the transaction amounts for each of the elements in the transaction are supported by independent evidence,*

any gain or loss resulting from initial recognition shall be included in net income, unless another Section requires alternative treatment. Otherwise, any difference resulting from the transaction shall be included in equity.

(Paragraph 3856.09 moved and renumbered 3856.07A)

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

.09A *An enterprise shall initially measure retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as:*

(a) *equity in accordance with paragraph* 3856.23*, at their par, stated or assigned value; or*

(b) *a financial liability in accordance with paragraph* 3856.23*, at their redemption amount.*

(paragraph 3856.10 moved and renumbered 3856.06A)

Subsequent measurement and income recognition

(Paragraph 3856.A13A provides related application guidance.)

.11 *Except for those financial instruments for which paragraphs* 3856.14-*.14A or* 3856.15A *apply, at each reporting date, an enterprise shall subsequently measure a financial instrument based on how it initially measured the instrument. If the enterprise initially measured the financial instrument at:*

(a) *fair value, it shall subsequently measure the instrument as follows:*

(i) *investments in equity instruments that are quoted in an active market and derivative contracts at fair value in accordance with paragraph* 3856.12;

(ii) *financial assets and financial liabilities at fair value, if the enterprise elects that fair value measurement shall apply in accordance with paragraphs* 3856.13 *or* 3856.13A;

(iii) *investments in equity instruments not quoted in an active market, when originated or acquired in an arm's length transaction, at cost less any reduction for impairment;*

(iv) *all other financial assets at amortized cost; and*

(v) *financial liabilities at amortized cost; or*

(b) *cost, it shall subsequently measure the instrument using the cost method less any reduction for impairment.*

Subsequent measurement of financial instruments assumed in a transaction accounted for in accordance with paragraph 3840.44*(b) shall be based on the initial measurement of the financial instrument in the transferred business.*

[Former paragraph 3856.11, amended by amendments to Section 3840, retained in Archived Pronouncements]

.12 *An enterprise shall subsequently measure the following financial instruments at fair value without any adjustment for transaction costs it may incur on sale or other disposal:*

(a) *investments in equity instruments that are quoted in an active market* (see paragraphs 3856.A9-.A11); and

(b) *derivative contracts other than:*

(i) *derivatives that are designated in a qualifying hedging relationship in accordance with paragraphs* 3856.30-*.36 or FOREIGN CURRENCY TRANSLATION, paragraph* 1651.39*; and*

(ii) *derivatives that are linked to, and must be settled by delivery of, equity instruments of another enterprise whose fair value cannot be readily determined.*

Changes in fair value shall be recognized in net income in the period incurred.

.12A *An enterprise discontinues measuring an investment in an equity instrument of a related party at fair value when the instrument ceases to be quoted in an active market. At each subsequent reporting date, the enterprise shall measure the instrument using the cost method in accordance with paragraph* 3856.11*(b). The fair value of the instrument, immediately before the instrument ceases to be quoted in an active market, is its cost.*

.13 *Except for a financial instrument to which paragraph* 3856.09A *applies, an enterprise may elect to subsequently measure any financial asset originated or acquired or financial liability issued or assumed in an arm's length transaction, at fair value by designating that fair value measurement shall apply:*

- *(a) when the asset or liability is first recognized in accordance with this Section; or*
- *(b) for an investment in an equity instrument that was previously measured at fair value in accordance with paragraph* 3856.12*(a), when the instrument ceases to be quoted in an active market.*

Any designation in accordance with this paragraph is irrevocable.

.13A *An enterprise may elect to subsequently measure debt instruments originated or acquired or issued or assumed in a related party transaction at fair value by designating that fair value measurement shall apply when the debt instrument is first recognized in accordance with this Section, and:*

- *(a) the debt instrument is quoted in an active market; or*
- *(b) the inputs significant to the determination of the fair value of the debt instrument are observable, either directly or indirectly.*

Any designation in accordance with this paragraph is irrevocable.

.13B *An enterprise discontinues measuring a debt instrument:*

- *(a) originated or acquired in a related party transaction at fair value when the instrument ceases to be quoted in an active market and when inputs significant to the determination of the fair value of the instrument are no longer observable; or*
- *(b) issued or assumed in a related party transaction at fair value when inputs significant to the determination of the fair value of the instrument are no longer observable.*

At each subsequent reporting date, the enterprise shall measure the instrument at amortized cost in accordance with paragraphs 3856.11*(a)(iv) or 3856.11(a)(v). The fair value of the instrument immediately before it ceases to be quoted in an active market or ceases to have inputs that are observable is the amount at which the instrument is recognized.*

.14 *The issuer of a financial liability that is indexed to a measure of the enterprise's financial performance or to changes in the value of the enterprise's equity shall account for the instrument as follows:*

- *(a) the liability is initially measured in accordance with paragraphs* 3856.07 *or* 3856.08*;*
- *(b) interest expense is calculated using the stated interest rate, plus or minus the amortization of any initial premium or discount; and*
- *(c) except as specified in paragraph* 3856.14A*, at each reporting date, the enterprise adjusts the carrying amount of the liability to the higher of:*
  - *(i) the amortized cost of the debt; and*
  - *(ii) the amount that would be due at the balance sheet date if the formula determining the additional amount was applied at that date (the conversion or intrinsic value).*

The amount of the adjustment in accordance with paragraph (c) above shall be recognized in net income and presented as a separate component of interest expense.

.14A *The issuer of a related party financial liability that is indexed to a measure of the enterprise's financial performance or to changes in the value of the enterprise's equity shall adjust the carrying amount of the liability, at each reporting date, to the higher of:*

- *(a) the cost of the debt; and*
- *(b) the amount that would be due at the balance sheet date if the formula determining the additional amount was applied at that date.*

The amount of the adjustment in accordance with this paragraph shall be recognized in net income and presented as a separate component of interest expense.

.15 *An enterprise shall report interest, dividends, losses and gains relating to a financial instrument, or a component part that is classified as a financial liability in net income as expense or income. The issuer shall report distributions to holders of a financial instrument it classifies as an equity instrument directly in equity.* (Paragraphs 3856.A39-.A40 provide related application guidance.)

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

.15A *An enterprise shall subsequently measure retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as:*

- *(a) equity in accordance with paragraph* 3856.23*, at their par, stated or assigned value; or*
- *(b) a financial liability in accordance with paragraph* 3856.23*, at their redemption amount.*

Impairment

.16 *At the end of each reporting period, an enterprise shall assess whether there are any indications that a financial asset, or group of similar financial assets, measured at cost or amortized cost or using the cost method may be impaired. When there is an indication of impairment, an enterprise shall determine whether a significant adverse change has occurred during the period in the expected timing or amount of future cash flows from the financial asset or group of assets.* (Paragraphs 3856.A14-.A21 provide related application guidance.)

.17 *Except as specified in paragraphs* 3856.17A-*.17B, when an enterprise identifies a significant adverse change in the expected timing or amount of future cash flows from a financial asset, or group of similar financial assets, it shall reduce the carrying amount of the asset, or group of assets, to the highest of the following:*

- *(a) the present value of the cash flows expected to be generated by holding the asset, or group of assets, discounted using a current market rate of interest appropriate to the asset, or group of assets;*
- *(b) the amount that could be realized by selling the asset, or group of assets, at the balance sheet date; and*
- *(c) the amount the enterprise expects to realize by exercising its right to any collateral held to secure repayment of the asset, or group of assets, net of all costs necessary to exercise those rights.*

The carrying amount of the asset, or group of assets, shall be reduced directly or through the use of an allowance account. The amount of the reduction shall be recognized as an impairment loss in net income.

.17A *For debt instruments originated or acquired in a related party transaction and initially measured at cost, an enterprise shall reduce the carrying amount of the asset, or group of similar assets, to the highest of the undiscounted cash flows expected to be generated by holding the asset, or group of similar assets, excluding the interest and dividend payments of the instrument, and the amounts specified in paragraphs* 3856.17*(b)-(c).*

.17B *For equity instruments originated or acquired in a related party transaction and initially measured at cost, an enterprise shall reduce the carrying amount of the asset, or group of similar assets, to the amount that could be realized by selling the asset, or group of similar assets, at the balance sheet date.*

.18 Estimates of the amounts and timing of expected future cash flows from impaired financial assets reflect management's best judgment, based on reasonable and supportable assumptions, and take into account the range of possible outcomes. Short-term receivables with no stated interest rate may be measured at the revised expected amount if the effect of discounting is immaterial.

.19 *When the extent of impairment of a previously written-down asset, or group of assets, decreases and the decrease can be related to an event occurring after the impairment was recognized (such as a return to profitability of the customer or issuer), the previously recognized impairment loss shall be reversed to the extent of the improvement, directly or by adjusting the allowance account. The adjusted carrying amount of the financial asset, or group of assets, shall be no greater than the amount that would have been reported at the date of the reversal had the impairment not been recognized previously. The amount of the reversal shall be recognized in net income in the period the reversal occurs.*

Forgiveness

(Former paragraph 3856.19A moved and renumbered 3856.19C)

.19AA *Except as specified in paragraph* 3856.19B*, after assessing for and recognizing any impairment in accordance with paragraphs* 3856.17A-*.17B, forgiveness of all or part of a related party financial asset shall be recognized in:*

- *(a) equity, when the transaction that resulted in the origination or acquisition of the financial asset was not in the normal course of operations; or*
- *(b) net income when:*
  - *(i) the transaction that resulted in the origination or acquisition of the financial asset was in the normal course of operations; or*
  - *(ii) it is impracticable to determine whether the forgiven related party financial asset was originated or was acquired in the normal course of operations or not in the normal course of operations.*

A borrower accounts for the extinguishment of a financial liability issued in a transaction between related parties in accordance with paragraph 3856.28A.

(Paragraphs 3856.A21A and .A21B provide related application guidance.)

.19B *Not-for-profit organizations shall recognize the forgiveness of a related party financial asset in the statement of operations.*

PRESENTATION

Investments

.19C *Income from investments subsequently measured at fair value or cost or using the cost method shall be separately presented on the face of the income statement.*

Liabilities and equity

.20 *Except as provided in paragraph* 3856.23*, the issuer of a financial instrument shall classify the instrument, or its component parts, as a liability or as equity in accordance with the substance of the contractual arrangement on initial recognition and the definitions of a financial liability and an equity instrument.* (Paragraphs 3856.A22-.A38 provide related application guidance.)

.21 *The issuer of a financial instrument that contains both a liability and an equity element, including warrants or options issued with and detachable from a financial liability, shall classify the instrument's component parts separately in accordance with paragraph* 3856.20*.* (Paragraphs 3856.A30-.A38 provide related application guidance.)

Arm's length transactions

.22 Acceptable methods for initial measurement of the separate liability and equity elements of an instrument issued in an arm's length transaction to which paragraph 3856.21 applies include the following:

(a) The equity component is measured as zero. The entire proceeds of the issue are allocated to the liability component.

(b) The less easily measurable component is allocated the residual amount after deducting from the entire proceeds of the issue the amount separately determined for the component that is more easily measurable.

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

Related party transactions

.22A Acceptable methods for initial measurement of the separate liability and equity elements of an instrument issued in a related party transaction, to which paragraph 3856.21 applies, include the following:

(a) The equity component is measured as zero. The entire proceeds of the issue are allocated to the liability component.

(b) The equity component is allocated the residual amount after deducting from the entire proceeds of the issue the amount separately determined for the liability component measured in accordance with paragraph 3856.08(a).

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

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

.23 *An enterprise that issues retractable or mandatorily redeemable shares in a tax planning arrangement may choose to present those shares at par, stated or assigned value as a separate line item in the equity section of the balance sheet only when all of the following conditions are met:*

(a) *control* (see SUBSIDIARIES, Section 1591) *of the enterprise issuing the retractable or mandatorily redeemable shares in a tax planning arrangement is retained by the shareholder receiving the shares in the arrangement;*

(b) *in the arrangement, either:*

(i) *no consideration is received by the enterprise issuing the retractable or mandatorily redeemable shares; or*

(ii) *only shares of the enterprise issuing the retractable or mandatorily redeemable shares are exchanged; and*

(c) *no other written or oral arrangement exists, such as a redemption schedule, that gives the holder of the shares the contractual right to require the enterprise to redeem the shares on a fixed or determinable date or within a fixed or determinable period.*

If any of the above conditions are not met for any or all of the shares issued, the issuer shall classify those shares as a financial liability, present them separately on the balance sheet and measure them in accordance with paragraph 3856.09A*. Any resulting adjustment shall be recognized in either retained earnings or a separate component of equity* (see EQUITY, Section 3251)*.*

.23A *The issuer of retractable or mandatorily redeemable shares in a tax planning arrangement may choose to present the shares issued in that arrangement as a financial liability. An enterprise that chooses to present the shares as a financial liability presents them separately on the balance sheet and measures them in accordance with paragraph* 3856.09A*. Any resulting adjustment shall be recognized in either retained earnings or a separate component of equity* (see EQUITY, Section 3251)*.*

.23AA *Retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as a financial liability in accordance with paragraphs* 3856.23 *and* 3856.23A*, cannot subsequently be reclassified to equity.*

Assessing which party has control in a related party group

.23B *If an enterprise issues retractable or mandatorily redeemable shares in a tax planning arrangement to two or more related parties* (see RELATED PARTY TRANSACTIONS, Section 3840)*, an assessment of which related party, if any, controls the enterprise is needed to determine whether the condition described in paragraph* 3856.23*(a) is met. This assessment of control should be performed by applying the guidance for control in SUBSIDIARIES, Section* 1591*, which includes an analysis of all relevant facts and circumstances. A related party has control over the enterprise which issues the retractable or mandatorily redeemable shares when it has the continuing power to determine its strategic operating, investing and financing policies without the co-operation of others.*

An enterprise shall only apply paragraph 3856.23B *for the purpose of assessing the control condition as described in paragraph* 3856.23*(a).*

.23C Assessing which related party, if any, controls the enterprise is determined by analyzing all facts and circumstances. For example, two spouses each receive 50 percent of the retractable or mandatorily redeemable shares issued by an enterprise in a tax planning arrangement. When assessing the control condition described in 3856.23(a), and assuming the conditions in 3856.23(b)-(c) are met, the result may be:

(a) one of either spouse controls the enterprise and the shares held by the spouse who controls the enterprise would be classified as equity and the other spouse's shares would be classified as a financial liability; or

(b) neither spouse controls the enterprise as control is jointly held (see INTERESTS IN JOINT ARRANGEMENTS, Section 3056). Therefore, all of the shares would be classified as a financial liability.

Assessing whether a series of transactions is one tax planning arrangement

.23D *If an enterprise issues retractable or mandatorily redeemable shares in a tax planning arrangement through a series of transactions in contemplation of one another, the transactions shall be viewed as one tax planning arrangement when assessing the conditions in paragraph* 3856.23*.*

Reclassification of retractable or mandatorily redeemable shares issued in a tax planning arrangement

.23E *Retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as equity in accordance with paragraph* 3856.23 *are not subsequently reclassified unless an event or transaction occurs that may indicate the conditions for equity classification in paragraph 3856.23 are no longer met. Retractable or mandatorily redeemable shares issued in a tax planning arrangement reclassified as a financial liability are not subsequently reclassified as equity.*

.23F Examples of events or transactions that may indicate the conditions for equity classification in paragraph 3856.23 are no longer met include, but are not restricted to:

(a) the death of the holder of the retractable or mandatorily redeemable shares issued in a tax planning arrangement;

(b) a change in the ownership of the enterprise that may affect the assessment of control of the enterprise that issued the retractable or mandatorily redeemable shares in a tax planning arrangement;

(c) a change in the shareholders' agreement that may affect the assessment of control of the enterprise that issued the retractable or mandatorily redeemable shares in a tax planning arrangement;

(d) redemption of some or all of the retractable or mandatorily redeemable shares issued in a tax planning arrangement;

(e) the creation of a written or oral arrangement that gives the holder of the retractable or mandatorily redeemable shares issued in a tax planning arrangement the right to require the enterprise to redeem the shares within a fixed or determinable period; or

(f) modifications to the retractable or mandatorily redeemable shares issued in a tax planning arrangement.

.23G *If the event or transaction gives rise to a reclassification of the retractable or mandatorily redeemable shares issued in a tax planning arrangement from equity to a financial liability, the enterprise shall measure the reclassified shares at the redemption amount on the date such an event or transaction occurs and present them separately on the balance sheet. Any resulting adjustment shall be recorded in retained earnings or a separate component of equity in accordance with EQUITY, Section* 3251*.*

Callable debt presentation

.23H *Callable debt presentation* (see Illustrative Example in CURRENT ASSETS AND CURRENT LIABILITIES, Section 1510) *is not permitted for retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as a financial liability.*

Offsetting of a financial asset and a financial liability

.24 *A financial asset and a financial liability shall be offset, and the net amount reported in the balance sheet, only when an enterprise:*

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

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

(Paragraphs 3856.A41-.A48 provide related application guidance.)

DERECOGNITION

Transfers of receivables

.25 *An enterprise shall derecognize receivables transferred to another enterprise only when control has been surrendered* (see Appendix B).

Financial liabilities

.26 *An enterprise shall remove a financial liability (or a part of a financial liability) from its balance sheet when it is extinguished (i.e., when the obligation is discharged or cancelled, or expires).* (Paragraphs 3856.A49-.A61 provide related application guidance.)

.27 Except as specified in paragraphs 3856.27A and 3856.29A, a transaction between a borrower and lender to replace a debt instrument with another instrument having substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

.27A A transaction between related parties to replace all or a part of a debt instrument with another instrument or to modify the terms of an existing financial liability is accounted for as an extinguishment of the original financial liability and the recognition of a new financial instrument. (Paragraph 3856.A60A provides related application guidance.)

.28 *Except as specified in paragraph* 3856.28A*, the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the fair value of the consideration paid, including any non-cash assets transferred, liabilities assumed or equity instruments issued, shall be recognized in net income for the period.*

.28A *Except as specified in paragraph* 3856.28B*, in a transaction between related parties, the difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another related party and the amount of the consideration paid, including any non-cash assets transferred, liabilities assumed or equity instruments issued, shall be recognized in:*

- *(a) equity, when the original transaction that resulted in the issuance or assumption of the financial liability was not in the normal course of operations; or*
- *(b) net income when:*
  - *(i) the original transaction that resulted in the issuance or assumption of the financial liability was in the normal course of operations; or*
  - *(ii) it is impracticable to determine whether the amount extinguished was issued or assumed in the normal or not in the normal course of operations.*

A lender accounts for the forgiveness of a related party financial asset in accordance with paragraph 3856.19AA*.*

.28B *The extinguishment of financial liabilities, exchanged in a related party, non-reciprocal transaction by a not-for-profit organization shall be accounted for in accordance with CONTRIBUTIONS — REVENUE RECOGNITION, Section* 4410 *in Part III of the Handbook.*

.29 When an issuer of a debt instrument repays or settles that instrument, the debt is extinguished. If an enterprise repays a part of a financial liability issued in an arm's length transaction, the enterprise allocates the carrying amount of the financial liability at the date of repayment based on their relative fair values between the part that continues to be recognized and the part that is derecognized. The difference between the carrying amount allocated to the part derecognized and the consideration paid to extinguish that part, including any non-cash assets transferred, liabilities assumed or equity instruments issued, is recognized in net income.

Interest rate benchmark reform – debt modifications

.29A As a practical expedient, an enterprise that modified one or more contractual terms in a debt instrument because of the interest rate benchmark reform (IBOR reform) may choose to account for such modifications in accordance with paragraph 3856.A55 as if they are not substantial.

.29B For the purpose of this Section, IBOR reform refers to the market-wide reform to replace interbank offered rates (IBORs), including but not limited to the Canadian dollar offered rate (CDOR) and the London interbank offered rate (LIBOR), with alternative benchmark rates.

.29C *The optional expedient described in paragraph* 3856.29A *shall apply to debt modifications if the terms that are modified directly replace, or have the potential to replace, IBORs with an alternative benchmark rate. If other terms are contemporaneously modified in a manner that changes, or has the potential to change, the amount or timing of contractual cash flows, the enterprise shall first apply the optional expedient to those modifications which are related to the replacement of IBOR with an alternative benchmark rate. The enterprise shall then apply the applicable requirements in this Section to any additional changes to which the practical expedient does not apply. Changes to terms related to the replacement of IBOR are those made to replace the existing IBOR with an alternative benchmark rate because of IBOR reform. (Paragraphs* 3856.A54A-.*A54B provide related application guidance.)*

.29D *If the optional expedient in paragraph* 3856.29A *is elected, it shall be applied to all debt instruments that reference IBORs as described in paragraph* 3856.29B*.*

HEDGE ACCOUNTING

.30 Hedge accounting is optional. The purpose of hedge accounting is to recognize offsetting gains, losses, revenues and expenses (including the effects of changes in cash flows) in net income in the same period or periods.

.31 *A hedging relationship qualifies for hedge accounting only when all of the following conditions are satisfied:*

- *(a) At the inception of the hedging relationship, the enterprise:*
  - *(i) designates that hedge accounting will be applied to the hedging relationship; and*
  - *(ii) formally documents the hedging relationship, identifying the hedged item, the related hedging item, the nature of the specific risk exposure or exposures being hedged and the intended term of the hedging relationship.*
- *(b) Both at the inception of the hedging relationship and throughout its term, the enterprise has reasonable assurance that the critical terms of the hedging item and the hedged item are the same, as described in paragraphs* 3856.A62-*.A65 or paragraphs* 1651.38-*.41.*
- *(c) When the hedged item is an anticipated transaction, it is probable the anticipated transaction will occur at the time and in the amount designated.*

.32 *An enterprise may designate only the following hedging relationships:*

- *(a) an anticipated transaction denominated in a foreign currency hedged with a forward contract to mitigate the effect of changes in future foreign currency exchange rates* (see paragraph 3856.A62)*;*
- *(b) an anticipated purchase or sale of a commodity hedged with a forward contract to mitigate the effect of future price changes of the commodity* (see paragraphs 3856.A63-.A63C)*;*
- *(c) an interest-bearing asset or liability hedged with an interest rate swap to mitigate the effect of changes in interest rates* (see paragraph 3856.A64)*;*
- *(d) a foreign currency denominated interest-bearing asset or liability hedged with a cross-currency interest rate swap to mitigate the effect of changes in interest rates and foreign currency exchange rates* (see paragraph 3856.A65)*; and*
- *(e) the net investment in a self-sustaining foreign operation hedged with a derivative or non-derivative financial instrument to mitigate the effect of changes in foreign currency exchange rates* (see FOREIGN CURRENCY TRANSLATION, paragraphs 1651.38-.41).

.33 *An enterprise accounts for a qualifying hedge of an anticipated transaction as follows:*

- *(a) The hedged item is recognized initially at the amount of consideration payable or receivable. The gain or loss on the hedging item (forward contract, or the percentage of the contract relating to the hedged item) is recognized as an adjustment of the carrying amount of the hedged item when the anticipated transaction results in the recognition of an asset or a liability. When the hedged item is recognized directly in net income, the gain or loss on the hedging item is included in the same category of income or expense.*
- *(b) When the hedging item matures before the hedged item is recognized, the gain or loss on the hedging item (forward contract, or the percentage of the contract related to the hedged item) is recognized as a separate component of equity until the hedged item is recognized. When the hedged item is recognized, the gain or loss on the hedging item is transferred from the separate component of equity to the carrying amount of the hedged item or to net income in accordance with (a)* (see paragraph 3856.A62A).
- *(c) When the hedging item matures after the hedged item is recognized, the hedging item (forward contract, or the percentage of the contract related to the hedged item) is recognized on the same date as the hedged item using the spot price or rate in effect on that date (i.e., at an amount equal to the difference between the contract rate and the spot rate on the measurement date multiplied by the notional amount or quantity of the contract). The gain or loss is included in the carrying amount of the hedged item or in net income in accordance with (a), with the offsetting amount recognized as a derivative-related asset or liability, as appropriate. If a reporting period ends before the hedging item matures, the hedging item is remeasured using the spot price or rate in effect at the reporting period balance sheet date with any gain or loss included in net income. When the hedging item matures, the derivative-related asset or liability is derecognized, the hedging item is recognized at the settlement amount, and any additional gain or loss on the hedging item is recognized in net income.*

.34 *An enterprise accounts for a qualifying hedge of an interest-bearing asset or liability as follows:*

- *(a) Interest on the hedged item is recognized using the hedged item's stated interest rate plus or minus amortization of any initial premium or discount and any financing fees and transaction costs* (see paragraphs 3856.A3-.A6).
- *(b) Net amounts receivable or payable on the hedging item (the interest rate swap or percentage of the interest rate swap designated as the hedging item) are recognized as an adjustment to interest on the hedged item in the period in which they accrue.*
- *(c) When applicable, recognized foreign currency receivables and payables on a cross-currency interest rate swap hedging item are translated using current exchange rates with gains and losses included in net income in the period in which they arise.*

.35 *Except as specified in paragraph* 3856.36A*, an enterprise shall discontinue hedge accounting only when:*

(a) the hedged item or the hedging item ceases to exist other than as designated and documented;

(b) the critical terms of the hedging item, as specified in paragraphs 3856.A62-*.A65, cease to match those of the hedged item, including, but not limited to, when:*

(i) it becomes probable that an interest bearing asset or liability hedged with an interest rate or cross currency interest rate swap will be prepaid; and

(ii) the hedged item is an anticipated transaction and it is no longer probable that the anticipated commodity purchase or sale transaction or the settlement of the anticipated foreign currency transaction will occur in the amount designated or within 30 days of the maturity date of the hedging forward contract.

.36 Hedge accounting cannot be discontinued electively. A hedging relationship no longer meets the objective of hedge accounting if either the hedged item or the hedging item ceases to exist prior to the intended end date of the hedging relationship or if circumstances change such that the critical terms of the hedging item no longer match those of the hedged item. An enterprise accounts for a discontinued hedging relationship as follows:

(a) When a hedging item ceases to exist, any gains or losses incurred on its termination are recognized in net income at the same time the hedged item affects net income, as follows:

(i) When the hedged item is an anticipated transaction, any gain or loss incurred on the termination of the hedging item is recognized in a separate component of shareholders' equity. When the anticipated transaction occurs, the gain or loss is removed from shareholders' equity and is recognized as an adjustment of the carrying amount of the hedged item.

(ii) When the hedged item is a recognized asset or liability, any gain or loss incurred on the termination of the hedging item is recognized as an adjustment of the carrying amount of the hedged item.

(b) When:

(i) a hedged item ceases to exist;

(ii) the critical terms of the hedging item cease to match those of the hedged item;

(iii) it becomes probable that the interest-bearing hedged item will be prepaid; or

(iv) the hedged item is an anticipated transaction and it is no longer probable that an anticipated commodity purchase or sale transaction or the settlement of an anticipated foreign currency transaction will occur in the amount designated or within 30 days of the maturity date of the hedging item;

the hedging item is measured as otherwise required by this Section and any gain or loss is recognized in net income.

Interest rate benchmark reform – hedge accounting

.36A *For the hedging relationships specified in paragraphs* 3856.32*(c)-(d) only, an enterprise shall continue applying hedge accounting to existing hedging relationships only if all changes made to the contractual terms of a hedging item or a hedged item are directly related to the replacement of IBORs. (Paragraphs* 3856.A54A-*.A54B provide related application guidance.) To qualify for this exception, the critical terms of the hedging item and the hedged item shall continue to match after the enterprise makes such changes.*

.36B *The contractual terms in the hedged item and the reference rate in the hedging item may be replaced at different times. In that case, there will be a temporary period during which the critical terms of the hedged item and the hedging item do not match. During this period, the exception specified in paragraph* 3856.36A *is applied and hedge accounting shall continue, provided that the enterprise is actively in the process of replacing the reference rate in the remaining instrument.*

.36C Some interest rate swaps and cross-currency interest rate swaps designated as hedging items may be modified through direct contract amendments to effect a change because of IBOR reform. Alternatively, they may be modified to effect the change because of IBOR reform by both:

(a) entering into a fully offsetting derivative contract to effectively cancel the original derivative contract; and

(b) contemporaneously entering into a new derivative contract with the revised contractual terms.

Both methods of effecting changes to contractual terms as a result of IBOR reform qualify for the exception described in paragraph 3856.36A.

.36D *An enterprise shall update its hedge documentation to reflect the changes required by IBOR reform to the hedging item, the hedged item and the description of the specific risk exposure being hedged. For the avoidance of doubt, such an amendment to the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.*

.36E *The exception specified in paragraph* 3856.36A *shall end when all changes related to the replacement of IBORs have been made to the hedged item and hedging item.*

DISCLOSURE

.37 *An enterprise shall disclose relevant enterprise-specific information that enables users of its financial statements to evaluate the significance of financial instruments to its financial position and performance. Information is relevant and enterprise-specific when it is considered significant based on the enterprise's current exposure.*

Financial assets

.38 *An enterprise shall disclose the carrying amounts of each of the following categories of financial instruments, either on the face of the balance sheet or in the notes:*

(a) financial assets measured at amortized cost;

(b) financial assets measured at fair value; and

(c) investments in equity instruments measured at cost less any reduction for impairment.

.39 *Accounts and notes receivable shall be segregated so as to show separately trade accounts, amounts owing by related parties and other unusual items of significant amount. The amounts and, when practicable, maturity dates of accounts maturing beyond one year shall be disclosed separately.*

Transfers of receivables

.40 *If an enterprise has transferred financial assets during the period and accounts for the transfer as a sale* (see Appendix B)*, it shall disclose:*

(a) the gain or loss from all sales during the period;

(b) the accounting policies for:

(i) initially measuring any retained interest (including the methodology used in determining its fair value); and

(ii) subsequently measuring the retained interest; and

(c) a description of the transferor's continuing involvement with the transferred assets, including, but not limited to, servicing, recourse and restrictions on retained interests.

.41 *If an enterprise has transferred financial assets in a way that does not qualify for derecognition* (see Appendix B)*, it shall disclose:*

(a) the nature and carrying amount of the assets;

(b) the nature of the risks and rewards of ownership to which the enterprise remains exposed; and

(c) the carrying amount of the liabilities assumed in the transfer.

Impairment

.42 *For financial assets other than current trade receivables, an enterprise shall disclose the carrying amount of impaired financial assets, by type of asset, and the amount of any related allowance for impairment. For current trade receivables* (see CURRENT ASSETS AND LIABILITIES, Section 1510), *an enterprise shall disclose the amount of any allowance for impairment.*

Forgiveness

.42A *If an enterprise recognizes the forgiveness of a related party financial asset in net income, as a result of applying the criteria in paragraph* 3856.19AA*(b)(ii), it shall disclose that fact and the nature of the transaction that gave rise to the financial asset.*

Financial liabilities

.43 *For bonds, debentures and similar securities, mortgages and other long-term debt, an enterprise shall disclose:*

(a) the title or description of the liability;

(b) the interest rate;

(c) the maturity date;

(d) the amount outstanding, separated between principal and accrued interest;

(e) the currency in which the debt is payable if it is not repayable in the currency in which the enterprise measures items in its financial statements; and

(f) the repayment terms, including the existence of sinking fund, redemption and conversion provisions.

.44 *An enterprise shall disclose the carrying amount of any financial liabilities that are secured. An enterprise shall also disclose:*

(a) the carrying amount of assets it has pledged as collateral for liabilities; and

(b) the terms and conditions relating to its pledge.

.45 *An enterprise shall disclose the aggregate amount of payments estimated to be required in each of the next five years to meet repayment, sinking fund or retirement provisions of financial liabilities.*

.46 *For financial liabilities recognized at the balance sheet date, an enterprise shall disclose:*

(a) whether any financial liabilities were in default or in breach of any term or covenant during the period that would permit a lender to demand accelerated repayment; and

(b) whether the default was remedied, or the terms of the liability were renegotiated, before the financial statements were completed.

.47 *An enterprise that issues any of the following financial liabilities or equity instruments shall disclose information to enable users of the financial statements to understand the effects of features of the instrument, as follows:*

- *(a) For a financial liability that contains both a liability and an equity element* (see paragraph 3856.21)*, an enterprise shall disclose the following information about the equity element including, when relevant:*
  - *(i) the exercise date or dates of the conversion option;*
  - *(ii) the maturity or expiry date of the option;*
  - *(iii)the conversion ratio or the strike price;*
  - *(iv)conditions precedent to exercising the option; and*
  - *(v) any other terms that could affect the exercise of the option, such as the existence of covenants that, if contravened, would alter the timing or price of the option.*
- *(b) For a financial instrument that is indexed to the enterprise's equity or an identified factor, as described in paragraphs* 3856.14 and 3856.14A, *an enterprise shall disclose information that enables users of the financial statements to understand the nature, terms and effects of the indexing feature, the conditions under which a payment will be made and the expected timing of any payment.*
- *(ba) For a related party financial instrument with variable or contingent payments as described in paragraph* 3856.08D*, an enterprise shall disclose information that enables users of the financial statements to understand the nature, terms and effects of the variable or contingent payments, the conditions under which a payment will be made and the expected timing of any payment.*
- *(c) For retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as equity as specified in paragraph* 3856.23*, an enterprise shall disclose:*
  - *(i) on the face of the balance sheet, the total redemption amount for all classes of such shares outstanding;*
  - *(ii) the aggregate redemption amount for each class of such shares; and*
  - *(iii)a description of the arrangement that gave rise to the shares.*
- *(d) In addition to the disclosure required for financial liabilities, for retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as a financial liability, as specified in paragraph* 3856.23*, an enterprise shall disclose a description of the arrangement that gave rise to the shares.*
- *(e) For retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as a financial liability, when the effect of classifying these shares is recorded in retained earnings, an enterprise shall disclose on the face of the balance sheet, the amount charged to retained earnings for all classes of such shares.*

.47A *If an enterprise recognizes the extinguishment of a financial liability in a related party transaction in net income, as a result of applying the criteria in paragraph* 3856.28A*(b)(ii), it shall disclose that fact and the nature of the transaction that gave rise to the financial liability.*

Derivatives

.48 *An enterprise shall disclose:*

- *(a) the notional and carrying amounts of all derivative assets measured at fair value;*
- *(b) the notional and carrying amounts of all derivative liabilities measured at fair value;*
- *(c) the method used to determine the fair value of all derivatives measured at fair value; and*
- *(d) the notional and accrued amounts of all interest rate and cross-currency interest rate swaps in designated hedging relationships.*

.49 *When an enterprise measures the fair value of a derivative asset or liability using a quote from a derivatives dealer, it discloses that fact and the nature and terms of the instrument.*

.50 *An enterprise shall disclose sufficient information about derivatives that are linked to, and must be settled by delivery of, equity instruments of another enterprise whose fair value cannot be readily determined* (see paragraph 3856.12(b)(ii)) *to permit the reader to assess the potential implications of the contract. This information shall include:*

- *(a) the name of the issuer of the equity instrument;*
- *(b) a description of the equity instrument; and*
- *(c) the terms under which settlement will take place.*

Hedge accounting

.51 *An enterprise that designates derivatives as hedging items shall disclose information that enables users of the financial statements to understand the effect of hedge accounting, as follows:*

- *(a) For a hedge of an anticipated transaction in accordance with paragraph* 3856.33*, during the term of the hedging relationship, the enterprise discloses the terms of the anticipated transaction including the nature and timing of the hedged item, the terms of the forward contract, the fact that hedge accounting applies and the net effect of the relationship.*

(b) *For a hedge of an interest-bearing asset or liability in accordance with paragraph* 3856.34*, the enterprise discloses the nature and terms of the hedged item, the nature and terms of the hedging interest rate or cross-currency interest rate swap, the fact that hedge accounting applies and the net effect of the relationship.*

Items of income

.52 *An enterprise shall disclose the following items of income, expense, gains or losses either on the face of the statements or in the notes to the financial statements:*

(a) *net gains or net losses recognized on financial instruments;*

(b) *total interest income;*

(c) *total interest expense on current financial liabilities;*

(d) *interest expense on long-term financial liabilities, separately identifying amortization of premiums, discounts and financing fees; and*

(e) *the amount of any impairment loss or reversal of a previously recognized impairment loss.*

Risks and uncertainties

.53 *For each significant risk* (see paragraph 3856.A66) *arising from financial instruments, including derivatives, an enterprise shall disclose:*

(a) *the exposures to risk and how they arise; and*

(b) *any change in risk exposures from the previous period.*

.53A *An enterprise shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the enterprise is exposed at the end of the reporting period.*

.54 *For each type of risk arising from financial instruments, an enterprise shall disclose concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions* (see paragraph 3856.A67).

Interest rate benchmark reform

.54A *An enterprise shall disclose the nature and the carrying amount of the financial instruments, and the notional amount of any derivatives, that are subject to IBOR reform.*

EFFECTIVE DATE AND TRANSITION

.55 Except as specified in paragraphs 3856.56-.62 and 3856.66-.68, this Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.

.56 Notwithstanding the requirement in paragraph 3856.31(a) to designate and document all hedging relationships at inception, an enterprise may designate and document any hedging relationship that otherwise meets the requirements of this Section at any time prior to the end of the first fiscal year beginning on or after January 1, 2011.

.57 New paragraph 3856.19A, issued in October 2012, applies to annual financial statements relating to fiscal years beginning on or after January 1, 2013. Earlier application is permitted.

.58 Amendments to paragraphs 3856.03(k), and new paragraph 3856.A26A, issued in October 2013, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2014. Earlier application is permitted.

.59 New paragraph 3856.A62A, issued in October 2013, applies to hedging relationships in effect at January 1, 2014. Earlier application to hedging relationships in effect on or after January 1, 2013 is permitted.

.60 Amendments to paragraphs 3856.03(a) and 3856.B25, issued in September 2014, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

.61 Amendments to paragraphs 3856.33(c) and 3856.42, issued in October 2014, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2015. Earlier application is permitted.

.62 The amendments to paragraphs 3856.23, 3856.47(c) and 3856.A29 and new paragraphs 3856.09A, 3856.15A, 3856.23A-.23H and 3856.47(d)-(e), issued in December 2018, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2021. An enterprise applies these amendments as specified in paragraph 3856.63. Earlier application is permitted.

.63 Except as specified in paragraphs 3856.64-.65, an enterprise may choose to apply the amendments specified in paragraph 3856.62, either:

(a) at the beginning of the earliest period presented; or

(b) at the beginning of the fiscal year in which the amendments are first applied.

.63A When the amendments specified in paragraph 3856.62 are applied:

(a) at the beginning of the earliest period presented, the cumulative effect of applying the amendments is recorded in opening retained earnings or a separate component of equity of the earliest period presented; or

(b) at the beginning of the fiscal year in which the amendments are first applied, the cumulative effect of applying the amendments is recorded in opening retained earnings or a separate component of equity of the fiscal year in which the amendments are first applied.

.64 When the amendments are applied for the first time, an enterprise that issued retractable or mandatorily redeemable shares in a tax planning arrangement may choose to present the shares as:

(a) a financial liability measured in accordance with paragraph 3856.09A; or

(b) in a separate line in the equity section of the balance sheet if:

(i) the retractable or mandatorily redeemable shares were issued on or after January 1, 2018, and all the conditions in paragraph 3856.23 are met; or

(ii) the retractable or mandatorily redeemable shares were issued prior to January 1, 2018, and all the following conditions are met:

– Control (see SUBSIDIARIES, Section 1591) of the enterprise that issued the retractable or mandatorily redeemable shares in a tax planning arrangement is held by the party that owns the shares in the arrangement at the date of initial application. The enterprise need not assess if control has been retained from the date of the initial transaction that gave rise to the shares.

– No other written or oral arrangement exists such as a redemption schedule, that gives the holder of the shares the contractual right to require the enterprise to redeem the shares within a fixed or determinable period.

If both of the conditions above are not met for some or all of the retractable or mandatorily redeemable shares issued in a tax planning arrangement, those shares are classified as a financial liability, and measured in accordance with paragraph 3856.09A.

.65 When an enterprise chooses to apply the amendments at the beginning of the earliest period presented, in accordance with paragraph 3856.63(a), the enterprise is not required to make retrospective adjustments in respect of retractable or mandatorily redeemable shares issued in a tax planning arrangement that were extinguished prior to the beginning of the fiscal year in which the amendments are first applied.

.66 Amendments to paragraphs 3856.04, 3856.07, 3856.07A, 3856.08, 3856.11, 3856.12, 3856.13, 3856.14, 3856.16, 3856.17, 3856.19C, 3856.22, 3856.27, 3856.28, 3856.29, 3856.37, 3856.47(b), 3856.53, 3856.A8, 3856.A30, 3856.A35-.A36, 3856.A37, 3856.A54, 3856.A56, 3856.A58, 3856.A59-.A60 and 3856.A61 and new paragraphs 3856.04A, 3856.05(ba)-.05(bb), 3856.05(da), 3856.05(ea), 3856.05(oa)-(od), 3856.08A-.08E, 3856.12A, 3856.13A-.13B, 3856.14A, 3856.17A-.17B, 3856.19AA, 3856.19B, 3856.22A, 3856.27A, 3856.28A-.28B, 3856.42A, 3856.47(ba), 3856.47A, 3856.53A, 3856.A7A, 3856.A8A-.A8K, 3856.A13A, 3856.A21A-.A21B, 3856.A37A-.A37C and 3856.A60A, issued in December 2018, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2021. An enterprise applies these amendments as specified in paragraph 3856.67. Earlier application is permitted.

.67 Except as specified in paragraph 3856.68, an enterprise applies the amendments specified in paragraph 3856.66 retrospectively, in accordance with ACCOUNTING CHANGES, Section 1506.

.68 An enterprise applies the amendments as follows:

(a) for financial instruments originated or exchanged in a related party transaction that exist at the date these amendments are applied for the first time:

(i) the cost of a financial instrument that has repayment terms is determined using the undiscounted cash flow(s), excluding interest and dividend payments, of the instrument less any impairment measured in accordance with paragraph 3856.17A, as at the beginning of the earliest comparative period for the period which the amendments are applied for the first time;

(ii) the cost of a financial instrument that does not have repayment terms is deemed to be the carrying amount of the instrument in the financial statements of the enterprise less any impairment measured in accordance with paragraph 3856.17B, at the beginning of the earliest comparative period for the period which the amendments are applied for the first time; or

(iii)the fair value of a financial instrument that is an investment in debt or equity instruments that are quoted in an active market, a debt instrument where inputs significant to the determination of the fair value of the instrument are observable or a derivative contract is determined at the beginning of the earliest comparative period for the period which the amendments are applied for the first time; and

(b) for financial instruments exchanged in a related party transaction that do not exist at the date these amendments are applied for the first time, an enterprise need not restate the instrument as at the beginning of the earliest comparative period.

.69 *Amendments* to paragraphs 3856.27 and 3856.35 and new paragraphs 3856.29A-.29D, 3856.36A-.36E, 3856.54A and 3856.A54A-.A54B issued in February 2022, apply to annual financial statements relating to fiscal years ending on or after February 1, 2022. Earlier application is permitted, including in financial statements not yet authorized for issue. Except as specified in paragraphs 3856.70-.71, an enterprise applies these amendments retrospectively, as defined in ACCOUNTING CHANGES, Section 1506.

.70 *Transactions entered into before the date these amendments are applied for the first time shall not be retrospectively designated as hedges.*

.71 *An enterprise shall reinstate a discontinued hedging relationship if, and only if, the following conditions are met:*

(a) the enterprise had discontinued that hedging relationship solely due to changes required by IBOR reform and the enterprise would not have been permitted to discontinue that hedging relationship if these amendments had been applied at that time; and

(b) at the beginning of the reporting period in which an enterprise first applies these amendments (date of initial application of these amendments), that discontinued hedging relationship meets the qualifying criteria for hedge accounting specified in paragraph 3856.31.

.72 Amendments to paragraphs 3856.04, 3856.08 and 3856.11, issued in September 2023, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2025. Earlier application is permitted.

.73 Amendments to paragraph 3856.04(c) issued in December 2025, apply prospectively, as defined in ACCOUNTING CHANGES, paragraph 1506.05(g), to annual financial statements relating to fiscal years beginning on or after January 1, 2026. Earlier application is permitted.

APPENDIX A
APPLICATION SUPPLEMENT

This Appendix is an integral part of this Section.

TABLE OF CONTENTS	Paragraph

DEFINITIONS — DERIVATIVES

A1 Financial instruments include primary instruments, such as receivables, payables and equity instruments, and derivative financial instruments, such as futures, forward, swap and option contracts. Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Section.

A2 The definition of a derivative in this Section includes contracts that are settled gross by delivery of the underlying item (for example, a forward contract to purchase a fixed-rate debt instrument). However, contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation to receive, deliver or exchange a financial asset.

MEASUREMENT

Amortized cost

A3 When a financial instrument is issued or purchased at a premium or discount relative to its face amount, the difference represents a prepaid adjustment of interest. This amount is a component of the initial carrying amount of the financial instrument. When the financial instrument is measured at amortized cost, any premium or discount is amortized over the expected life of the item and recognized in net income as interest income or expense.

A4 Similarly, when a lender charges a borrower a fee in lieu of interest, either when a financial instrument is initially recognized or periodically throughout its term, the amounts paid represent adjustments of interest. Any such financing fee is recognized as an adjustment to the carrying amount of the financial instrument and amortized over the expected life of the financial instrument or the period to which the fee relates, if shorter.

A5 Amortization of prepaid interest in accordance with paragraphs 3856.A3-.A4 may be presented as a separate component of interest income or expense.

A6 If a financial asset or a group of similar interest-bearing financial assets has been written down as a result of an impairment loss, interest income is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fair value

A7 Fair value is defined as a price agreed upon by a willing buyer and a willing seller in an arm's length transaction. Underlying the definition of fair value is a presumption that an enterprise is a going concern. Therefore, fair value is not the amount that an enterprise would receive or pay in a forced transaction, involuntary liquidation, or distress sale. Fair value reflects the credit quality of the instrument, including collateral or other credit enhancements. The existence of published price quotations in an active market is the best evidence of fair value.

Initial measurement

A7A Initial measurement of financial instruments

Instrument	**Originated or acquired or issued or assumed in an arm's length or related party transaction?**	**Initial measurement**
Retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as a financial liability	Arm's length transaction	**Redemption amount** in accordance with paragraph 3856.09A
	Related party transaction	**Redemption amount** in accordance with paragraph 3856.09A
Investments in equity instruments quoted in an active market	Arm's length transaction	**Fair value** in accordance with paragraph 3856.07
	Related party transaction	**Fair value** in accordance with paragraph 3856.08C(a)
Investments in equity instruments **not** quoted in an active market	Arm's length transaction	**Fair value** in accordance with paragraph 3856.07
	Related party transaction	**Cost** in accordance with paragraph 3856.08A
Derivatives	Arm's length transaction	**Fair value** in accordance with paragraph 3856.07
	Related party transaction	**Fair value** in accordance with paragraph 3856.08C(d)
Debt instruments quoted in an active market	Arm's length transaction	**Fair value** in accordance with paragraph 3856.07
	Related party transaction	**Fair value** in accordance with paragraph 3856.08C(b)

Debt instruments when the inputs significant to the determination of the fair value of the instrument are observable, either directly or indirectly	Arm's length transaction	**Fair value** in accordance with paragraph 3856.07
	Related party transaction	**Fair value** in accordance with paragraph 3856.08C(c)
Debt instruments **not** quoted in an active market and for which inputs significant to the determination of the fair value of the instrument are **not** observable	Arm's length transaction	**Fair valu**e in accordance with paragraph 3856.07
	Related party transaction	**Cost** in accordance with paragraph 3856.08(a)

A8 When part of the consideration given or received in a transaction to acquire or issue a financial instrument in an arm's length transaction is for something other than the financial instrument, its fair value is estimated using a valuation technique. The fair value of a financial instrument with a non-market rate of interest is not equal to the cash consideration. It can be estimated as the present value of all future cash receipts discounted using the prevailing market rates of interest for a similar instrument (similar as to currency, term, type of interest rate, or other factors) with a similar credit rating. Any difference between the fair value of a financial asset or a financial liability and the cash consideration is recognized immediately in net income unless it qualifies for recognition as some other type of asset or liability. For example, when an enterprise receives an interest-free loan from a government agency, in the absence of evidence to the contrary, the difference between the fair value of the loan and the cash received is accounted for as a government grant (see GOVERNMENT ASSISTANCE, Section 3800). Similarly, when an enterprise extends an interest-free loan to an employee, in the absence of evidence to the contrary, the difference between the fair value of the loan and the cash paid to the employee is accounted for as employee compensation.

A8A A contract may be written or oral. Examples of financial instruments having repayment terms include:

(a) trade accounts receivable and payable;

(b) notes receivable and payable;

(c) loans receivable and payable;

(d) bonds receivable and payable;

(e) debt instruments with no stated repayment terms deemed to be payable on demand in accordance with paragraph 3856.A12; and

(f) retractable or mandatorily redeemable shares.

A8B Examples of financial instruments that do not have repayment terms include:

(a) common shares;

(b) warrants;

(c) preferred shares that do not have a stated redemption amount; and

(d) options.

A8C Some related party transactions include the exchange of multiple assets and liabilities. When measuring financial instruments that do not have repayment terms in these transactions, the value of the instrument without repayment terms is determined using the residual of the total consideration transferred in the transaction less the amounts attributed to the other assets or liabilities recognized in the transaction.

A8D A non-monetary related party transaction has commercial substance when the enterprise's future cash flows are expected to change significantly as a result of the transaction. The enterprise's future cash flows are expected to change significantly when:

(a) the configuration, as defined in paragraph 3856.A8E, of the future cash flows of the asset received differs significantly from the configuration of the future cash flows of the asset given up; or

(b) the enterprise-specific value of the asset received differs from the enterprise-specific value of the asset given up and the difference is significant in relation to the exchange amount of the items exchanged.

In some cases, a qualitative assessment will be conclusive in determining that the estimated cash flows of the enterprise are expected to change significantly as a result of the transaction.

A8E The configuration of future cash flows is composed of the risk, timing and amount of the cash flows. A change in any one or more of these considerations is a change in the configuration.

A8F Enterprise-specific value, resulting from enterprise-specific measurement, differs from fair value. It attempts to capture the value of an item in the context of the reporting enterprise. The enterprise uses its expectations about its use of the asset rather than the use assumed by marketplace participants. When a non-monetary related party transaction has commercial substance, it is measured at the exchange amount rather than enterprise-specific value.

A8G Independent evidence in support of the use of an exchange amount of the consideration transferred includes at least one of the following:

(a) independent appraisals, valuations or approvals, by appropriately qualified parties that are not related to the enterprise, carried out to determine the exchange amount;

(b) comparable recently quoted market prices, in an open and unrestricted market;

(c) comparable independent bids on the same transaction; or

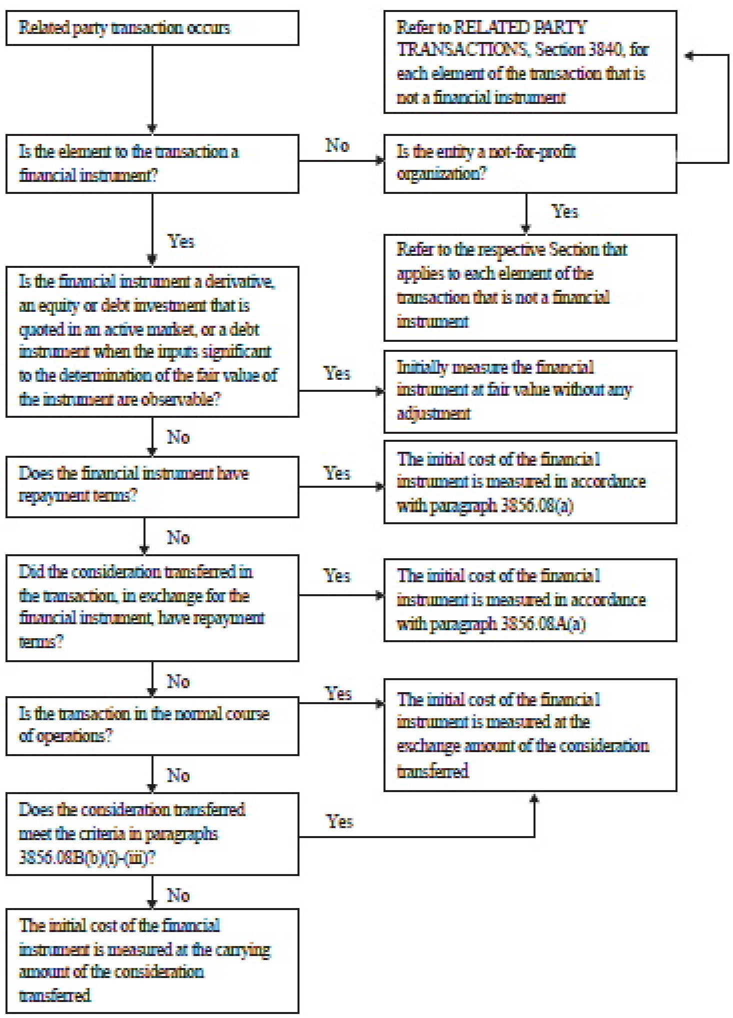
(d) comparable amounts of similar transactions actually undertaken with unrelated parties.

A8H The sufficiency and appropriateness of independent evidence required to support the exchange amount of the consideration transferred is a matter of professional judgment. Such evidence may be in the form of independent documentation supporting the exchange amount, or may be a result of the participation of unrelated parties in determining the exchange amount. In some instances, several items of consistent evidence may be required to support the exchange amount. In other instances, one piece of very persuasive evidence may be sufficient. Generally, the more involved unrelated parties are in developing the evidence, the more persuasive it will be.

A8I An enterprise may have a formal policy to bargain with related parties so that the enterprise would reject an offer from a related party if a better offer were received from an unrelated party. When such bargaining involves unrelated parties, or those selected by the unrelated parties, or those appointed pursuant to regulatory requirements, to act on their behalf, it provides independent evidence to support use of the exchange amount.

A8J Not all inputs used to determine the fair value of a debt instrument need be observable. A valuation technique used to determine the fair value of a debt instrument may include inputs that are not observable to the extent that they have an insignificant effect on the fair value measurement of the instrument.

A8K Decision tree for the initial measurement of financial instruments in a related party transaction



Quoted price in an active market

A9 A financial instrument is regarded as quoted in an active market when quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices reflect actual and regularly occurring market transactions on an arm's length basis.

A10 The appropriate quoted market price for an investment in an equity instrument is usually the latest closing price. Non-option derivatives are usually measured using mid-market prices or rates. Derivatives that are options are usually measured using bid prices for purchased options and ask prices for issued options. Mid-market prices may be used. A quote from a derivatives dealer may be used as a proxy for the fair value of a derivative. At each reporting date, an enterprise uses consistent price quotes for each financial instrument measured at fair value. In other words, an enterprise that applies a bid price to a financial instrument uses the most current bid price to remeasure that instrument. When current rates or prices are unavailable, the price of the most recent transaction provides evidence of the current fair value so long as there has not been a significant change in economic circumstances since the time of that transaction.

A11 When a quoted market price in an active market is no longer available for an equity instrument to which paragraph 3856.12(a) applies, and the enterprise does not elect to continue to carry the instrument at fair value in accordance with paragraph 3856.13(b), the fair value carrying amount of the instrument on that date becomes its cost. The enterprise shall measure the instrument at this amount less any reduction for impairment until a quoted market price in an active market becomes available.

Financial liability with a demand feature

A12 The fair value of a financial liability with a demand feature (for example, 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. A debt instrument with no stated repayment terms is deemed to be payable on demand. When the payment of a debt instrument is subordinated to the interest of another party, the earliest date at which payment could be demanded is the day following the maturity of the instrument to which it is subordinated.

A13 The interest rate used to discount a financial instrument payable on demand is determined by reference to rates available to the enterprise on a similar financial instrument maturing on, or as close as possible to, the first date that the instrument payable on demand could be required to be paid. It incorporates any risk premium that a third party would charge for a financial instrument of comparable credit quality.

Subsequent measurement of financial instruments

A13A The subsequent measurement of a financial instrument is dependent on how the instrument was initially measured. This table illustrates the initial measurement of a financial instrument as it pertains to the subsequent measurement of the instrument. Additional application guidance on the initial measurement of financial instruments is available in paragraph 3856.A7A.

Instrument	Initial measurement	Subsequent measurement
Retractable or mandatorily redeemable shares issued in a tax planning arrangement that are classified as a liability	**Redemption amount** in accordance with 3856.09A	**Redemption amount** in accordance with 3856.15A
Investments in equity instruments quoted in an active market	**Fair value** in accordance with paragraphs 3856.07 or 3856.08C(a)	**Fair value** in accordance with paragraph 3856.12(a)
Investments in equity instruments **not** quoted in an active market	**Fair value** in accordance with paragraph 3856.07	**Cost** or **fair value** in accordance with paragraphs 3856.11(a)(iii) or 3856.13
	Cost in accordance with paragraph 3856.08A	**Cost method** in accordance with paragraph 3856.11(b)
Derivatives	**Fair value** in accordance with paragraphs 3856.07 or 3856.08C(d)	**Fair value** in accordance with paragraph 3856.12(b)
Debt instruments quoted in an active market	**Fair value** in accordance with paragraphs 3856.07 or 3856.08C(b)	**Amortized cost** in accordance with paragraphs 3856.11(a)(iv)-(v); or **fair value** in accordance with paragraphs 3856.13(a) or 3856.13A(a)
Debt instruments when the inputs significant to the determination of the fair value of the instrument are observable, either directly or indirectly	**Fair value** in accordance with paragraphs 3856.07 or 3856.08C(c)	**Amortized cost** in accordance with paragraph 3856.11(a); or **fair value** in accordance with paragraphs 3856.13(a) or 3856.13A(b)
Debt instruments **not** quoted in an active market and for which inputs significant to the determination of	**Fair value** in accordance with paragraph 3856.07	**Amortized cost** or **fair value** in accordance with paragraphs 3856.11(a)(iv)-(v) or 3856.13(a)

the fair value of the instrument are **not** observable	**Cost** in accordance with paragraph 3856.08(a)	**Cost method** in accordance with paragraph 3856.11(b)

Impairment

A14 Each investment in another enterprise's equity instruments and each other financial asset that is individually significant is assessed individually for impairment. Other financial assets are assessed for impairment either individually or grouped on the basis of similar credit risk characteristics. Group assessment might be appropriate when available information is not sufficient to permit identification of each of the individual assets within a group that is impaired, or there are numerous assets affected by the same factors. For example, an enterprise might collectively evaluate customers that operate in a particular industry or geographic region, or that share other identifiable common characteristics.

A15 Indicators of impairment include:

(a) significant financial difficulty of the customer or issuer;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the enterprise granting a concession to the customer or issuer;

(d) it becoming probable that the customer or issuer will enter bankruptcy or other financial reorganization;

(e) the disappearance of an active market for a financial asset because of financial difficulties of the issuer;

(f) a significant adverse change in the technological, market, economic or legal environment in which the customer or issuer operates (for example, a sharp decline in the price of a commodity, such as oil or lumber, may cause economic instability in the related industry or have an adverse effect on other customers in a region that is dependent on the particular industry); and

(g) adverse national or local economic conditions or adverse changes in industry conditions indicate that there is a decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

A16 The following events or circumstances are not necessarily indicators of impairment:

(a) the disappearance of an active market because an enterprise's financial instruments are no longer publicly traded;

(b) a downgrade of an enterprise's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information; and

(c) when readily determinable, a decline in the fair value of a financial asset below its cost or amortized cost (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the basic, risk-free interest rate).

A17 When a group of financial assets, such as accounts receivable, is comprised of large numbers of homogeneous balances of relatively small dollar amounts, impaired assets within the group are commonly identified based upon delays in receipt of payment. The extent of impairment present in the group is estimated by applying formulae that take into account the analysis of arrears, aging of balances, past loss experience, current economic conditions and other relevant circumstances such as uncompensated payment delays. To ensure that the loss ratios applied reflect the most current information available, it is necessary that the formulae be reviewed regularly.

A18 For other groups of assets that share identifiable common characteristics, information available at the date of preparation of the financial statements may not be adequate to identify each individual impaired loan and the full extent of impairment within the group as a whole. In such cases, the extent of additional impairment is estimated collectively based on the enterprise's judgment of the impact on the group of assets of recent events and changes in economic conditions that indicate the existence of impairment. In making such judgments, consideration is given to the effect on loss experience of similar events and changes in conditions in the past. Measurement of the extent of the additional impairment present in a group of assets is based on an assessment of the extent to which future cash flows are expected to be reduced or delayed.

A19 The amount of the impairment loss on an unquoted equity instrument or a derivative asset that is linked to, and must be settled by delivery of, such an unquoted equity instrument is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

A20 While the ability to estimate reliably the amounts and timing of the expected future cash flows from a group of assets is constrained by the limitations of the information available and the inability to assess the effect on individual accounts, reasonable assumptions can be made to achieve a result that is consistent with the measurement objective. When an additional allowance for impairment is recognized against the remaining assets in a group after allowing for impairment identified on an asset-by-asset basis, it may be reasonable to assume that future cash flows are impaired in approximately the same proportion.

A21 Impairment losses recognized on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

FORGIVENESS

A21A A related party financial asset, or part thereof, is forgiven when the enterprise terminates all or part of a liability for payment to settle the financial asset. Cancellation, set-off and release are examples of possible means of termination.

A21B When an enterprise forgives a financial asset, or part thereof, due from a counterparty that is acting solely in the capacity of management, the amount forgiven is considered compensation and shall be recognized as an expense, by the enterprise, in net income.

LIABILITIES AND EQUITY

A22 The substance of the contractual terms of a financial instrument, rather than its legal form, governs its classification on the issuer's balance sheet. While substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance, and others may combine features associated with equity instruments and features associated with financial liabilities. The classification of an instrument is made on the basis of an assessment of its substance when it is first recognized. Such a classification is not circumvented by non-substantive or minimal features included in the financial instrument. Any non-substantive or minimal feature is disregarded in applying the classification provisions of this Section. Judgment, based on consideration of all of the terms of an instrument and other relevant facts and circumstances, is necessary to distinguish substantive, non-minimal features from non-substantive or minimal features. The classification made at inception continues at each subsequent reporting date until the terms of the financial instrument change or it is removed from the enterprise's balance sheet.

A23 The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled. A restriction on the ability of the issuer to satisfy an obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the issuer's obligation or the holder's right under the instrument.

A24 An enterprise may have a contractual obligation of a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the enterprise's own equity instruments, but the enterprise must, or can, settle the obligation by delivery of its own equity instruments (the number of which depends on the amount of the obligation). Such an obligation is a financial liability of the enterprise. When the number of an enterprise's own shares or other equity instruments required to settle the obligation varies with changes in their fair value, so that the total fair value of the equity instruments to be delivered is based solely or predominantly on the amount of the contractual obligation, the counterparty does not hold a residual interest in the enterprise until it has received the equity instruments. The enterprise may have to deliver more or fewer of its own equity instruments than would have been the case at the date of entering into the contractual arrangement. Such an obligation is a financial liability of the enterprise even though the enterprise must or can settle by delivering its own equity instruments. These financial liabilities are treated as monetary items.

A25 When a financial instrument does not give rise to a contractual obligation on the part of the issuer to deliver cash or another financial asset or to exchange another financial instrument under conditions that are potentially unfavourable, it is an equity instrument. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions out of equity, the issuer does not have a contractual obligation to make such distributions. Thus, the terms and conditions of some preferred shares may be such that they meet the definition of an equity instrument and are classified accordingly.

A26 When a preferred share, other than a share to which paragraph 3856.23 applies, provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A preferred share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. For example, if a financial instrument labelled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. An enterprise does not change the classification of the financial instrument based on a change in its estimate of the probability of the future event occurring. If occurrence or non-occurrence of the future event does not result in the maturity, expiry, settlement, discharge or cancellation of the financial instrument, the enterprise derecognizes the original financial instrument and recognizes a new financial liability or equity instrument based on the remaining terms.

A26A In the absence of a contractual obligation to redeem a financial instrument, economic compulsion does not cause the instrument to be classified as a financial liability.

A27 Some financial instruments, such as partnership interests and certain types of shares in co-operative organizations, provide for payments to the holder of a pro rata share of the residual equity of the issuer. These financial instruments may require redemption in specified circumstances that are certain to arise, such as the death of the holder, but do not impose an obligation on the issuer to deliver or exchange any specific amount of financial assets in advance of redemption. On issuance, and subject to paragraph 3856.A28, such financial instruments constitute an equity instrument of the issuer. When the holder subsequently chooses to withdraw its equity and is entitled to do so, the issuer may become obliged to make a payment that is fixed or determinable as to amount and timing. This obligation satisfies the definition of a financial liability and is presented as such.

A28 A retractable or mandatorily redeemable share, other than a share to which paragraph 3856.23 applies, is classified as a liability unless all of the following criteria are met:

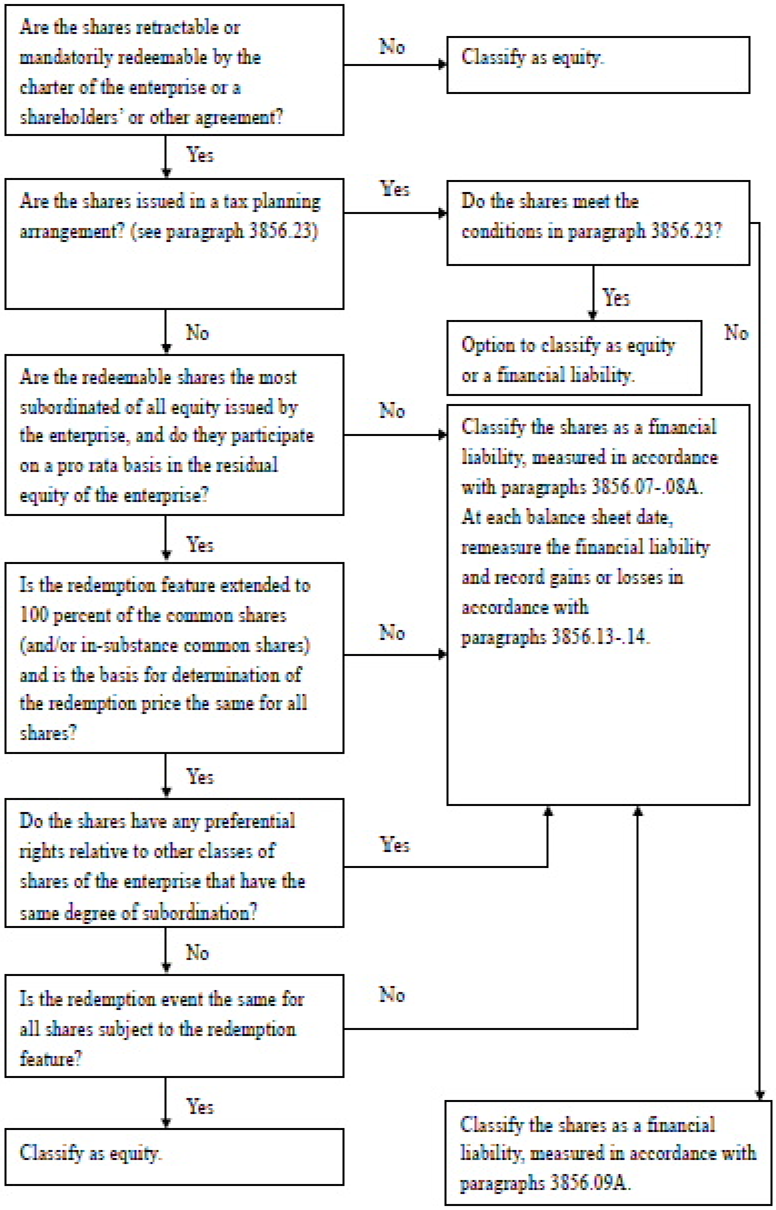
(a) The redeemable shares are the most subordinated of all equity instruments issued by the enterprise (i.e., along with the enterprise's common shares, they represent the "residual equity interest" in the enterprise), and the redeemable shares participate on a pro rata basis in the residual equity of the enterprise. An instrument represents a residual equity interest if its participation in the enterprise's earnings is substantially similar to the enterprise's common shares. The holders participate in the enterprise's residual net assets, or undistributed earnings (after any preferred shares are redeemed), on a pro rata basis. Undistributed earnings are allocated to the shares based on their contractual participation rights. Participation will include the right to participate in all dividends declared, including dividends that must be declared upon the occurrence of a specified event, the occurrence of which is subject to management discretion or is not objectively determinable (for example, liquidation of the enterprise or declaration of an "extraordinary" dividend).

(b) The redemption feature is extended to 100 percent of the common shares (and/or in-substance common shares), and the basis for determination of the redemption price is the same for all shares. There cannot be a class of common shares with the same degree of subordination that is not entitled to the same redemption feature. The basis for determination of the redemption price is the same for all shares. However, the redemption price may be determined based on the fair value of the redeemable shares at the redemption date, or it may be based on a formula (which might be book value) that all the shareholders agree on as being equitable, provided the same basis or formula is applied to all of the redeemable shares.

(c) The shares have no preferential rights relative to other classes of shares of the enterprise that have the same degree of subordination. All of the redeemable shares include substantially similar characteristics to the enterprise's common shares; for example, they do not include any substantive liquidation preferences or dividend distribution preferences.

(d) The redemption event is the same for all the shares subject to the redemption feature. However, this criterion does not require all of the shares to be redeemed at the same time. Rather, it requires that the same event or events trigger redemption rights for all shares, for example, redemption on the resignation, termination, retirement or death of the shareholder. When an event occurs that triggers the redemption right, the shares are reclassified as liabilities.

A29 **Decision tree — Classification of retractable or mandatorily redeemable shares**



Compound financial instruments

A30 Paragraph 3856.20 requires the separate presentation on an issuer's balance sheet of liability and equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and equity interests are created by a single financial instrument rather than two or more separate instruments. Consequently, the same accounting applies whether the liability and equity interests are created by a single instrument or by two or more separate but linked instruments (see paragraphs 3856.21-.22A). An issuer's financial position is more faithfully represented by separate presentation of the liability and equity components contained in a single instrument according to their nature.

A31 For purposes of balance sheet presentation, an issuer recognizes separately the component parts of a financial instrument that creates a financial liability of the issuer and grants an option to the holder of the instrument to convert it into an equity instrument of the issuer. A bond or similar instrument convertible by the holder into common shares of the issuer is an example of such an instrument. From the perspective of the issuer, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or other financial assets) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert into common shares of the issuer). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase common shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the issuer presents the liability and equity elements separately on its balance sheet.

A32 Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The issuer's obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument or some other transaction.

A33 A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument may give the holder the right to receive a non-financial asset such as a commodity in settlement and an option to exchange that right for shares of the issuer. The issuer recognizes and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.

Accounting for convertible debt instruments

A34 When an option to convert a financial liability to equity is exercised and the issuer settles the obligation by issuing shares in accordance with the original terms of the instrument, the carrying amount of the equity element, if any, plus the carrying amount of the liability element (including any accrued but unpaid interest), are transferred to share capital. No gain or loss is recognized on this form of conversion because it is according to the original terms of the instrument.

A35 When an option to convert a financial liability issued in an arm's length transaction to equity is exercised and the issuer settles the obligation in cash, the enterprise accounts for the settlement as the extinguishment of the instrument, and a gain or loss on extinguishment of the liability element is recognized in net income (see paragraphs 3856.20-.23, and 3856.A49-.A61). The settlement of the equity element is recognized as a capital transaction (see CAPITAL TRANSACTIONS, Section 3610), with any gain credited to contributed surplus and any loss applied first against contributed surplus to the extent of prior gains, and then against retained earnings.

A36 On extinguishment of a convertible debt instrument issued in an arm's length transaction, the issuer allocates the consideration paid to the liability and equity elements as follows:

(a) When the initial measurement of the equity element was zero in accordance with paragraph 3856.22(a), the consideration is allocated first to the liability, up to the carrying amount of the debt, including accrued interest, and the balance, if any, to the equity element.

(b) When the initial measurement of the liability and equity elements was based on measuring one or both components at its fair value in accordance with paragraph 3856.22(b), the consideration is allocated on the same basis as that used in the original allocation of the proceeds received by the enterprise on issuance of the convertible instrument.

A37 When the issuer of an instrument that was issued in an arm's length transaction offers a more favourable conversion ratio than the original ratio specified in the debt agreement, or offers additional shares if the holder converts the debt security by a specified time (i.e., in an induced early conversion), the number of shares converted under the terms of the original instrument is measured at the original contract price (i.e., based on the original conversion ratio) and any additional shares issued to induce the conversion are measured at fair value. Any resulting gain or loss is treated as follows:

(a) the amount of gain or loss relating to the liability element is credited or charged to income; and

(b) the difference between the carrying amount and the amount considered to be settled relating to the holder option element is treated as a capital transaction.

A37A In a transaction between related parties, when an option to convert a financial liability to equity is exercised and the issuer settles the obligation in cash, the enterprise accounts for the settlement as the extinguishment of the instrument, and any difference on extinguishment of the liability element is measured and recognized in accordance with paragraph 3856.28A. The settlement of the equity element is recognized as a capital transaction (see CAPITAL TRANSACTIONS, Section 3610), with any gain credited to contributed surplus and any loss applied first against contributed surplus to the extent of prior gains, and then against retained earnings.

A37B On extinguishment of a convertible debt instrument issued in a related party transaction, the issuer allocates the consideration paid to the liability and equity elements as follows:

(a) the consideration is allocated first to the liability, up to the carrying amount of the debt, including accrued interest and the excess, if any, is accounted for in accordance with paragraphs 3856.04A or 3856.28A.

(b) if the consideration paid to extinguish the instrument is less than the carrying amount of the liability, any shortfall is accounted for in accordance with paragraphs 3856.28A or 3856.28B.

A37C When the issuer of an instrument that was issued in a related party transaction offers a more favourable conversion ratio than the original ratio specified in the debt agreement, or offers additional shares if the holder converts the debt security by a specified time (i.e., in an induced early conversion), the number of shares converted under the terms of the original instrument is measured at the original contract price (i.e., based on the original conversion ratio) and any additional shares issued to induce the conversion are measured at fair value. Any resulting gain or loss is treated as follows:

(a) the difference relating to the liability element is recognized in accordance with paragraph 3856.28A; and

(b) the difference between the carrying amount and the amount considered to be settled relating to the holder option element is treated as a capital transaction.

A38 If an option to convert a financial liability to equity is not exercised and the conversion option expires at maturity, the issuer accounts for the settlement of the instrument at its redemption value (which, at that time, is also the stated principal amount of the instrument). Accordingly, the liability element is derecognized, and the carrying amount of the equity element, if any, is transferred to contributed surplus. If the enterprise settles the debt element through issuance of shares, the redemption value of the debt element is credited to share capital.

Interest, dividends, losses and gains

A39 The classification of a financial instrument in the balance sheet determines whether interest, dividends, losses and gains relating to that instrument are classified as expenses or income and reported in the income statement. Thus, dividend payments on shares classified as liabilities are classified as expenses in the same way as interest on a bond and reported in net income. Similarly, gains and losses associated with redemptions or refinancings of instruments classified as liabilities are reported in net income, while redemptions or refinancings of instruments classified as equity are reported as changes in equity.

A40 Dividends classified as an expense may be presented in the income statement either with interest on other liabilities or as a separate item. Disclosure of interest and dividends is subject to the requirements of INCOME STATEMENT, Section 1520. In some circumstances, because of significant differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately within the income statement. Disclosures of the amounts of tax effects are made in accordance with INCOME TAXES, Section 3465.

OFFSETTING OF A FINANCIAL ASSET AND A FINANCIAL LIABILITY

A41 Paragraph 3856.24 requires the presentation of financial assets and financial liabilities on a net basis when this reflects an enterprise's expected future cash flows from settling two or more separate financial instruments. When an enterprise has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistent with their characteristics as resources or obligations of the enterprise.

A42 Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from ceasing to recognize a financial asset or a financial liability. While offsetting does not give rise to recognition of a gain or a loss, ceasing to recognize a financial instrument not only results in the removal of the previously recognized item from the balance sheet, but may also result in recognition of a gain or a loss.

A43 A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. Since the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another, and care must be taken to establish which laws apply to the relationships between the parties.

A44 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability, and may affect significantly an enterprise's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an enterprise's future cash flows are not affected. When an enterprise does intend to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting since the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

A45 An enterprise's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously.

A46 Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearinghouse in an organized financial market or a face-to-face exchange. In these circumstances, the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an enterprise may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are considered simultaneous only when the transactions occur at the same moment.

A47 The conditions in paragraph 3856.24 are generally not satisfied and offsetting is usually inappropriate when, for example:

(a) several different financial instruments are used to emulate the features of a single financial instrument (i.e., a "synthetic instrument");

(b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;

(c) financial or other assets are pledged as collateral for non-recourse financial liabilities;

(d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or

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

A48 An enterprise that undertakes a number of financial instrument transactions with a single counterparty may enter into a "master netting arrangement" with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless the circumstance making it a current right has already occurred and both of the criteria in paragraph 3856.24 are satisfied.

DERECOGNITION OF FINANCIAL LIABILITIES

A49 A financial liability (or part of it) is extinguished when the debtor:

(a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods, or services; or

(b) is legally released from primary responsibility for the liability (or part of it), either by process of law or by the creditor. (When the debtor has given a guarantee, this condition may still be met.)

A transfer of debt instruments between debt holders does not result in a modification of the terms of the original debt instrument or an exchange of debt instruments between the debtor and the debt holders.

A50 When a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognize the debt obligation unless the condition in paragraph 3856.A49(b) is met. Payment to a third party, including a trust (sometimes called "in-substance defeasance"), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release. When the debtor pays a third party to assume an obligation and obtains a legal release from its creditor, the debtor has extinguished the debt. However, when the debtor agrees to make payments on the debt to the third party or directly to its original creditor, the debtor recognizes a new debt obligation to the third party.

A51 In order to determine whether there has been a modification or exchange of debt instruments in transactions involving a third party intermediary, it is necessary to determine whether the intermediary is acting as an agent or as a principal. If the intermediary acts on behalf of the debtor and does not place its own funds at risk, there is an agency relationship and the actions of the intermediary are viewed as those of the debtor. However, if the intermediary commits its own funds and is subject to the risk of loss of those funds, the intermediary is acting as a principal and is viewed as a third party creditor similar to any other creditor. In order to determine whether the third party intermediary is acting as an agent or a principal, all the facts surrounding the role of the intermediary are evaluated.

A52 For the purpose of paragraph 3856.27, the terms of a renegotiated financial liability differ substantially from the original liability when:

(a) the present value of the cash flows under the new terms, including any fees paid net of any fees received differs by at least 10 percent from the present value of the remaining cash flows of the original financial liability, both discounted at the original interest rate; or

(b) there is a change in the creditor and the original debt is legally discharged by the debtor through a cash payment or otherwise.

A53 In comparing the present value of discounted cash flows in accordance with paragraph 3856.A52(a), an enterprise includes changes in principal amounts, interest rates or maturity as well as fees exchanged between the debtor and creditor to effect changes in such attributes as:

(a) recourse or non-recourse features;

(b) priority of the obligation;

(c) collateralized (including changes in collateral) or non-collateralized features;

(d) debt covenants or waivers;

(e) the guarantor (or elimination of the guarantor); or

(f) call or redemption features.

A54 When an exchange of debt instruments (exchange) or a modification of the terms of a financial liability (modification) issued in an arm's length transaction is accounted for as an extinguishment in accordance with paragraph 3856.26, the debtor accounts for the difference between:

(a) the fair value of the new debt instrument; and

(b) the carrying amount of the original debt instrument (together with all unamortized financing fees and transaction costs accounted for as adjustments to the original debt instrument)

as a gain or loss in net income.

A54A For the purposes of paragraphs 3856.29C and 3856.36A, examples of changes to terms that are related to the replacement of IBORs include, but are not restricted to, the following:

(a) changes to the interest rate benchmark (e.g., a change from CDOR to an alternative benchmark rate);

(b) addition of or changes to a spread adjustment (e.g., adding or adjusting a spread to the interest rate index, amending the fixed rate for an interest rate swap or paying or receiving a cash settlement for any difference intended to compensate for the difference in reference rates);

(c) changes to the reset period, reset dates, day-count conventions, business-day conventions, payment dates, payment frequency and repricing calculation;

(d) addition of or changes to contractual fallback terms that are consistent with fallback terms developed by a regulator, a private sector working group convened by a regulator, central banks or similar governmental organizations; or

(e) changes to terms that are necessary to comply with laws or regulations or to align with market conventions for the replacement rate.

A54B For the purposes of paragraphs 3856.29C and 3856.36A, examples of changes to terms that are unrelated to the replacement of IBORs include, but are not restricted to, the following:

(a) changes to the notional amount;

(b) changes to the maturity date;

(c) changes from the existing interest rate benchmark to a stated fixed rate;

(d) the addition of an underlying or variable unrelated to the interest rate benchmark;

(e) a concession granted to debtor experiencing financial difficulty; or

(f) the addition or removal of a feature that is intended to provide leverage.

A55 When an exchange or modification is not accounted for as an extinguishment, fees and transaction costs accounted for as adjustments to the original debt instrument continue to be recognized as a component of the carrying amount of the debt instrument and, together with fees and transaction costs related to the renegotiation, are amortized over the remaining term of the renegotiated debt (see paragraph 3856.A4).

A56 For the purpose of paragraph 3856.27, the terms of a renegotiated line of credit or revolving debt arrangement issued in an arm's length transaction differ substantially from the original liability when the product of the remaining term and the maximum available credit (the borrowing capacity) of the old arrangement exceeds the borrowing capacity of the new arrangement.

A57 Fees and transaction costs associated with a line of credit or revolving debt arrangement relate to securing the availability of financing for a specified period of time. Accordingly, standby fees and transaction costs paid by enterprise are recognized as an asset and amortized over the period to which they relate. When a line of credit or revolving debt arrangement is renegotiated, fees and costs associated with the renegotiation are amortized over the term of the new arrangement. Any unamortized fees and costs associated with the old arrangement are amortized over the term of the new arrangement when the borrowing capacity of the new arrangement is greater than or equal to the borrowing capacity of the old arrangement. When the borrowing capacity of the new arrangement is less than the borrowing capacity of the old arrangement, any unamortized fees and costs relating to the old arrangement at the time of the change are written off in proportion to the decrease in borrowing capacity of the old arrangement. The remaining unamortized costs relating to the old arrangement are recognized as an asset and amortized over the term of the new arrangement.

A58 In some arm's length transactions, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In this circumstance, the debtor:

(a) recognizes a new financial liability based on the fair value of its obligation under the guarantee; and

(b) recognizes a gain or loss based on the difference between:

  (i) any amounts paid; and

  (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

A59 The issue of an enterprise's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraphs 3856.28-.28A.

A60 An enterprise initially measures equity instruments issued to a creditor in an arm's length transaction to extinguish all or part of a financial liability at either the fair value of the equity instruments issued or the fair value of the liability extinguished.

A60A An enterprise initially measures equity instruments issued to a creditor to extinguish all or part of a financial liability issued in a related party transaction at the carrying amount of the liability extinguished.

A61 If only part of the financial liability issued in an arm's length transaction is extinguished by the issue of equity instruments, the enterprise also assesses the terms of the financial liability that remains outstanding to determine whether they are substantially different from those of the original financial liability. If the terms of the financial liability that remains outstanding are substantially different from those of the original financial liability, the enterprise accounts for the modification as the extinguishment of the original financial liability and the recognition of a new financial liability in accordance with paragraph 3856.26.

HEDGE ACCOUNTING

A62 An enterprise may designate a foreign exchange forward contract as a hedge of an anticipated foreign currency transaction or a group of foreign currency transactions only when:

(a) the forward contract is for the purchase or sale of the same amount of the same currency as the designated hedged anticipated transaction or group of transactions;

(b) the forward contract matures within 30 days of the settlement of each designated anticipated transaction;

(c) it is probable the settlement of each anticipated foreign currency transaction will occur at the time and in the amount expected; and

(d) the fair value of the forward contract at the inception of the hedging relationship is zero.

A62A Foreign exchange forward contracts may be settled net by transferring the gain or loss amount, or gross by exchanging the two currencies. When a foreign exchange forward contract is designated as a hedge of an anticipated purchase transaction and the contract settles gross before the purchase is recognized, the foreign currency acquired on settlement of the contract is initially recognized at the spot rate in effect on the settlement date. When the foreign currency is held continuously between the date the contract is settled and the date the purchase transaction is recognized, any gain or loss on translating the foreign currency cash held is presented as a separate component of equity until the purchase is recognized. When the purchase is recognized, the gain or loss on the foreign currency held is transferred from the separate component of equity to the carrying amount of the asset acquired in the purchase transaction or to net income in accordance with paragraph 3856.33(a).

A63 An enterprise may designate a forward contract as a hedge of an anticipated purchase or sale of a commodity or a group of anticipated purchases and sales only when:

(a) the commodity forward contract is for the purchase or sale of the same quantity and similar grade or purity of the same commodity as the designated hedged anticipated purchases or sales;

(b) it is probable that each hedged anticipated purchase or sale will occur within 30 days of the maturity of the commodity forward contract;

(c) it is probable that each anticipated commodity purchase or sale will occur at the time and in the amount expected; and

(d) the fair value of the forward contract at the inception of the hedging relationship is zero.

A63A In many circumstances, commodity transactions are undertaken in currencies other than that in which an enterprise measures transactions for financial reporting purposes. An enterprise may decide to enter into a foreign exchange forward contract to mitigate the currency risk created by the following commodity hedging relationships:

(a) an anticipated purchase or sale of a commodity denominated in the currency in which the enterprise measures transactions for financial reporting purposes hedged with a commodity forward contract denominated in a foreign currency;

(b) an anticipated purchase or sale of a commodity denominated in a foreign currency hedged with a commodity forward contract denominated in the same foreign currency; and

(c) an anticipated purchase or sale of a commodity denominated in a foreign currency hedged with a commodity forward contract denominated in the currency in which an enterprise measures transactions for financial reporting purposes.

A63B When the hedged item (the anticipated purchase or sale of a commodity) is denominated in a foreign currency (the circumstances referred to in paragraph 3856.A63A(b) or (c)), a commodity forward contract may be designated as hedging the commodity price risk in the hedged item if it meets the conditions in paragraph 3856.A63. A foreign exchange forward contract may also be designated as hedging the currency risk in the anticipated purchase or sale in a separate hedging relationship provided it meets the conditions in paragraph 3856.A62.

A63C When the hedged item (the anticipated purchase or sale of a commodity) is not denominated in a foreign currency and the commodity price risk is hedged with a commodity forward contract denominated in a foreign currency (paragraph 3856.A63A(a)), the commodity forward contract meeting the conditions in paragraph 3856.A63 may be designated as a hedge of the anticipated transaction in combination with a foreign exchange forward contract with the following terms:

(a) the foreign exchange forward contract converts the same amount of the same currency as the commodity forward contract into the currency of the anticipated purchase or sale; and

(b) the foreign exchange forward contract matures on the same day as the commodity forward contract.

A64 An enterprise may designate an interest rate swap as a hedge of interest rate risk exposure in a recognized interest-bearing asset or liability only when all of the applicable criteria in the following list are satisfied:

(a) The notional amount of the swap matches the principal amount of the interest-bearing asset or liability that is designated as the hedged item.

(b) The fair value of the swap at the inception of the hedging relationship is zero.

(c) The formula for computing net settlements under the interest rate swap is the same for each net settlement. Accordingly, the fixed rate is the same throughout the term, and the variable rate is based on the same index and includes the same constant adjustment or no adjustment.

(d) It is probable that the instrument will not be prepaid.

(e) The index on which the variable leg of the swap is based matches the interest rate designated as the interest rate risk being hedged for that hedging relationship.

(f) The swap matures within two weeks of the maturity date of the designated financial asset or liability.

(g) There is no floor or ceiling on the variable interest rate of the swap.

(h) In the case of a hedge of a fixed rate asset or liability, the interval between repricings of the variable interest rate in the swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).

(i) In the case of a hedge of a variable rate asset or liability, the repricing dates are within two weeks of those of the variable rate asset or liability.

A65 An enterprise may designate a cross-currency interest rate swap as a hedge of a recognized foreign currency interest-bearing asset or liability only when all of the conditions in paragraph 3856.A64 apply, except as follows:

(a) When settlements of a cross-currency interest rate swap are not on a net basis, the formula for computing the gross settlement amounts are the same for each settlement. Accordingly, the fixed rate is the same throughout the term, and the variable rate is based on the same index and includes the same constant adjustment or no adjustment.

(b) The currency of one leg of the swap is the same as the currency in which the underlying hedged asset or liability is denominated and the currency of the other leg of the swap is the same as the currency in which the reporting enterprise measures the underlying hedged asset or liability in its financial statements.

(c) When multiple swaps are used, the combined effect of all of the swaps is as described in (b) for a single swap.

DISCLOSURE

Financial risk

A66 Transactions in financial instruments may result in an enterprise assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information that assists users of financial statements in assessing the extent of risk related to financial instruments.

(a) **Credit risk** is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

(b) **Currency risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

(c) **Interest rate risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

(d) **Liquidity risk** is the risk that an enterprise will encounter difficulty in meeting obligations associated with financial liabilities.

(e) **Market risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.

(f) **Other price risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

Concentrations of risk

A67 Concentrations of credit risk may arise from:

(a) industry sectors. Thus, if an enterprise's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it discloses separately exposure to risks arising from each concentration of counterparties.

(b) credit rating or other measure of credit quality. Thus, if an enterprise's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it discloses separately exposure to risks arising from each concentration of counterparties.

(c) geographical distribution. Thus, if an enterprise's counterparties are concentrated in one or more geographical markets, it discloses separately exposure to risks arising from each concentration of counterparties.

(d) a limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realize liquid assets. Concentrations of foreign exchange risk may arise if an enterprise has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

APPENDIX B
TRANSFERS OF RECEIVABLES

This Appendix is an integral part of this Section.

PURPOSE AND SCOPE

B1 This Appendix focuses particularly on transactions that result in the transferor having some continuing interest in transferred assets. The principal issue addressed is when to account for securitizations of receivables and similar types of transactions as sales of the transferred assets, and when to account for such transactions as secured borrowings. This Appendix also indicates how to account for a sale transaction, including the resulting gain or loss.

B2 This Appendix does not address:

(a) transfers of financial assets through repurchase and reverse repurchase arrangements and securities lending;

(b) transfers of custody of financial assets for safekeeping, contributions or investments by owners, or distributions to owners of a business enterprise;

(c) subsequent measurement of assets and liabilities, except for servicing assets and servicing liabilities; or

(d) transfers of non-financial assets, such as servicing assets, or transfers of unrecognized financial assets, such as minimum lease payments to be received under operating leases.

B3 In a transfer of receivables, recognition of assets and liabilities is unaffected by the sequence of transactions that result in their acquisition or incurrence unless the effect of those transactions is to maintain effective control over a transferred receivable. For example, if a transferor sells receivables it owns and at the same time writes an "at-the-money" put option (such as a guarantee or recourse obligation) on those receivables, it recognizes the put obligation in the same manner as would another unrelated entity that writes an identical put option on receivables it never owned. However, certain agreements to repurchase or redeem transferred receivables maintain effective control over those receivables and, therefore, are accounted for differently than agreements to acquire receivables never owned.

DEFINITIONS

B4 The following terms are used in this Appendix with the meanings specified:

(a) A **transfer** is the conveyance of a receivable by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

(b) **Receivables** are recognized financial assets that, by their terms, convert into cash within a finite time period.

(c) **Securitization** is the process by which financial assets are transformed into securities.

(d) **Adequate compensation** is the amount of benefits of servicing that would fairly compensate a substitute servicer should one be required, which includes the profit that would be demanded in the marketplace.

(e) An **agent** is a party that acts for and on behalf of another party. For example, a third-party intermediary is an agent of the transferor if it acts on behalf of the transferor.

(f) An **attached call** is a call option held by the transferor of a receivable that becomes part of and is traded with the underlying instrument. Rather than being an obligation of the transferee, an attached call is traded with and diminishes the value of the underlying instrument transferred subject to that call.

(g) **Beneficial interests** are rights to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest, principal, or other cash inflows to be "passed-through" or "paid-through", premiums due to guarantors, commercial paper obligations, and residual interests, whether in the form of debt or equity.

(h) **Benefits of servicing** are revenues from contractually specified servicing fees, late charges, and other ancillary sources, including "float".

(i) A **cleanup call** is an option held by the servicer or its affiliate, which may be the transferor, to purchase the remaining transferred receivables, or the remaining beneficial interests not held by the transferor, its affiliates, or its agents in a qualifying special-purpose entity (or in a series of beneficial interests in transferred receivables within a qualifying special-purpose entity), when the amount of outstanding assets or beneficial interests falls to a level at which the cost of servicing those assets or beneficial interests becomes burdensome in relation to the benefits of servicing.

(j) A **consolidated affiliate** of the transferor is an entity whose assets and liabilities are included with those of the transferor in the consolidated, combined, or other financial statements being presented.

(k) **Contractually specified servicing fees** are all amounts that, per contract, are due to the servicer in exchange for servicing the receivable and would no longer be received by a servicer if the beneficial owners of the serviced assets (or their trustees or agents) were to exercise their actual or potential authority under the contract to shift the servicing to another servicer. Depending on the servicing contract, those fees may include some or all of the difference between the interest rate collectible on the asset being serviced and the rate to be paid to the beneficial owners of those assets.

(l) An **embedded call** is a call option held by the issuer of a financial instrument that is part of and trades with the underlying instrument. For example, a bond may allow the issuer to call it by posting a public notice well before its stated maturity that asks the current holder to submit it for early redemption and provides that interest ceases to accrue on the bond after the early redemption date. Rather than being an obligation of the initial purchaser of the bond, an embedded call trades with and diminishes the value of the underlying bond.

(m) A **freestanding call** is a call that is neither embedded in nor attached to an asset subject to that call.

(n) An **interest-only strip** is a contractual right to receive some or all of the interest due on a bond, mortgage loan, collateralized mortgage obligation, or other interest-bearing receivable.

(o) **Proceeds** are cash, derivatives, or other assets that are obtained in a transfer of receivables, less any liabilities incurred.

(p) **Recourse** is the right of a transferee of receivables to receive payment from the transferor of those receivables for failure of debtors to pay when due, the effects of prepayments, or adjustments resulting from defects in the eligibility of the transferred receivables.

(q) A **security interest** is a form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

(r) A **seller** is a transferor that relinquishes control over receivables by transferring them to a transferee in exchange for consideration.

(s) A **servicing asset** is a contract to service receivables under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either undertaken in conjunction with selling or securitizing the receivables being serviced, or purchased or assumed separately.

(t) A **servicing liability** is a contract to service receivables under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

(u) A **transferee** is an entity that receives a receivable, a portion of a receivable, or a group of receivables from a transferor.

(v) A **transferor** is an entity that transfers a receivable, a portion of a receivable, or a group of receivables that it controls to another entity.

(w) An **undivided interest** is a partial legal or beneficial ownership of an asset as a tenant in common with others. The proportion owned may be pro rata (for example, the right to receive 50 percent of all cash flows from a security), or non-pro rata (for example, the right to receive the interest from a security while another has the right to the principal).

(x) **Unilateral ability** is a capacity for action not dependent on the actions (or failure to act) of any other party.

RECOGNITION AND MEASUREMENT OF TRANSFERRED RECEIVABLES

Criteria for sale treatment

B5 A transfer of receivables (or all or a portion of a receivable) in which the transferor surrenders control over those receivables is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if all of the following conditions are met:

(a) The transferred assets have been isolated from the transferor — put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (see paragraphs 3856.B6-.B7).

(b) Each transferee (or, if the transferee is a qualifying special-purpose entity (SPE) (see paragraph 3856.B14), each holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (see paragraphs 3856.B8-.B13).

(c) The transferor does not maintain effective control over the transferred assets through either:

(i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 3856.B26-.B28 and 3856.B34-.B37); or

(ii) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call (see paragraphs 3856.B29-.B33).

Isolation beyond the reach of the transferor and its creditors

B6 The nature and extent of supporting evidence required for an assertion in financial statements that transferred receivables have been isolated — put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole — depend on the facts and circumstances. An entity considers all available evidence that either supports or questions an assertion. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or SPE might be placed, whether a transfer of receivables would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any consolidated affiliate of the transferor that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership.

B7 A securitization carried out in one transfer or a series of transfers may or may not isolate the transferred assets beyond the reach of the transferor and its creditors. Whether it does depends on the structure of the securitization transaction taken as a whole, considering such factors as the type and extent of further involvement in arrangements to protect investors from credit and interest rate risks, the availability of other assets, and the powers of courts, bankruptcy trustees, receivers and similar authorities. The powers of courts, bankruptcy trustees, receivers and similar authorities in different jurisdictions may vary considerably, and therefore some of these authorities may be able to reach receivables transferred under a particular structure and others may not.

Conditions that constrain a transferee

B8 Sale accounting is allowed under paragraph 3856.B5(b) only if each transferee has the right to pledge, or the right to exchange, the transferred assets or beneficial interests it received, but constraints on that right also matter. Many transferor-imposed or other conditions on a transferee's right to pledge or exchange a transferred asset both constrain a transferee from pledging or exchanging the transferred assets and, through that constraint, provide more than a trivial benefit to the transferor. For example, a provision in the transfer contract that prohibits selling or pledging a transferred loan receivable not only constrains the transferee but also provides the transferor with the more than trivial benefits of knowing who has the asset, a prerequisite to repurchasing the asset, and of being able to block the asset from finding its way into the hands of a competitor for the loan customer's business or someone that the loan customer might consider an undesirable creditor. Transferor-imposed contractual constraints that narrowly limit timing or terms, for example, allowing a transferee to pledge only on the day assets are obtained or only on terms agreed with the transferor, also constrain the transferee and presumptively provide the transferor with more than trivial benefits.

B9 However, some conditions do not constrain a transferee from pledging or exchanging the asset and therefore do not preclude a transfer subject to such a condition from being accounted for as a sale. For example, a transferor's right of first refusal on the occurrence of a bona fide offer to the transferee from a third party presumptively would not constrain a transferee, because that right in itself does not enable the transferor to compel the transferee to sell the assets and the transferee would be in a position to receive the sum offered by exchanging the asset, albeit possibly from the transferor rather than the third party. Further examples of conditions that presumptively would not constrain a transferee include:

(a) a requirement to obtain the transferor's permission to sell or pledge that is not to be unreasonably withheld,

(b) a prohibition on sale to the transferor's competitor if other potential willing buyers exist,

(c) a regulatory limitation such as on the number or nature of eligible transferees (as in the case of securities issued under regulations applicable to private placements or debt placed privately), and

(d) illiquidity, for example, the absence of an active market.

Judgment is required to assess the significance of some conditions. For example, a prohibition on sale to the transferor's competitor would be a significant constraint if that competitor were the only potential willing buyer other than the transferor.

B10 A condition imposed by a transferor that constrains the transferee presumptively provides more than a trivial benefit to the transferor. A condition not imposed by the transferor that constrains the transferee may or may not provide more than a trivial benefit to the transferor. For example, if the transferor refrains from imposing its usual contractual constraint on a specific transfer because it knows an equivalent constraint is already imposed on the transferee by a third party, it presumptively benefits more than trivially from that constraint. However, the transferor cannot benefit from a constraint if it is unaware at the time of the transfer that the transferee is constrained.

Transferor's rights or obligations to reacquire transferred assets

B11 Some rights or obligations to reacquire transferred assets both constrain the transferee and provide more than a trivial benefit to the transferor, thus precluding sale accounting under paragraph 3856.B5(b). For example, a freestanding call option written by a transferee to the transferor benefits the transferor and, if the transferred assets are not readily obtainable in the marketplace, is likely to constrain a transferee because it might have to default if the call was exercised and it had exchanged or pledged the assets. A freestanding forward purchase-sale contract between the transferor and the transferee on transferred assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner. Judgment is necessary to assess constraint and benefit. For example, put options written to the transferee generally do not constrain it, but a put option on a not-readily-obtainable asset may benefit the transferor and effectively constrain the transferee if the option is sufficiently deep-in-the-money when it is written that it is probable that the transferee will exercise it and the transferor will reacquire the transferred asset. In contrast, a sufficiently out-of-the-money call option held by the transferor may not constrain a transferee if it is probable when the option is written that it will not be exercised. Freestanding rights to reacquire transferred assets that are readily obtainable presumptively do not constrain the transferee from exchanging or pledging them and thus do not preclude sale accounting under paragraph 3856.B5(b).

B12 Other rights or obligations to reacquire transferred assets, regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets, as discussed in paragraphs 3856.B29-.B33, thus precluding sale accounting under paragraph 3856.B5(c)(ii). It is also necessary to consider the overall effect of related rights and obligations in assessing such matters as whether a transferee is constrained or a transferor has maintained effective control. For example, if the transferor or its affiliate or agent is the servicer for the transferred asset, is empowered to decide to put the asset up for sale, and has the right of first refusal, that combination would place the transferor in a position to unilaterally cause the return of a specific transferred asset and thus maintain the transferor's effective control of the transferred asset as discussed in paragraphs 3856.B5(c)(ii) and 3856.B29.

Conditions that constrain a holder of beneficial interests in a qualifying SPE

B13 The considerations in paragraphs 3856.B8-.B11, about conditions that may or may not constrain a transferee that is not a qualifying SPE from pledging or exchanging the transferred assets, also extend to conditions that may or may not constrain a beneficial interest holder (BIH) from pledging or exchanging its beneficial interests in assets transferred to a qualifying SPE. For example, if BIHs agree to sell their beneficial interests in a qualifying SPE back to the transferor upon request at the price paid plus a stated return, that arrangement clearly conveys more than a trivial benefit to the transferor; sale accounting for the transfer to the qualifying SPE would be precluded if that agreement constrained a BIH from exchanging or pledging its beneficial interest.

Qualifying SPE

B14 A qualifying SPE is a trust or other legal vehicle that meets all of the following conditions:

(a) It is demonstrably distinct from the transferor (see paragraph 3856.B15).

(b) Its permitted activities:

- (i) are significantly limited;
- (ii) were entirely specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds; and
- (iii) may be significantly changed only with the approval of the holders of at least a majority of the beneficial interests held by entities other than any transferor, its affiliates, and its agents (see paragraphs 3856.B16-.B17).

(c) It may hold only:

- (i) financial assets transferred to it that are passive in nature (see paragraph 3856.B18);
- (ii) passive derivative financial instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents (see paragraphs 3856.B18-.B19);
- (iii) financial assets (for example, guarantees or rights to collateral) that would reimburse it if others were to fail to adequately service financial assets transferred to it or to timely pay obligations due to it and that it entered into when it was established, when assets were transferred to it, or when beneficial interests (other than derivative financial instruments) were issued by the SPE;
- (iv) servicing rights related to financial assets that it holds;
- (v) temporarily, non-financial assets obtained in connection with the collection of financial assets that it holds (see paragraph 3856.B20); and
- (vi) cash collected from assets that it holds and investments purchased with that cash pending distribution to holders of beneficial interests that are appropriate for that purpose (i.e., money market or other relatively risk-free instruments without options and with maturities no later than the expected distribution date).

(d) If it can sell or otherwise dispose of non-cash financial assets, it can do so only in automatic response to one of the following conditions:

- (i) Occurrence of an event or circumstance that:
  - — is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds;
  - — is outside the control of the transferor, its affiliates, or its agents; and
  - — causes, or is expected at the date of transfer to cause, the fair value of those financial assets to decline by a specified degree below the fair value of those assets when the SPE obtained them (see paragraphs 3856.B21-.B22).
- (ii) Exercise by a BIH (other than the transferor, its affiliates, or its agents) of a right to put that holder's beneficial interest back to the SPE (see paragraph 3856.B23).
- (iii) Exercise by the transferor of a call or removal-of-accounts provision specified in the legal documents that established the SPE, transferred assets to the SPE, or created the beneficial interests in the transferred assets that it holds (see paragraphs 3856.B30-.B37).
- (iv) Termination of the SPE or maturity of the beneficial interests in those financial assets on a fixed or determinable date that is specified at inception (see paragraph 3856.B24).

Need to be demonstrably distinct from the transferor

B15 A qualifying SPE is demonstrably distinct from the transferor only if it cannot be unilaterally dissolved by any transferor, its affiliates, or its agents, and at least 10 percent of the fair value of its beneficial interests is held by parties other than any transferor, its affiliates, or its agents. An ability to unilaterally dissolve an SPE can take many forms, including but not limited to holding sufficient beneficial interests to demand that the trustee dissolve the SPE, the right to call all the assets transferred to the SPE, and a right to call or a prepayment privilege on the beneficial interests held by other parties.

Limits on permitted activities

B16 The powers of the SPE must be limited to those activities allowed by paragraph 3856.B14 for it to be a qualifying SPE. Many kinds of entities are not so limited. For example, any bank, insurance company, pension plan, or investment company has powers that cannot be sufficiently limited for it to be a qualifying SPE.

B17 The BIHs other than the transferor, its affiliates, or its agents may have the ability to change the powers of a qualifying SPE. If the powers of a previously qualifying SPE are changed so that the SPE is no longer qualifying, unless the conditions in paragraph 3856.B5(b) are then met by the SPE itself and the conditions in paragraphs 3856.B5(a) and 3856.B5(c) continue to be met, that change would bring the transferred assets held in the SPE back under the control of the transferor (see paragraph 3856.B50).

Limits on what a qualifying SPE may hold

B18 A financial asset or derivative financial instrument is passive only if holding the asset or instrument does not involve its holder in making decisions other than the decisions inherent in servicing (see paragraph 3856.B54). An equity instrument is not passive if the qualifying SPE can exercise the voting rights and is permitted to choose how to vote. Investments are not passive if through them, either in themselves or in combination with other investments or rights, the SPE or any related entity (such as the transferor, its affiliates, or its agents) is able to exercise control or significant influence (as defined in generally accepted accounting principles for consolidation policy and for the equity method, respectively) over the investee. A derivative financial instrument is not passive if, for example, it includes an option allowing the SPE to choose to call or put other financial instruments; but other derivative financial instruments can be passive (for example, interest rate caps and swaps and forward contracts). Derivative financial instruments that result in liabilities, like other liabilities of a qualifying SPE, are a kind of beneficial interest in the qualifying SPE's assets.

B19 A derivative financial instrument pertains to beneficial interests (other than another derivative financial instrument) issued only if it:

(a) Is entered into:

  (i) when the beneficial interests are issued by the qualifying SPE to parties other than the transferor, its affiliates, or its agents or sold to such other parties after being issued by the qualifying SPE to the transferor, its affiliates, or its agents; or

  (ii) when a passive derivative financial instrument needs to be replaced upon occurrence of an event or circumstance (specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets that it holds) outside the control of the transferor, its affiliates, or its agents (for example, when the counterparty to the derivative defaults or is downgraded below a specified threshold).

(b) Has a notional amount that does not initially exceed the amount of those beneficial interests and is not expected to exceed them subsequently.

(c) Has characteristics that relate to, and partly or fully but not excessively counteract, some risk associated with those beneficial interests or the related transferred assets.

B20 A qualifying SPE may hold non-financial assets other than servicing rights only temporarily and only if those non-financial assets result from collecting the transferred receivables. For example, a qualifying SPE could be permitted to temporarily hold foreclosed non-financial collateral. In contrast, an entity cannot be a qualifying SPE if, for example, it receives from a transferor significant secured receivables likely to default with the expectation that it will foreclose on and profitably manage the securing non-financial assets. A qualifying SPE also may hold the residual value of a sales-type or a direct financing lease only to the extent that it is guaranteed at the inception of the lease either by the lessee or by a third party financially capable of discharging the obligations that may arise from the guarantee (see paragraph 3856.B51).

Limits on sales or other dispositions of assets

B21 Examples of requirements to sell, exchange, put, or distribute (hereinafter referred to collectively as dispose of) non-cash financial assets that are permitted activities of a qualifying SPE — because they respond automatically to the occurrence of an event or circumstance that is specified in the legal documents that established the SPE or created the beneficial interests in the transferred assets it holds; is outside the control of the transferor, its affiliates, or its agents; and causes, or is expected to cause, the fair value of those assets to decline by a specified degree below the fair value of those assets when the qualifying SPE obtained them — include requirements to dispose of transferred assets in response to:

(a) A failure to properly service transferred assets that could result in the loss of a substantial third-party credit guarantee.

(b) A default by the obligor.

(c) A downgrade by a major rating agency of the transferred assets or of the underlying obligor to a rating below a specified minimum rating.

(d) The involuntary insolvency of the transferor.

(e) A decline in the fair value of the transferred assets to a specified value less than their fair value at the time they were transferred to the SPE.

B22 The following are examples of powers or requirements to dispose of non-cash financial assets that are not permitted activities of a qualifying SPE, because they do not respond automatically to the occurrence of a specified event or circumstance outside the control of the transferor, its affiliates, or its agents that causes, or is expected to cause, the fair value of those transferred assets to decline by a specified degree below the fair value of those assets when the SPE obtained them:

(a) A power that allows an SPE to choose to either dispose of transferred assets or hold them in response to a default, a downgrade, a decline in fair value, or a servicing failure.

(b) A requirement to dispose of marketable equity securities upon a specified decline from their "highest fair value" if that power could result in disposing of the asset in exchange for an amount that is more than the fair value of those assets at the time they were transferred to the SPE.

(c) A requirement to dispose of transferred assets in response to the violation of a non-substantive contractual provision (i.e., a provision for which there is not a sufficiently large disincentive to ensure performance).

B23 A qualifying SPE may dispose of transferred assets automatically to the extent necessary to comply with the exercise by a BIH (other than the transferor, its affiliates, or its agents) of its right to put beneficial interests back to the SPE in exchange for:

(a) a full or partial distribution of those assets;

(b) cash (which may require that the SPE dispose of those assets or issue beneficial interests to generate cash to fund settlement of the put); or

(c) new beneficial interests in those assets.

B24 A qualifying SPE may have the power to dispose of assets to a party other than the transferor, its affiliate, or its agent on termination of the SPE or maturity of the beneficial interests, but only automatically on fixed or determinable dates that are specified at inception. For example, if an SPE is required to dispose of long-term mortgage loans and terminate itself at the earlier of the specified maturity of beneficial interests in those mortgage loans or the date of prepayment of a specified amount of the transferred mortgage loans, the termination date is a fixed or determinable date that was specified at inception. In contrast, if that SPE has the power to dispose of transferred assets on two specified dates and the SPE can decide which transferred assets to sell on each date, the termination date is not a fixed or determinable date that was specified at inception.

Qualifying SPEs and consolidated financial statements

B25 A qualifying SPE is not consolidated in the financial statements of a transferor or its affiliates. The event that warrants derecognition of receivables transferred to a qualifying SPE is the issuance of beneficial interests in the transferred receivables to third-party BIHs in exchange for cash or other assets. Once beneficial interests are issued to BIHs other than the transferor or its affiliates in exchange for consideration, the economic benefits of all the receivables held in a qualifying SPE are divided among and controlled by the BIHs, not by the transferor whose assets they once were and not by the qualifying SPE or the trustee that may be the legal owner. Once the receivables are legally isolated and beneficial interests in those receivables are issued, the qualifying SPE is in the position of a custodian holding the underlying assets for the BIHs. Receivables held in a qualifying SPE are therefore effectively the assets of its BIHs. Accordingly, receivables sold to a qualifying SPE are not recognized as assets and related beneficial interests are not recognized as liabilities in consolidated or other financial statements of a transferor, servicer, or sponsor of the SPE. Any entity having an interest in a SPE, other than a transferor of receivables to a qualifying SPE, or an affiliate of the transferor, needs to consider SUBSIDIARIES, Section 1591, to determine whether it is required to consolidate the SPE in the financial statements being presented.

Maintaining effective control over transferred receivables

Agreement to repurchase or redeem transferred receivables

B26 An agreement that both entitles and obligates the transferor to repurchase or redeem transferred assets from the transferee maintains the transferor's effective control over those assets under paragraph 3856.B5(c)(i), and the transfer is therefore to be accounted for as a secured borrowing, if and only if all of the following conditions are met:

(a) The assets to be repurchased or redeemed are the same or substantially the same as those transferred (see paragraph 3856.B27).

(b) The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (see paragraph 3856.B28).

(c) The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price.

(d) The agreement is entered into concurrently with the transfer.

B27 To be substantially the same, the asset that was transferred and the asset that is to be repurchased or redeemed need to have all of the following characteristics:

(a) The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same).

(b) Identical form and type so as to provide the same risks and rights.

(c) The same maturity (or in the case of mortgage-backed pass-through and pay-through securities, similar remaining weighted average maturities that result in approximately the same market yield).

(d) Identical contractual interest rates.

(e) Similar assets as collateral.

(f) The same aggregate unpaid principal amount or principal amounts within accepted "good delivery" standards for the type of security involved.

B28 To be able to repurchase or redeem assets on substantially the agreed terms, even in the event of default by the transferee, a transferor must at all times during the contract term have obtained cash or other collateral sufficient to fund substantially all of the cost of purchasing replacement assets from others.

Ability to unilaterally cause the return of specific transferred assets

B29 Some rights to reacquire transferred assets (or to acquire beneficial interests in transferred assets held by a qualifying SPE), regardless of whether they constrain the transferee, may result in the transferor's maintaining effective control over the transferred assets through the unilateral ability to cause the return of specific transferred assets. Such rights preclude sale accounting under paragraph 3856.B5(c)(ii). For example, an attached call in itself would not constrain a transferee who is able, by exchanging or pledging the asset subject to that call, to obtain substantially all of its economic benefits. An attached call could result, however, in the transferor's maintaining effective control over the transferred asset(s) because the attached call gives the transferor the ability to unilaterally cause whoever holds that specific asset to return it. In contrast, transfers of financial assets subject to calls embedded by the issuers of the financial instruments (for example, callable bonds or prepayable mortgage loans) do not preclude sale accounting. Such an embedded call does not result in the transferor's maintaining effective control, because it is the issuer rather than the transferor who holds the call.

B30 If the transferee is a qualifying SPE, it has met the conditions in paragraph 3856.B14(d) and therefore must be constrained from choosing to exchange or pledge the transferred assets. In that circumstance, any call held by the transferor is effectively attached to the assets and could — depending on the price and other terms of the call — maintain the transferor's effective control over transferred assets through the ability to unilaterally cause the transferee to return specific assets. For example, a transferor's unilateral ability to cause a qualifying SPE to return to the transferor or otherwise dispose of specific transferred assets at will or, for example, in response to its decision to exit a market or a particular activity, could provide the transferor with effective control over the transferred assets.

B31 A call that is attached to transferred assets maintains the transferor's effective control over those assets if, under its price and other terms, the call conveys more than a trivial benefit to the transferor. Similarly, any unilateral right to reclaim specific assets transferred to a qualifying SPE maintains the transferor's effective control over those assets if the right conveys more than a trivial benefit to the transferor. A call or other right conveys more than a trivial benefit if the price to be paid is fixed, determinable, or otherwise potentially advantageous, unless because that price is so far out of the money or for other reasons it is probable when the option is written that the transferor will not exercise it. Thus, for example, a call on specific assets transferred to a qualifying SPE at a price fixed at their principal amount maintains the transferor's effective control over the assets subject to that call. Effective control over transferred assets can be present even if the right to reclaim is indirect. For example, if an embedded call allows a transferor to buy back the beneficial interests of a qualifying SPE at a fixed price, then the transferor remains in effective control of the assets underlying those beneficial interests. A cleanup call, however, is permitted as an exception to that general principle.

B32 A right to reclaim specific transferred assets by paying their fair value when reclaimed generally does not maintain effective control, because it does not convey a more than trivial benefit to the transferor. However, a transferor has maintained effective control if it has such a right and also holds the residual interest in the transferred assets. For example, if a transferor can reclaim such assets at termination of the qualifying SPE by purchasing them in an auction, and thus at what might appear to be fair value, then sale accounting for the assets it can reclaim would be precluded. Such circumstances provide the transferor with a more than trivial benefit and effective control over the assets, because it can pay any price it chooses in the auction and recover any excess paid over fair value through its residual interest.

B33 A transferor that has a right to reacquire transferred assets from a qualifying SPE does not maintain effective control if the reclaimed assets would be randomly selected and the amount of the assets reacquired is sufficiently limited (see paragraph 3856.B36(a)), because that would not be a right to reacquire specific assets. Nor does a transferor maintain effective control through an obligation to reacquire transferred assets from a qualifying SPE if the transfer could occur only after a specified failure of the servicer to properly service the transferred assets that could result in the loss of a third-party guarantee (see paragraph 3856.B21(a)) or only after a BIH other than the transferor, its affiliate, or its agent requires a qualifying SPE to repurchase that beneficial interest (see paragraph 3856.B23(b)), because the transferor could not cause that reacquisition unilaterally.

Removal-of-accounts provisions

B34 Many transfers of receivables in securitizations empower the transferor to reclaim assets subject to certain restrictions. Such a power is sometimes called a removal-of-accounts provision (ROAP). Whether a ROAP precludes sale accounting depends on whether the ROAP results in the transferor's maintaining effective control over specific transferred assets (see paragraphs 3856.B5(c)(ii) and 3856.B30-.B33).

B35 The following are examples of ROAPs that preclude transfers from being accounted for as sales:

(a) An unconditional ROAP or repurchase agreement that allows the transferor to specify the assets that may be removed, because such a provision allows the transferor unilaterally to remove specific assets.

(b) A ROAP conditioned on a transferor's decision to exit some portion of its business, because whether it can be triggered by cancelling an affinity relationship, spinning off a business segment, or accepting a third party's bid to purchase a specified (for example, geographic) portion of the transferor's business, such a provision allows the transferor unilaterally to remove specific assets.

B36 The following are examples of ROAPs that do not preclude transfers from being accounted for as sales:

(a) A ROAP for random removal of excess assets, if the ROAP is sufficiently limited so that the transferor cannot remove specific transferred assets (for example, by limiting removals to the amount of the transferor's retained interest and to one removal per month).

(b) A ROAP for defaulted receivables, because the removal would be allowed only after a third party's action (default) and could not be caused unilaterally by the transferor.

(c) A ROAP conditioned on a third-party cancellation, or expiration without renewal, of an affinity or private-label arrangement, because the removal would be allowed only after a third party's action (cancellation) or decision not to act (expiration) and could not be caused unilaterally by the transferor.

B37 A ROAP that can be exercised only in response to a third party's action that has not yet occurred does not maintain the transferor's effective control over assets potentially subject to that ROAP. However, when a third party's action (such as default or cancellation) or decision not to act (expiration) occurs that allows removal of assets to be initiated solely by the transferor, the transferor recognizes any assets subject to the ROAP, whether the ROAP is exercised or not. If the ROAP is exercised, the assets are recognized because the transferor has reclaimed the assets. If the ROAP is not exercised, the assets are recognized because the transferor now can unilaterally cause the qualifying SPE to return those specific assets and, therefore, once again has effective control over those assets (see paragraph 3856.B52).

Accounting for transfers of receivables

B38 Upon completion of any transfer of receivables, the transferor:

(a) continues to carry in its balance sheet any retained interest in the transferred assets, including, if applicable, servicing assets (see paragraphs 3856.B54-.B56), beneficial interests in assets transferred to a qualifying SPE (see paragraphs 3856.B48-.B50), and retained undivided interests (see paragraphs 3856.B41-.B43); and

(b) allocates the previous carrying amount between the assets sold, if any, and the retained interests, if any, based on their relative fair values at the date of transfer (see paragraphs 3856.B41-.B43).

B39 Upon completion of a transfer of receivables that satisfies the conditions to be accounted for as a sale (see paragraph 3856.B5), the transferor (seller):

(a) derecognizes all assets sold;

(b) recognizes all assets obtained and liabilities incurred in consideration as proceeds of the sale, including cash, put or call options held or written (for example, guarantee or recourse obligations), forward commitments (for example, commitments to deliver additional receivables during the revolving periods of some securitizations), swaps (for example, provisions that convert interest rates from fixed to variable), and servicing liabilities, if applicable (see paragraphs 3856.B41 and 3856.B54-.B56);

(c) initially measures at fair value assets obtained and liabilities incurred in a sale (see paragraphs 3856.B44-.B46) or, if it is not practicable to estimate the fair value of an asset or a liability, apply alternative measures (see paragraph 3856.B47); and

(d) recognizes in income any gain or loss on the sale.

The transferee recognizes all assets obtained and any liabilities incurred and initially measures them at fair value (in aggregate, presumptively the price paid).

B40 If a transfer of receivables in exchange for cash or other consideration (other than beneficial interests in the transferred assets) does not meet the criteria for a sale in paragraph 3856.B5, the transferor and transferee account for the transfer as a secured borrowing with pledge of collateral (see paragraph 3856.B58).

Measurement of assets obtained and liabilities incurred in a transfer of receivables

B41 The proceeds from a sale of receivables consist of the cash and any other assets obtained in the transfer less any liabilities incurred. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of receivables is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale are initially measured at fair value, if practicable.

Retained interests

B42 Interests in transferred assets that are not part of the proceeds of the transfer are retained interests over which the transferor has not relinquished control. They are measured at the date of the transfer by allocating the previous carrying amount between the assets sold, if any, and the retained interests, based on their relative fair values. Allocation procedures are applied to all transfers in which interests are retained, even those that do not qualify as sales. Examples of retained interests include securities backed by the transferred assets, undivided interests, servicing assets, and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is a retained interest or proceeds from the sale, the asset is treated as proceeds from the sale and accounted for in accordance with paragraph 3856.B41.

B43 If the retained interests are subordinated to more senior interests held by others, that subordination may concentrate into the retained interests most of the risks inherent in the transferred assets and is taken into consideration in estimating the fair value of the retained interests. For example, if the amount of the gain recognized, after allocation, on a securitization with a subordinated retained interest is greater than the gain would have been had the entire asset been sold, the transferor needs to be able to identify why that can occur. Otherwise, it is likely that the impact of the retained interest being subordinate to a senior interest has not been adequately considered in the determination of the fair value of the subordinated retained interest.

B44 Paragraphs 3856.B45-.B47 provide guidance on determination of fair value for the purposes of accounting for a transfer of receivables only.

B45 Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times that market price. If quoted market prices are not available, the estimate of fair value is based on the best information available in the circumstances. The estimate of fair value takes into account prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques used for measuring financial assets and liabilities and servicing assets and liabilities are consistent with the objective of measuring fair value. Those techniques incorporate assumptions that market participants use in their estimates of values, future revenues and future expenses, including assumptions about interest rates, default, prepayment and volatility. The timing and amount of future cash flows for retained interests in securitizations are commonly uncertain, especially if those interests are subordinate to more senior beneficial interests. Applying the present value approach depends heavily on assumptions about default and prepayment of all the assets securitized, because of the implicit credit or prepayment risk enhancement arising from the subordination. In measuring financial liabilities and servicing liabilities at fair value, the objective is to estimate the value of the assets required currently to settle the liability with the holder or to transfer a liability to an entity of comparable credit standing.

B46 Estimates of expected future cash flows, if used to estimate fair value, are based on reasonable and supportable assumptions and projections. All available evidence is considered in developing estimates of expected future cash flows. The weight to be given to the evidence is commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes is considered either directly, if applying an expected cash flow approach, or indirectly through the risk-adjusted discount rate, if determining the best estimate of future cash flows.

B47 If it is not practicable to estimate the fair values of assets, the transferor records those assets at zero. If it is not practicable to estimate the fair values of liabilities, the transferor recognizes no gain on the transaction and records those liabilities at the greater of:

(a) the excess, if any, of the fair values of assets obtained less the fair values of other liabilities incurred, over the sum of the carrying values of the assets transferred; and

(b) the amount that would be recognized in accordance with CONTINGENCIES, Section 3290.

Revolving-period securitizations

B48 The value of the forward contract implicit in a revolving-period securitization arises from the difference between the agreed-upon rate of return to investors on their beneficial interests in a pool of receivables or a trust and current market rates of return on similar investments. For example, if the agreed-upon annual rate of return to investors in a pool of receivables or a trust is six percent, and later market rates of return for those investments increased to seven percent, the forward contract's value to the transferor (and burden to the investors) would approximate the present value of one percent of the amount of the investment for each year remaining in the revolving structure after the receivables already transferred have been collected. If a forward contract to sell receivables is entered into at the market rate, its value at inception may be zero. Changes in the fair value of the forward contract are likely to be greater if the investors receive a fixed rate than if the investors receive a rate that varies based on changes in market rates.

B49 Gain or loss recognition for revolving-period receivable securitizations is limited to receivables that exist and have been sold. Recognition of servicing assets or liabilities for revolving-period receivables is similarly limited to the servicing for the receivables that exist and have been transferred. As new receivables are sold, rights to service them become assets or liabilities and are recognized.

B50 Certain revolving-period securitizations use either a discrete purchase or trust structure for a single securitization, or a master trust structure for many securitizations. To achieve another securitization using an existing master trust or co-ownership structure, a transferor may first transfer additional receivables to the trust or to the custodian for the benefit of the co-owners and then sell to investors additional ownership interests in the trust or the pool of receivables. Adding receivables to a master trust or transferring receivables to a custodian, in itself, is neither a sale nor a secured borrowing under paragraph 3856.B5, because that transfer only increases the transferor's beneficial interest in the assets of the trust or the co-ownership pool. A sale or secured borrowing does not occur until the transferor receives consideration other than beneficial interests in the transferred assets. Transfers that result in an exchange of cash (i.e., either transfers that in essence replace previously transferred receivables that have been collected or sales of beneficial interests to outside investors), are transfers in exchange for consideration other than beneficial interests in the transferred assets and thus are accounted for as sales (if they satisfy all the criteria in paragraph 3856.B5) or as secured borrowings.

Sales-type and direct financing lease receivables

B51 Sales-type and direct financing receivables secured by leased equipment, referred to as gross investment in lease receivables, are made up of two components: minimum lease payments and residual values. Minimum lease payments are requirements for lessees to pay cash to lessors and meet the definition of a financial asset. Thus, transfers of minimum lease payments are subject to the requirements of this Appendix. Residual values represent the lessor's estimate of the "salvage" value of the leased equipment at the end of the lease term and may be either guaranteed or unguaranteed; residual values meet the definition of financial assets to the extent that they are guaranteed at the inception of the lease. Thus, transfers of residual values guaranteed at inception also are subject to the requirements of this Appendix. Unguaranteed residual values do not meet the definition of financial assets, nor do residual values guaranteed after inception, and transfers of them are not subject to the requirements of this Appendix. Entities securitizing lease financing receivables allocate the gross investment in receivables between minimum lease payments, residual values guaranteed at inception, and residual values not guaranteed at inception using the individual carrying amounts of those components at the date of transfer. Those entities also record a servicing asset or liability in accordance with paragraphs 3856.B38 and 3856.B53, if appropriate.

Changes that result in the transferor regaining control of receivables sold

B52 A change in law, status of the transferee as a qualifying SPE, or other circumstance may result in the transferor regaining control of assets previously accounted for appropriately as having been sold, because one or more of the conditions in paragraph 3856.B5 are no longer met. Such a change, unless it arises solely from either the initial application of this Appendix or a change in market prices (for example, an increase in price that moves into-the-money a freestanding call that was originally sufficiently out-of-the-money that it was judged not to constrain the transferee), is accounted for in the same manner as a purchase of the assets from the former transferee(s) in exchange for liabilities assumed (see paragraph 3856.B33. After that change, the transferor recognizes in its financial statements those assets together with liabilities to the former transferee(s) or BIHs in those assets (see paragraph 3856.B17). The transferor initially measures those assets and liabilities at fair value on the date of the change, as if the transferor purchased the assets and assumed the liabilities on that date. The former transferee would derecognize the assets on that date, as if it had sold the assets in exchange for a receivable from the transferor.

RECOGNITION AND MEASUREMENT OF SERVICING ASSETS AND LIABILITIES

B53 Each time an entity undertakes an obligation to service receivables it recognizes either a servicing asset or a servicing liability for that servicing contract, unless it securitizes the assets, retains all of the resulting securities, and classifies them as assets measured on other than a fair value basis. If the servicing asset or liability was purchased or assumed rather than undertaken in a sale or securitization of the receivables being serviced, it is measured initially at its fair value, presumptively the price paid. A servicing asset or liability is amortized in proportion to and over the period of estimated net servicing income (if servicing revenues exceed servicing costs) or net servicing loss (if servicing costs exceed servicing revenues). A servicing asset or liability is assessed for impairment or increased obligation based on its fair value (see paragraphs 3856.B54-.B56).

B54 Servicing of mortgage loans, credit card receivables, or other receivables commonly includes, but is not limited to, collecting principal, interest, and escrow payments from borrowers; paying taxes and insurance from escrowed funds; monitoring delinquencies; executing foreclosure if necessary; temporarily investing funds pending distribution; remitting fees to guarantors, trustees, and others providing services; and accounting for and remitting principal and interest payments to the holders of beneficial interests in the receivables. Servicing is inherent in all receivables; it becomes a distinct asset or liability only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained or separate purchase or assumption of the servicing.

B55 An entity that undertakes a contract to service receivables recognizes either a servicing asset or a servicing liability, unless the transferor securitizes the assets and retains all of the resulting securities, in which case the servicing asset or liability may be reported together with the asset being serviced. Each securitization with servicing retained or separate purchase or assumption of servicing results in a servicing contract. A servicer of receivables commonly receives the benefits of servicing — revenues from contractually specified servicing fees, late charges, and other ancillary sources, including "float", all of which it is entitled to receive only if it performs the servicing — and incurs the costs of servicing the assets. Each servicing contract results in a servicing asset or servicing liability. The benefits of servicing may be more than adequate compensation to a servicer for performing the servicing, in which case the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate the servicer for performing the servicing, the contract results in a servicing liability. (A servicing asset may become a servicing liability, or vice versa, if circumstances change, and the initial measure for servicing may be zero if the benefits of servicing are just adequate to compensate the servicer for its servicing responsibilities.)

B56 A servicer that recognizes a servicing asset or servicing liability accounts for the contract to service receivables separately from those assets, as follows:

(a) Report servicing assets separately from servicing liabilities in the balance sheet (see paragraph 3856.B53).

(b) Initially measure servicing assets retained in a securitization of the assets being serviced at their allocated previous carrying amount based on relative fair values, if practicable, at the date of the securitization (see paragraphs 3856.B38 and 3856.B42-.B47).

(c) Initially measure servicing assets purchased or servicing liabilities assumed at fair value (see paragraph 3856.B53).

(d) Initially measure servicing liabilities undertaken in a securitization at fair value, if practicable (see paragraphs 3856.B39(b), 3856.B39(c), and 3856.B44-.B47).

(e) Account separately for rights to future interest income from the serviced assets that exceed contractually specified servicing fees. Those rights are not servicing assets; they are financial assets, effectively interest-only strips to be accounted for in accordance with paragraph 3856.B57 of this Appendix.

(f) Subsequently measure servicing assets by amortizing the amount recognized in proportion to and over the period of estimated net servicing income — the excess of servicing revenues over servicing costs (see paragraph 3856.B53).

(g) Subsequently evaluate and measure impairment of servicing assets as follows:

(i) Stratify servicing assets based on one or more of the predominant risk characteristics of the underlying receivables. Those characteristics may include receivable type, size, interest rate, date of origination, term, and geographic location.

(ii) Recognize impairment through a valuation allowance for an individual stratum. The amount of impairment recognized is the amount by which the carrying amount of servicing assets for a stratum exceeds their fair value. The fair value of servicing assets that have not been recognized are not used in the evaluation of impairment.

(iii) Adjust the valuation allowance to reflect changes in the measurement of impairment subsequent to the initial measurement of impairment. Fair value in excess of the carrying amount of servicing assets for that stratum, however, is not recognized. This Appendix does not address when an entity records a direct write-down of recognized servicing assets (see paragraph 3856.B53).

(h) Subsequently measure servicing liabilities by amortizing the amount recognized in proportion to and over the period of estimated net servicing loss — the excess of servicing costs over servicing revenues. However, if subsequent events have increased the fair value of the liability above the carrying amount, for example, because of significant changes in the amount or timing of actual or expected future cash flows from the cash flows previously projected, the servicer revises its earlier estimates and recognizes the increased obligation as a loss in income (see paragraph 3856.B53).

MEASUREMENT OF RETAINED INTERESTS SUBSEQUENT TO A TRANSFER ACCOUNTED FOR AS A SALE

B57 Subsequent to a transfer accounted for as a sale, an entity analyzes the substance of any retained interest in the transferred assets and accounts for that interest as a loan or an investment in accordance with its established accounting policies or generally accepted practices for assets of a similar nature. An entity discloses any significant accounting policies applied in accounting for a retained interest and, at each period end, applies the relevant test for impairment in its carrying amount.

SECURED BORROWINGS

B58 When a transaction is accounted for as a secured borrowing, an entity continues to account for transferred assets after the transaction on the same basis as beforehand, and accounts for the secured borrowing in accordance with its established accounting policies for liabilities of a similar nature or generally accepted practices for secured borrowings.

ILLUSTRATIVE EXAMPLES

This material is illustrative only.

These examples illustrate how the accounting treatment specified in this Section might be applied in particular situations. Matters of principle related to particular situations should be decided in the context of this Section. For simplicity, the income tax effects have not been reflected in these illustrative examples.

Initial measurement of financial instruments in a related party transaction

Example 1 — Initial measurement of a loan between related parties

Example 2 — Initial measurement of common shares issued between related parties

Example 3 — Initial measurement of common shares and a note receivable issued between related parties in exchange for land and a trade receivable

Example 4 — Initial measurement of debt instruments issued between related parties

Retractable or mandatorily redeemable shares issued in a tax planning arrangement

Example 5 — Classification of retractable or mandatorily redeemable shares issued in tax planning arrangement

INITIAL MEASUREMENT OF FINANCIAL INSTRUMENTS IN A RELATED PARTY TRANSACTION

Example 1 — Initial measurement of a loan between related parties

Company A advances $100,000 cash to Company B, a related party, and receives as consideration a note receivable. The note receivable:

- is not quoted in an active market;
- does not have inputs that are significant to the determination of the fair value of the instrument that are observable;
- has a face amount of $100,000; and
- does not have a maturity date or stated terms of repayment.

Entry by Company A

Dr. Note receivable	100,000	
Cr. Cash		100,000

To record advance to Company B.

The debt instrument is not quoted in an active market and does not have inputs that are significant to the determination of the fair value of the instrument that are observable therefore, the instrument is initially measured at cost. Furthermore, the instrument has repayment terms 1 therefore, the cost of the instrument is determined using the undiscounted cash flow(s), excluding interest and dividend payments, of the instrument.

Entry by Company B

Dr. Cash	100,000	
Cr. Note payable		100,000

To record loan from Company A.

The debt instrument does not have inputs that are significant to the determination of the fair value of the instrument that are observable therefore, the instrument is initially measured at cost. Furthermore, the instrument has repayment terms 1 therefore the cost of the instrument is determined using the undiscounted cash flow(s), excluding interest and dividend payments, of the instrument.

Example 2 — Initial measurement of common shares issued between related parties

Company C received common shares in Company D, a related party, as consideration for land transferred from Company C to Company D. Companies C and D are under the common control of Company E. The carrying amount of the land in the accounts of Company C is $250,000 and the land's exchange amount is $300,000. The common shares of Company D are not quoted in an active market.

Entries by Company C (Seller)

Situation I — The financial instrument is initially measured at the carrying amount of the consideration transferred in the transaction			Situation II — The financial instrument is initially measured at the exchange amount of the consideration transferred in the transaction		
Dr. Investment in Co. D	250,000		Dr. Investment in Co. D	300,000	
Cr. Land		250,000	Cr. Land		250,000
			Cr. Gain		50,000
To record the sale of the land.			To record the sale of the land.		

In Situations I and II, the shares of Company D are not quoted in an active market and do not have repayment terms; therefore, the cost of the investment in Company D is initially measured by Company C at the carrying or exchange amount of the land transferred as consideration for the investment in accordance with the guidance in paragraphs 3856.08-.08B.

In Situation II, the gain is included in net income because the related party transaction includes a financial instrument, and is either in the normal course of operations, or is not in the normal course of operations and meets the criteria in paragraphs 3856.08E(a)-(c).

Example 3 — Initial measurement of common shares and a note receivable issued between related parties in exchange for land and a trade receivable

Company F transferred a trade receivable and land to Company G, a related party. As consideration for the transaction, Company F received common shares in Company G and a note receivable from Company G. The common shares of Company G are not quoted in an active market and have an assigned value of $45,000.

The face amount of the trade receivable is $100,000 and there were no previously recognized impairments. The carrying amount of the land in the accounts of Company F is $45,000 and the land's exchange amount is $65,000. The terms of the note receivable from Company G are:

- the note is not quoted in an active market;
- does not have inputs that are significant to the determination of the fair value of the instrument that are observable;
- the face amount of the note is $120,000;
- the note is due in five years; and
- the interest rate on the note is 7 percent.

Entries by Company F (Seller)

Situation I — The Investment in Company G is initially measured at the **carrying amount** of consideration transferred by Company F in the transaction. The note receivable due from Company G is initially measured at the undiscounted cash flows, excluding interest and dividend payments of the instrument

Dr. Investment in Co. G	25,000	
Dr. Note receivable	120,000	
Cr. Land		45,000
Cr. Trade receivable		100,000

To record receipt of the investment in G and the note receivable, and the sale of the land and transfer of the trade receivable.

Situation II — The Investment in Company G is initially measured at the **exchange amount** of the consideration transferred by Company F in the transaction. The note receivable due from Company G is initially measured at the undiscounted cash flows, excluding interest and dividend payments of the instrument

Dr. Investment in Co. G	45,000	
Dr. Note receivable	120,000	
Cr. Gain		20,000
Cr. Land		45,000
Cr. Trade receivable		100,000

To record receipt of the investment in G and the note receivable, and the sale of the land and transfer of the trade receivable.

In Situations I and II, the note receivable issued by Company G is not quoted in an active market and does not have inputs that are significant to the determination of the fair value of the instrument that are observable. The note receivable does have repayment terms; therefore, its cost is determined using the undiscounted cash flows of the instrument, excluding interest and dividend payments. The shares of Company G are also not quoted in an active market and have no repayment terms. Therefore, the cost of this instrument is determined using the consideration transferred. The consideration transferred in this transaction includes a trade receivable and land. The cost of the trade receivable transferred in the transaction is $100,000, which reflects the undiscounted cash flows, excluding interest and dividend payments, of the instrument.

In Situation I, the value of the land portion of the consideration transferred in the transaction is $45,000, which reflects the carrying amount of the land in Company F's accounts. Therefore, the total consideration transferred in Situation I in exchange for the investment in Company G and note receivable from Company G is $145,000. The cost of the note receivable from Company G is $120,000. Therefore, Company F initially measures its investment in Company G at the total consideration transferred less the cost of the note receivable in Company G ($145,000 – $120,000 = $25,000).

In Situation II, the value of the land portion of the consideration transferred is $65,000, which reflects its exchange amount. Therefore, the total consideration transferred in Situation II in exchange for the investment in Company G and note receivable from Company G is $165,000. The cost of the note receivable from Company G is $120,000. Therefore, Company F initially measures its investment in Company G at the total consideration transferred less the cost of the note receivable in Company G ($165,000 – $120,000 = $45,000). Furthermore, the gain is included in income because the transaction includes a financial instrument, and is either in the normal course of operations, or is not in the normal course of operations and meets the criteria in paragraphs 3856.08E(a)-(c).

Entries by Company G (Buyer)

Situation I — Transaction measured at carrying amount of the land

Situation II — Transaction measured at exchange amount of the land

Dr. Land	45,000		Dr. Land	65,000	
Dr. Trade receivable	100,000		Dr. Trade receivable	100,000	
Dr. Equity	20,000				
Cr. Note payable		120,000	Cr. Note payable		120,000
Cr. Common shares		45,000	Cr. Common shares		45,000
To record the purchase of the land and receipt of the trade receivable.			To record the purchase of the land and receipt of the trade receivable.		

In Situations I and II, neither the note payable nor trade receivable have inputs that are significant to the determination of the fair value of the instrument that are observable. Furthermore, the trade receivable is not quoted in an active market. Both instruments have stated payment terms. Therefore, the cost of the note payable and trade receivable is determined using the undiscounted cash flows of the instrument, excluding interest and dividend payments. The land is recognized in Company G's accounts at the predecessor's carrying amount or the land's exchange amount in accordance with RELATED PARTY TRANSACTIONS, Section 3840. The common shares are measured at the value assigned by Company G.

In Situation I, the difference is included in equity because the transaction includes a financial instrument, is not in the normal course of operations and does not meet the criteria in paragraphs 3856.08E(a)-(c).

Example 4 — Initial measurement of debt instruments issued between related parties

Company H sold land to Company I in return for a debt instrument issued by Company I. Company H and I are related parties. The carrying amount of the land in the accounts of Company H is $500,000 and the land's exchange amount is $550,000. The debt instrument issued by Company I is not quoted in an active market, but the instrument does have inputs that are significant to the determination of fair value that are observable. At issuance, the fair value of the debt instrument in Company I was $525,000. The transaction is not in the normal course of operations.

Entries by Company H (Seller)

Situation I — The transaction is not in the normal course of operations and meets the criteria in paragraphs 3856.08E(a)-(c)			Situation II — The transaction is not in the normal course of operations and does **not** meet the criteria in paragraphs 3856.08E(a)-(c)		
Dr. Debt instrument in Co. I	525,000		Dr. Debt instruments in Co. I	525,000	
Cr. Land		500,000	Cr. Land		500,000
Cr. Gain		25,000	Cr. Equity		25,000
To record the sale of the land.			To record the sale of the land.		

In Situations I and II, the debt instrument is not quoted in an active market, but the instrument does have inputs that are significant to the determination of fair value that are observable. Therefore, the debt instrument is initially measured at fair value.

In Situation I, the gain is included in net income because the transaction includes a financial instrument, and is either in the normal course of operations, or is not in the normal course of operations and meets the criteria in paragraphs 3856.08E(a)-(c).

In Situation II, the difference is included in equity because the transaction includes a financial instrument, is not in the normal course of operations and does not meet the criteria in paragraphs 3856.08E(a)-(c).

Entries by Company I (Buyer)

Situation I — The land received in the transaction is measured at carrying amount			Situation II — The land received in the transaction is measured at exchange amount		
Dr. Land	500,000		Dr. Land	550,000	
Dr. Equity	25,000		Cr. Debt instrument		525,000
Cr. Debt instrument		525,000	Cr. Gain		25,000
To record the purchase of the land.			To record the purchase of the land.		

In Situations I and II, the debt instrument has inputs that are significant to the determination of the fair value that are observable. Therefore, the debt instrument is initially measured at fair value. The land is recognized in Company I's books at the predecessor's carrying amount or the land's exchange amount in accordance with RELATED PARTY TRANSACTIONS, Section 3840.

In Situation I, the difference is included in equity because the transaction includes a financial instrument, is not in the normal course of operations and does not meet the criteria in paragraphs 3856.08E(a)-(c).

In Situation II, the gain is included in net income because the transaction includes a financial instrument, and is either in the normal course of operations, or is not in the normal course of operations and meets the criteria in paragraphs 3856.08E(a)-(c).

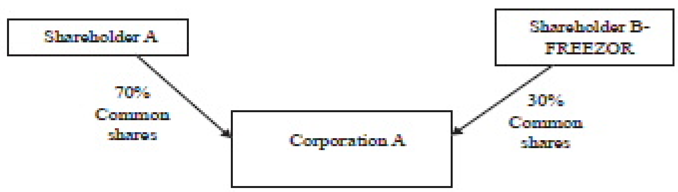
RETRACTABLE OR MANDATORILY REDEEMABLE SHARES ISSUED IN A TAX PLANNING ARRANGEMENT

Example 5 — Classification of retractable or mandatorily redeemable shares issued in tax planning arrangement

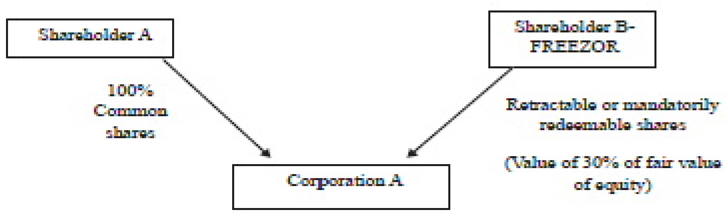
The following example illustrates how the accounting treatment specified in paragraph 3856.23 might be applied in a particular situation. Matters of principle relating to particular situations should be decided in the context of paragraph 3856.23.

Shareholder A owns 70 percent of the voting shares and Shareholder B owns 30 percent of the voting shares of Corporation A. Shareholder B executes a tax planning arrangement exchanging their common shares for retractable or mandatorily redeemable shares as below:

Before



After



The retractable or mandatorily redeemable shares issued by Corporation A to Shareholder B would not qualify for equity classification as Shareholder B did not retain control of Corporation A. Therefore, the shares are classified as a financial liability at the redemption amount.

Footnotes

1. Debt instruments without stated terms of repayment are deemed payable on demand.
1. Debt instruments without stated terms of repayment are deemed payable on demand.