

# Accounting alert

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## Financial instruments: Disclosure and presentation

Pending AASB 132 can be obtained from the AASB's web site: [www.aasb.com.au](http://www.aasb.com.au)

Applicable for annual reporting periods beginning on or after 1 January 2005. Early adoption is not permitted

The Australian Accounting Standards Board (AASB) has made available Pending Accounting Standard AASB 132 'Financial Instruments: Disclosure and Presentation'.

This *Accounting Alert* provides an overview of Pending AASB 132 and some analysis of the issues arising. Refer *Accounting Alert 2004/03* for an analysis of issues related to the recognition and measurement of financial instruments.

### Overview

As noted in *Accounting Alert 2004/19* the AASB is issuing Pending AASB Standards prior to their finalisation in April/May 2004, to be effective for annual reporting periods beginning on or after 1 January 2005. Early adoption will not be permitted.

Pending AASB 132 prescribes the presentation and disclosure requirements for financial instruments including:

- a) clarifying the liability and equity classification of financial instruments
- b) prescribing conditions under which assets and liabilities may be set-off
- c) requiring disclosure of fair value for each class of financial assets and liabilities.

Entities that comply with the requirements of Pending AASB 132 will simultaneously be in compliance with IAS 32 'Financial Instruments: Presentation and Disclosure', although additional disclosure requirements have been included in Pending AASB 132.

Pending AASB 132 will replace AASB 1033 'Presentation and Disclosure of Financial Instruments'. Pending AASB 132 is similar to AASB 1033 but will change the required classification of some financial instruments.

Pending AASB 132 applies to all types of financial instrument except:

- a) those covered by another more specific standard such as interests in subsidiaries, associates and joint ventures and post-employment benefits (eg. pensions)
- b) insurance contracts and certain other contracts that are similar in nature to insurance contracts
- c) contracts for contingent consideration in a business combination as they relate to the acquirer
- d) contracts that require a payment based on climatic, geological or other physical variables.

The Standard applies to both recognised and unrecognised financial instruments. The Standard also applies to contracts to buy or sell a non-financial item (such as commodity contracts) where these are not for the entity's own purchase, sale or usage requirements, but for trading purposes.



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### Major differences between pending AASB 132 and AASB 1033 and implications for Australian reporting

Resetting preference shares will be classified as liabilities under Pending AASB 132

#### Classification of convertible financial instruments

Where the number of equity securities required to settle a contractual obligation vary with changes in their fair value so that the total fair value of equity securities paid always equals a contractual amount, Pending AASB 132 requires the instrument to be classified as a financial liability. AASB 1033 addressed converting financial instruments (financial instruments that mandatorily convert to equity instruments of the issuer) and required that the instrument be classified as a financial liability by the issuer on initial recognition to the extent that the holder of the instrument was not exposed to changes in the fair value of the issuer's equity instruments. AASB 1033 did not explicitly address convertible financial instruments (instruments that specify but do not mandate settlement by conversion to a number of equity securities that vary with changes in the fair value of the equity securities).

Accordingly, where there is an instrument that specifies settlement by conversion to a number of equity securities that vary with changes in their fair value, but conversion is not mandatory, Pending AASB 132 will require a liability classification where AASB 1033 may not. For example, the current practice in Australia is to classify resetting preference shares where the holder has an option to redeem the preference shares for a variable number of the issuer's ordinary shares, as equity. Under Pending AASB 132, such financial instruments will be classified as liabilities.

Units in a unlisted unit trust that can be redeemed for cash will be classified as liabilities under Pending AASB 132

#### Classification of puttable instruments

A financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset is required by Pending AASB 132 to be classified as a financial liability. The current practice in Australia is to classify units in an unlisted unit trust that can be redeemed for cash equal to the proportionate share of the net asset value of the trust, as equity. Under Pending AASB 132, such units will be classified as liabilities.

Compound financial instruments issued prior to 1 January 1998 where the liability component is still outstanding will need to be segregated under Pending AASB 132

#### Classification of compound financial instruments

Compound financial instrument issued before 1 January 1998 were exempt from segregation into equity and liability components under AASB 1033. A similar exemption is only available under Pending AASB 132 if the liability component is no longer outstanding at the date of first adoption.

Pending AASB 132 requires the liability component of compound financial instruments to be measured first at fair value with the residual being the equity component. AASB 1033 allows alternative measurement approaches.

Guidance on alternative settlement options and contingent settlement provisions

#### Settlement options

Pending AASB 132 requires that financial instruments with alternative settlement options (eg. cash or shares) to be classified as financial liabilities unless all the settlement options would result in it being an equity instrument. AASB 1033 often allowed such instruments to be classified as compound financial instruments.

#### Contingent settlement provisions

Contingent settlement provisions which are beyond the control of both the issuer and holder of the instrument, eg. changes in a stock market index or CPI, or the issuers future revenue are required to be classified as liabilities unless the part of the contingent settlement provision that could require settlement in cash or another financial asset is not genuine or the issuer can be required to settle the obligation in cash or another financial asset only in the event of liquidation of the issuer. Under AASB 1033 such provisions were likely to cause an instrument to be classified as a compound financial instrument.

In-substance defeasance no longer results in derecognition

#### In-substance defeasance

In-substance defeasance cannot be used as a basis for offsetting financial assets and liabilities under Pending AASB 132. This treatment had been previously required under AASB 1014 'Set-off and Extinguishment of Debt'.

#### Disclosures

Pending AASB 132 requires disclosure of 'fair value' information whilst AASB 1033 requires disclosure of 'net fair value'. The inclusion of transaction costs in the determination of net fair value will yield different disclosure values for financial assets and liabilities.

There are also a number of other disclosure changes.

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### Proposed amendments as result of other projects

Comparative information is not required to be restated in which case adjustments are made at beginning of first IFRS reporting period

### Proposed amendments

The IASB is currently considering responses to Exposure Drafts that contain the following proposals for further amendments to IAS 32:

- ED 2 'Share-based payment' proposes the addition of a scope exclusion for financial instruments, contracts and obligations within the scope of ED 2
- ED 5 'Insurance contracts' proposes to amend the scope of IAS 32:
  - (iii) by amending the definition of insurance contracts (insurance contracts are outside the scope of IAS 32)
  - (iv) to clarify which derivatives that are embedded in insurance contracts are within the scope of IAS 32
  - (v) to exempt financial instruments with a discretionary participation feature from the requirements on liability and equity classification
  - (vi) to delete the scope exclusion for derivatives based on climatic, geological or other physical variables.

### First-time adoption of AASB 132

Application of this Standard will begin in the first annual reporting period beginning on or after 1 January 2005.

Full retrospective application of Pending AASB 132 will be required on first time adoption. However:

- comparative information does not need to be restated and therefore the date of transition for Pending AASB 132 purposes may be the beginning of the first IFRS reporting period
- in classifying financial instruments, consideration should be given to the substance of contractual arrangements when the instrument first satisfied recognition criteria
- components of a compound financial instrument do not need to be separately identified if the liability component is no longer outstanding at the date of transition.

### Action points

Entities should consider the following major points in relation to AASB 132:

- a full inventory of financial instrument should be performed, with particular consideration given to:
  - convertible financial instruments such as resetting preference shares
  - puttable instruments such as units in unlisted unit trusts
  - any compound financial instruments issued prior to 1 January 1998 where the liability component is still outstanding and has not been segregated
  - financial instruments with alternative settlement options
  - contingent settlement provisions
- consider whether any debt has been subject to an in-substance defeasance
- consider the impact of re-classification of financial instruments previously classified as equity as debt on loan covenants.

### Feedback and assistance

We welcome your feedback on the matters covered in this *Accounting Alert* – please email your comments to [accounting\\_alerts@deloitte.com.au](mailto:accounting_alerts@deloitte.com.au).

For assistance in applying the requirements outlined above in your organisation, please contact your local Deloitte office or contact our Lead National Technical Partner, Bruce Porter on (03) 9208 7490, or by email to [bruporter@deloitte.com.au](mailto:bruporter@deloitte.com.au).

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