Section 3856 - Financial Instruments

### SCOPE

**Applies to all financial instruments except for the following:**
- Interests in subsidiaries, entities subject to significant influence, and joint arrangements that are accounted for in accordance with Section 1591, Subsidiaries, Section 3051, Investments, Section 3056, Interests in Joint Arrangements; however, this Section does apply to a derivative that is based on such an interest.
- Leases (see Section 3065, Leases), although Appendix B of this Section applies to transfers of lease receivables.
- Employer’s rights and obligations for employee future benefits and related plan assets (see Section 3462, Employee Future Benefits).
- Insurance contracts, including the cash surrender value of a life insurance policy.
- Investments held by an investment company that are accounted for at fair value in accordance with AcG-18, Investment Companies; however, the disclosure requirements in paragraphs 3856.37-.54 apply to an investment company.
- Contracts and obligations for stock-based compensation to employees and stock-based payments to non-employees (see Section 3870, Stock-based Compensation and Other Stock-based Payments).
- Guarantees, other than guarantees that replace financial liabilities as described in paragraph 3856.58 (see also AcG-14, Disclosure of Guarantees).
- Contracts based on revenues of a party to the contract.
- Loan commitments (see Section 3280, Contractual Obligations, and Section 3290, Contingencies).
- Contractual arrangements that prevent sale treatment (for example, an option to repurchase transferred receivables).
- 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 Section 1582, Business Combinations, paragraphs .41-.42). This exception applies only to the acquirer (the entity that is accounting for the combination) and not to the seller.

**Does not apply to contracts to buy or sell non-financial items except for:**
- Exchange-traded futures contracts; and
- Contracts that are designated in a qualifying hedging relationship in accordance with paragraphs 3856.30-.36.

### COMMON FINANCIAL INSTRUMENTS

- Cash;
- Demand and fixed-term deposits;
- Commercial paper, bankers’ acceptances, treasury notes and bills;
- Accounts, notes and loans receivable and payable;
- Bonds and similar debt instruments, both issued and held as investments;
- Common and preferred shares and similar equity instruments, both issued and held as investments; and
- Options, warrants, futures contracts, forward contracts, and swaps.

### DEFINITIONS

#### Financial Instrument
- A contract that creates a financial asset for one entity and a financial liability or equity instrument of another entity.

#### Financial Asset
- Any asset that is:
  - Cash;
  - A contractual right to receive cash or another financial asset from another party;
  - A contractual right to exchange financial instruments with another party under conditions that are potentially favourable; or
  - An equity instrument of another entity.
- The cost incurred by an entity to purchase a right to reacquire its own equity instruments from another party is a deduction from its equity, not a financial asset.

#### Financial Liability
- Any liability that is a contractual obligation:
  - To deliver cash or another financial asset to another party; or
  - To exchange financial instruments with another party under conditions that are potentially unfavourable to the entity.

#### Equity Instrument
- Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

#### Derivative
- A contract with all three of the following characteristics:
  - It’s 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;
  - It requires no initial 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
  - It is settled at a future date.

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1 Except as specified in paragraph 3856.55.
**Financial Instruments**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>RECOGNITION</strong></td>
<td>Financial instruments are recognized on the Balance Sheet when the entity becomes party to the contractual provisions of the instrument.</td>
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<tr>
<td><strong>MEASUREMENT</strong></td>
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</table>
| **INITIAL MEASUREMENT** | • All financial instruments are measured initially at fair value.  
  • **Fair value** - the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.  
  • Directly attributable transaction costs are added to or deducted from the carrying value of those financial instruments that are not measured subsequently at fair value.  
  • **Directly attributable transaction costs** - incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. (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.)  
  • When a financial asset is originated or acquired or a financial liability is issued or assumed in a related party transaction, the transaction should be measured in accordance with Section 3840, Related Party Transactions, (parties whose sole relationship with the entity is in the capacity of management, are deemed to be unrelated third parties for financial instrument purposes).  
  • If there is a difference between the consideration paid or received and the fair value of the instrument, the difference should be recognized in net income unless it qualifies as some other type of asset or liability. |
| **SUBSEQUENT MEASUREMENT - AMORTIZED COST** | Financial assets and liabilities are measured at amortized cost except for those noted below.  
When determining amortized cost either the effective interest rate or straight line methods may be used to recognize the premium or discount and all related transactions costs and financing fees over the expected life of the instrument with limited exceptions. |
| **SUBSEQUENT MEASUREMENT - FAIR VALUE** | The following financial instruments should be measured at fair value without any adjustment for transaction costs:  
  • Investments in equity instruments that are quoted in an active market.  
  • Derivative contracts except for derivatives that are designated in a qualifying hedging relationship or derivatives that are linked to, and must be settled by delivery of, equity instruments of another entity whose fair value cannot be readily determined.  
  All gains and losses are recognized in net income.  
An entity may elect to measure any financial asset or financial liability at fair value by designating it to be measured at fair value:  
  • By irrevocably designating that financial instrument when it is initially recognized; or  
  • When an equity instrument ceased to be quoted in an active market.  
  All gains and losses are recognized in net income. |
| **DISCLOSURE** | An entity 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:  
  • Financial assets measured at amortized cost;  
  • Financial assets measured at fair value; and  
  • Investments in equity instruments measured at cost less any reduction for impairment.  
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. |
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<tr>
<th>IMPAIRMENT</th>
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<td>At the end of each reporting period, the existence of any indicators that a financial asset, or group of similar financial assets, measured at cost or amortized cost may be impaired should be assessed.</td>
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<tr>
<th>INDICATORS</th>
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<td>An indicator of impairment is a condition or event that will cause a significant adverse change in the expected timing or amount of future cash flows such as significant financial difficulty of the issuer or customer or significant adverse changes in technological, market, economic or legal environment in which the issuer/customer operates in.</td>
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<td>If there is evidence of impairment, reduce the carrying amount of the asset, or group of assets, to the highest of the following:</td>
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<tr>
<td>- The present value of the cash flows from holding the asset discounted using a current market rate of interest;</td>
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<td>- The amount that could be realized by selling the asset, or group of assets, at the balance sheet date; and</td>
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<td>- The net amount the entity expects to realize by exercising its right to any collateral held to secure repayment of the asset.</td>
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<td>The carrying amount of the asset shall be reduced directly or through the use of an allowance account through net income.</td>
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<td>The impairment can also be reversed through net income if the situation changes. The adjusted carrying amount of the asset shall not be greater than the amount that would have been reported at the date of the reversal had the impairment not been recognized previously.</td>
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<td>For financial assets other than trade receivables, an entity 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, an entity shall disclose the amount of any allowance for impairment.</td>
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<tr>
<th>INTEREST, DIVIDENDS, LOSSES AND GAINS</th>
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<td>The classification of an 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 or as a charge to equity.</td>
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<tr>
<td>- Dividend payments on shares classified as liabilities are classified as expenses.</td>
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<td>- Interest on a bond is reported in net income.</td>
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<tr>
<td>- Gains and losses on redemptions or refinancing of instruments classified as liabilities or equity are reported in net income or equity respectively.</td>
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<tr>
<th>PRESENTATION - EQUITY OR LIABILITY</th>
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<tr>
<td>A financial instrument, or its components, should be classified as a liability or as equity in accordance with the substance of the contractual arrangement on initial recognition and not based on its legal form.</td>
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<tr>
<td>A financial liability exists when:</td>
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<td>- The issuer has a contractual obligation to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to the issuer. A restriction on the ability of the issuer to satisfy an obligation does not negate the issuer's obligation or the holder's right under the instrument; or</td>
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<tr>
<td>- An issuer’s obligation can be settled through the issuance of shares and the number of shares fluctuates in response to changes in a variable other than the market price of the entity’s own equity instruments.</td>
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<td>The following instruments shall be classified as equity on initial recognition:</td>
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<td>- Preferred shares issued in a tax planning arrangement under Sections 51, 85, 85.1, 86, 87 or 88 of the Income Tax Act. The entity must present the shares at par, stated or assigned value as a separate line item in the equity section of the balance sheet.</td>
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<tr>
<td>- Partnership interests and certain types of shares in co-operative organizations that provide for payments to the holder of a pro rata share of the residual equity of the issuer in the event of specific events like liquidation or death of the holder.</td>
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<td>- A retractable or mandatorily redeemable share is classified as a liability unless all of the following criteria are met:</td>
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<td>- The redeemable shares are the most subordinated of all equity instruments issued by the enterprise;</td>
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<td>- The redemption feature is extended to 100 percent of the shares and the basis for determination of the redemption price is the same for all shares;</td>
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<tr>
<td>- The shares have no preferential rights relative to other classes of shares of the enterprise that have the same degree of subordination; and</td>
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<tr>
<td>- The redemption event is the same for all the shares subject to the redemption feature.</td>
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<th>HYBRID INSTRUMENTS</th>
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<td>If an instrument has both liability and equity components, such as the case with convertible debt or when warrants or options are issued with and detachable from a liability, an accounting policy choice exists as there are two acceptable methods for measurement of the liability and equity elements on initial measurement:</td>
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<tr>
<td>- The equity component is measured at zero. As a result, the entire proceeds are allocated to the liability component; or</td>
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<td>- The less easily measurable component is allocated to the residual amount after deducting from the entire proceeds of the issue the amount separately determined for the component that is more easily measurable.</td>
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### Financial Assets

Receivables shall be derecognized only when the transferor has surrendered control. Control is surrendered when all of the following conditions are met:

- 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;
- Each transferee has the right to pledge or exchange the assets 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; and
- The transferor does not maintain effective control over the transferred assets through either:
  - An agreement that both entities and obligates the transferor to repurchase or redeem them before their maturity; or
  - The ability to unilaterally cause the holder to return specific assets with limited exception.

Upon completion of a transfer of receivables that satisfies the conditions to be accounted for as a sale, the transferor (seller):

- DERECOGNIZES all assets sold;
- Recognizes all assets obtained and liabilities incurred in consideration as proceeds of the sale;
- Initially measures at fair value assets obtained and liabilities incurred in a sale; and
- 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).

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

- Report servicing assets separately from servicing liabilities in the Balance Sheet.
- 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.
- Initially measure servicing assets purchased or servicing liabilities assumed at fair value.
- Initially measure servicing liabilities undertaken in a securitization at fair value, if practicable.
- Account separately for rights to future interest income from the serviced assets that exceed contractually specified servicing fees.
- 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.
- Subsequently evaluate and measure impairment of servicing assets.
- 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.

### Financial Liabilities

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

- Discharges the liability (or part of it) by paying the creditor; or
- Is legally released from primary responsibility for the liability (or part of it), either by process of law or by the creditor.

As a result, payments to third parties, including a trust (i.e. in-substance defeasance), by itself will not result in derecognition of the liability, without legal release from the creditor.

When the terms of a financial liability are changed, an entity must determine whether the change is substantial and as such should be accounted for as an extinguishment of old debt and recognition of new debt, or whether the change is a modification of debt.

Extinguishment accounting will be applied when the change in terms is substantial. The change is considered substantial when the present value of the cash flows under the new terms differs by at least 10% from the present value of the remaining cash flows under the original terms, both discounted at the original rate of interest. The difference between the carrying amount of a financial liability extinguished and the fair value of the consideration paid, is recognized in net income for the period.

### Disclosure

If an entity has transferred financial assets during the period and accounts for the transfer as a sale it shall disclose:

- The gain or loss from all sales during the period;
- The accounting policies for:
  - Initially measuring any retained interest (including the methodology used in determining its fair value); and
  - Subsequently measuring the retained interest; and
- A description of the transferor’s continuing involvement with the transferred assets, including, but not limited to, servicing, recourse and restrictions on retained interests.

If an entity has transferred financial assets in a way that does not qualify for derecognition, it shall disclose:

- The nature and carrying amount of the assets;
- The nature of the risks and rewards of ownership to which the entity remains exposed; and
- The carrying amount of the liabilities assumed in the transfer.
**HEDGE ACCOUNTING**

The purpose of hedge accounting is to recognize offsetting gains, losses, revenues and expenses of the hedged item and the hedging instrument in net income in the same period or periods.

Hedge accounting is **optional**.

### ELIGIBILITY

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

- At the inception of the hedging relationship, the entity designates that hedge accounting will be applied to the hedging relationship and formally documents the hedging relationship;
- Both at the inception of the hedging relationship and throughout its term, the entity has reasonable assurance that the critical terms of the hedging item and the hedging instrument are the same, as described in paragraphs 3856.A62-.A65 or paragraphs 1651.38-.41; and
- When the hedged item is an anticipated transaction, it is probable the anticipated transaction will occur at the time and in the amount designated.

An entity may designate only the following hedging relationships:

- An anticipated transaction denominated in a foreign currency hedged with a forward contract (see paragraph 3856.A62);
- An anticipated purchase or sale of a commodity hedged with a forward contract (see paragraph 3856.A63-A63C);
- An interest-bearing asset or liability hedged with an interest rate swap (see paragraph 3856.A64);
- A foreign currency denominated interest-bearing asset or liability hedged with a cross-currency interest rate swap (see paragraph 3856.A65); and
- The net investment in a self-sustaining foreign operation hedged with a derivative or non-derivative financial instrument (see Section 1651, Foreign Currency Translation, paragraphs .38-.41).

### RECOGNITION

A hedge of an **anticipated transaction** is accounted for as follows:

- When the anticipated transaction occurs, the hedged item is recognized initially at the amount of consideration received or paid; and
- The forward contract is not recognized until its maturity.

- When the forward contract matures, the gain or loss on the contract is recorded as an adjustment of the carrying amount of the hedged item. When the hedged item is recognized directly in net income, the gain or loss on the forward contract is included in the same category of revenue or expense in the income statement.

- When the forward contract matures **before** the hedged item is recognized, the gain or loss on the forward contract is recognized as a separate component of equity until the hedged item is recognized. Then when the hedged item is recognized, the gain or loss on the forward contract is transferred from the separate component of equity to the carrying amount of the hedged item or into net income and is included in the same category of revenue or expense in the income statement (see paragraph 3856.A62A).

- When the forward contract matures **after** the hedged item is recognized, the forward contract is recognized on the same date as the hedged item using the spot price / rate in effect on that date. The resulting gain or loss is included in the carrying amount of the hedged item or in net income, in the same category of revenue or expenses in the income statement, and the offsetting amount is recognized as a derivative-related asset or liability, as appropriate. If a reporting period ends before the forward contract matures, the forward contract 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 forward contract matures, the asset or liability is derecognized and any additional gain or loss on the forward contract is recognized in net income.

A hedge of an **interest bearing asset or liability** is accounted for as follows:

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

The approach for both types of hedges results in the derivative being accounted for off-balance sheet. This approach is offset by the requirement for disclosures which describe the nature and terms of the hedged item, the nature and terms of the hedging instrument, the fact that hedge accounting applies and the net effect of the relationship.

### DISCONTINUANCE

Once a hedging relationship is accounted for using hedge accounting, an entity cannot choose to discontinue hedge accounting. Once hedge accounting is being used for a specific relationship, any entity can only discontinue hedge accounting when:

- The hedged item or the hedging item ceases to exist;
- The critical terms of the hedging item set out in paragraphs 3856.A62-A65 cease to match those of the hedged item, including but not limited to, when:
  - It becomes probable an interest bearing asset or liability hedged with an interest rate or cross currency interest rate swap will be prepaid; and
  - It is no longer probable that an anticipated transaction will occur in the amount designated or within 30 days of the maturity date of the hedging item.

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.

If 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.

If 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.

When hedge accounting is discontinued, the hedging item is measured as otherwise required by Section 3856 and any gain or loss is recognized in net income.
### Financial Liabilities

For bonds, debentures and similar securities, mortgages and other long-term debt, an entity shall disclose:
- The title or description of the liability;
- The interest rate;
- The maturity date;
- The amount outstanding, separated between principal and accrued interest;
- The currency in which the debt is payable if it is not repayable in the currency in which the entity measures items in its financial statements; and
- The repayment terms, including the existence of sinking fund, redemption and conversion provisions.

An entity shall disclose the carrying amount of any financial liabilities that are secured. An entity shall also disclose:
- The carrying amount of assets it has pledged as collateral for liabilities; and
- The terms and conditions relating to its pledge.

An entity 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.

For financial liabilities recognized at the balance sheet date, an entity shall disclose:
- 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
- Whether the default was remedied, or the terms of the liability were renegotiated, before the financial statements were completed.

For a financial liability that contains both a liability and an equity element, an entity shall disclose the following information about the equity element including, when relevant:
- The exercise date or dates of the conversion option;
- The maturity or expiry date of the option;
- The conversion ratio or the strike price;
- Conditions precedent to exercising the option; and
- 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.

For a financial instrument that is indexed to the entity's equity or an identified factor, an entity 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.

For a preferred share issued in a tax planning arrangement, an entity shall disclose:
- On the face of the Balance Sheet, the total redemption amount for all classes of such shares outstanding;
- The aggregate redemption amount for each class of such shares; and
- The aggregate amount of any scheduled redemptions required in each of the next five years.

### Risk

For each significant risk arising from financial instruments, and separately for derivatives, an entity shall disclose:
- The exposures to risk and how they arise; and
- Any change in risk exposures from the previous period.

For each type of risk arising from financial instruments, an entity shall disclose concentrations of risk.

### Derivatives

An entity shall disclose:
- The notional and carrying amounts of all derivative assets measured at fair value;
- The notional and carrying amounts of all derivative liabilities measured at fair value;
- The method used to determine the fair value of all derivatives measured at fair value; and
- The notional and accrued amounts of all interest rate and cross-currency interest rate swaps in designated hedging relationships.

When an entity 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.

An entity shall disclose sufficient information about derivatives that are linked to, and must be settled by delivery of, equity instruments of another entity whose fair value cannot be readily determined to permit the reader to assess the potential implications of the contract. This information shall include:
- The name of the issuer of the equity instrument;
- A description of the equity instrument; and
- The terms under which settlement will take place.

### Items of Income

An entity 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:
- Net gains or net losses recognized on financial instruments;
- Total interest income;
- Total interest expense on current financial liabilities;
- Interest expense on long-term financial liabilities, separately identifying amortization of premiums, discounts and financing fees; and
- The amount of any impairment loss or reversal of a previously recognized loss.