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**SINGAPORE FINANCIAL REPORTING STANDARDS  
(INTERNATIONAL)**

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**SFRS(I) 1-32  
Financial Instruments: Presentation**

**Illustrative Examples**

This Guidance is applicable for annual reporting period beginning on  
1 January 2022.

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*from paragraph***SFRS(I) 1-32 FINANCIAL INSTRUMENTS: PRESENTATION  
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## SFRS(I) 1-32 *Financial Instruments: Presentation* Illustrative examples

*These examples accompany, but are not part of, SFRS(I) 1-32.*

### Accounting for contracts on equity instruments of an entity

IE1 The following examples<sup>1</sup> illustrate the application of paragraphs 15–27 and SFRS(I) 9 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

#### **Example 1: Forward to buy shares**

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

*Assumptions:*

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

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

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

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

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

**1 February 20X2**

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

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

**31 December 20X2**

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

|    |               |         |         |
|----|---------------|---------|---------|
| Dr | Forward asset | CU6,300 |         |
|    | Cr            | Gain    | CU6,300 |

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

**31 January 20X3**

On 31 January 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 [(CU106 × 1,000) – CU104,000].

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

|    |      |               |         |
|----|------|---------------|---------|
| Dr | Loss | CU4,300       |         |
|    | Cr   | Forward asset | CU4,300 |

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

|    |      |               |         |
|----|------|---------------|---------|
| Dr | Cash | CU2,000       |         |
|    | Cr   | Forward asset | CU2,000 |

*To record the settlement of the forward contract.*

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

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

**31 January 20X3**

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

|    |        |               |         |
|----|--------|---------------|---------|
| Dr | Equity | CU2,000       |         |
|    | Cr     | Forward asset | CU2,000 |

*To record the settlement of the forward contract.*

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

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

**1 February 20X2**

|    |        |           |           |
|----|--------|-----------|-----------|
| Dr | Equity | CU100,000 |           |
|    | Cr     | Liability | CU100,000 |

*To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see SFRS(I) 9, paragraph B5.1.1).*

**31 December 20X2**

|    |                  |           |         |
|----|------------------|-----------|---------|
| Dr | Interest expense | CU3,660   |         |
|    | Cr               | Liability | CU3,660 |

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

**31 January 20X3**

|    |                  |           |       |
|----|------------------|-----------|-------|
| Dr | Interest expense | CU340     |       |
|    | Cr               | Liability | CU340 |

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

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

|    |           |           |           |
|----|-----------|-----------|-----------|
| Dr | Liability | CU104,000 |           |
|    | Cr        | Cash      | CU104,000 |

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

**(d) Settlement options**

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

**Example 2: Forward to sell shares**

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

computed as the difference between the market share price and the present value of the fixed forward price.

*Assumptions:*

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

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

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

**1 February 20X2**

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

**31 December 20X2**

|    |      |                   |         |
|----|------|-------------------|---------|
| Dr | Loss | CU6,300           |         |
|    | Cr   | Forward liability | CU6,300 |

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

**31 January 20X3**

|    |                   |         |         |
|----|-------------------|---------|---------|
| Dr | Forward liability | CU4,300 |         |
|    | Cr                | Gain    | CU4,300 |

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

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

|    |                   |         |        |
|----|-------------------|---------|--------|
| Dr | Forward liability | CU2,000 |        |
|    | Cr                | Cash    | C2,000 |

*To record the settlement of the forward contract.*

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

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

**31 January 20X3**

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

|    |                   |         |         |
|----|-------------------|---------|---------|
| Dr | Forward liability | CU2,000 |         |
|    | Cr                | Equity  | CU2,000 |

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

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

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

**1 February 20X2**

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

**31 December 20X2**

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

**31 January 20X3**

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

|    |      |           |           |
|----|------|-----------|-----------|
| Dr | Cash | CU104,000 |           |
|    | Cr   | Equity    | CU104,000 |

*To record the settlement of the forward contract.*

*(d) Settlement options*

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

**Example 3: Purchased call option on shares**

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

*Assumptions:*

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

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

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

**1 February 20X2**

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the option contract on 1 February 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it



would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

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

*To recognise the purchased call option.*

### 31 December 20X2

On 31 December 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ( $[(CU104 - CU102) \times 1,000]$ ), and CU1,000 is the remaining time value.

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

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

### 31 January 20X3

On 31 January 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ( $[(CU104 - CU102) \times 1,000]$ ) because no time value remains.

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

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

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

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

*To record the settlement of the option contract.*

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

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

### 31 January 20X3

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

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

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

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

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

**1 February 20X2**

|    |        |         |         |
|----|--------|---------|---------|
| Dr | Equity | CU5,000 |         |
|    | Cr     | Cash    | CU5,000 |

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

**31 December 20X2**

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

**31 January 20X3**

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

|    |        |           |           |
|----|--------|-----------|-----------|
| Dr | Equity | CU102,000 |           |
|    | Cr     | Cash      | CU102,000 |

*To record the settlement of the option contract.*

*(d) Settlement options*

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

## Example 4: Written call option on shares

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

*Assumptions:*

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

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

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

**1 February 20X2**

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

*To recognise the written call option.*

**31 December 20X2**

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

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

**31 January 20X3**

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

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

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

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

*To record the settlement of the option contract.*

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

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

**31 December 20X3**

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

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

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

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

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

**1 February 20X2**

|    |      |         |         |
|----|------|---------|---------|
| Dr | Cash | CU5,000 |         |
|    | Cr   | Equity  | CU5,000 |

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

**31 December 20X2**

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

**31 January 20X3**

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

|    |      |           |           |
|----|------|-----------|-----------|
| Dr | Cash | CU102,000 |           |
|    | Cr   | Equity    | CU102,000 |

*To record the settlement of the option contract.*

**(d) Settlement options**

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

**Example 5: Purchased put option on shares**

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

*Assumptions:*

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

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

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

**1 February 20X2**

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

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

*To recognise the purchased put option.*

**31 December 20X2**

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

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

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

**31 January 20X3**

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

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

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

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

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

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

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

*To record the settlement of the option contract.*

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

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

**1 February 20X2**

|    |        |         |         |
|----|--------|---------|---------|
| Dr | Equity | CU5,000 |         |
|    | Cr     | Cash    | CU5,000 |

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

**31 December 20X2**

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

**31 January 20X3**

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

|    |      |          |          |
|----|------|----------|----------|
| Dr | Cash | CU98,000 |          |
|    | Cr   | Equity   | CU98,000 |

*To record the settlement of the option contract.*

*(d) Settlement options*

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

**Example 6: Written put option on shares**

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

*Assumptions:*

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

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

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



**1 February 20X2**

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

*To recognise the written put option.*

**31 December 20X2**

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

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

**31 January 20X3**

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

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

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

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

*To record the settlement of the option contract.*

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

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

**31 January 20X3**

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

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

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

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

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

**1 February 20X2**

|    |      |         |         |
|----|------|---------|---------|
| Dr | Cash | CU5,000 |         |
|    | Cr   | Equity  | CU5,000 |

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

|    |        |           |          |
|----|--------|-----------|----------|
| Dr | Equity | CU95,000  |          |
|    | Cr     | Liability | CU95,000 |

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

**31 December 20X2**

|    |                  |           |         |
|----|------------------|-----------|---------|
| Dr | Interest expense | CU2,750   |         |
|    | Cr               | Liability | CU2,750 |

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

**31 January 20X3**

|    |                  |           |       |
|----|------------------|-----------|-------|
| Dr | Interest expense | CU250     |       |
|    | Cr               | Liability | CU250 |

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

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

|    |           |          |          |
|----|-----------|----------|----------|
| Dr | Liability | CU98,000 |          |
|    | Cr        | Cash     | CU98,000 |

*To record the settlement of the option contract.*

**(d) Settlement options**

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

## Entities such as mutual funds and co-operatives whose share capital is not equity as defined in SFRS(I) 1-32

### Example 7: Entities with no equity

IE32 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have equity as defined in SFRS(I) 1-32. Other formats are possible.

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

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

#### Statement of financial position at 31 December 20X1

|   | 20X1          | 20X0          |
|---|---------------|---------------|
| CU  | CU            | CU            |
| <b>ASSETS</b>   |               |               |
| Non-current assets<br>(classified in accordance<br>with SFRS(I) 1-1)  | <u>91,374</u> | <u>78,484</u> |
| <b>Total non-current assets</b>                                       | 91,374        | 78,484        |
| Current assets (classified in<br>accordance with SFRS(I)<br>1-1)      | <u>1,422</u>  | <u>1,769</u>  |
| <b>Total current assets</b>   | <u>1,422</u>  | <u>1,769</u>  |
| <b>Total assets</b>   | 92,796        | 80,253        |
| <b>LIABILITIES</b>  |               |               |
| Current liabilities (classified<br>in accordance with SFRS(I)<br>1-1) | <u>647</u>    | <u>66</u>     |
| <b>Total current liabilities</b>                                      | (647)         | (66)          |

**Statement of financial position at 31 December 20X1**

|  | CU  | 20X1<br>CU    | CU  | 20X0<br>CU    |
|--|-----|---------------|-----|---------------|
| Non-current liabilities<br>excluding net assets<br>attributable to unitholders<br>(classified in accordance<br>with SFRS(I) 1-1) | 280 |               | 136 |               |
|  |     | (280)         |     | (136)         |
| <b>Net assets attributable to<br/>unitholders</b>  |     | <b>91,869</b> |     | <b>80,051</b> |

**Example 8: Entities with some equity**

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in SFRS(I) 1-32 because the entity has an obligation to repay the share capital on demand but does not have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. Other formats are possible.

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

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

**Statement of financial position at 31 December 20X1**

|   | CU  | 20X1<br>CU   | CU  | 20X0<br>CU   |
|---|-----|--------------|-----|--------------|
| <b>ASSETS</b>   |     |              |     |              |
| Non-current assets<br>(classified in accordance<br>with SFRS(I) 1-1)      | 908 |              | 830 |              |
| <b>Total non-current assets</b>   |     | 908          |     | 830          |
| Current assets (classified in<br>accordance with SFRS(I)<br>1-1)          | 383 |              | 350 |              |
| <b>Total current assets</b>   |     | 383          |     | 350          |
| <b>Total assets</b>   |     | <u>1,291</u> |     | <u>1,180</u> |
| <b>LIABILITIES</b>  |     |              |     |              |
| Current liabilities (classified<br>in accordance with SFRS(I)<br>1-1)     | 372 |              | 338 |              |
| <b>Share capital repayable<br/>on demand</b>                              | 202 |              | 161 |              |
| <b>Total current liabilities</b>  |     | (574)        |     | (499)        |
| <b>Total assets less current<br/>liabilities</b>                          |     | <u>717</u>   |     | <u>681</u>   |
| Non-current liabilities<br>(classified in accordance<br>with SFRS(I) 1-1) | 187 |              | 196 |              |
|   |     | (187)        |     | (196)        |
| <b>OTHER COMPONENTS<br/>OF EQUITY<sup>(a)</sup></b>                       |     |              |     |              |
| Reserves eg revaluation<br>surplus, retained earnings<br>etc              | 530 |              | 485 |              |
|   |     | 530          |     | 485          |
|   |     | <u>717</u>   |     | <u>681</u>   |
| <b>MEMORANDUM NOTE – Total members' interests</b>                         |     |              |     |              |
| Share capital repayable on<br>demand                                      |     | 202          |     | 161          |
| Reserves  |     | 530          |     | 485          |
|   |     | <u>732</u>   |     | <u>646</u>   |

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

## Accounting for compound financial instruments

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

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

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

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

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

### Example 11: Repurchase of a convertible instrument

- IE39 The following example illustrates how an entity accounts for a repurchase of a convertible instrument. For simplicity, at inception, the face amount of the instrument is assumed to be equal to the aggregate carrying amount of its liability and equity components in the financial statements, ie no original issue premium or discount exists. Also, for simplicity, tax considerations have been omitted from the example.
- IE40 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At

the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

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

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

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

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

- IE44 The repurchase price is allocated as follows:

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

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

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

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

*To recognise the repurchase of the liability component.*

|    |        |       |       |
|----|--------|-------|-------|
| Dr | Equity | CU619 |       |
|    | Cr     | Cash  | CU619 |

*To recognise the cash paid for the equity component.*

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

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

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

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

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

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

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

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

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

*Number of incremental ordinary shares issued upon conversion*

            10     shares

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

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

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