Relevant Extracts From FRS 102

FRS 102 paragraph 11.8 states the following:
"11.8 An entity shall account for the following financial instruments as basic financial instruments in accordance with Section 11:
(a) cash;
(b) a debt instrument (such as an account, note, or loan receivable or payable) that meets the conditions in paragraph 11.9 and is not a financial instrument described in paragraph 11.6(b);
(c) commitments to receive or make a loan to another entity that: (i) cannot be settled net in cash; and (ii) when the commitment is executed, are expected to meet the conditions in paragraph 11.9; and
(d) an investment in non-convertible preference shares and non-puttable ordinary shares or preference shares."

"**FRS 102 paragraph 11.9**
The conditions a debt instrument shall satisfy in accordance with paragraph 11.8(b) are:
(a) The contractual return to the holder (the lender), assessed in the currency in which the debt instrument is denominated, is:
(i) a fixed amount;
(ii) a positive fixed rate or a positive variable rate10; or
(iii) [not used]
(iv) a combination of a positive or a negative fixed rate and a positive variable rate (eg LIBOR plus 200 basis points or LIBOR less 50 basis points, but not 500 basis points less LIBOR).

(aA) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged.

(aB) The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that:
(i) the new rate satisfies condition (a) and the variation is not contingent on future events other than:
(1) a change of a contractual variable rate;
(2) to protect the holder against credit deterioration of the issuer;
(3) changes in levies applied by a central bank or arising from changes in relevant taxation or law; or
(ii) the new rate is a market rate of interest and satisfies condition (a). Contractual terms that give the lender the unilateral option to change the terms of the contract are not determinable for this purpose.

(b) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods. The fact that a debt instrument is subordinated to other debt instruments is not an example of such a contractual provision.

(c) Contractual provisions that permit the issuer (the borrower) to prepay a debt instrument or permit the holder (the lender) to put it back to the issuer before maturity are not contingent on future events other than to protect:
(i) the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or
(ii) the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.

The inclusion of contractual terms that, as a result of the early termination, require the issuer to compensate the holder for the early termination does not, in itself, constitute a breach of this condition.

(d) [Not used]

(e) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c)."

FRS 102 paragraph 11.13 states:

"When a financial asset or financial liability is recognised initially, an entity shall measure it at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss) unless the arrangement constitutes, in effect, a financing transaction. A financing transaction may take place in connection with the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate. If the arrangement constitutes a financing transaction, the entity shall measure the financial asset or financial liability at the present value of the future payments discounted at a market rate of interest for a similar debt instrument."

FRS 102 paragraph 11.14 says the following:

At the end of each reporting period, an entity shall measure financial instruments as follows, without any deduction for transaction costs the entity may incur on sale or other disposal:

1. Debt instruments that are payable or receivable within one year shall be measured at the undiscounted amount of the cash or other consideration expected to be paid or received unless the arrangement constitutes, in effect, a financing transaction.
2. If the arrangement constitutes a financing transaction, the entity shall measure the debt instrument at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

3. Debt instruments that meet the conditions in paragraph 11.8(b) shall be measured at amortised cost using the effective interest method.
4. Debt instruments that meet the conditions in paragraph 11.8(b) and commitments to receive a loan and to make a loan to another entity that meet the conditions in paragraph 11.8(c) may upon their initial recognition be designated by the entity as at fair value through profit or loss provided doing so results in more relevant information, because either:

   (i) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or debt instruments or recognising the gains and losses on them on different bases; or
   (ii) a group of debt instruments or financial assets and debt instruments is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in Section 33 Related Party Disclosures, paragraph 33.6), for example members of the entity's board of directors and its chief executive officer.

5. Commitments to receive a loan and to make a loan entity that meet the conditions in paragraph 11.8(c) shall be measured at cost less impairment.

6. Investments in non-convertible preference shares and non-puttable ordinary shares or preference shares shall be measured as follows (paragraphs 11.27 to 11.32 provide guidance on fair value):

   (i) if the shares are publicly traded or their fair value can otherwise be measured reliably, the investment shall be measured at fair value with changes in fair value recognised in profit or loss; and
   (ii) all other such investments shall be measured at cost less impairment.

   Impairment or uncollectability must be assessed for financial assets in (a), (c) and (d)(ii) above. Paragraphs 11.21 to 11.26 provide guidance.