Swiss GAAP FER

‘Financial instruments’

August 2025

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Introduction

The Swiss GAAP FER standards focus on small and medium-sized entities and groups with a national reach[1], they are however also applied by larger groups with international operations. The increased use of Swiss GAAP FER, in particular by groups with a global reach, together with the accounting challenges arising from ever increasing complexity in business transactions and financial instruments, has led to more questions on how to apply the standards in practice – for example in relation to the accounting for financial instruments.

This brochure provides answers to questions that, in our experience, arise frequently when preparing financial statements in accordance with Swiss GAAP FER. The examples provided and the practice observations shared within this publication focus on the accounting for financial instruments by non-financial institutions (corporate entities), as from our experience, those are the primary preparers of Swiss GAAP FER financial statements.

Entities must carefully assess whether the guidance provided in this publication is applicable to their specific facts and circumstances. This brochure does not reflect all provisions included in Swiss GAAP FER. It is rather a collection of questions that arose or are likely to arise in practice and approaches how to solve those questions that are, in our view, in-line with the principles outlined in Swiss GAAP FER. For significant transactions or items, we recommend consulting the official Swiss GAAP FER standards as well as seeking professional advice. PwC does not accept any liability for damages arising in connection with the use of this brochure.

[1] Swiss GAAP FER – Accounting and Reporting Recommendations, Introduction 3.1.

Scope

1. Unlike other 'true and fair view' accounting standards such as IFRS® Accounting Standards and US GAAP, Swiss GAAP FER does not include a comprehensive standard on financial instruments. While FER 27 provides guidance on the accounting for derivative financial instruments, there is limited explicit guidance included in Swiss GAAP FER around recognition, measurement, presentation and disclosure of non-derivative financial instruments such as for example trade receivables, loans, bonds and shares.

2. Framework 1 outlines that preparers should apply the principles in the framework to develop suitable accounting principles that reflect a true and fair view which is, as per Framework 6, the fundamental purpose of financial statements. The financial statements need to reflect the economic facts, need to be reliable, and directed to the needs of the users. In the absence of specific guidance, preparers have interpreted terms and accounting policies for financial instruments based on the principles outlined above.

   We observe that, in practice, preparers have developed a variety of accounting principles to account for financial instruments. These principles are mainly influenced by the type of financial instrument and the industry they are operating in.
   [Framework 1, Framework 6, FER 1/4]

3. The principles are often based on measurement approaches that exist in the framework and other Swiss GAAP FER standards (i.e. historical cost, par value, fair value, or amortised cost), but also on other true and fair accounting standards that provide explicit guidance.

Definitions

4. Swiss GAAP FER does not provide a definition of financial instruments. It is however generally acknowledged in practice that a financial instrument originates from a contract that results in the recognition of a financial asset in one entity and a financial liability or equity in another entity.

   FAQ 4.1 – Is a contractual basis necessary to originate a financial instrument?

   FAQ 4.2 – Distinguishing characteristics between a provision and a financial liability

5. Framework 15 defines assets as stemming from past transactions or events, being controlled by the entity, and benefitting the entity. Their value must be reliably determinable. The following are common examples of financial assets:
   - Cash and cash equivalents;
   - Trade and other receivables;
   - Debt instruments such as loans and bonds;
   - Equity instruments of another entity such as common shares;
   - Derivative financial assets such as options and forward contracts; and
   - Other contracts that convey the right to receive cash or another financial asset from another entity or to exchange financial instruments with another entity at favourable conditions

   [Framework 15]

6. Framework 17 defines liabilities as stemming from past transactions or events where a future cash outflow is probable. Their value must be reliably determinable. The following are common examples of financial liabilities:
   - Trade and other payables (stemming from operating activities of the entity);
   - Other debt instruments issued by the entity (stemming from financing activities);

- Derivative financial liabilities

[Framework 17]

7. While not defined in Swiss GAAP FER, it is generally acknowledged that a financial liability represents a contractual obligation to deliver cash or another financial asset, or a contractual obligation to exchange financial instruments at unfavourable terms.

8. Equity instruments are commonly understood as ownership rights in another entity that provide the investor with a residual interest in the net assets of that entity which corresponds to the investor's relative ownership. Share certificates (securities) are an example of equity instruments.
[Framework 19]

Initial recognition

Initial recognition of financial assets

9. Financial assets need to be recognised on the balance sheet once the recognition criteria for assets as per Framework 15 are met (refer to paragraph 5). A financial asset is usually recognised once a valid contract with the counterparty has been established that conveys enforceable rights and obligations to the parties of the arrangement. If the criteria are not cumulatively met at the reporting date, no financial asset may be recognised. Depending on the facts and circumstances, an entity might however have a contingent asset at the reporting date, which would be disclosed in the notes to the financial statements.
[Framework 15, Framework 20]

10. Financial assets are initially recognised at the transaction price (acquisition cost). The transaction price usually (but not always) reflects the fair value of consideration transferred between knowledgeable, willing and independent business partners.

FAQ 10.1 – Example of transaction price

Initial recognition of financial liabilities

11. Financial liabilities need to be recognised on the balance sheet once the defining criteria for liabilities as per Framework 17 are met (refer to paragraph 6). A financial liability is recognised once a valid contract with the counterparty has been established that conveys enforceable rights and obligations to the parties of the arrangement.
[Framework 17]

12. Liabilities are recognised at the value of the consideration received in exchange for the liability incurred (historical cost).
[Framework 27]

Measurement

13. A number of measurement principles exist in Swiss GAAP FER. They are outlined in more detail in this section. For financial assets and liabilities, the general principle of individual measurement applies. As an exception, portfolio measurement is allowed for financial assets or liabilities of equal quality (e.g., receivables with equal terms and comparable default risk).
[Framework 25]

14. If financial assets and liabilities are of different quality or nature and may thus not be measured collectively, surpluses and deficits between the financial assets and liabilities measured individually shall not be offset.
[Framework 25]

General measurement principles

15. As per the framework and FER 2, the following measurement principles apply to financial assets:
    - Historical cost less impairment, and
    - Fair value

    However, it should be noted that FER 2 also mentions explicit measurement principles for particular classes of financial assets, such as securities held for trading purposes, trade receivables and non-current financial assets. Those are described in more detail in the following sections.
    [Framework 25, Framework 26, FER 2/2, FER 2/7, FER 2/8, FER 2/12, FER 2/33]

16. Framework 27 and FER 2 allow the following measurement principles for financial liabilities:
    - Par value / historical cost, and
    - Fair value

    [Framework 25, Framework 27, FER 2/14]

Historical cost / par value

17. Framework 26 clarifies that the historical cost of acquisition consists of all costs occurring at acquisition that can be directly allocated to the asset. In the context of financial assets, historical cost usually represents:
    - the amount of cash that has been paid to acquire a financial asset;
    - the fair value of assets that have been exchanged to acquire a financial asset; or
    - the nominal amount in case of cash and cash equivalents and trade receivables.

    [Framework 26, FER 2/8]

18. As per Framework 27, liabilities are recognised at the value of the consideration received in exchange for the liability incurred (historical cost). This value typically remains unchanged until the settlement of the financial liability. FER 2/14 states further that liabilities are normally recognised at par value. Oftentimes, there is no difference between the two methods, which is why we use the term ‘par value’ throughout this publication. However, as outlined in the below FAQ, there are instances when the two methods result in a different accounting for the issuer of the financial liability.
    [Framework 27, FER 2/14]

FAQ 18.1 – Example of difference between the historical cost and par value method: discounts

Fair value

19. Swiss GAAP FER does not define the term fair value, however Framework 26-27 subsume a number of measurement methods as being a measure of fair value. For assets, those include:
    - Current cost – the price that would have to be paid at the balance sheet date for the acquisition of an asset in the ordinary course of business;
    - Net selling price – the amount agreed through the sale of an asset between knowledgeable, willing and independent business partners less the cost of disposal (e.g. transportation, sales commission, taxes);
    - Value in use – the present value of the expected future cash in- and outflows from the further use of the asset; and
    - Liquidation value – the most favourable disposal value, taking the available time into account

    For liabilities, those include:
    - Current cost – the non-discounted amount that would be necessary to settle the liability at the balance sheet date; and
    - Present value – the present value of future net cash outflow that is expected to be needed to settle the liability in the ordinary course of business

    [Framework 26, Framework 27]

20. For financial instruments, the fair value is sometimes observable in an active market, such as for example the trading price of an equity (e.g. shares) or debt (e.g. bond) instrument listed at a stock exchange. If the instrument is not traded in an active market, the fair value is usually determined through application of valuation models that use observable inputs (such as multiple-based valuation models) or unobservable inputs (such as discounted cash flow models).

21. The Swiss GAAP FER framework does not prescribe a fair value hierarchy. We are however of the opinion that entities should use observable market prices, if available, and if not, give preference to valuation models that maximise the use of observable inputs. This view is supported by FER 40 that describes a hierarchy for the measurement of financial assets at fair value and FER 27 that prescribes an order of preference for determining fair values for derivatives.
    [FER 27/13, FER 40/2]

    FAQ 21.1 – Which is the appropriate fair value if more than one is available?

Amortised cost

22. While the framework and FER 2/2 do not mention the amortised cost method as an acceptable measurement principle, it is a method sometimes applied in practice for the measurement of debt instruments, in particular for loans and bonds. The amortised cost method is however a known measurement principle in Swiss GAAP FER. FER 40/3 prescribes that fixed income investments may be measured in accordance with the amortised cost method. While FER 40 applies to insurance entities only, we view it as acceptable also for other entities to use amortised cost as a measurement principle for fixed income financial instruments when those are not held for trading purposes as it is a generally accepted method to reflect the economic substance of the transaction.
    [Framework 10, FER 2/2, FER 40/3]

23. FER 40/21 defines fixed income investments as fixed interest securities, loans and mortgages without embedded derivatives. It is further outlined, that measurement in accordance with the amortised cost method may be chosen separately per category of fixed income investment.
    [FER 40/21]

24. In applying the amortised cost method, preparers recognise premiums and discounts, pre-payment, call and similar options as well as transaction costs and fees over the term of the financial instrument as part of the interest income or expense through application of the effective interest rate.
[FER 40/3]

25. The effective interest rate is the rate that exactly discounts estimated future cash receipts/ payments through the financial asset's/ liability's expected life to the gross carrying amount/ amortised cost of the financial asset/ liability.

FAQ 25.1 – Effective interest rate: estimation of cash flows

FAQ 25.2 – How to account for discounts and premiums applying amortised cost measurement

26. From our experience, corporate entities do rarely apply the amortised cost method in practice which is why this publication does not focus on this measurement approach.

Treatment of transaction costs

27. In the course of origination of financial instruments such as loans, convertible loans, bonds and mortgages, an entity generally incurs transaction costs. These are commonly understood to be incremental costs that are directly attributable to the acquisition, issue, or disposal of a financial asset or a financial liability. A cost is only considered to be incremental if it would have been avoided if the financial instrument was not acquired, issued or disposed of.

28. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs. Only incremental costs qualify as transaction costs. Internal employee hours worked on obtaining financing for example would not qualify as a transaction cost. This is because the employee compensation would have been due irrespective of whether a transaction was completed or not.

29. For entities that apply the historical cost/ par value measurement method, diversity exists in practice as to how transaction costs are accounted for. The most frequently observed approach in practice is to recognise the transaction cost as a deferred position in the balance sheet and amortise it over the term of the financial instrument. The rationale for this treatment is grounded in the accrual principle and preparers view these incremental costs as relating to the financing and hence recognise them in the income statement over the same term as the financing arrangement itself. Another approach sometimes observed in practice is to recognise the transaction costs in the income statement entirely in the period in which they are incurred. Proponents of this view argue that the costs incurred relate to the origination of the financing arrangement which is completed once the funds are transferred to the borrower. Both approaches are acceptable. Whichever approach is chosen, preparers should ensure that meaningful disclosures are provided to enable the readers to understand how transaction costs are treated in the financial statements.
[Framework 11]

FAQ 29.1 – Accounting for transaction costs when applying par value measurement from the borrower's perspective

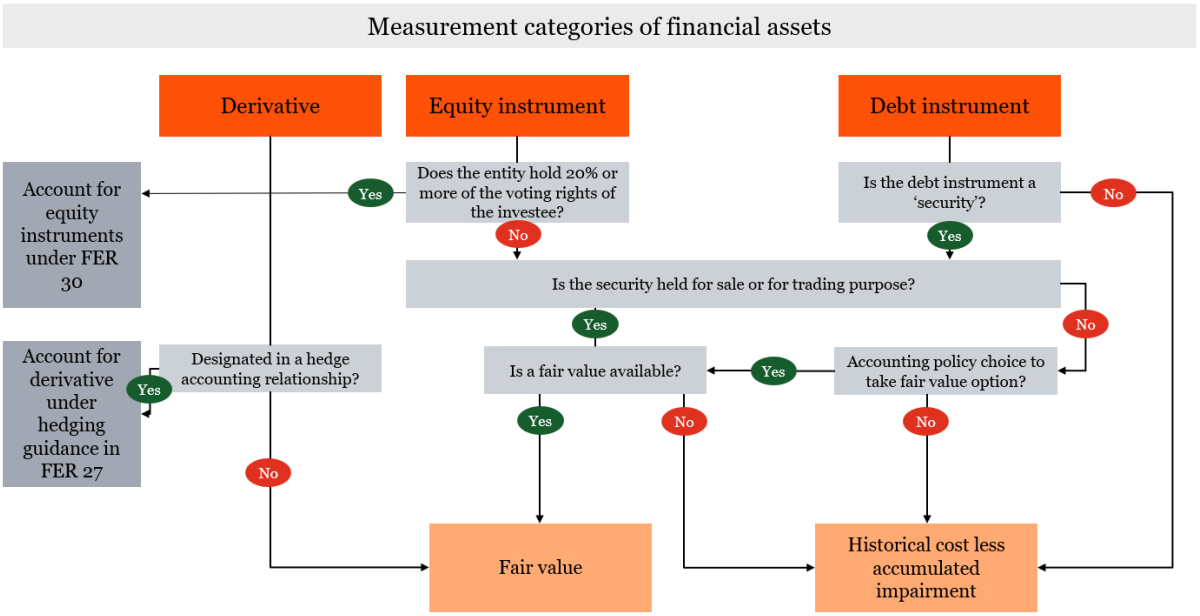
30. If a financial asset or a financial liability is measured at fair value, transaction costs are recognised in the income statement in the period in which these are incurred.

31. When an entity applies the amortised cost method, transaction costs are included in the calculation of the amortised cost using the effective interest method, thus effectively increasing the amount of interest expense recognised over the life of the instrument.

FAQ 31.1 – Accounting for transaction costs applying amortised cost measurement from the borrower's perspective

Measurement categories of financial assets

32. This section discusses the various measurement categories for financial assets, with the exception of derivative instruments which are discussed in section 'Derivative financial instruments'. The below illustration provides an overview of the different measurement categories as well as the facts and circumstances that determine categorisation.



Equity instruments

33. Equity instruments are commonly understood as ownership rights in another entity that provide the investor with a residual interest in the net assets of that entity which corresponds with the investor's relative ownership. FER 3/16 defines registered, bearer, preferred and common shares as well as participation certificates as equity (non-exhaustive).
[Framework 19, FER 3/16]

34. Swiss GAAP FER provides measurement guidance for 'securities' without defining the term. Art. 965 of the Swiss Code of Obligations does however provide such a definition which includes equity instruments. As per FER 2/7, if securities are held for sale or trading purposes and thus are presented as current assets in the balance sheet, they need to be measured at fair value, if such value is observable. If such value is not available, the instrument shall be measured at historical cost less

accumulated impairment.
[Framework 16, FER 2/7]

35. If equity instruments are classified as non-current in the balance sheet (as they're neither held for trading nor held for sale), FER 2/12 allows a policy choice to measure those instruments at either historical cost less accumulated impairment or fair value.
[FER 2/12]

36. If the fair value is not observable it may need to be determined using a valuation model in which preparers should prioritise the use of observable inputs over unobservable inputs (see also paragraph 21). We are of the view that Swiss GAAP FER allows but does not require preparers to determine a fair value for instruments that are not traded in an active market.

37. If equity instruments are measured at fair value, the changes in fair value are recognised in the income statement.
[FER 2/33]

> FAQ 37.1 – In which line item are fair value changes presented in the income statement?

38. If a group holds equity instruments equal to (or more than) 20 percent, or it can demonstrate significant influence or control over the investment by other means, the equity instruments need to be accounted for in accordance with FER 30 'Consolidated financial statements'.

39. Derivative financial instruments not accounted for as hedging instruments such as warrants and options have to be measured at fair value (FER 27/5). Changes in the fair value of such instruments are recognised in the income statement, see further details in the section 'Derivative financial instruments'.
[FER 27/5]

Debt instruments

40. Debt instruments are contracts that obligate a borrower to transfer funds to the lender at a defined future date. Examples are bonds, loan receivables, lease receivables, or trade receivables resulting from sales contracts.

41. To determine the proper measurement category, preparers need to first assess whether a debt instrument qualifies as 'security'. Preparers might look at Art. 965 of the Swiss Code of Obligations which provides a definition of security which entails any instrument to which a right attaches in such a manner that it may not be exercised or transferred to another party without the instrument. A common example of a debt instrument that qualifies as a security is a bond.

42. Debt instruments that do not qualify as securities are measured at historical cost less accumulated impairment.
[FER 2/12]

43. Debt instruments that do qualify as securities are measured at fair value if they are held for sale or trading purposes and thus are presented as current assets in the balance sheet if a fair value is observable. If such value is not available, the instrument shall be measured at historical cost less accumulated impairment.
[FER 2/7]

44. If the debt instruments that do qualify as securities are classified as non-current in the balance sheet (as they're neither held for trading nor held for sale), FER 2/12 allows a policy choice to measure those instruments at either historical cost less accumulated impairment or fair value.
[FER 2/12]

45. If the fair value is not observable it may need to be determined using a valuation model in which preparers should prioritise the use of observable inputs over unobservable inputs (see also paragraph 21). We are of the view that Swiss GAAP FER allows but does not require preparers to determine a fair value for instruments that are not traded in an active market. If debt instruments are measured at fair value, the changes in fair value are recognised in the income statement.
[FER 2/33]

Impairment of financial assets

46. FER 2/16 requires an impairment assessment to be carried out for all assets not recognised at fair value, regardless of whether assets are of financial nature or not. In conducting such an assessment, an entity needs to determine whether indicators exist that the assets' carrying amount might exceed its recoverable amount. If one or more indicators are identified, the recoverable amount needs to be determined. FER 20/4 explains that the recoverable amount is the higher of the net selling price and the value in use. If the carrying amount exceeds the recoverable amount, an impairment needs to be recognised.
[FER 2/16, FER 20/4]

47. Indicators that a financial asset might be impaired include but are not limited to an increase in credit risk (e.g. for trade receivables, lease receivables and loans receivables) or unfavourable macroeconomic developments.

Recoverable amount of financial assets

48. Generally, FER 20/8 states that the recoverable amount is to be determined for each individual asset. As such, if an indicator of impairment is identified, an entity needs to determine the recoverable amount on an individual financial instrument level. One exception to this general rule relates to the measurement of allowances for receivables (see paragraph 51 onwards).
[FER 20/8]

49. The net selling price (also referred to as fair value less cost of disposal) is the price that can be realised in a transaction between independent third parties (market participants) less related costs to sell.
[Framework 26]

50. The value in use in the context of financial assets reflects the present value of the expected future cash inflows from the asset over the term of the financial asset.
[Framework 26]

FAQ 50.1 – What is the appropriate discount rate to apply for financial assets (debt instruments) to calculate the value in use?

Allowance for receivables

51. FER 2 requires that a two-step approach is followed for the measurement of the allowance for receivables. As a first step, all significant receivable balances need to be assessed individually for impairment. Afterwards, an allowance is booked for the remaining (individually non-significant) receivable balances using a flat loss rate.
[FER 2/8, FER 2/23, FER 2/24]

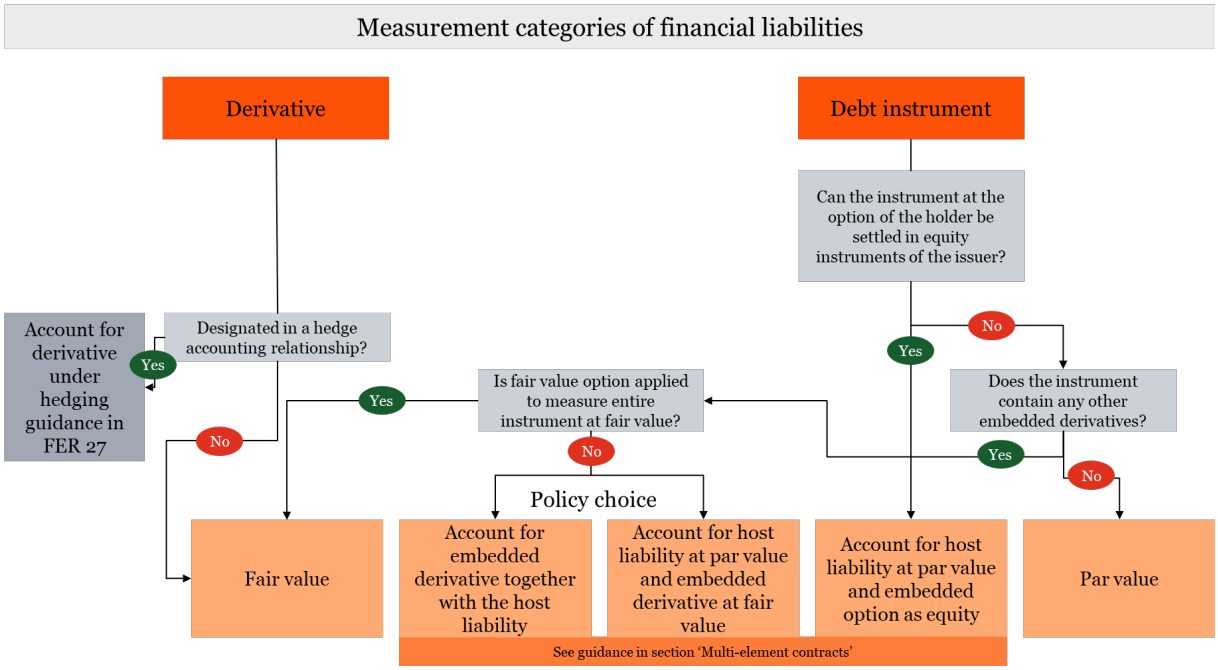
52. The flat loss rate applied to non-significant receivables need to be based on historical experience (i.e. historical loss rates for similar receivables). The flat loss rate represents an estimate, which needs to be adjusted at every reporting date if there is a change in estimate. The assumptions used in the calculation of the flat loss rate allowance are to be disclosed in the notes.
[FER 2/24]

FAQ 52.1 – Example: calculating the allowance for receivables

FAQ 52.2 – For which receivable balances does the two-step approach outlined in FER 2 apply?

Measurement categories of financial liabilities

53. The below illustration provides an overview of the different measurement categories of financial liabilities, as well as the facts and circumstances that determine categorisation. A detailed discussion of derivative financial instruments and multi-element contracts such as hybrid instruments and compound instruments can be found in sections 'Derivative financial instruments' and 'Multi-element contracts' respectively.



54. Debt instruments such as loans and bonds that do not contain any options for the holder to require settlement of the instruments in equity instruments of the issuer (so called conversion options) or other types of embedded derivatives, such as for example variable interest linked to an underlying index (e.g. SMI) are measured at par value. The same applies to other types of debt instruments such as trade and other payables.
[FER 2/14]

Modifications

55. Modifications are changes in the contractual terms affecting the contractual cash flows of a financial instrument as a result of renegotiations between a borrower and a lender. Examples of modifications include contract extensions, waivers, interest rate adjustments, early repayments and similar.

56. Swiss GAAP FER does not provide guidance on how to account for modifications of financial instruments. Given this lack of explicit guidance, preparers need to develop their own accounting policy to reflect those transactions, considering all relevant facts and circumstances. [FER 1/4]

57. In practice, it is observed that most preparers recognise the effects from modifications, for example a change in term or interest rate, over the remainder of the modified term rather than at the point in time of modification.

FAQ 57.1 – Example: modification of loan term and interest rate from the borrower's perspective

FAQ 57.2 – Example: termination of loan arrangement prior to maturity

Derecognition

Derecognition of financial assets

58. A financial asset is derecognised when the definition of an asset as per Framework 15 is no longer met, which is usually once the rights to receive cash flows from the asset have expired or at maturity (e.g. once an option expires). A financial asset is derecognised for example, if:
    - the counterparty has settled all contractual payments, and no further rights and obligations exist (e.g. repayment of all principal and interest of a loan);
    - the entity has transferred its rights to receive the cash flows from the asset (e.g. factoring of receivables); or
    - the parties to the contract have agreed on a termination or settlement of the financial instrument and no further rights and obligations exist (e.g. early repayment of a loan for which early repayment was not initially foreseen in the original contractual terms)

    [Framework 15]

59. At derecognition, the difference between the carrying amount of the financial asset and the consideration received is recognised as gain or loss in the income statement.

60. It is often straightforward to determine whether a financial asset should be derecognised. For example, if a corporate entity receives cash in settlement of a trade receivable, there are no longer any rights to receive cash from the asset, therefore the receivable is derecognised. However, there are also more complex examples, such as factoring arrangements.

61. In a factoring arrangement, an entity transfers some or all of its rights to receive cash flows from the underlying receivables to a financial institution in exchange for cash of usually less than the nominal amount of the receivables. Subsequently, depending on the legal set-up of the arrangement, the customer of that entity either pays the financial institution to extinguish their liability or it pays the entity which in turn has an obligation to forward the proceeds to the financial institution.

62. In our view, preparers need to assess whether the substance of the factoring transaction is that of a sale of the underlying receivables which would result in derecognition, or whether it is a secured financing in nature, in which case the receivables would continue to be recognised in the balance sheet and the funds received from the financial institution would give rise to a financial liability. In order to make that assessment, preparers need to carefully analyse the terms of the factoring arrangement. [Framework 10]

FAQ 62.1 – Example: factoring of trade receivables resulting in derecognition

FAQ 62.2 – Example: factoring of trade receivables that fails derecognition

Derecognition of financial liabilities

63. A financial liability is derecognised when it does not meet the definition of a liability as per Framework 17 anymore, for example if either the liability has been settled or when the future cash flows are no longer due (extinguishment of liability). At derecognition, the difference between the carrying amount of the financial liability and the consideration paid is recognised as gain or loss in the income statement.
[Framework 17]

64. Entities that have bonds or similar instruments issued account for any repurchase of such instruments prior to contractual due date as a redemption which results in a reduction of the liability rather than the recognition of a separate asset.

65. Sometimes financial liabilities are extinguished through the issuance of own equity instruments by the issuer (borrower). Where this settlement choice was not part of the original contractual terms (i.e. conversion was not foreseen in the contract at inception), such an extinguishment is commonly referred to as debt-to-equity swap. In such cases, the own equity instruments are used as currency to extinguish the liability. Following the guidance in FER 24, preparers may derecognise the carrying amount of the financial liability and increase equity with the same amount. This approach is based on the rationale that own equity instruments are liberated by the creditors in the amount of their outstanding debt.
[Framework 6, FER 24/4, FER 24/20]

Equity instruments of the issuer

66. As noted in paragraph 8, equity instruments are ownership rights, such as share certificates, in another company or firm. They provide the investor with a residual interest in the net assets of the investee that corresponds with the investor's relative ownership.
[Framework 19]

67. In practice, it is sometimes difficult to determine, whether a financial instrument is an equity instrument or a financial liability from the issuer's perspective (e.g. when evaluating the classification of preference shares). Preparers should first assess whether the instrument meets the definition of a liability. If the instrument does not qualify as a financial liability, it is an equity instrument.
[Framework 17]

FAQ 67.1 – Classification of mandatorily redeemable preference shares

FAQ 67.2 – Classification of non-mandatorily redeemable preference shares: liability

FAQ 67.3 – Classification of non-mandatorily redeemable preference shares: equity

Derivative financial instruments

68. Swiss GAAP FER defines a derivate as a financial instrument:
    - whose value is primarily impacted by the price of one or several underlying basic values (e.g. assets or reference rates);
    - which, compared with a direct purchase of an underlying basic value, requires only a minor initial investment; and
    - which will only be settled at a future date.

    [FER 27/1, FER 27/9]

> FAQ 68.1 – What is meant by "only a minor initial investment"?

69. Examples of derivatives include forwards, futures, options, financial instruments consisting of several derivatives, and embedded derivatives.
    [FER 27/10]

70. Examples of underlying basic values include:
    - interest rates;
    - foreign exchanges rates;
    - prices of equity instruments or indices;
    - credit risk; and
    - commodities

    [FER 27/11]

71. In contrast to other true-and-fair view accounting standards, in Swiss GAAP FER, own equity instruments of the entity do not qualify as an underlying basic value.
    [FER 27/11]

72. Derivatives can be embedded within other contracts such as conversion options for convertible loans or extension options within bonds or loans. It is generally accepted practice that such embedded derivatives need to meet the definition of derivatives on a stand-alone basis to qualify as embedded derivatives.
    [FER 27/12]

73. Prepares can elect to separate embedded derivatives from contracts in which they are contained. We believe this policy choice is available on an instrument-by-instrument basis.
    [FER 27/12]

74. If the preparer does not elect to separate the embedded derivative, the contract containing the embedded derivative will be valued as a whole either on:
    - the measurement basis of the host instrument (usually at par value); or
    - at fair value

    see also section 'Multi-element contracts'.
    [FER 27/12]

75. A separated embedded derivative is treated like any other derivative, as described in the section below.
    [FER 27/12]

Recognition and measurement

76. Derivatives are recognised in the balance sheet when they meet the definition of an asset or a liability according to the framework.
[Framework 15, Framework 17, FER 27/2]

77. Derivatives are recognised initially at their fair value. In many cases, the initial fair value is zero. For options, the premium paid for a purchased option is recognised as an asset whereas the premium received for an issued option is recognised as a liability.
[FER 27/3]

78. All derivatives, with exception of those which are used in a hedge accounting relationship (see section 'Hedge accounting'), are subsequently measured at fair value. Changes in fair value are recognised in the income statement
[FER 27/5]

79. Subsequent to initial recognition, fair value movements triggered for example by movements of the underlying basic value to which the derivative relates, are likely to occur, resulting in a derivative asset or a derivative liability. FER 27/9 stipulates that:
    - a derivate asset corresponds to the maximum amount which the reporting entity could lose if the counterparty defaults; and
    - a derivative liability corresponds to the maximum amount the counterparty could lose if the reporting entity does not fulfil its obligations

    [FER 27/9]

80. Fair values are determined based on the following order of preference:
    - price in an active market either from a securities exchange or over-the counter
    - if there is no active market: valuation based on similar transactions or use of valuation methods that use observable market data

    [FER 27/13]

81. Once a valuation method has been selected, it shall be applied consistently.
[FER 27/13]

Multi-element contracts

82. Many financial instruments are structured in a rather straight forward manner. There are however also some that are more complex and contain two or more elements. We use the term multi-element contracts for such instruments throughout this publication. A common example are convertible loans that commonly contain a contractual obligation for the borrower to repay cash and an option for the holder to convert the borrowed amount (either including or excluding accrued interest) into equity instruments of the issuer.

83. Multi-element contracts can, depending on their specific terms, either result in classification as financial liabilities or equity instruments in their entirety or as compound instruments which are split in a liability and an equity portion. The preparer should carefully assess multi-element contracts to ensure they are properly classified and accounted for.

84. Compound financial instruments contain both, a financial liability element and an equity element. The most commonly observed example of a compound instrument are loans that are convertible into equity instruments of the issuer (convertible loans). Swiss GAAP FER does not provide guidance to assess, in which circumstances a conversion option qualifies as equity. Framework 19 merely defines equity as the residual interest in the assets after deducting all liabilities. Consequently, it is reasonable to classify the conversion option as an equity component as it does not meet the definition of a (financial) liability or that of an embedded derivative as FER 27/11 excludes own shares as applicable underlying items for derivatives.
[Framework 19, FER 27/11]

FAQ 84.1 – Classification of a mandatorily convertible loan as equity in its entirety

FAQ 84.2 – Classification of a convertible loan as compound instrument

85. If a multi-element instrument includes a contractual obligation to pay cash and an embedded derivative (so called hybrid contract), preparers have the choice to either measure the embedded derivative together with the host element as a single financial liability or to separate the embedded derivative from the host liability and account for the two elements separately. An example of such a hybrid contract would be a variable interest loan based on SARON.
[FER 27/12]

86. In our view, if preparers opt to account for the entire hybrid contract as a whole rather than to separate the embedded derivative, they have an accounting policy choice to either measure the entire hybrid contract applying the same measurement basis as the host liability (usually at par value) or to apply fair value measurement to the entire hybrid contract.
[Framework 27, FER 2/14, FER 27/12]

Hedge accounting

87. Swiss GAAP FER does not contain a definition of hedge accounting, however it is generally accepted that hedge accounting is a method in which a hedging instrument (usually a derivative) is entered into to mitigate risks in an underlying basic value. The application of hedge accounting can help to reduce volatility in the income statement otherwise generated by the related risks in the underlying basic value.
[FER 27/4]

88. Unlike other true-and-fair view accounting standards, in Swiss GAAP FER there is no formal documentation requirement of the hedge relationship and there is no requirement for testing effectiveness. In our view, preparers should however prepare a documentation that describes the hedged item, hedging instrument and effectiveness to support their accounting policy choice of applying hedge accounting.

89. The hedged item is the underlying balance or transaction for which volatility in the income statement is reduced or eliminated by applying hedge accounting. Hedged items can be assets, liabilities or alternatively contractually agreed future cash flows that are not yet recognised but highly probable to occur.
[FER 27/4, FER 27/18]

90. The hedging instrument is the derivative which is measured in accordance with the underlying hedged item to reduce or eliminate volatility.
[FER 27/4]

91. If the hedged item is a recognised asset or a liability (e.g. bond or loan) then the preparer has a policy choice to either value the hedging instrument at fair value or applying the same measurement principle as the underlying hedged item. In our view this policy choice can be applied separately for each hedge relationship. Any change in the valuation of the hedging instrument is recognised in the income statement. However, if the underlying hedged item is measured at fair value, the hedging instrument shall also be measured at fair value.
[FER 27/4, FER 27/15]

FAQ 91.1 – Example: hedge of foreign currency risk in recognised payables (fair value)

FAQ 91.2 – Example: hedge of market price risk in recognised inventory (lower of cost and NRV)

92. If the hedged item is a contractually agreed future cash flow which is highly probable to occur and does not yet have an impact on the balance sheet, then the entity has a policy choice to either recognise any changes in fair value of the hedging instrument directly in equity or to only disclose its fair value in the notes (off-balance sheet treatment). A common example of such a contractually agreed highly probable future cash flow is an agreement to purchase a non-financial item (e.g. property, plant and equipment or inventory) in foreign currency at a future date.
[FER 27/18]

FAQ 92.1 – Example: hedge of a highly probable forecast purchase of inventory

Presentation, disclosure and offsetting of financial instruments

93. There exists only very limited guidance in Swiss GAAP FER relating to the presentation and disclosure of financial instruments. Preparers should keep the fundamental objective of Swiss GAAP FER in mind which is to provide information that is true and fair and assist readers of the financial statements to assess the economic position and performance of the reporting entity. Preparers should therefore provide disclosures that fit this fundamental objective.
[Framework 6, FER 6/2]

General presentation and disclosure requirements

94. FER 3/2 requires separate presentation of the following financial instruments:

Current assets
- Cash and cash equivalents
- Securities
- Trade receivables
- Other current receivables
- Accrued income

Non-current assets
- Financial assets

Current liabilities
- Current financial liabilities
- Trade payables
- Other current (financial) liabilities

Non-current liabilities
- Non-current financial liabilities
- Other non-current (financial) liabilities

Equity
- Share capital (capital of the entity)

The above terminology can be adapted to industry-specific terms to increase relevance for the users of the financial statements
[FER 3/2, FER 3/11]

95. Moreover, FER 3/3 requires that the following aspects relating to financial instruments need to either be presented separately in the balance sheet or disclosed in the notes to the financial statements:

Under receivables
- Amounts due from related parties

Under financial assets
- Securities
- Deferred tax assets
- Investments
- Amounts due from related parties
- Other financial assets

Under liabilities
- Amounts due to related parties

Under equity
- Amounts of each category of capital of the entity

[FER 3/3]

96. Preparers are required to disclose, in the notes to the financial statements, the accounting policies applied in accounting for financial assets and financial liabilities. The extent of disclosure depends on the significance of the financial instruments on the financial statements overall, but usually encompasses at a minimum:
    - the recognition and measurement principles for the various classes of financial instruments;
    - if accounting policy choices are available, which policy was applied (e.g. measurement of non-current securities at cost less accumulated impairment or at fair value);
    - treatment of transaction costs and presentation in the balance sheet, if applicable;
    - if instruments are measured at fair value, how that value was determined and what the significant inputs are if a valuation model was applied;
    - treatment of modifications;
    - if and for which transactions, hedge accounting is applied; and
    - for which financial assets and financial liabilities offsetting is applied

    [FER 6/2]

FAQ 96.1 – Different measurement bases in one financial statement line item

Disclosures related to derivative financial instruments

97. The amount of outstanding derivatives need to be disclosed in the notes. Additionally, FER 27/8 requires the disclosure of the gross amounts of derivative assets and derivative liabilities separately, as well as the reason for holding the instruments. All disclosures need to be grouped based on the following underlying basic values:
    - interest rates;
    - foreign exchange rates;
    - equity instruments and indices;
    - other underlying basic values

    [FER 27/8, FER 27/14]

98. A reconciliation of the total fair values in relation to derivatives disclosed in the notes to the values presented as derivative assets and liabilities in the balance sheet is to be disclosed in the notes. The reconciliation shall include the effect of offsetting, if applicable.
    [FER 27/21]

99. Derivatives for which no fair value can be determined need to be disclosed separately, including the reason for the inability to determine the fair value.
    [FER 27/20]

Offsetting of financial assets and financial liabilities

100. In general, the principle of individual valuation of assets and liabilities applies in Swiss GAAP FER. As an exception, assets and liabilities of equal quality (e.g. receivables with equal terms and comparable default risk) may be measured collectively. If assets and liabilities are of a different quality or nature and may thus not be measured collectively, surpluses and deficits between the assets and liabilities valued individually may not be offset.
[Framework 25]

101. Swiss GAAP FER contains no specific general guidance on offsetting of financial assets and financial liabilities. Framework 14 does however allow net presentation of assets and liabilities as well as income and expenses in objectively substantiated cases if it does not result in misleading presentation.
[Framework 14]

102. An objectively substantiated case exists, if:
- Swiss GAAP FER requires or allows net presentation, and
- net presentation reflects the economic substance of the transaction or event.

FAQ 102.1 – Can a financial liability be presented net of deferred transaction costs?

103. For derivative financial instruments, offsetting is allowed if there are derivative asset and liability positions towards the same counterparty and there exist legally enforceable netting arrangements or netting rules.
[FER 27/14]

104. In Switzerland, the legal netting rules are defined in Art. 120 of the Swiss Code of Obligations and are as follows:
- the offsetting assets and liabilities need be similar in nature,
- they need to correspond to the same counterparty, and
- the corresponding liability needs to be due whereas the offsetting assets needs to be realisable.

Frequently asked questions

FAQ 4.1 – Is a contractual basis necessary to originate a financial instrument?

In our view, there needs to be a contractual basis as it establishes enforceable rights and obligations for the parties that are subject to the arrangement. If rights are not enforceable, an entity cannot demonstrate that it is likely to benefit from an asset and as such the recognition criteria in Framework 15 would not be met. The same applies in analogy to financial liabilities.

The contractual basis can take different forms and depend on the applicable laws and regulations in the respective jurisdiction. In Switzerland, a contractual basis would be, for example, a loan agreement between a bank (lender) and an entity (borrower) that originates a financial asset for the lender and a financial liability for the borrower. Another example would be a sales contract between an entity and its customer that originates, once the contractual promises have been fulfilled, a trade receivable in the entity and a trade payable for the customer.

FAQ 4.2 – Distinguishing characteristics between a provision and a financial liability

A financial liability originates with the creation of a financial instrument. In other words, for an entity to be able to recognise a financial liability, the counterparty to the contractual arrangement needs to be able to recognise a financial asset. A financial liability requires a contractual obligation to deliver cash or another financial asset, or a contractual obligation to exchange financial instruments at unfavourable terms.

While financial liabilities present contractual obligation to deliver cash or other financial assets, provisions are broader and include for example future costs for restoration which will be incurred by the entity rather than paid to a counterparty. Provisions result from past events for which a future outflow of resources is probable and the outflow can be estimated reliably. There can be a contractual basis for provisions (e.g., a lease contract that requires restoration of the leased assets) but it is not a defining criterion. Moreover, a provision does not necessarily result in the recognition of an asset for the counterparty. One example would be a court case for which the defendant has recognised a provision, but the plaintiff cannot recognise an asset yet, as the recognition criteria are not met prior to the court verdict.

FAQ 10.1 – Example: transaction price

Assume Lender L enters into a loan agreement with Entity B, a company that has recently suffered a shortage of liquidity and is deemed to be a higher risk company in terms of credit risk. The loan agreement was signed on 30.06.20X1 and stipulates a par value of CHF 32 million, to be provided at a discount of CHF 2 million. The cash was disbursed by Lender L on the same date. The loan bears interest of 5% and is to be repaid in full after 36 months.

What does Lender L need to recognise as at 30.06.20X1?

Lender L needs to recognise a financial asset of CHF 30 million at initial recognition, representing the fair value of the consideration that is transferred to Entity B (CHF 32 million notional amount less the discount of CHF 2 million).

FAQ 18.1 – Example: difference between the historical cost and par value method – discounts

The below illustrates the difference between the two methods using the example of a discount. However, there are other circumstances that would result in a difference between the two methods, for example if transaction costs are paid to the lender.

Assume Entity B, a company that has recently suffered a shortage of liquidity and is deemed to be a higher risk company in terms of credit risk, enters into a loan agreement with Bank L. The loan agreement was signed on 30.06.20X1 and stipulates a par value of CHF 32 million, to be provided at a discount of CHF 2 million. The loan bears interest of 5% and is to be repaid in full after 36 months.

What does Entity B recognise as at 30.06.20X1?

The accounting depends on the accounting policy selected by Entity B for recognition and measurement of debt instruments, as illustrated below:

Historical cost method:

Under the historical cost method, Entity B initially recognises the financial liability at the amount of proceeds received from Bank L, being CHF 30 million. The issue discount of CHF 2 million is subsequently accrued over the term of the loan (linearly over 36 months). Note that this treatment leads to a similar (but not identical) result as the amortised cost treatment when applying the effective interest rate method.

Par value method:

If the par value method is applied, the financial liability is initially recognised at par, being CHF 32 million. The difference of CHF 2 million between the proceeds received and the liability's par value is recognised as an accrual (deferred expense) in the balance sheet and subsequently expensed over the term of the loan arrangement (linearly over 36 months).

FAQ 21.1 – Which is the appropriate fair value if more than one is available?

Entity A holds a 3% equity ownership in Entity B, a publicly listed entity. The vast majority of shares are held by strategic institutional investors. Consequently, the 'free float' is rather low and as such, there are not many transactions in the public market per month. Entity A plans to sell its stake in the course of the next 12 months.

As per Entity A's reporting period end, the public share price of Entity B equals CHF 8. Using the publicly available information from Entity B's financial statements, Entity A's management has prepared a valuation using a discounted cash flow (DCF) model which resulted in a value per share of CHF 9.

What is the appropriate fair value of Entity A's investment in Entity B at the reporting date?

It is our view that preparers should maximise the use of observable inputs when preparing a valuation as stipulated by the fair value hierarchy outlined in FER 40/2. In the example at hand, this would be the traded price at period end of CHF 8, because the fair value of CHF 9 determined using the DCF relies on a number of unobservable inputs (management estimates) such as future cash flows and the discount rate.

FAQ 25.1 – Effective interest rate: estimation of cash flows

The effective interest method uses estimated future cash flows throughout the expected life of the financial instrument based on all of the financial instrument's contractual terms, rather than contractual cash flows. However, the financial instrument's expected life cannot exceed its contractually determined maturity. In estimating the future cash flows, all of the instrument's contractual terms, including pre-payment, call and similar options, should be considered.

Imagine a loan arrangement with a contractual period of 5 years that contains an option for the borrower to repay the loan at any time prior to maturity at a pre-payment penalty. If, at inception, the borrower expects to pre-pay the loan at the end of year 2, the estimated future cash flows taken into account when determining the effective interest rate will include interest payments for 2 years, repayment of principal, as well as the pre-payment penalty. It would not be appropriate to project future cash flows over the entire 5 year contractual period, if the pre-payment is expected to occur in year 2.

FAQ 25.2 – How to account for discounts and premiums applying amortised cost measurement

Assume Entity L enters into a loan agreement with Entity B, a company that has recently suffered a shortage of liquidity and is deemed to be a higher risk company in terms of credit risk. The loan agreement was signed on 30.06.20X1 and stipulates a notional amount of CHF 32 million, to be provided at a discount of CHF 2 million. The loan bears interest of 5% payable at each calendar year end and the principal amount is to be repaid in full after 18 months (at 31.12.20X2). The contractual cash flows (representing also the estimated cash flows) are displayed below:

	Issuer (Entity B) view		
30.06.20X1			
	Cash to be received	CHF 30,000,000	
31.12.20X1			
	Interest to be paid	CHF (800,000)	32,000,000 x 5% x 180/360
31.12.20X2			
	Interest to be paid	CHF (1,600,000)	32,000,000 x 5%
	Principal to be repaid	CHF (32,000,000)	

How does Entity B account for this instrument applying the amortised cost measurement?

In a first instance, we need to determine the effective interest rate which is the rate that exactly discounts estimated future cash payments through the financial liability's expected life to the amortised cost amount of the financial liability. Using the estimated future cash flows from above, we determine the effective interest rate to equal 9.17%, resulting in the following movement table:

	Opening balance	(A) Interest expense in P/L	(B) Cash flow	(C) = (A) – (B) Amortisation of discount	Closing balance
20X1	30,000,000	1,466,667	(800,000)	666,667	30,666,667
20X2	30,666,667	2,933,333	(1,600,000)	1,333,333	
			(32,000,000)		-

From the perspective of Entity B (issuer/borrower), the following journal entries would be booked:

30.06.20X1		
	Dr. Cash	30,000,000
	Cr. Loan payable	30,000,000
31.12.20X1		
	Dr. Interest expense	1,466,667
	Cr. Cash	800,000
	Cr. Loan payable	666,667
31.12.20X2		
	Dr. Interest expense	2,933,333
	Cr. Cash	1,600,000
	Cr. Loan payable	1,333,333
	Dr. Loan payable	32,000,000
	Cr. Cash	32,000,000

FAQ 29.1 – Accounting for transaction costs when applying par value measurement from the borrower's perspective

On 1 January 20X1, Entity B originates a 3-year 5% CHF 1 million loan. The interest is payable at the end of each year and the nominal is payable at par at the end of year 3. The bank charges Entity B a 1.25% (CHF 12,500) non-refundable loan origination fee.

How is the loan accounted for at initial recognition and in subsequent periods?

There are two approaches commonly observed in practice.

Approach 1 – deferral of transaction costs:

Entity B recognises a financial liability of CHF 1 million and a prepaid expense position of CHF 12,500. Assuming no other clauses and/or contract modifications during the term of the loan, the carrying amount of the loan will remain stable at CHF 1 million until maturity, while the prepaid expense balance will be amortised through profit and loss over the term. The following movement table illustrates the accounting impact:

	Loan (financial liability)				Prepaid expense (asset)		
	Opening balance	Interest expense in P/L	Cash flow	Closing balance	Opening balance	Amortisation expense[1] in P/L	Closing balance
20X1	1,000,000	50,000	(50,000)	1,000,000	(12,500)	4,167	(8,333)
20X2	1,000,000	50,000	(50,000)	1,000,000	(8,333)	4,167	(4,166)
20X3	1,000,000	50,000	(50,000)	1,000,000	(4,166)	4,166	-

Alternatively, the entity may deduct the amount of prepaid expense from the carrying amount of the liability as explained in FAQ 102.1.

Approach 2 – no deferral of transaction costs:

Entity B recognises the non-refundable loan origination fee paid in full as expense in the income statement on loan inception (no amortisation over the term).

[1]*Presented as part of finance expense in the income statement.*

FAQ 31.1 – Accounting for transaction costs applying amortised cost measurement from the borrower's perspective

On 1 January 20X1, Entity B obtains a 3-year 5% CHF 1 million loan. The loan carries an annual interest rate of 5% payable at the end of each year, and it is repayable at par at the end of year 3. The bank charges Entity B a 1.25% (CHF 12,500) non-refundable loan origination fee.

The contract specifies that Entity B has an option to pre-pay the instrument and that no penalty will be charged for pre-payment. At inception, Entity B does not expect to pre-pay the loan.

What is the carrying amount on initial recognition, and what impact does the pre-payment feature have on the amortised cost calculations?

The initial carrying amount of the loan liability at 1.1.20X1 is calculated as follows:

Cash received	1,000,000
Origination fees charged to Entity B	(12,500)
Carrying amount of the loan	987,500

Because Entity B does not expect to pre-pay, the amortisation period is equal to the instrument's full term. In calculating the effective interest rate that will apply over the term of the loan at a constant rate on the carrying amount, the discount rate necessary to equate 3 annual payments of CHF 50,000 (5% on the par value) and a final payment at maturity of CHF 1 million to the initial carrying amount of CHF 987,500 is approximately 5.46%.

The carrying amount of the loan over the period to maturity will, assuming that Entity B continues to expect not to pre-pay, be as follows:

	Opening balance	Interest in P/L	Cash flow	Closing balance
20X1	987,500	53,947	(50,000)	991,447
20X2	991,447	54,163	(50,000)	995,610
20X3	995,610	54,390	(50,000)	
			(1,000,000)	-

The effective interest expense for the period is calculated by applying the effective interest rate of 5.46% to the loan's amortised cost at the end of the previous reporting period. The annual interest expense increases each year, to reflect the increase in the liability's carrying value as the initial origination fee of CHF 12,500 is amortised. The difference between the calculated effective interest expense for a given reporting period and the loan's coupon is the amortisation of the transaction costs during that reporting period. The loan's amortised cost at the end of the previous period plus amortisation in the current period gives the loan's amortised cost at the end of the current period. By maturity date, the origination fees paid are fully amortised and the loan's carrying amount equals the par value, which is then repaid in full.

FAQ 37.1 – In which line item are fair value changes presented in the income statement?

If the minimum format of the income statement as per FER 3/7 or FER 3/8 is applied, fair value movements of securities should be presented consistently either in 'other operating income/expense' or as part of the financial result, depending on the nature of the investment. If the fair value movements are individually material, presentation as a separate line item in the income statement would be recommended.

FAQ 50.1 – What is the appropriate discount rate to apply for financial assets (debt instruments) to calculate the value in use?

For financial assets, the value in use represents the present value of the expected future cash inflows over the term of the instrument. FER 20/7 in combination with FER 20/25 states that the discount rate shall be an adequate pre-tax interest rate which takes into account the current market conditions and the specific risks of the asset as far as they have not already been reflected in the forecasted cash flows. In our view, the current market interest rate of the borrower would be the appropriate rate to apply.

FAQ 52.1 – Example: calculating the allowance for receivables

Entity A is an industrial manufacturing company that is operating in Switzerland and mainland Europe. At the reporting date, the following trade receivables are open:

Switzerland			Europe		
Item	**Amount (CHF)**	**Past due (days)**	**Item**	**Amount (CHF)**	**Past due (days)**
Invoice A	120,000	n/a	Invoice G	47,000	20
Invoice B	80,000	12	Invoice H	510,000	4
Invoice C	750,000	186	Invoice I	240,000	78
Invoice D	320,000	35	Invoice J	225,000	62
Invoice E	108,000	n/a	Invoice K	85,000	n/a
Invoice F	210,000	68	Invoice L	130,000	140

Entity A is monitoring the collection of its trade receivables on an ongoing basis. The analysis of historical collectability shows the following loss rates:

	Not past due	**0 < 90 days**	**91 < 180 days**	**< 180 days**
Switzerland	0.2%	1.8%	4.2%	18.5%
Europe	0.6%	2.1%	3.6%	42.2%

In determining the amount of allowance for doubtful receivables, Entity A identifies Invoice C and Invoice H to be individually significant receivables. As part of the monthly receivables collection process, Entity A becomes aware that bankruptcy proceedings have been opened against the debtor C and that only 20% is realistically deemed to be collectible, resulting in an impairment of CHF 600 thousand. Debtor H has historically paid its invoices in time. Entity A estimates the loss allowance to amount to CHF 10 thousand.

As per the reporting date, Entity A calculates the loss allowance as follows:

	Switzerland		Europe	
	Invoice amounts	**Loss allowance**	**Invoice amounts**	**Loss allowance**
Individual valuation				
Invoices C and H	750,000	600,000	510,000	10’000
Flat rate valuation				
Not past due (0.2% / 0.6%)	228,000	456	85,000	510
0<90 days (1.8% / 2.1%)	610,000	10,980	512,000	10,752
91<180 days (4.2% / 3.6%)	-	-	130,000	4,680
<180 days (18.5% / 42.2%)	-	-	-	-
	1,588,000	**611,436**	**1,237,000**	**25,942**

FAQ 52.2 – For which receivable balances does the two-step approach outlined in FER 2 apply?

FER 2/8 in connection with FER 2/23 and FER 2/24 does not define the term 'receivable'. However, we believe it would be sensible to apply the two-step valuation approach only to receivable balances that include a large number of homogenous items, such as trade receivables for a corporate entity or lease receivables for a real estate investor.

FAQ 57.1 – Example: modification of loan term and interest rate from the borrower's perspective

On 1.1.20X1 Entity A entered into a loan arrangement with Bank B for a notional amount of CHF 10 million with a term of 5 years. Interest has been agreed to be fixed at 5% per annum, payable annually. Assume for simplicity of illustration that no transaction costs were incurred by Entity A.

At inception of the loan arrangement, the carrying amount of the loan liability amounts to CHF 10 million and future cash flows and expenses from the liability are projected as follows:

	20X1	20X2	20X3	20X4	20X5
Future cash flow	500,000	500,000	500,000	500,000	10,500,000
Interest expense to be recognised	500,000	500,000	500,000	500,000	500,000

At the end of 20X4, Entity A renegotiated the loan arrangement with Bank B and came to an agreement that the borrowing will be extended for 3 more years (repayment at the end of 20X8) and the contractual interest rate will be adjusted to 7% from the beginning of 20X5 to reflect the current market interest rate of Entity A.

This modification of the terms of the borrowing arrangement will result in the following change to the projected future cash flows and expenses from the liability:

	20X4	20X5	20X6	20X7	20X8
Future cash flow	500,000	700,000	700,000	700,000	10,700,000
Interest expense to be recognised	500,000	700,000	700,000	700,000	700,000

The modification does not have an impact on the carrying amount of the loan liability at the date of modification in 20X4.

FAQ 57.2 – Example: termination of loan arrangement prior to maturity

In 20X0, Entity C has entered into a loan arrangement with Bank B for a notional of CHF 5 million, a term of 5 years and a fixed interest rate of 4% per annum.

At inception of the loan arrangement, the carrying amount of the loan liability amounts to CHF 5 million and future cash flows and expenses from the liability are projected as follows:

	20X0	20X1	20X2	20X3	20X4
Future cash flow	200,000	200,000	200,000	200,000	5,200,000
Interest expense to be recognised	200,000	200,000	200,000	200,000	200,000

During 20X2, Entity C has renegotiated with Bank B that they will repay the existing loan early at at the half-year date in 20X2 and simultaneously enter into a new arrangement over an notional of CHF 10 million, a fixed interest rate of 3% and repayment in full at the end of 20X6. Bank B charges Entity C a one-time fee of CHF 400 thousand for terminating the original arrangement early.

This termination of the existing, and entering into a new financing arrangement will result in the following change to the projected future cash flows and expenses from the liabilities:

	20X2	20X3	20X4	20X6	20X6
Future cash flow	650,000	300,000	300,000	300,000	10,300,000
Interest expense	250,000*	300,000	300,000	300,000	300,000
Termination fee	400,000				

**includes 6 months interest of 4% on notional amount of CHF 5 million and 6 months interest of 3% on notional amount of CHF 10 million.*

The accounting treatment for the termination fee depends on whether preparers view the arrangement as an in-substance modification of the original borrowing arrangement or a termination and entering into a new borrowing arrangement. In an in-substance modification, the termination fee could be regarded as a deferred cost accrual which is expensed linearly over the remaining term of the modified borrowing.

If accounted for as termination, Entity C records the following journal entries:

Dr. Loan payable	5,000,000	
Dr. Cash	4,600,000	
Dr. Termination fee (finance expense)	400,000	
Cr. Loan payable		10,000,000

FAQ 62.1 – Example: factoring of trade receivables resulting in derecognition

Entity A sells products to several customers including Entity B. Entity A's general payment terms are 90 days from the invoice date. Entity A aims to reduce the number of days until cash collection and to increase its available cash balance. As such, Entity A enters into a factoring arrangement with Bank X to transfer all currently open and future receivables towards Entity B in exchange for cash of 97% of the notional amount of the receivables. The arrangement stipulates that:

- The factoring relationship is disclosed to Entity B which shall transfer all payments directly to Bank X;
- Bank X has an obligation to inform Entity A which receivable balances have been settled by Entity B;
- Entity A continues to act as the collection agent in servicing the receivables;
- In case of dispute or default of Entity B, Bank X can under no circumstances take recourse of the cash transferred to Entity A;
- Bank X bears the credit risk, late payment risk and foreign currency exchange risk related to the receivables towards Entity B

The arrangement was entered into on 31 January 20X1, at which date Entity A had recognised a trade receivable balance towards Entity B of CHF 430 thousand.

On 3 February 20X1, the arrangement is disclosed to Entity B and the bank pays CHF 417,100 (97% of the notional amount of the receivables) to Entity A, which books the following journal entries:

Dr. Cash	417,100	
Dr. Factoring expense	12,900	
Cr. Receivables Entity B		430,000

Factoring of trade receivables is a cash management strategy frequently observed in practice. However, such arrangements are usually significantly more complex, and it is often not entirely clear if the rights to receive cash flows from the receivables have transferred to the factor (financial institution) or not. If the rights to receive cash flows have not been transferred or if a substantial portion is retained and the entity continues to control the assets, the trade receivables should not be derecognised, see FAQ 62.2 below.

FAQ 62.2 – Example: factoring of trade receivables that fail derecognition

Building on FAQ 62.1, assume a slightly different fact pattern as illustrated below:

Entity A's general payment terms are 30 days from the invoice date. Historically, Entity B has shown a low payment morale and has not paid certain disputed invoices. Moreover, it has not adhered to the payment terms and rather paid their invoices on average after 90 days from the invoice date. Entity A enters into a factoring arrangement with Bank X to transfer all currently open and future receivables towards Entity B in exchange for cash of 97% of the notional amount of the receivables. Compared to FAQ 62.1, the arrangement differs on following clauses:

- In case of dispute or default of Entity B, Bank X can take recourse of the cash transferred to Entity A;
- If payment is not received after 75 days from the invoice date, Bank X has the right to demand repurchase of the transferred receivables from Entity A;
- For invoices in foreign currency, if the exchange rate develops into an unfavourable direction by 3% or more, Bank X has the right to demand that Entity A repurchases the receivables

The arrangement was entered into on 31 January 20X1, at which date Entity A had recognised a trade receivable balance towards Entity B of CHF 430 thousand.

On 3 February 20X1, the arrangement is disclosed to Entity B and the bank pays CHF 417,100 (97% of the notional amount of the receivables) to Entity A.

How is this transaction reflected in Entity A's financial statements?

The rights to receive cash flows have not transferred to Bank X because Entity A retains substantially all of the risks and rewards associated with the ownership of these assets. Based on the contractual terms of the arrangement, Entity A retains all credit risk based on the recourse clause in case of dispute or default. Moreover, it retains a substantial amount of the late payment risk based on the bank's right to demand repurchase of the factored receivables if not paid 75 days after invoice issuance, when historically payments were collected after 90 days on average. Lastly, while the upside potential from foreign currency exchange rate movements is transferred to the bank, Entity A retains a substantial portion of the downside foreign exchange risk. As a consequence, the substance of the transaction is that of a secured financing transaction, i.e. Entity A receives an advance from Bank X at borrowing conditions that are favourable compared to a non-secured financing. Control over the original asset is not lost. Consequently, the trade receivables remain in Entity A's balance sheet until payments from Entity B have been collected by the bank.

Assume that Bank X demanded repurchase of factored receivables with a notional amount of CHF 200,000, corresponding to a claim of CHF 194'000 (97% of the notional) for an amount of CHF 197'000 on April 8 of 20X1. These receivables were settled on 10 July. All other receivables were settled at the interim reporting date as of 30 June 20X1. This would lead to the following accounting entries:

3 February 20X1

Dr. Cash	417,100	
Cr. Financial liability towards Bank X	417,100	

8 April 20X1

Dr. Financial liability towards Bank X	194,000	
Dr. Finance expense	3,000	
Cr. Cash	197,000	

30 June 20X1

Dr. Financial liability towards Bank X	223,100	= 230,000 * 97%
Dr. Finance expense	6,900	= residual
Cr. Receivables Entity B	230,000	

The finance expense of CHF 6,900 presents the difference between the amount paid by the debtor that is transferred to the bank as part of the factoring of the receivables (CHF 230'000) and the carrying amount of the liability towards the bank (CHF 223,100 - representing 97% of the cash receivable balance prior to settlement by the debtor).

10 July 20X1

Dr. Cash	200,000	
Cr. Receivables Entity B	200,000	

FAQ 67.1 – Classification of mandatorily redeemable preference shares

As part of the most recent capital raising, Entity X issued mandatorily redeemable preference shares to interested investors. The preference shares have the following features:

- Same voting rights and entitlement to the distribution of net assets of the entity as holders of ordinary shares;
- Preference dividend of 5% whenever an ordinary dividend is declared
- Mandatory redemption at par value 10 years after issuance

Are the preference shares classified as financial liabilities or equity in Entity X's balance sheet?

While Entity X has the ability to avoid an obligation to pay preference dividends (by not declaring an ordinary dividend), the mandatorily redeemable preference shares are financial liabilities as they meet the general definition of a liability in Framework 17, as well as the more specific, commonly accepted, definition of a financial liability (see paragraph 7). This is because Entity X has a contractual obligation to redeem the shares at par value at the end of year 10. When preference dividends are declared, they are recognised as finance expense in the income statement.

FAQ 67.2 – Classification of non-redeemable preference shares: liability

As part of the most recent capital raising, Entity H issued non-redeemable preference shares to interested investors. The preference shares have the following features:

- Same voting rights and entitlement to the distribution of net assets of the entity as holders of ordinary shares;
- Annual mandatory preference dividend of 5%

Are the preference shares classified as financial liabilities or equity in Entity H's balance sheet?

Such non-redeemable preference shares are financial liabilities because the annual mandatory preference dividend of 5% meets the general definition of a liability in Framework 17, as well as the more specific, commonly accepted, definition of a financial liability (a contractual obligation to deliver cash – see paragraph 7).

FAQ 67.3 – Classification of non-redeemable preference shares: equity

Assume the same fact pattern as in FAQ 67.2 with the only distinction that preference dividends are only due if an ordinary dividend is declared.

In this modified fact pattern, the non-redeemable preference shares would be classified as equity in its entirety as Entity H has the ability to avoid the obligation to pay preference dividends. This is because the entity has discretion as to whether they want to distribute an ordinary dividend, which in turn would trigger the obligation to distribute a 5% preference dividend. Consequently, the definition of a liability in Framework 17, as well as the more specific, commonly accepted, definition of a financial liability (see paragraph 7) is not met and the instrument is classified as equity in its entirety.

FAQ 68.1 – What is meant by "only a minor initial investment"?

Judgement is needed to assess what constitutes a "minor initial investment". In many cases, the initial investment to enter into a derivative is zero or close to zero. In some instances, the initial investment can however be significant. In our view, the criterion of "only a minor initial investment" would be met if the initial investment is clearly lower than what would be required to directly purchase the underlying basic value.

FAQ 84.1 – Classification of a mandatorily convertible loan as equity in its entirety

Entity A issued a mandatorily convertible loan that contains the following features:

- Interest is accumulated and converted into equity instruments of Entity A at maturity. The interest rate reflects a market rate.
- Fixed term of 5 years
- Holder has the option to convert principal and interest at any time prior to maturity into a pre-determined number of equity instruments of Entity A
- If the holder does not convert prior to maturity, the entire amount of principal and accumulated interest is converted into equity instruments of Entity A at maturity

For this particular instrument, none of the contractual terms stipulate an obligation for Entity A that would result in the instrument being classified as a financial liability. In all scenarios, the loan principal and accrued interest will be settled through issuance of Entity A's equity instruments. As such, the instrument is classified as equity in its entirety.

FAQ 84.2 – Classification of a convertible loan as compound instrument

On 1.1.20X1 Entity B issued a convertible loan that contains the following features:

- Par value amounts to CHF 100 million
- Holder has the right to convert the entire principal amount into a pre-determined number of equity instruments at any time until maturity
- Maturity of 24 months
- The contractual interest rate is 5%. Interest is payable annually at the end of each calendar year
- A market interest rate for such a loan excluding the conversion feature would be 8%

How does entity B classify the instrument?

This instrument contains multiple elements:

- a contractual obligation to repay the borrowed amount of CHF 100 million as well as the accrued interest; and
- a conversion option for the holder to convert the principal into equity of Entity B

The contractual obligation towards the holder to pay cash presents a financial liability in Entity B's financial statements (host liability). Swiss GAAP FER does not provide guidance to assess, in which circumstances a conversion option qualifies as equity. Framework 19 merely defines equity as the residual interest in the assets after deducting all liabilities. Consequently, it is reasonable to classify the conversion option as an equity component as it does not meet the definition of a (financial) liability.

In line with Framework 19, the equity component of a compound instrument would be the assets (cash) received in exchange for the issued convertible loan less the fair value of the liability component.

In order to determine the fair value of the host liability, the future principal and interest payments are discounted to their present value using the 8% market rate of interest that would be applicable to Entity B for a similar loan excluding any conversion options.

	1.1.20X1	31.12.20X1	31.12.20X2
Cash flows (@ 5%)	-	5,000,000	105,000,000
Net present value (@ 8%)	94,650,206		

The equity component consequently amounts to CHF 5.35 million, being the excess of cash received over the fair value of the host liability.

Applying the historical cost method, Entity B records the following journal entries at 1.1.20X1:

Dr. Cash	100,000,000	
Cr. Financial liability		94,650,206
Cr. Equity		5,349,794

If the par value method is applied, an additional accrual would need to be recognised leading to the following journal entries:

Dr. Cash	100,000,000	
Dr. Deferred expense	5,349,794	
Cr. Financial liability		100,000,000
Cr. Equity		5,349,794

FAQ 91.1 – Example: hedge of foreign currency risk in recognised payables (fair value)

At 30 November 20X1, Entity A, a Swiss manufacturing entity with a CHF functional currency, purchased inventory from Supplier S for EUR 1 million. At the date delivery, the CHF/EUR rate is 1:1. Payment of the accounts payable balance is due on 31 January 20X2. In order to partially mitigate the CHF/EUR foreign currency exposure on the accounts payable balance, Entity A enters into an FX forward to purchase EUR 0.8 million at a rate of 1:1 at 31. January 20X2. The below tables depict the movement in the carrying amounts of the accounts payable and derivative balances at the relevant dates.

Date	CHF/EUR FX rate	Carrying amount of accounts payable	Impact on income statement (income)
30 November 20X1	1:1	CHF 1,000,000	
31 December 20X1	1:1.02	CHF 980,400	CHF 19,600
31 January 20X2	1:1.05	CHF 952,400	CHF 28,000

Date	CHF/EUR FX rate	Carrying amount of FX derivative (liability)	Impact on income statement (expense)
30 November 20X1	1:1	CHF -	
31 December 20X1	1:1.02	CHF 15,700	CHF 15,700
31 January 20X2	1:1.05	CHF 38,100	CHF 22,400

In this very simple example, it becomes apparent that approximately 80% of the foreign currency exposure on the accounts payable balance has been hedged by entering into the FX forward. As at Entity A's reporting period end of 31 December 20X1, it recognises the following journal entries related to the FX movements and the fair value movements of the FX derivative:

Dr. Accounts payable	19,600	
Cr. FX income		19,600
Dr. FX expense	15,700	
Cr. Derivative liability		15,700

FAQ 91.2 – Example: hedge of market price risk in recognised inventory (lower of cost and NRV)

The following example is based on FER 27/17. Entity B holds an inventory of cacao beans of 1,000 tons at an acquisition cost of CHF 900/ton as of its 31.12.20X1 reporting date. Thus, the carrying amount of the inventory at the 20X1 reporting date amounts to CHF 900,000.

On 1.1.20X2, Entity B decides to hedge the market price exposure by entering into a future of CHF 900/ton. Considering that the hedged item (cacao beans) is measured at the lower of cost and net realisable value, Entity B designates that the measurement of the hedging instrument (cacao future) follows the measurement of the underlying hedged item. This results in the following movements and balances at the various reporting dates:

Date	Price per ton	Inventory carrying amount	Expense related to inventory	Derivative (future) carrying amount	Income related to derivative
1.1.20X2	CHF 900/t	CHF 900,000	-	-	-
31.12.20X2	CHF 950/t	CHF 900,000	-	-	-
31.12.20X3	CHF 850/t	CHF 850,000	CHF -50,000	CHF 50,000	CHF 50,000

Given that, as per the 20X2 reporting date, the market price of the cacao beans is higher than their historical acquisition cost, there is no movement in the carrying amount of the inventory and hence also not in the related future. At the 20X3 reporting date, the market price of the inventory decreases below historical acquisition cost and Entity B records the following journal entries:

Dr. Cost of inventory	50,000	
Cr. Inventory		50,000
Dr. Derivative asset	50,000	
Cr. Cost of inventory		50,000

FAQ 92.1 – Example: hedge of a highly probable forecast purchase of inventory

On 31 October 20X1, Entity C, a Swiss manufacturing entity with CHF functional currency, entered into a binding contract to purchase inventory of EUR 500 thousand from Supplier S on 15 January 20X2. To hedge its foreign currency exposure on the cash flows associated with this highly probably forecast transaction related to purchase of inventory, Entity C entered into an FX forward to purchase EUR 500 thousand on 15 November 20X1.

The following table depicts the movements in FX rate and the fair value of the derivative (FX forward) at the relevant points in time.

Date	CHF/EUR FX rate	Fair value of derivative
15 November 20X1	1:1.01	CHF -
31 December 20X1	1:1.02	CHF -4,900
15 January 20X2	1:1.04	CHF -14,300

The following illustrates the journal entries Entity C would need to record under the two accounting policy options provided by FER 27/18:

Date & description	Journal entries On-balance sheet treatment (through equity)	Journal entries Off-balance sheet treatment (notes disclosure)
31 October 20X1: entering into the binding purchase agreement	-	-
15 November 20X1: entering into the hedging instrument	-	-
31 December 20X1: reporting date	Dr. Equity 4,900 Cr. Derivative liability 4,900	N/A – notes disclosure only
15 January 20X2: recognition of fair value movements of derivative	Dr. Equity 9,400 Cr. Derivative liability 9,400	N/A
15 January 20X2: delivery of inventory and settlement of derivative (hedging instrument)	Dr. Inventory 480,800* Cr. Cash 480,800 Dr. Inventory 14,300 Cr. Equity 14,300 Dr. Derivative liability 14,300 Cr. Cash 14,300	Dr. Inventory 480,800* Cr. Cash 480,800 Dr. Inventory 14,300 Cr. Cash 14,300

**480,800 = 500,000 EUR @ CHF/EUR rate of 1:1.04*

As the above example illustrates, both alternatives result in a hedge of the highly probable future cash flows in foreign currency to the desired FX rate of CHF/EUR of 1:1.01.

FAQ 96.1 – Different measurement bases in one financial statement line item

Based on the guidance in FER 2/7 and FER 2/12 it might be that entities apply multiple measurement bases to their equity instruments. Let's illustrate with the following example. Entity A holds the following investments for sale or trading purposes at the reporting date:

Investment	Measurement	Value in CHF
Shares in Entity Z	Fair value	3,100,000
Shares in Entity Y	Acquisition cost less impairment	250,000
Shares in Entity X	Fair value	1,700,000
		5,050,000

Can these equity investments be presented in a single line item in the balance sheet?

Yes, FER 2/7 explicitly allows different measurement bases if no fair value is observable and FER 3/2 only requires separate presentation of the line item 'securities', not distinguishing between possibly different measurement bases.

Consequently, it would be acceptable to present one line item labelled 'securities' or 'equity investments' with a value of CHF 5,050,000 in the balance sheet. The different measurement bases are to be disclosed (FER 6/2) in the notes to the financial statements.

FAQ 102.1 – Can a financial liability be presented net of deferred transaction costs?

FER 2/14 mandates that financial liabilities are generally presented at par value. When entering into borrowing arrangements such as loans or bonds, entities frequently encounter transaction costs. As outlined in FAQ 29.1, most preparers capatalise those costs as a deferred transaction cost accrual at inception of the borrowing arrangement and recognise the expense from release of accrual over the term of the borrowing arrangement. It is observed in practice that most preparers present the deferred transaction cost accrual as an asset in the balance sheet.

Can the deferred transaction cost accrual also be presented as a deduction of the underlying financial liability to which it relates?

In our view, presenting the financial liability net of the remaining carrying amount of the deferred transaction cost accrual would be acceptable on the basis that there is a clear economic relationship and dependency between the two items and as such, net presentation would not result in misleading presentation.

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