ACCAspace

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Financial Reporting(INT.)

财务报告（国际会计准则）

Chapter 10 Financial Instrument

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1. Financial liability
2. Financial assets
3. Compound financial instrument
4. Example

Financial Instruments

IAS 32: *Financial instruments: presentation,*

IFRS 9: *Financial instruments* and

IFRS 7: *Financial instruments: disclosure* are the relevant standards. IAS 32 and IAS 39 were introduced to regulate the accounting treatment of financial instruments, especially derivatives which had previously been 'off balance sheet'.

IFRS 9 was brought in to simplify the treatment of financial instruments and now replaces IAS 39.

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Financial Instruments

IAS 32 *Financial instruments: presentation*, which deals with:

- (i) The classification of financial instruments between liabilities and equity
- (ii) Presentation of certain compound instruments (instruments combining debt and equity)

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Definition

Financial instrument. Any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

a)Financial asset

b)Financial liability

c)Equity instruments

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Financial Instruments

Financial assets

This is a contract if a party is holding then it can **give** benefit to the other.

Examples of **financial assets** include:

- Cash (eg, currency in the safe);
- Equity instruments of another party (Eg, investment in ordinary shares);
- Contractual right to receive cash or financial assets (Eg, Receivables);
- Contractual right to exchange financial instrument under favourable conditions (Eg, call/put option).

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Financial Instruments

This is a contract if a party is holding then it will **deliver** cash to other party

Examples of **financial liabilities** include:

Eg, [Based on Substance over Form concept]

- Contractual obligation to deliver cash or another financial asset, ie, trade payables; redeemable preference shares.
- Contractual obligation to exchange financial instrument under unfavorable conditions.

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Equity instrument.

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

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Recognition

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Financial Instruments

Recognition

A financial asset or financial liability should be recognised in the statement of financial position when the reporting entity becomes a party to the contractual provisions of the instrument.

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Financial assets

On **recognition,** IFRS 9 requires that financial assets are **classified as measured** at either:

- **Amortized cost**
- **Fair value through other comprehensive income;**
- **Fair value through profit or loss**

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Financial Instruments

对于上述三种确认方法的选择：

(a) The **entity's business model** for managing the financial assets, and

(b) The **contractual cash flow** characteristics of the financial asset.

两者全部满足时，用Amortized cost.否则用FVTOCI\FVTPL.

Financial Instruments

(a) The objective of the business model within which the asset is held is to hold assets in order to collect contractual cash flows

(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding

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Financial Instruments

- **Financial liability**
- Keep :Amortized cost
- Trade ：FV

Measurement

Financial assets

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FVTPL:

Initial measurement： Fair value (transaction cost being expense to p/l)

Subsequent measurement:P/L

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Financial Instruments

- FVTOCI
- Initial measurement:FV+transaction cost（capitalised）
- Subsequent measurement：OCI

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Financial Instruments

- Amortized cost
- Initial measurement：FV+transaction cost
- Subsequent measurement: amortized cost to calculated.

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Example of amortized cost

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Financial Instruments

On 1 January 20X1 Abacus Co purchases a debt instrument for its fair value of $1,000. The debt instrument is due to mature on 31 December 20X5. The instrument has a principal amount of $1,250 and the instrument carries fixed interest at 4.72% that is paid annually. The effective rate of interest is 10%.

How should Abacus Co account for the debt instrument over its five year term?

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Abacus Co will receive interest of $59 (1,250 × 4.72%) each year and $1,250 when the instrument matures.

Abacus must allocate the discount of $250 and the interest receivable over the five year term at a constant rate on the carrying amount of the debt. To do this, it must apply the effective interest rate of 10%. The following table shows the allocation over the years:

Year	*Amortised cost at beginning of year*	*Profit or loss: Interest income for year (@10%)*	*Interest received during year (cash inflow)*	*Amortised cost at end of year*
	$	$	$	$
20X1	1,000	100	(59)	1,041
20X2	1,041	104	(59)	1,086
20X3	1,086	109	(59)	1,136
20X4	1,136	113	(59)	1,190
20X5	1,190	119	(1,250+59)	–

Each year the carrying amount of the financial asset is increased by the interest income for the year and reduced by the interest actually received during the year.

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Financial liability

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Initial measurement

Keep: FV-cost

FVTPL: FV+transaction cost

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KEEP

- After initial recognition all financial liabilities should be measured at amortized cost, with the exception of financial liabilities at fair value through profit or loss. These should be measured at fair value, but where the fair value is not capable of reliable measurement, they should be measured at cost.

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Financial Instruments

A company issues 6% loan notes with a nominal value of $200,000. They are issued at a 5% discount and $1,700 of issue costs are incurred. The loan notes will be repayable at a premium of 10% after four years. The effective interest rate is 10%.

What amounts will be shown in the statement of profit or loss and statement of financial position at the end of years 1–4?

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Financial Instruments

Year	Statement of profit or loss – Finance costs	Statement of financial position – 6% loan notes
	$	$
1	18,830	195,130
2	19,513	202,643
3	20,264	210,907
4	21,093	-

Financial Instruments

Working

		$
Year 1	Capital balance *	188,300
	Interest 10%	18,830
	Interest paid (200,000 x 6%)	(12,000)
Year 2 b/f		195,130
	Interest 10%	19,513
	Interest paid	(12,000)
Year 3 b/f		202,643
	Interest 10%	20264
	Interest paid	(12,000)
Year 4 b/f		210,907
	Interest (ß)**	21,093
	Interest paid	(12,000)
		220,000
	Capital repaid	(220,000)
		–

*((200,000 × 95%) – 1,700)

** Final interest amount is a balancing figure incorporating a $2 rounding.

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Compound financial instrument

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Financial Instruments

Some financial instruments contain both a liability and an equity element. In such cases, IAS 32 requires the component parts of the instrument to be **classified separately**, according to the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument.

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Financial Instruments

One of the most common types of compound instrument is **convertible debt.** This creates a primary financial liability of the issuer and grants an option to the holder of the instrument to convert it into an equity instrument (usually ordinary shares) of the issuer. This is the economic equivalent of the issue of conventional debt plus a warrant to acquire shares in the future.

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Financial Instruments

Although in theory there are several possible ways of calculating the split, IAS 32 requires the following method.

a)Calculate the value for the liability component.

b)Deduct this from the instrument as a whole to leave a residual value for the equity component.

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Financial Instruments

Rathbone Co issues 2,000 convertible bonds at the start of 20X2. The bonds have a three year term, and are issued at par with a face value of $1,000 per bond, giving total proceeds of $2,000,000. Interest is payable annually in **arrears** at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9%.

- *Required*
- What is the value of the equity component in the bond?

Financial Instruments

		$
Principal		
$2,000,000 discounted at 9% over 3 years:		
2,000,000 ÷ 1.09 ÷ 1.09 ÷ 1.09 (or 2,000,000 x 1 / 1.09^3)		1,544,367
Interest		
Year 1 120,000 ÷ 1.09	110,091	
Year 2 110,091 ÷ 1.09	101,002	
Year 3 101,002 ÷ 1.09	92,662	
		303,755
Value of liability component		1,848,122
Equity component (balancing figure)		151,878
Proceeds of bond issue		2,000,000

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De-recognition

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De-recognition

Derecognition is the removal of a previously recognised financial instrument from an entity's statement of financial position.

An entity should derecognise a **financial asset** when:

- (a) The **contractual rights** to the cash flows from the financial asset **expire**; or
- (b) It transfers substantially all the risks and rewards of ownership of the financial asset to another party.

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De-recognition

This means that the entity has settled their contractual obligations to deliver cash and in other words, when they pay the loan back.

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