

# Study Unit 8

## FINANCIAL INSTRUMENTS

**Disclosure & presentation (IAS 32)**  
**Recognition & measurement (IFRS 9)**

# Study Unit 8 (i)

## Theory and Financial Assets

IFRS 9: Financial Instruments

# **INTRODUCTION**

# Financial instruments

Definition:

Any *contract* that gives rise to:

- a financial asset of one entity *and*
- a financial liability/equity instrument of another entity.

# Financial instruments

Financial instruments



Financial assets (FA)  
(buyer/holder)

Financial liabilities (FL)  
(issuer)

# Financial assets

Definition of financial asset includes:

- a) cash
- b) contractual right to receive cash (e.g. debtors)
- c) equity instrument of another entity (i.e. shares)
- d) any derivative instrument (e.g. a forward exchange contract (FEC)) that is *favourable* to the entity

# Examples

- Investment in listed shares
- Investment in unlisted shares
- Investment in listed bonds
- Loan receivable
- Trade and other receivables (debtors)
- Option contract (derivative with favourable balance)
- Futures contract (derivative with favourable balance)

# Financial liabilities

Definition of financial liability includes:

- a) a contractual obligation to deliver cash/financial asset
- b) a contract settled in the entity's own equity instruments (shares) that obliges the entity to deliver a *variable* number of its own shares in settlement of a *fixed* rand value
- c) any derivative instrument (e.g. FEC) that is *unfavourable* to the entity.



# Examples

- Loan payable
- Trade and other payables
- Finance lease liability
- Issued bond onto a listed exchange
- Option contract (derivative with unfavourable balance)
- Futures contract (derivative with unfavourable balance)

IFRS 9: Financial Instruments

# **INITIAL MEASUREMENT**

# Measurement – initial recognition

- Measure at fair value on initial recognition
  - Fair value defined in IFRS 13
- Fair value should normally be the transaction price (fair value of the consideration given or received)
  - But may have to use a valuation technique
  - For example to measure fair value of a long-term receivable/payable at a below market rate of interest

# IFRS 13 Fair Value Definition

- The **price** that would be
- received to **sell an asset** or
- paid to **transfer a liability** in
- an **orderly transaction**
- between **market participants**
- at the **measurement date**

# Initial recognition journal

*Assuming fair value > transaction price = First day gain*

Dr Financial Asset (SFP) <i>(at fair value)</i>	X	
Cr Bank / creditor (SFP) <i>(at transaction price)</i>		X
Cr First day gain (P/L) <i>(balancing fig)</i>		X

*Assuming fair value < transaction price = First day loss*

Dr Financial Asset (SFP) <i>(at fair value)</i>	X	
Cr Bank / creditor (SFP) <i>(at transaction price)</i>		X
Dr First day loss (P/L) <i>(balancing fig)</i>	X	

# Initial fair value – debt instrument

- IFRS 13 requires that quoted market price on an active exchange is first prize
  - Therefore if you have a market price available, utilise that quoted price as the fair value
- If no exchange, but you can determine a market interest rate....
  - Use the market interest rate to discount the actual cash receipts over the life of the instrument.

IFRS 9: Financial Instruments

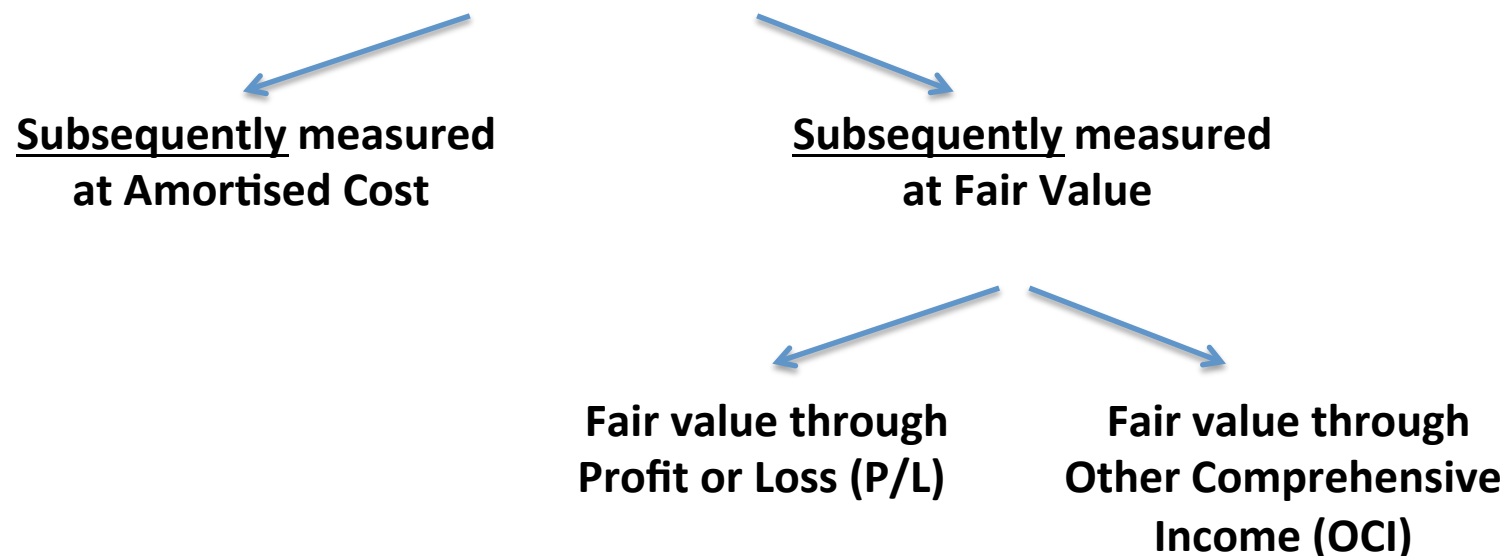
# **CLASSIFICATION OF FINANCIAL ASSETS**

# Classification -IFRS 9 Financial Assets

## *Financial asset categories – subsequent measurement*

**Basis:**

- 1) entity's *business model* for managing the FA's
- 2) contractual cash flow characteristics of the FA





# Classification FRS 9 Financial Assets

Basis: 1) entity's *business model* for managing the FAs *and*  
2) contractual cash flow characteristics of the FA

## Subsequently measured at AC

A FA *must* be measured at AC if *both* of the following are met (exception at right):

- asset held within business model whose objective is to hold assets in order to collect contractual cash flows
- contractual terms of the FA give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding

## Subsequently measured at FV

At initial recognition irrevocably designated as subsequently measured at FV in order to eliminate/ significantly reduce an "accounting mismatch"

*or*

All other FAs (catch all)

*NB: no subsequent measurement at cost exception*

# Subsequently measured at FV

## Financial asset categories, continued

### Subsequently measured at FV

#### Gains/losses presented in OCI

Requirements:

**Equity** instrument *not* held for trading

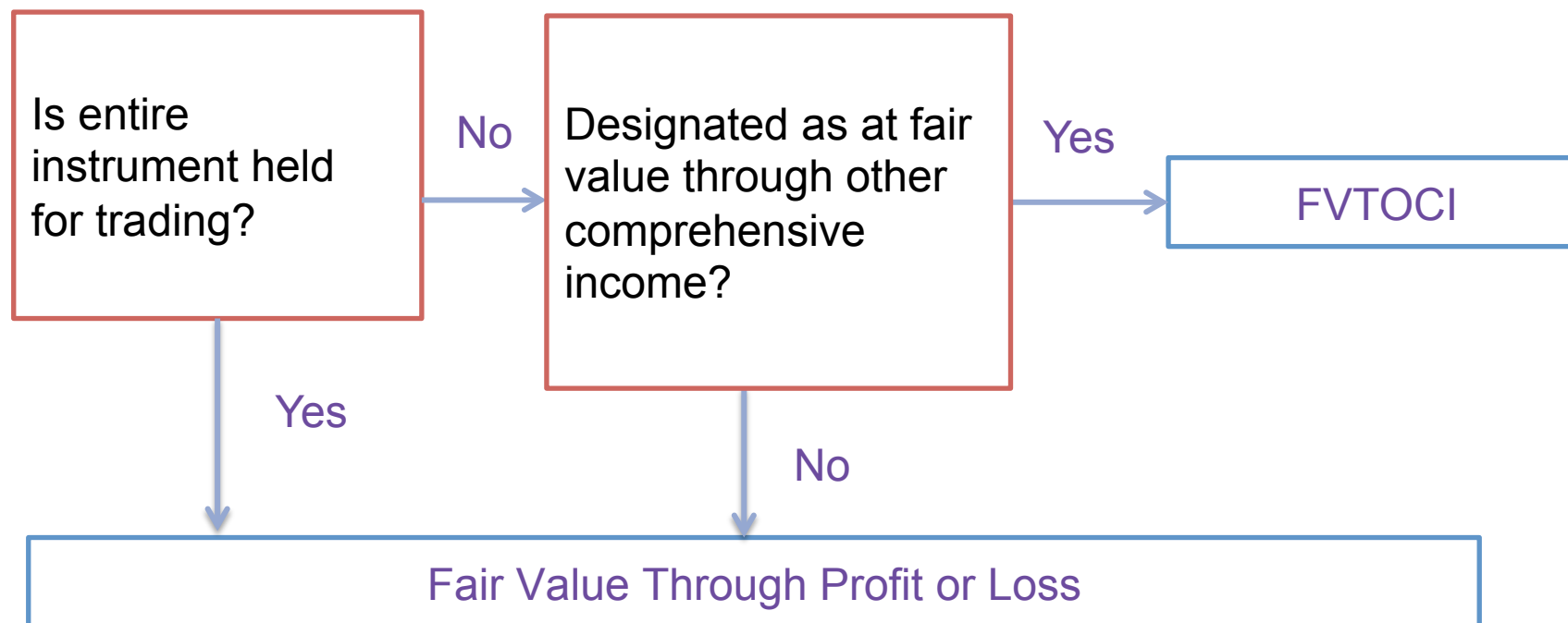
*May* at initial recognition irrevocably elect to present subsequent changes in FV in **OCI**

(NB dividends: **P/L**)

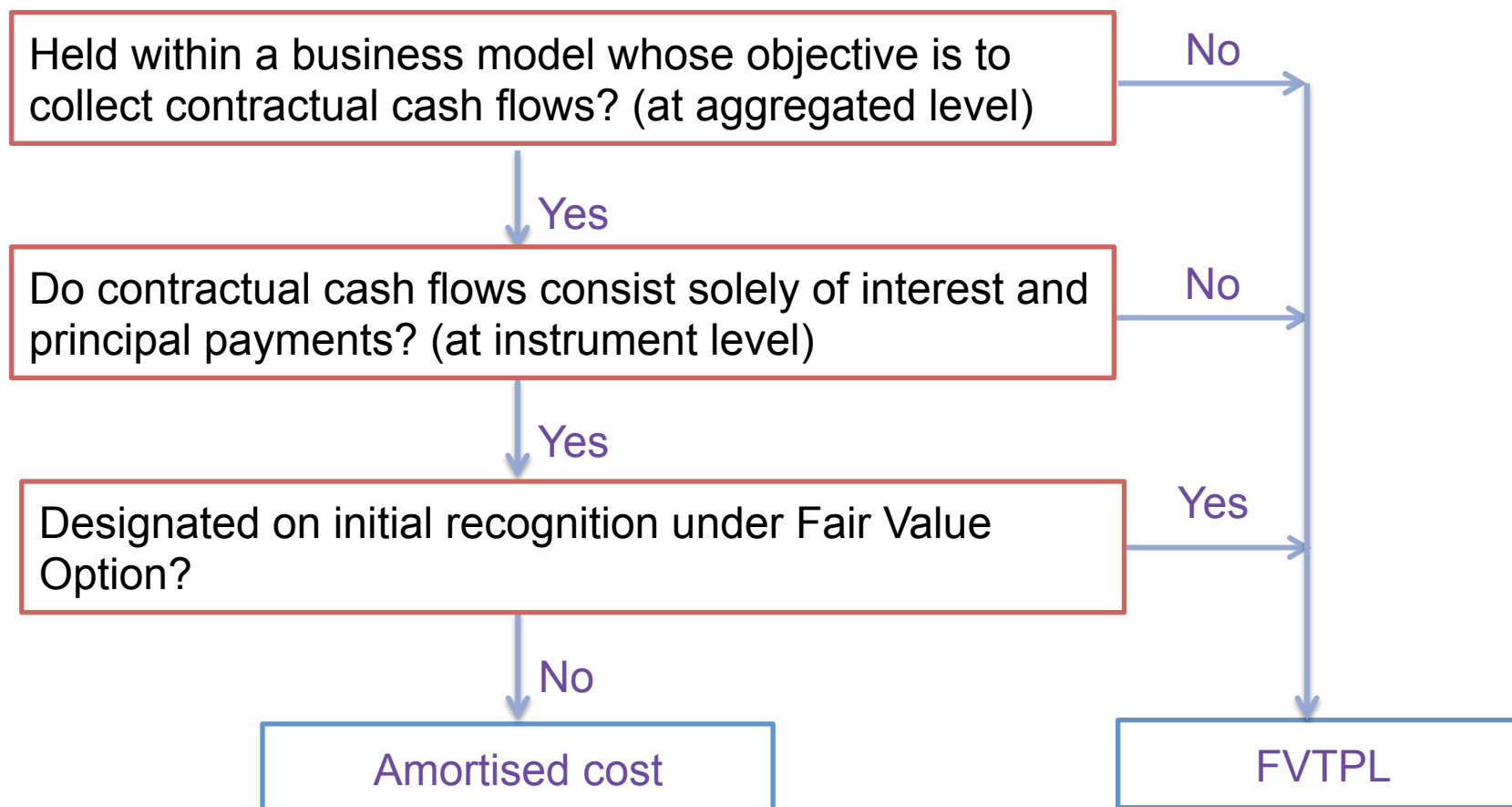
#### Gains/losses recognised in P/L

All other FAs subsequently measured at FV (catch all)

# Equity Instruments



# Debt Instruments



IFRS 9: Financial Instruments

# TRANSACTION COSTS

# Measurement – transaction costs

- Financial assets and liabilities at fair value through profit or loss (FVTPL):
  - *Expense transaction costs immediately – incremental costs such as fees, commissions, transfer taxes that are directly attributable acquiring or issuing the financial asset or liability*
- Other financial assets and liabilities:
  - *Measure initially at fair value plus directly attributable transaction costs – i.e. capitalise these*
  - *This affects the effective interest rate for amortised cost assets and liabilities*

# Transaction Costs

*Subsequently measured at fair value through profit or loss*

Dr Transaction cost expense (P/L)	X	
Cr Bank / creditor (SFP)		X

*Subsequently measured at Amortised Cost*

*Subsequently measured at fair value through OCI*

Dr Financial Asset (SFP) <i>(at fair value)</i>	X	
Cr Bank / creditor (SFP)		X

IFRS 9: Financial Instruments

# **JOURNALS: FAIR VALUE THROUGH PROFIT OR LOSS (EQUITY INSTRUMENTS)**



# FVTPL - Initial recognition

## *Initial recognition*

Dr Financial Asset - FVTPL (SFP)	X	
Cr Bank / creditor (SFP)		X
Cr First day gain (P/L) ( <i>balancing fig</i> )		X

## *Expense transaction costs*

Dr Transaction cost expense (P/L)	X	
Cr Bank / creditor (SFP)		X

# FVTPL – Subsequent measurement

*Fair value increase – reporting date & transaction / settlement date*

Dr Financial Asset - FVTPL (SFP)	X	
Cr Fair value gain (P/L)		X

*Fair value decrease – reporting date & transaction / settlement date*

Dr Fair value loss (P/L)	X	
Cr Financial Asset - FVTPL (SFP)		X

*Impairment*

NOT APPLICABLE		
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# FVTPL – Derecognition

*Derecognition at fair value (remeasure before derecognition)*

Dr Bank / Receivable	X	
Cr Financial Asset - FVTPL (SFP)		X

IFRS 9: Financial Instruments

**JOURNALS:  
FAIR VALUE THROUGH PROFIT OR LOSS  
(DEBT INSTRUMENTS)**

# FVTPL (Debt) - Initial recognition

## *Initial recognition*

Dr Financial Asset - FVTPL (SFP)	X	
Cr Bank / creditor (SFP)		X
Cr First day gain (P/L) ( <i>balancing fig</i> )		X

## *Expense transaction costs*

Dr Transaction cost expense (P/L)	X	
Cr Bank / creditor (SFP)		X

# FVTPL (Debt) – Subsequent interest

## *Accrue interest income*

*Based on opening period balance and interest rates*

Dr Financial Asset - FVTPL (SFP)	X	
Cr Interest income (P/L)		X

## *Coupon interest received*

Dr Bank (SFP)	X	
Cr Financial Asset - FVTPL (SFP)		X

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Carrying amount of Financial Asset before fair value adjustment = XXX

# FVTPL (Debt) – Subsequent valuation

*(Fair value – Carrying amount)*

*Fair value increase – reporting date & transaction / settlement date*

Dr Financial Asset - FVTPL (SFP)	X	
Cr Fair value gain (P/L)		X

*Fair value decrease – reporting date & transaction / settlement date*

Dr Fair value loss (P/L)	X	
Cr Financial Asset - FVTPL (SFP)		X

*Impairment*

NOT APPLICABLE		
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# FVTPL (Debt) – Derecognition

*Derecognition at fair value (remeasure before derecognition)*

Dr Bank / Receivable	X	
Cr Financial Asset - FVTPL (SFP)		X



IFRS 9: Financial Instruments

# **JOURNALS: FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME**

# FVTOCI - Initial recognition

## *Initial recognition*

Dr Financial Asset - FVTOCI (SFP)	X	
Cr Bank / creditor (SFP)		X
Cr First day gain (P/L) ( <i>balancing fig</i> )		X

## *Capitalise transaction costs*

Dr Financial Asset - FVTOCI (SFP)	X	
Cr Bank / creditor (SFP)		X

# FVTOCI – Subsequent measurement

*Fair value increase – reporting date & transaction / settlement date*

Dr Financial Asset - FVTOCI (SFP)	X	
Cr Fair value gain (OCI)		X

*Fair value decrease – reporting date & transaction / settlement date*

Dr Fair value loss (OCI)	X	
Cr Financial Asset - FVTOCI (SFP)		X

*Impairment*

NOT APPLICABLE		
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# OCI to Mark to Market Reserve

*Close out OCI to Mark to Market Reserve Equity (if period gain)*

Dr Fair value gain (OCI)	X	
Cr Mark to Market Reserve (EQUITY)		X

*Close out OCI to Mark to Market Reserve Equity (if period loss)*

Dr Mark to Market Reserve (EQUITY)	X	
Cr Fair value loss (OCI)		X

# FVTOCI – Derecognition

*Derecognition at fair value (remeasure before derecognition)*

Dr Bank / Receivable	X	
Cr Financial Asset - FVTOCI (SFP)		X

*Transfer Mark to Market reserve to Retained Earnings (Optional)*

Dr Mark to Market Reserve (EQUITY)	X	
Cr Retained earnings (EQUITY)		X

IFRS 9: Financial Instruments

**JOURNALS:**

**AMORTISED COST FINANCIAL ASSET**

# Amort. Cost - Initial recognition

## *Initial recognition*

Dr Financial Asset – Amort Cost (SFP) (N1)	X	
Cr Bank / creditor (SFP)		X
Cr First day gain (P/L) ( <i>balancing fig</i> )		X

*(N1) – You may have to calculate the PV of future cash flows using the market interest rate if no quoted market price is available*

## *Capitalise transaction costs*

Dr Financial Asset - Amort Cost (SFP)	X	
Cr Bank / creditor (SFP)		X

*(N2) – Remember to recalculate the effective interest rate  
Change the PV and recompute  $i$*

# Amortised Cost – Subsequent

## *Accrue interest income*

*Based on opening period balance and EFFECTIVE interest rate*

Dr Financial Asset - Amort Cost (SFP)	X	
Cr Interest income (P/L)		X

## *Coupon interest received*

Dr Bank (SFP)	X	
Cr Financial Asset - Amort Cost (SFP)		X

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Carrying amount of Financial Asset is the amortised cost balance = XXX



# Amortised cost - Impairment

*Long term decreases in the carrying amount due to changes in the future cash flows (Future Value or Payments) or extension of payment period (N).*

*You NEVER change the interest rate from the effective interest rate !*

## Calculation

Carrying amount of Financial Asset before impairment = XXX

PV new future cash flows (lower than old CA) = XXX

Impairment loss to P/L = XXX

Dr Impairment Loss (P/L)	X	
Cr Financial Asset - Amort Cost (SFP)		X

# Amortised Cost– Derecognition

*Derecognition at carrying amount – gain or loss in P/L*

Dr Bank / Receivable	X	
Cr Profit on derecognition (P/L) (bal fig)		X
Cr Financial Asset – Amort Cost (SFP)		X