

N.B. – Text in purple are not converged between ASPE and IFRS

## DEFINITIONS

- **Financial Instrument** is a contract that creates a financial asset for one entity and a financial liability or equity instrument of another entity.
- **Financial Asset**
  - cash
  - an **equity instrument** of another entity;
  - a contractual **right to receive cash** or another financial asset from another entity; or
  - a contractual **right to exchange financial assets** or **financial liabilities** with another entity under conditions that are potentially favourable to the entity
- **Financial Liability**
  - a contractual obligation to **deliver cash or another financial asset** to another entity; or
  - a contractual obligation to **exchange financial assets** or **financial liabilities** with another entity under conditions that are potentially **unfavourable** to the entity; or

## MEASUREMENT OF FINANCIAL INSTRUMENTS:

### Categories of financial instruments under IFRS

#### 1. Fair value through profit or loss (FVTPL)

- Financial Assets **and Financial Liabilities**
- Either it was designated to be FVTPL or
- It meets the conditions of FVTPL:
  - Acquired with the intention of selling (asset) or re-purchasing (a liability) in near term
  - Recent actual pattern of short term profit taking
- Usually assets in this category are designated as such
- **Measurement = FV every balance sheet date (gains/losses to P&L)**
  - This category can be used with both financial assets and financial liabilities; therefore, under IFRS you can have financial liabilities that are intended to be settled in the near term designated to be FVTPL

#### 2. Held-To-Maturity (HTM)

- Financial Assets
- Fixed maturity (i.e. cannot be shares)
- Fixed payments
- Intent and ability to hold till maturity
- Can be publically traded
- **Measurement = amortized cost using the effective interest method**

N.B. – Text in purple are not converged between ASPE and IFRS

**3. Loans and Receivable (L&R)**

- Financial Assets
- Fixed payments or determinable payments
- Not publically traded
  - i.e. can't be shares

○ **Measurement = amortized cost using the effective interest method**

**4. Available For Sale (AFS or FVTOCI)**

- Designated as such
- It is catch all category (You do not have the intention to sell – not FVTPL, but no intention to also hold till maturity – not HTM or Loans/Receivable)

○ **Measurement = FV at every B/S date (gains/losses through OCI); the cumulative gains/losses in AOCI gets transferred to P&L when the instrument is sold or impaired.**

**5. Investment in non-publically traded shares where FV cannot be reliably measured – measure @ cost**

**Transaction costs**

- Transaction costs = costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (i.e. legal fees, commission, transfer taxes)
- Only capitalize transaction costs and fees on investment purchases if they're **not** going to be revalued to FV @ the end of the period (i.e. active market does not exist **or** not designated to be held at FV)
- In other words, If you're buying an investment that's carried at cost then capitalize transactions costs

**Reclassifications into and out of FVTPL, HTM, L&R,**

1. **Into FVTPL** - not allowed
2. **Out of FVTPL** – Rare situation – ONLY allowed to reclassify to loans and receivable if when you purchased this investment, it would have met the definition of loans and receivable, had you not designated it as a FVTPL and entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The FV on date of reclassification becomes the new cost basis going forward.
3. **Out of AFS (into loans and receivable only)**
  - Only to the loans or receivable if it met the definition of loans and receivable had it not been designated as available for sale
  - Ability and intent to hold it till maturity or the foreseeable future
  - amortize any gains or losses in OCI to net income over the life of the asset using the effective interest method
4. **Out of HTM - allowed to reclassify to AFS**
  - Revalued to FV and gain or loss put to OCI – on date of reclassification

## PMR: FINANCIAL INSTRUMENTS IFRS: IAS 39 (measurement), IAS 32 (presentation)

---

N.B. – Text in purple are not converged between ASPE and IFRS

### Impairment of financial assets carried at cost/amortized cost

- For financial assets you need to assess at the end of every fiscal year if there are indications of impairment
- If there are indications of impairment write down the financial asset to the:
  - PV future expected CF (using **original effective interest rate** rate) by holding the asset
- What if the value of these financial assets subsequently increases?
  - Assets carried at cost - cannot reverse
  - Assets carried at amortized cost – can reverse to extend of previous losses but the asset balance cannot be any higher than it would be had the impairment not taken

### Impairment of financial assets carried as Available for Sale:

- Shares that are AFS
  - Reclassify the accumulated gain or loss in AOCI to NI
  - Impairment loss recognized in P&L
  - **Reversal is done through OCI**
- Bonds (debt instruments) that are AFS
  - Reclassify cumulative loss in AOCI to Profit or Loss
  - Impairment and **reversal done through P&L**
    - Put the loss to AOCI and then just reclassify it to P&L or
    - Reclassify the AOCI and show the impairment loss in P&L

### PRESENTATION OF A FINANCIAL INSTRUMENT

- The issuer either records financial instruments as liabilities or equity
- The key takeaway here is substance over form - just because someone issues preferred shares; in legal form it may be shares; but in substance it may be a liability (so please consider the definition of financial assets/liabilities before making the classification)

### Compound Financial Instrument

- Compound financial instrument has both equity and liability components
- *Example: ABC Bank issues to me a convertible debt; the bank has the option to convert this debt into a fixed number of shares (say 100 shares).*
  - This particular instrument has both a debt component - i.e. the loan
  - It also has an equity component because the bank has the option to convert to a fixed number of shares
  - One other thing to take away is that because this is a convertible debt, its less risky for the lender and therefore it has a lower interest rate
- **Compound financial instruments under IFRS**  
Measure the liability first (this is usually the PV of the liability using interest rate without the conversion option) and allocate the remainder of the proceeds to the equity.

N.B. – Text in purple are not converged between ASPE and IFRS

### **Mandatory Redemption/ Retractable Shares**

- This is when either you must redeem your shares or the holder of the shares has the right to force you to redeem
  - Substance over form kicks in; it is a financial liability because it is a contractual obligation to **deliver cash**
  - Once these “shares” are presented as financial liability any dividends you pay are actually interest and shown as interest expense (rather than a dividend through R/E)
  
- If shares have mandatory redemption/retractable feature and they are like common shares (i.e. the most subordinate) then it is treated as equity. These shares must have **all** the following properties to be classified as equity:
  - Most subordinate of all shares ( like common shares)
  - Available to 100% of common shareholders
  - The shares get a pro rata share of the residual equity
  - No preferred rights to other share classes
  - Redemption event same for all classes
  
- The reasoning behind this is that there needs to be at least one common share (i.e. most subordinate class of shares) issued for a company

### **Contingent settlement provisions**

- Example: I issue shares for \$5/share; if the share price in the future drops below \$2/share I am forced to redeem all the shares.
- Under IFRS the default is to measure this as a financial liability – since the issuer does not have the right to avoid delivering cash

### **Perpetual Debt**

- These are debt instruments where the principal is never due; you just continue to pay interest
- Is this a financial liability or equity?
  - This is a financial liability because a contractual obligation to **deliver cash (interest)**
  - The PV of the future interest cash flows is shown on the balance sheet as a financial liability accounted for using amortized cost method!

### **Offsetting Financial Asset and Financial Liability**

A financial asset and a financial liability shall be offset, and the net amount reported in the balance sheet, only when an entity:

1. Currently has a **legally enforceable right** to set off the recognized amounts; and
  - Therefore, there needs to be contract in place that allows a borrower to offset the amount owing to and owing from a creditor
  - In rare cases, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off.
  
2. **Intends** either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

## **PMR: FINANCIAL INSTRUMENTS** IFRS: IAS 39 (measurement), IAS 32 (presentation)

---

N.B. – Text in purple are not converged between ASPE and IFRS

### **Comparison to ASPE**

- Compound financial instruments - IFRS does not give option to measure equity at zero
- The Impairment testing is different under IFRS (see above)
- Shares issued under tax planning arrangements under IFRS don't have to be classified as equity if they do not meet the definition
- ASPE doesn't use the 4 categories to group the financial instruments