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IFRS 9 *Financial Instruments*

Presenter:
Anton van Wyk M. Com CA (SA)

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Anton van Wyk M. Com CA (SA)

Anton van Wyk is a **chartered accountant** and independent consultant in International Financial Reporting Standards (IFRS and IFRS for SMEs). As former subject head of Financial Accounting at various higher education providers (including the University of Johannesburg and Monash University South Africa), he has gained valuable insights into and understanding of the important principles underlying the International Financial Reporting Standards (IFRS). Anton is a well-known and popular presenter who has presented numerous IFRS updates for several accounting bodies across South Africa. He is known for his ability to simplify and highlight the most important principles contained in IFRS, whilst keeping the learning process enjoyable for attendees.

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Welcome to the webinar

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IFRS 9 *Financial Instruments*

This webinar focuses on the basic principles in IFRS 9 only!

Some background to note:

- Supersedes IAS 39 *Financial Instruments: Recognition and Measurement*
  - Gradual replacement of IAS 39 approach was followed, now complete
- Focuses on recognition and measurement, not presentation and not disclosure
- IFRS 9 contains simplified approach i.r.o. recognition and measurement
- IFRS 9 does not deal with an entity's own equity instruments
  - Equity is initially measured as the difference between financial assets and financial liabilities (E = FA – FL)
  - An entity's own equity instruments are not remeasured

“Financial Instruments”

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- The topic is a nightmare for many accountants…

- The secret lies in **componentisation** (i.e. breaking down the topic into smaller components, and applying the relevant guidance to that component)

IAS 32
Financial Instruments: Presentation

Classification of equity instruments, financial liabilities and financial assets
Presentation = FACE of the AFS!!

IFRS 9
Financial Instruments

Recognition and measurement of financial assets and financial liabilities

THIS WEBINAR

IFRS 7
Financial Instruments: Disclosure

Disclosure required i.r.o. all financial instruments in the NOTES to the AFS

Content of IFRS 9

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Broken into 7 chapters:

1. Objective
2. Scope
3. Recognition and derecognition
4. Classification
5. Measurement
6. Hedge accounting
7. Effective date and transition

Appendix A: Defined terms

Appendix B: Application guidance

Basis for conclusions

Illustrative examples

Implementation guidance

Examples of simpler FIs

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- Cash on hand/cash in bank (FA)
- Bank overdrafts (FL)
- Investments in the ordinary shares of another entity (FA)
- Contracts that provide the right to receive cash (e.g. trade receivables) (FA)
- Contracts that create the obligation to pay cash (e.g. trade payables, LTLs) (FL)
- Contracts with potentially favourable balances to be settled in cash or other financial assets (e.g. in-the-money option held) (FA)
- Contracts with potentially unfavourable balances to be settled in cash or other financial assets (e.g. out-of-the-money options given) (FL)

Examples of more complex FIs

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Derivative contracts

- Futures (traded on SAFEX market)
- Forwards (OTC instruments)
- Options (put and call)
- Swap agreements (variable interest rate for fixed interest rate)

Non-derivative contracts

- Bonds
- Debentures
- Preference shares etc.

Amortization Schedule

Period	Payment	Interest	Principal	Balance
0				$200,000.00
1	$1,297.20	$ 1,125.00	$172.20	$199,827.80
2	$1,297.20	$ 1,124.03	$173.16	$199,654.64
3	$1,297.20	$ 1,123.06	$174.14	$199,480.50
4	$1,297.20	$ 1,122.08	$175.12	$199,305.38
5	$1,297.20	$ 1,121.09	$176.10	$199,129.28
6	$1,297.20	$ 1,120.10	$177.09	$198,952.18

Remember…

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This is the financial instrument!!

TODAY

CONTRACT
Derivative
Non-derivative

What is the risk of the contract?

IN THE FUTURE

FUTURE TRANSACTION
Buying/selling fin item
Buying/selling non-fin item

THIS IS BEING RECOGNISED & MEASURED (IFRS 9)

CONSIDERED TO HELP US CLASSIFY THE CONTRACT (IAS 32)

IFRS 9

1. Is a contract in the *scope*?

2. When is a FI *initially recognised*?

3. When is a FA and FL *derecognised*?

4. How are FA's *classified* for measurement?

5. How are FL's *classified* for measurement?

6. How are FI's *initially measured*?

7. How are FA's *subsequently measured*?

8. How are FL's *subsequently measured*?

Scope exclusions (IFRS 9)

(OUTCOME 1)

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* Rights and obligations under leases to which IFRS 16 *Leases* applies, but:

  > Finance lease and operating lease receivables (recognised by lessor) are subject to derecognition and impairment principles of IFRS 9; and

  > Lease liabilities recognised by lessee are subject to the derecognition principles of IFRS 9

* Financial instruments issued by an entity that are classified as equity instruments i.t.o. IAS 32

* A forward contract (derivative) between an acquirer and selling shareholder to buy or sell an acquire that will result in a business combination in terms of IFRS 3 *Business Combinations* at a future acquisition date (i.e. the business combination has not occurred yet, BUT the derivative is the contract that will lead to the future transaction being the business combination)

* Loan commitments, but:

  > The issuer of a loan commitment shall apply the impairment requirements of IFRS 9; and

  > All loan commitments are subject to the derecognition requirements of IFRS 9

* Rights to payments to reimburse the entity for expenditure that it is required to make to settle a liability that it recognises as a provision i.t.o. IAS 37

* Rights and obligations within the scope of IFRS 15 *Revenue from Contracts with Customers* that are financial instruments, except where IFRS 15 determines these instruments to be within the scope of IFRS 9

Scope: Own use/commodity

(OUTCOME 1)

Scope inclusion/exclusion the same as per IAS 32 *Financial Instruments: Presentation*

IAS 32 stated that if such contracts are designated as subsequently measured at fair value through profit or loss, then IAS 32 and IFRS 9 will apply

IFRS 9 therefore provides more guidance on this designation

1. The designation is irrevocable
2. The choice to designate is only available at inception of the contract
3. The designation can only be done if it reduces a recognition inconsistency ("accounting mismatch") that would arise if the contract is not accounted for as it is outside the scope of IAS 32/IFRS 9

Remember: this principle applies to contracts where an entity intends to take physical delivery of a non-financial item for use in its day-to-day activities, that are therefore outside the scope of IAS 32 and IFRS 9, but can be designated @FVTPL, which places them inside the scope of IAS 32 and IFRS 9

Initial recognition of FI

(OUTCOME 2)

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Crux: An entity shall *recognise* a financial asset or a financial liability in its statement of financial position when, and only when, the *entity becomes party to the contractual provisions* of the instrument

No contract, no financial instrument…

When does the entity become party to the contractual provisions?

- Legal question
- When the rights are established, and the liabilities are incurred
- When the contractual provisions become legally enforceable, i.e. ‘unavoidable’

Derecognition of FAs

(OUTCOME 3)

A "FA" is derecognised when, and only when,:

- The contractual rights to the cash flows from the FA expire, **or**
- It transfers (*) the FA and the transfer qualifies for derecognition

(*) An entity transfers a FA if, and only if, it either:

- *Transfers the contractual rights to receive the cash flows of the FA,* ***or***
- *Retains the contractual rights to receive the cash flows of the FA, but assumes a contractual obligation to pay the cash flows to one or more 'eventual' recipients*

The second bullet will only be a transfer if ALL the following conditions are met:

- *Entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset, and*
- *Entity prohibited by T's and C's of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them, and*
- *Entity has obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay and is not entitled to invest those cash flows until it so does*

Derecognition of FAs

(OUTCOME 3)

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When a FA is "transferred", we then evaluate the extent to which the entity retains risks and rewards of ownership of the FA, as follows:

(a) If entity transfers substantially all the R&R's of ownership of the FA: the entity derecognises the FA, and separately recognises any new rights and obligations created in the transfer

(b) If entity retains substantially all the R&R's of ownership of the FA: the entity continues to recognise the FA

(c) If the entity neither transfers nor retains substantially all the R&R's of ownership of the FA: the entity determines whether it has retained **control** of the FA *(consider IFRS 10 definition: Power + Exposure + Ability = Control)*

(i) If no control retained: the FA is derecognised, and entity separately recognises any new rights and obligations created in the transfer

(ii) If control retained: the entity continues to recognise the FA to the extent of its continued involvement with the FA

Derecognition of FAs

(OUTCOME 3)

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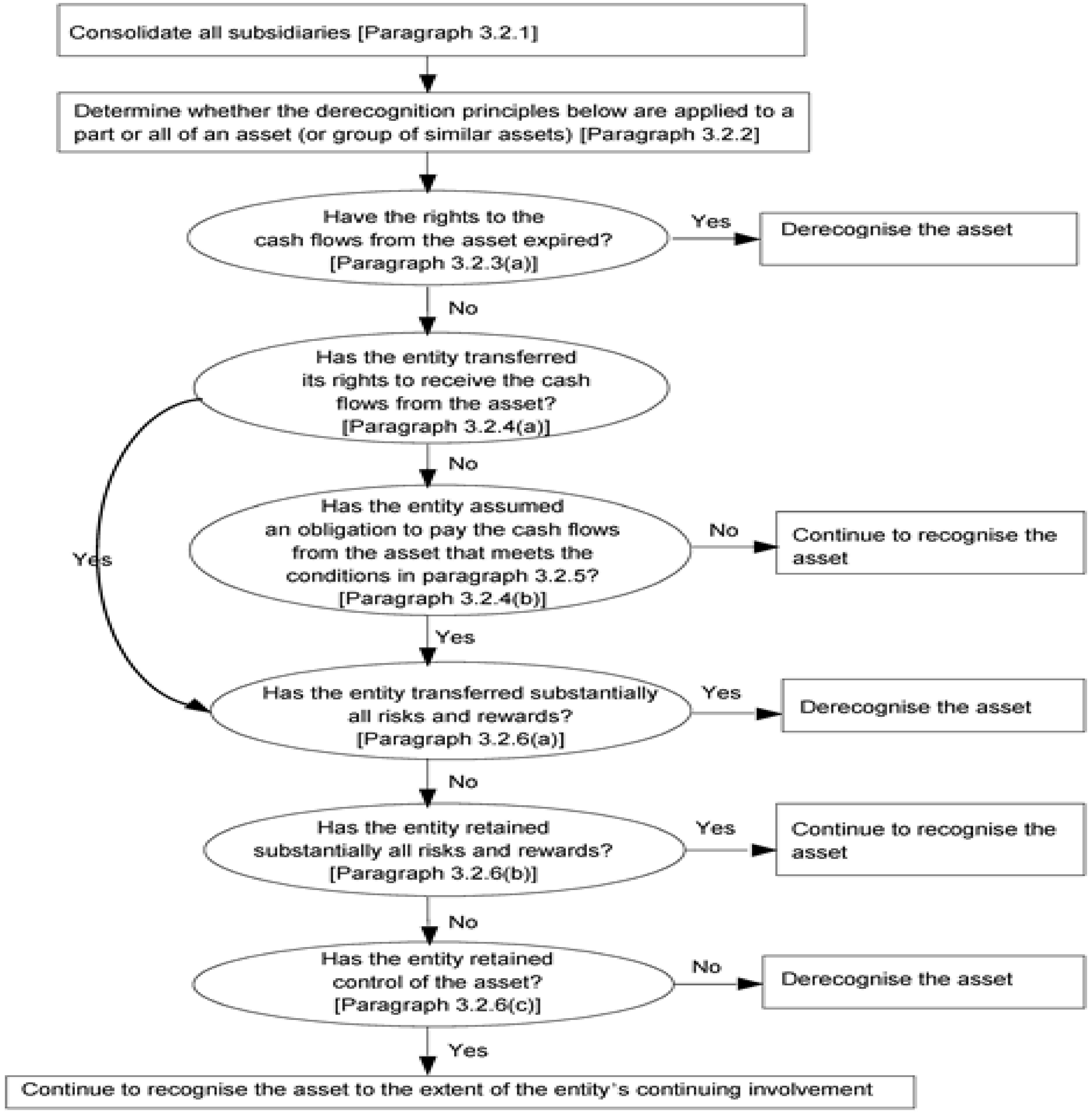

Derecognition of FLs

(OUTCOME 3)

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When, and only when it is extinguished, i.e. when the obligation specified in the contract has been discharged, cancelled or expires

Classification of FAs

(OUTCOME 4)

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POSSIBILITIES

FAs are classified i.t.o. IFRS 9, for purposes of subsequent measurement, as either:

- FAs at amortised cost **or**
- FAs at fair value through other comprehensive income (FVTOCI) **or**
- FAs at fair value through profit or loss (FVTPL)

CLASSIFICATION BASED ON:

- The entity's business model for managing the FA's; **and**
- The contractual cash flow characteristics of the FA's

Classification of FAs

(OUTCOME 4)

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(A) FA is classified as subsequently measured at amortised cost if:

FA is held within a business model whose objective is to hold FA's to collect contractual cash flows, **and**

The 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 ("SPPI")

(B) FA is classified as subsequently measured at FVTOCI if:

FA is held within a "mixed" business model whose objective is achieved by both collecting contractual cash flows and selling financial assets (i.e. mixed intention), **and**

The 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 ("SPPI")

Classification of FAs

(OUTCOME 4)

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(C) FA is classified as subsequently measured at FVTPL if not measured at amortised cost or FVTOCI

- i.e. the default classification when (A) and (B) do not apply
- The entity may make an irrevocable election (at initial recognition) for particular investments in equity instruments (e.g. investments in ordinary shares of another entity) that would otherwise be measured at FVTPL, to present subsequent changes in fair value in **OCI** – this investment may NOT be: held for trading; and not contingent consideration i.t.o. IFRS 3

Despite all the above, an entity may make an irrevocable election (at initial recognition) to designate a FA as subsequently measured at FVTPL if doing so eliminates/significantly reduces a measurement or recognition inconsistency (accounting mismatch) that would otherwise arise from measuring FA's on a different basis

FINANCIAL ASSETS CLASSIFICATION: DECISION TREE

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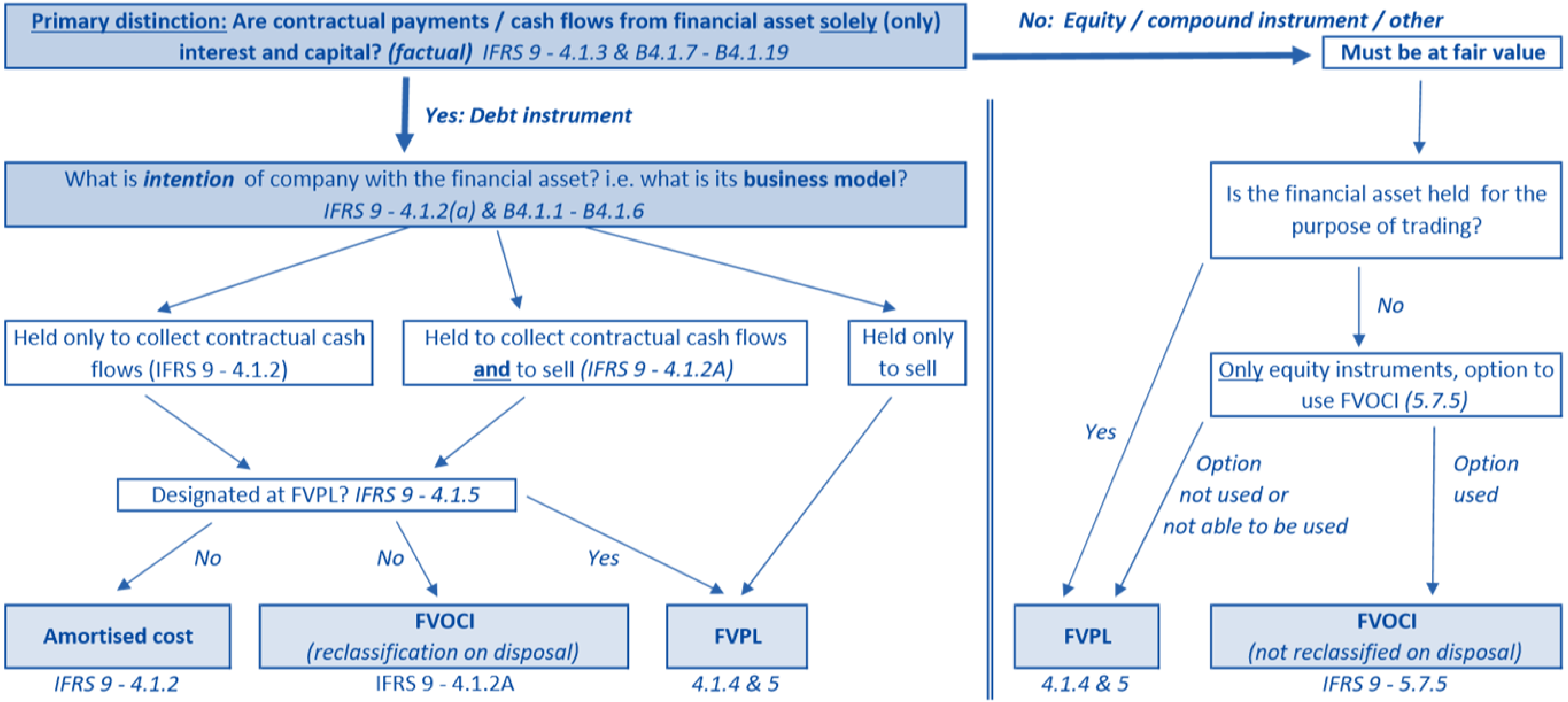
Once recognised, financial assets for the holder / lender are classified as subsequently measured at:

1. **Amortised cost (AC)**
2. **Fair value through P/L (FVPL)**
3. **Fair value through OCI (FVOCI)**

How do we decide which classification is used? IFRS 9 - 4.1



Classification of FLs

(OUTCOME 5)

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All FL's shall be classified as subsequently measured at amortised cost, except for:

- FLs designated at FVTPL (such liabilities (including derivatives that are liabilities) shall be subsequently measured at fair value **<u>or</u>**
- FLs that arise when a transfer of a FA does not qualify for derecognition **<u>or</u>**
- Contingent consideration in a business combination (measured at FVTPL i.t.o. IFRS 3)

From the above it is clear that an entity may, at initial recognition, <u>irrevocably</u> designate a FL as subsequently measured at FVTPL when doing so results in more relevant information, because either:

- It eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch) that would otherwise arise from measuring FL's on another basis **<u>or</u>**
- A group of FL's/group of FL's and FA's is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (e.g. board of directors, or CEO, CFO etc.)

Initial measurement of FI

(OUTCOME 6)

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At initial recognition, an entity shall measure a FA or FL:

at its fair value,

plus or minus *(in the case of a FA or FL not classified as subsequently measured at FVTPL)* transaction costs that are directly attributable to the acquisition or issue of the FA or FL

Hence if a FA or FL is subsequently measured at FVTOCI or amortised cost, the initial recognition of such FA or FL will be at its fair value, plus transaction costs

One exception: Trade receivables with no significant financing component (as per IFRS 15 *Revenue from Contracts with Customers)*, shall be initially measured at their transaction price

Initial measurement of FI

(OUTCOME 6)

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Company A **issues** 1 000 redeemable 10% cumulative preference shares, at their par value of R1 000 each, for cash. The preference shares are redeemable at par value in 3 years' time. Similar preference shares in the market, subjected to a similar risk profile, bear dividends at 11% p.a., compounded annually. How are the preference shares initially measured?

Transaction price = 1 000 x R1 000 = R1 million

Fair value = R975 563

(FV = -R1m; P/Yr = 1; N = 3; I/Yr = 11%; Pmt = -R100 000)

IFRS 9 Appendix B5.1.2A determines that if the difference between the transaction price and fair value is based on observable inputs from a market (IFRS 13 Level 1), the difference will be recognised in profit or loss, at initial recognition

Journal entry at initial recognition and measurement

	Dr	Cr
Dr Bank (cash flow = transaction price)	R1 000 000	
Cr Preference share liability (SoFP) – at fair value		R975 563
Cr First day gain (P/L)		R24 437

Subs. measurement: FAs and FLs

(OUTCOMES 7 AND 8)

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Any gain/loss on a FA/FL subsequently measured at fair value, is recognised in profit or loss, unless:

> It is an *investment in equity instruments* and the entity has elected (irrevocably at initial recognition) to present gains and losses on that investment in OCI (see next slide);

> It is a *FL designated at FVTPL* and the entity is required to present the effects of changes in the FL's credit risk in OCI (see next slide)

> It is a *FA measured at FVTOCI* and changes in fair value recognised in OCI (see next slide)

Any gain/loss on a FA measured at amortised cost, shall be recognised in profit or loss when FA is:

> derecognised;

> reclassified;

> through the amortisation process; or

> in order to recognise impairment gains or losses

Any gain or loss on a FL measured at amortised cost, shall be recognised in profit or loss when FL is:

> derecognised; and

> through the amortisation process

Subs. measurement: FAs and FLs

(OUTCOMES 7 AND 8)

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1. FAs that are investments in equity instruments of another entity (e.g. ordinary shares)

Entity may make irrevocable election at initial recognition to present subsequent changes in fair value of the investment in equity instruments, in **OCI (other comprehensive income)**, but note:

1. The investment in equity instruments may NOT be held for trading
2. The investment in equity instruments may NOT be contingent consideration i.t.o. IFRS 3 *Business Combinations*
3. Dividends received from such investments will still be recognised in profit or loss

2. FLs designated as at FVTPL

A gain or loss on such FLs shall be recognised as follows:

1. The amount of change in fair value of the FL attributable to changes in the ***credit risk*** of that FL, shall be presented in OCI
2. The remaining amount of change in the fair value of the FL shall be presented in profit or loss
3. UNLESS: this treatment (of recognition of credit risk changes in OCI) will create or enlarge an accounting mismatch, then all changes in fair value will be recognised in profit or loss

3. FAs measured at FVTOCI (mixed business model and cash flows are SPPI)

1. Gains and losses are recognised in OCI (except for impairment gains/losses and foreign exchange gains/losses), until the FA is derecognised or reclassified
2. When the FA is derecognised, the cumulative gain/loss in OCI is reclassified from OCI to profit or loss

Subsequent measurement: FAs

(OUTCOME 7)

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ABC Ltd acquires 10 000 debentures for cash at their par value of R1 000 per debenture, on 1 January 2020. This is the fair value of the debentures at this date. The debentures bear interest at 8% per annum, nominal and pre-tax. Interest is compounded annually. Interest is received in cash on 31 December of each year. The debentures are redeemable by the issuer at a premium of 20% on par value, on 31 December 2024. The fair value of the debentures on 31 December 2020, is R10.4 million.

What will the subsequent measurement of the investment in debentures look like for the year ended 31 December 2020?

Subsequent measurement: FAs

(OUTCOME 7)

Possibility 1: The investment in debentures is subsequently measured using the amortised cost (AC) model

Step 1: Calculate the effective interest rate

PV = -R10m; FV = R12m; N = 5; P/Yr = 1; Pmt = R800k; Thus: I/Yr = 11,2% → Used for the AC model

Step 2: Journal entries

Dr Investment in debentures (FA)	R10m		Initial recognition
Cr Bank		R10m	
Dr Bank (coupon interest)	R800k		
Cr Investment in debentures (FA)		R800k	
Dr Investment in debentures (FA)	R1,12m		
Cr Interest income (P/L) (effective interest)		R1,12m	

Subsequent measurement: FAs

(OUTCOME 7)

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Possibility 2: The investment in debentures is subsequently measured using the <u>FVTOCI</u> model

<u>Step 1: Calculate the effective interest rate:</u> This is the same as Possibility 1 = 11,2%

<u>Step 2: Journal entries</u>

	Dr	Cr	
Dr Investment in debentures	R10m		Initial recognition
Cr Bank		R10m	
Dr Bank (coupon interest)	R800k		
Cr Investment in debentures		R800k	
Dr Investment in debentures	R1,12m		
Cr Interest income (P/L) (effective interest)		R1,12m	
Dr Investment in debentures	R80k		
Cr Fair value gain (OCI) (R10m – R800k +R1,12m vs R10.4m)		R80k	

Subsequent measurement: FAs

(OUTCOME 7)

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Possibility 3: The investment in debentures is subsequently measured using the FVTPL model

Step 1: Calculate the effective interest rate

Not applicable, as the amortised cost model is not applied

Step 2: Journal entries

Dr Investment in debentures	R10m		Initial recognition
Cr Bank		R10m	
Dr Bank (coupon interest)	R800k		
Cr Investment in debentures		R800k	
Dr Investment in debentures	R1,20m		
Cr Fair value gain (P/L) (R10m – R800k vs R10.4m)		R1,20m	

Impairment of FAs

(OUTCOME 7)

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Recognition of expected credit losses (ECLs) = a new approach in IFRS 9…

Important to know: Under the impairment approach in IFRS 9 it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity always accounts for expected credit losses, and changes in those expected credit losses. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition and, consequently, more timely information is provided about expected credit losses.

Crux: An entity shall recognise a loss allowance for *expected credit losses* on:

> A financial asset that is measured subsequently at amortised cost or at FVTOCI

* the *loss allowance* for FAs measured at FVTOCI is recognised in OCI **and**

* the *loss allowance* shall not reduce the CA of the FA in the SoFP (as it is recognised in OCI)

> A lease receivable of the lessor (IFRS 16)

> A contract asset (IFRS 15)

> A loan commitment

> A financial guarantee contract

Impairment of FAs

(OUTCOME 7)

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Example of impairment on a FA measured at FVTOCI

Company ABC Ltd invests in debentures of R1 million (also the fair value) and pays cash on 1 January 2020. ABC Ltd decides to subsequently measure the debentures at FVTOCI. At 31 December 2020, the following information is available (assuming there has been no significant increase in credit risk on the debentures since initial recognition and the ECL is based on credit losses for the next 12 months):

Fair value of debentures (based on increase in market interest rates)	R950 000
12-month expected credit loss (ECL) on debentures	R30 000

The journal entries at 31 December 2020 will be as follows:

Dr Fair value loss (OCI) (R1m – R950k)	R50 000	
Cr Investment in debentures (measured at FVTOCI)		R50 000
Dr Impairment loss (P/L)	R30 000	
Cr Loss allowance (OCI)		R30 000

Net loss in:
OCI = R20 000
P/L = R30 000

Impairment of FAs

(OUTCOME 7)

At each reporting date, an entity shall measure the loss allowance for a FA at an amount equal to the lifetime expected credit losses if the credit risk on that FA has increased significantly since initial recognition

If, at the reporting date, the credit risk on a FA has not increased significantly since initial recognition, an entity shall measure the loss allowance for that FA at an amount equal to 12-month expected credit losses

It is therefore crucial to determine whether there has been a significant increase in credit risk since initial recognition…

Impairment of FAs

(OUTCOME 7)

The simplified approach for trade receivables, contract assets and lease receivables (NB)

An entity shall ALWAYS measure the loss allowance at an amount equal to lifetime expected credit losses, for trade receivables or contract assets within the scope of IFRS 15 *Revenue from Contracts with Customers* and that:

> do not contain a significant financing component (or the practical expedient has been applied in IFRS 15) **or**

> do contain a significant financing component, if the entity chooses as its accounting policy to measure the loss allowance at amount equal to lifetime expected credit losses *(such accounting policy must be applied to ALL trade receivables or ALL contract assets, but may be separately applied to trade receivables and contract assets)*

and

lease receivables resulting from transactions within the scope of IFRS 16 *Leases* if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses *(such accounting policy must be applied to ALL lease receivables but may be separately applied to operating and finance lease receivables)*

Impairment of FAs

(OUTCOME 7)

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3 components must be reflected in the measurement of ECLs:

(a) An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) The time value of money; and

(c) Reasonable and supportable information that is available without undue cost or effort at the reporting date about

> past events,

> current conditions and

> forecasts of future economic conditions

Subsequent measurement: FLs

(OUTCOME 8)

Important aspects to recap regarding measurement of FLs:

- Most FLs (99%) will be subsequently measured at **amortised cost**
- The amortised cost model works exactly the same as with FAs
- FLs are **not assessed for impairment**
- Entity can irrevocably, at initial recognition, **designate** a FL to be subsequently measured at **FVTPL**, but there are certain requirements i.r.o. the *credit risk portion* contained in the fair value adjustments

Hedge Accounting (HA)

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- One of the last parts of IFRS 9 to be finalised
- Simplified i.r.o. "hedge effectiveness" (easier to prove hedge effectiveness)
- Only <u>designated</u> hedging relationships can qualify for HA
  - Formal documentation in place
  - Qualifying hedged item and hedging instrument
  - Highly effective throughout hedging relationship
- Two types of hedges i.t.o. IFRS 9's HA:
  - Fair value hedge
  - Cash flow hedge

Fair value hedges

- Hedged risk = unexpected fair value movements ("market deviation risk") since commitment/transaction
- Hedged items usually existing transactions (e.g. trade payable) or future transactions that are firm commitments
- Hedging instrument (e.g. derivative) is initially and subsequently measured at fair value, and fair value adjustments are recognised in profit or loss
- Relatively simple accounting treatment for this type of hedge

Cash flow hedges

- Hedged risk = unexpected cash flow movements (cash flow risk)
- Hedged items usually existing transactions (where cash flow risk is evident) or future/forecast transactions that are highly probable to occur
- Hedging instrument (e.g. derivative) is initially and subsequently measured at fair value, and fair value adjustments are recognised in other comprehensive income (OCI), while the hedge is overall effective (with some limitations on amount deferred in OCI)
- Release of amount deferred in OCI?
  - Basis adjustment (adjust cost price of asset acquired)
  - Released to P/L gradually over time or as the underlying asset/liability affects P/L
- More complex accounting treatment for this type of hedge

Example

ABC Ltd places a non-cancellable order for inventory to the value of $100 000 from an overseas supplier. On the same date, a FEC is taken out to hedge the payment of the foreign creditor. The spot exchange rates are as follows at:

Order date (1 March 2020): $1 = R16,00 (3-month FEC: $1 = R16,50)

Year-end (30 April 2020): $1 = R16,20 (1-month FEC: $1 = R16,70)

Settlement date (31 May 2020): $1 = R16,80 (0-month FEC: N/A)

The hedge (FEC) qualifies for treatment in terms of hedge accounting of IFRS 9. The entity will perform a basis adjustment on the transaction date.

Solution: option 1

The hedge is hedge of a foreign firm commitment. The entity can therefore choose to treat the hedge as either a fair value hedge OR a cash flow hedge. Remember: the hedge qualifies for HA.

ABC Ltd elects the FEC to be a cash flow hedge:

1 March 2020 – no journal entry

30 April 2020 (year-end)

Dr FA at FVTOCI (\$100k x (R16,70 – R16,50))	R20 000	
Cr Fair value gain (OCI)		R20 000

31 May 2020 (transaction date)

Dr Inventory (\$100k x R16,80 spot rate)	R1 680 000	
Cr Bank		R1 680 000
Dr FA at FVTOCI (\$100k x (R16,80 – R16,70))	R10 000	
Cr Fair value gain (OCI)		R10 000
Dr Fair value gain (OCI) (R20k + R10k)	R30 000	
Cr Inventory (basis adjustment)		R30 000
Dr Bank	R30 000	
Cr FA at FVTOCI (R20k + R10k)		R30 000

Solution: option 2

The hedge is hedge of a foreign firm commitment. The entity can therefore choose to treat the hedge as either a fair value hedge OR a cash flow hedge. Remember: the hedge qualifies for HA.

ABC Ltd elects the FEC to be a fair value hedge:

1 March 2020 – no journal entry

30 April 2020 (year-end)

Dr FA at FVTPL ($100k x (R16,70 – R16,50))	R20 000	
Cr Fair value gain (P/L)		R20 000
Dr Foreign exchange loss (P/L) ($100k x (R16,20 – R16,00))	R20 000	
Cr Firm commitment (SoFP)		R20 000

31 May 2020 (transaction date)

Dr FA at FVTPL ($100k x (R16,80 – R16,70))	R10 000	
Cr Fair value gain (P/L)		R10 000
Dr Foreign exchange loss (P/L) ($100k x (R16,80 – R16,20))	R60 000	
Cr Firm commitment (SoFP)		R60 000
Dr Inventory ($100k x R16,80 spot rate)	R1 680 000	
Cr Bank		R1 680 000
Dr Firm commitment (SoFP) (R20k + R60k)	R80 000	
Cr Inventory (basis adjustment)		R80 000
Dr Bank	R30 000	
Cr FA at FVTPL (R20k + R10k)		R30 000

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Thank you for your participation

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