SA | ACCOUNTING ACADEMY

Connect. Partner. Succeed.

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs
Section 11 *Basic Financial Instruments*

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

About SAAA

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Creating opportunities to connect our partners to succeed

SAAA offers CPD training for accountants, auditors, bookkeepers and tax practitioners. We offer a range of webinars, seminars, conferences and courses.

The CPD policy is compliant with IFAC IES7

All training offered by SAAA is recognised for CPD purposes by the relevant professional bodies including: SAICA, AAT, ACCA, SAIPA, ICBA, SAIBA, IAC, IIA and CIMA.

SAAA Rewards

CPD Subscribers gain access to various rewards

These can be accessed from your profile by logging in and navigating to your “My Rewards” > “Find out more” to see the reward partner benefits and claim it.

These rewards include discounts, reduced premiums and free stuff.

Reward Partners

Presenter

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

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.

Webinar Housekeeping

The webinar recording and presentation will be available at the end of the webinar within your SAAA profile.

These can be accessed from your profile by logging in and navigating to your “My Dashboard” > “View Events” and then clicking on “Links & Resources” next to the webinar title.

The webinar is available under the “Recording(s)” tab and the presentation under the “Files” tab.

Recognising CPD

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Depending on your designation, you can claim your CPD hours for this webinar at the end of the webinar within your SAAA profile, or update your CPD Reflective Plan within your SAAA profile.

This can be accessed from your profile by logging in and navigating to your “My Dashboard” > “View Events” and then clicking on “Links & Resources” next to the webinar title.

The “Claim My CPD” option is available under the “CPD” tab. Once claimed you will be able to view and download your certificate.

Disclaimer

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Disclaimer

Whilst every effort has been made to ensure the accuracy of this presentation and handouts, the presenters / authors, the organisers do not accept any responsibility for any opinions expressed by the presenters / author, contributors or correspondents, nor for the accuracy of any information contained in the handouts.

Copyright

Copyright of this material rests with SA Accounting Academy (SAAA) and the documentation or any part thereof, may not be reproduced either electronically or in any other means whatsoever without the prior written permission of SAAA.

Ask Questions

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

To ask questions and interact during the webinar please use the chat sidebar to the right of the video / presentation on the screen.

Feel free to ask your questions during the webinar in the chat, these will be addressed in the formal Q & A at the end of the presentation.

Welcome to the Webinar

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Welcome to this webinar dealing with **Section 11 *Basic Financial Instruments*** in the **IFRS for SMEs**

Agenda – points to cover in the webinar

1. Introduction to Section 11 *Basic Financial Instruments*
2. Initial recognition and measurement of financial instruments
3. Subsequent measurement of financial instruments
4. Impairment testing of financial assets
5. Derecognition of financial assets and financial liabilities
6. Disclosures
7. A glimpse into IFRS 9 *Financial Instruments*

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs

Section 11 *Basic Financial Instruments*

Introduction to Section 11 *Basic Financial Instruments*

Overview of main areas in s11

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Scope
  - Section 11 versus section 12?
  - Accounting policy choice (IFRS for SMEs versus full IFRSs (IAS 39))
  - Basic financial instruments
- Initial recognition
- Initial measurement
- Subsequent measurement
  - Amortised cost and effective interest method
  - Impairment of financial instruments measured at cost or amortised cost
    - Recognition
    - Measurement
    - Reversal
  - Fair value
    - Valuation technique
- Derecognition of financial assets and financial liabilities
- Disclosures

Examples of financial instruments

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- **WITHIN THE SCOPE OF <u>SECTION 11</u> OF THE IFRS FOR SMEs**
- Cash
- Demand and fixed term deposits (entity is the depositor)
- Commercial paper and commercial bills held
- Trade receivables
- Trade payables
- Loans receivable
- Loans payable
- Bonds and similar **debt** instruments
- Investments in non-convertible preference shares
- Investments in non-puttable ordinary shares and preference shares
- Commitments to receive a loan, where the commitment cannot be settled net in cash

Simple instruments!!

Scope of Sections 11 and 12

S11 and s12 together deal with **recognition** (including derecognition), **measurement** and **disclosure** of financial instruments

SECTION 11

Basic financial instruments

Relevant to ALL entities with financial instruments

SECTION 12

More complex financial instruments

Must be considered to ensure correct inclusion or exclusion from scope

Accounting policy choice

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- An entity with financial instruments, shall CHOOSE to apply either:

  - Sections 11 and 12 in IFRS for SMEs in FULL; **or**
  - IAS 39 *Financial Instruments: Recognition and Measurement* (in full IFRSs) plus the disclosure requirements of Sections 11 and 12 of IFRS for SMEs

- The above choice is an **accounting policy** choice!

- Section 10 *Accounting Policies, Estimates and Errors* in IFRS for SMEs will apply to changes in accounting policies! Make sure a change made qualifies as a change in accounting policy!

Specific scope exclusions

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- The following do **not** fall within the scope of section 11:
  - Investments in subsidiaries, associates and joint ventures
  - Financial instruments that meet the definition of equity (i.e. entity's own equity)
  - Leases
    - Derecognition per s11 will apply to lease receivables and lease payables
    - S12 may also apply to some leases
  - Employers' rights and obligations under employee benefit plans

What is a financial instrument (FI)?

- A contract (NB)
- That gives rise to a **financial asset** of one entity and
- A **financial liability** or **equity instrument** of another entity
- **Important to note:**
  - No contract, no financial instrument!
  - A financial instrument can be a **financial asset**, or a **financial liability**
  - An equity instrument, in itself, is not a financial instrument (e.g. a company's own ordinary shares)
  - Classification is very important!

What are basic FI's? Section 11!

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

4 MAIN CATEGORIES OF FINANCIAL INSTRUMENTS

- (a) **Cash**
- (b) A **debt instrument** that meets the *prescribed conditions (next slide)*
- (c) A **commitment** to receive a loan that:
    - (i) cannot be settled NET in cash; and
    - (ii) when the commitment is executed, is expected to meet the *prescribed conditions (next slide)*
- (d) An **investment in non-convertible preference shares** and **non-puttable ordinary shares or preference shares**

What are the prescribed conditions?

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- A **debt instrument** that satisfies (a) to (d) below, shall be accounted for i.t.o. s11:

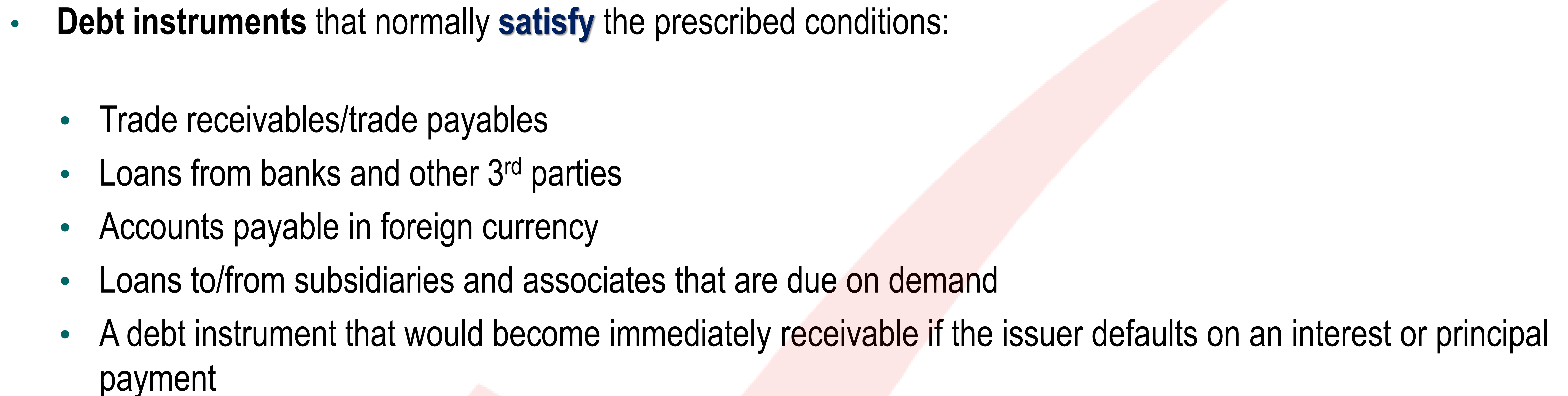
  (a) Returns to the holder are
    - (i) a fixed amount, or
    - (ii) a fixed rate of return over the life of the instrument, or
    - (iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted and observable interest rate (such as LIBOR or prime rate)
    - (iv) A combination of (ii) and (iii), provided that both rates are positive

  (b) No contractual provision that determines that the holder can lose the principal amount or any interest attributable to current/prior periods *(note: subordination agreement of debt instrument is not an example of this)*

  (c) Contractual provisions that permit issuer to prepay or holder to put back before maturity are not contingent on future events

  (d) No conditional returns or repayment provisions except for the variable rate return in (a) (iii) and prepayment provisions in (c) above.

Examples – satisfy



- **Debt instruments** that normally **satisfy** the prescribed conditions:
  - Trade receivables/trade payables
  - Loans from banks and other 3rd parties
  - Accounts payable in foreign currency
  - Loans to/from subsidiaries and associates that are due on demand
  - A debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment

Examples – don't satisfy

SA ACCOUNTING ACADEMY
Connect. Partner. Succeed

These fall within S12!

- Debt instruments that normally **don't satisfy** the prescribed conditions:
  - An investment in another entity's equity instruments other than non-convertible preference shares or non-puttable ordinary or preference shares
  - Interest rate swap that returns a cash flow that is positive or negative
  - Forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow (positive and negative cash flows not acceptable)
  - Options and forward contracts (returns not fixed)
  - Investments in convertible debt (return to the holder can vary with price of issuer's equity shares)
  - Loan receivable from 3rd party that gives the 3rd party the right or obligation to prepay IF the applicable tax/accounting requirements change (contingent on future events)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs
Section 11 *Basic Financial Instruments*
Initial recognition and measurement of financial instruments

Initial recognition – when?

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Financial assets (FA's) or financial liabilities (FL's) shall be initially recognised ONLY when the entity becomes a party to the contractual provisions of the instrument

- Legal form prevails…

Initial measurement

- When a FA or FL is recognised initially (i.e. at FIRST recognition), the entity shall measure the FI at its **transaction price**
  - Transaction costs are usually included in the transaction price…
  - If the FA or FL is subsequently measured at fair value through profit or loss, the transaction costs are expensed at initial recognition through profit or loss
- If the arrangement/agreement, in effect, constitutes a financing transaction, the FA or FL shall be measured at the **present value of the future payments** discounted at a market rate of interest for similar debt
  - This is normally evident in:
    - Interest-free financing
    - Financing below market-related terms

Most FI's i.t.o. IFRS for SMEs will initially be measured at the transaction price

Thoughts on initial measurement

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Initial measurement is interesting ☺
- Goal is to ensure **initial measurement at an appropriate amount**, which is market-related
- *If transaction is based on 'arm's length' terms, the* ***transaction price*** *will approximate the* ***fair value*** *of the financial instrument (FA or FL)*
- Therefore always compare transaction terms with market terms!!

Possibility 1: Sales/purchase transactions with 'implicit' financing element

Possibility 2: Other debt instruments – interest below market-related rates

Examples of initial measurement

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Company GHI (Pty) Ltd obtains a long-term loan from ZZZ Bank of R3 million. Interest of 9.5% per annum (nominal and pre-tax) is compounded and paid annually. The loan's capital will be paid back at the end of the 5 year term of the agreement. Similar loans bear interest at 9.5% per annum, nominal and pre-tax

- *It is evident that there is no sign of:*
  - *An 'implicit' financing element (this is not a sales/purchase transaction)*
  - *Interest below market-related rates*

- The loan will therefore be initially measured by GHI (Pty) Ltd **at the transaction price of R3 million**
- *(Test: Discounting future cash flows (interest and capital) will return a present value of R3 million, as the loan's terms are the same as the market-related terms)*

Examples of initial measurement (2)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Parent A grants a loan of R2 million to subsidiary B. The loan is repayable at the end of 5 years and bears nominal interest of 5% per annum, pre-tax. Interest is compounded and paid annually. Loans to entities with a **similar** risk profile to that of entity B, bear market-related interest at 10% per annum, nominal and pre-tax

- *It is evident that there is an **effective financing transaction** present as the subsidiary and the parent are related parties and the interest rate on the loan is 5% below the market interest rate*

- The loan will be **initially** measured at the **present value of the expected cash flows**, as it constitutes an effective financing arrangement…

- FV = R2 million (redemption amount)
- Pmt = 5% x R2 million = R100 000 interest paid annually
- I/Yr = 10% (market-related)
- N = 5 (term of loan in years)
- P/Yr = 1 (compounded annually)
- Thus PV = R1 620 921 (rounded)

- The loan will be initially measured at **R1 620 921**

Journal entry in Parent's books:

Dr Loan receivable	**1 620 921**	
Dr Loss (P/L)	**379 079**	
Cr Bank		**2 000 000**

Examples of initial measurement (3)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Purchase or sales transaction = risk of 'implicit' financing element!
- Company A sells goods to the value of R25 000 (excluding VAT) to customer X on credit. Customer X is granted 90 days, which is the **standard credit period** for all customers, to settle the debt. The prime rate of interest is 10% per annum, nominal and pre-tax.
- The debtor (financial asset) that is recognised by company A is measured **initially** at the transaction price. As the debt is within the normal credit terms of the company and also short-term (3 months), the amount will be left undiscounted. There is no evidence of an 'implicit' financing element present…
- The trade debtor will be initially measured at R28 750 (including VAT) – this is **the transaction price**!

Examples of initial measurement (4)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Purchase or sales transaction = risk of 'implicit' financing element!

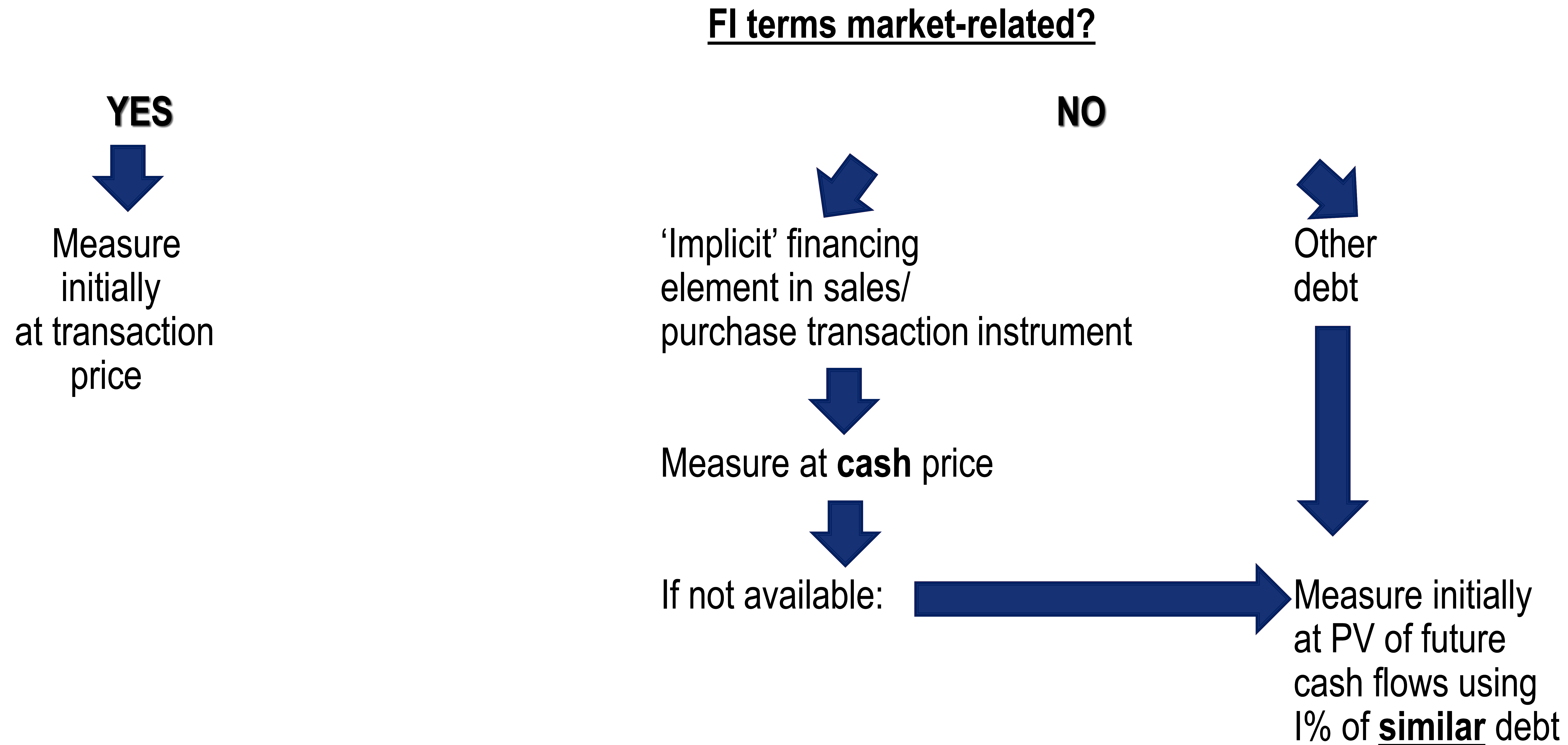
- Company B sells goods to Customer Z for R2 million on credit and charges no interest. Customer Z is granted 12 months to settle the debt. The credit terms **exceed the normal credit terms** of company B. The applicable interest rate is 10% per annum, nominal and pre-tax in respect of similar customers.

- The debtor (financial asset) that is recognised by company B is measured **initially** at the present value of the expected cash flows as it constitutes an effective financing arrangement (there is an 'implicit' financing element present)

- The trade debtor will be initially measured at the **current cash price of the item**, or if that price is not available, the **present value of the future cash flows discounted at a market-related interest rate** (e.g. 10% per annum)

Initial measurement – summary

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed



SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs

Section 11 *Basic Financial Instruments*

Subsequent measurement of financial instruments

Subsequent measurement of FI’s

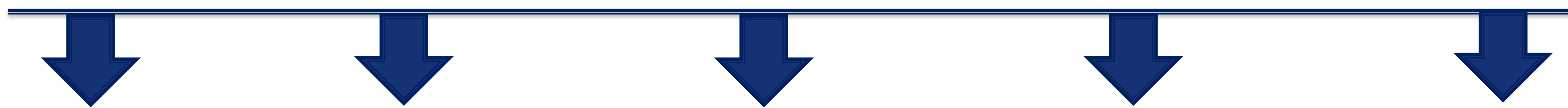
SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Debt instruments that satisfy prescribed conditions
  - **Amortised cost**, using the effective interest method
- Debt instruments classified as *current assets* or *current liabilities*
  - **Undiscounted** amount of cash or other consideration expected to be paid or received, net of impairment where appropriate
  - Unless the arrangement constitutes a financing transaction: **PV of future payments** discounted at a market-related interest rate for similar debt instrument
- Commitments to receive a loan: **at cost**, which could be zero
- Investments in non-convertible preference shares or non-puttable ordinary or preference shares:
  - If traded publicly or fair value can be reliably measured: **@FVTPL**
  - Otherwise at **cost less impairment**

Effective interest method?

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Affected by discounts, premiums and transaction costs
- The nominal interest rate is not (necessarily) the interest recognised in profit or loss…
- Effective interest takes into account ALLOCATION of items such as transaction costs, discounts/premiums at acquisition, discounts/premiums at redemption and effectively 'smoothes' them over the term of the instrument



- This is also why the prescribed conditions are important in respect of limiting uncertainty and contingencies and fixing returns (rates and amounts)
- Remember: Section 24J of the Income Tax Act refers to **effective** interest, not nominal interest…

Example: amortised cost

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Company DEF (Pty) Ltd issues bonds and receives R2 million in cash on 1/1/2020. The bonds bear interest at 12% per annum (nominal and pre-tax) and are redeemable at R2.2 million (i.e. R200 000 premium) at maturity date, being 31/12/2024 (i.e. 5 years). Interest receivable is compounded and received annually at the end of the year. Similar bonds in the market bear interest at 12% per annum, nominal and pre-tax. Transaction costs amount to R50 000 and are paid in cash on 1/1/2020.

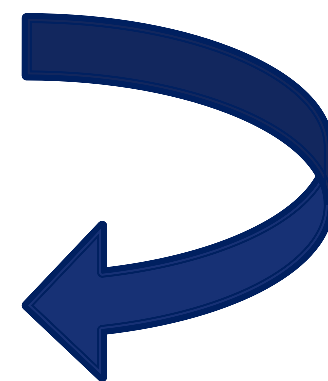
- The bonds are **debt instruments** that satisfy prescribed conditions:
  - Returns: fixed amount, fixed rate
  - No contractual provision that determines that company DEF can lose principle or interest for any current or prior period(s)
  - No contingent prepayment provisions for holder or issuer
  - No conditional returns (not even interest rate is variable)

- Bond will be subsequently measured at <u>amortised cost</u>, using **effective interest method**

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- The effective interest rate must be calculated first
  - PV = R2 million less R50 000 transaction costs = R1 950 000 net inflow
  - N = 5 years
  - P/Yr = 1 (compounded once per annum)
  - Pmt = (R240 000) (i.e. R2 million x 12%)
  - FV = (R2.2 million) (redemption amount)
  - Thus: effective I% = **14.24%**



- **Why not 12%?**
  - Transaction costs reduce net cash inflow by R50 000
  - Redemption premium not reflected in the 12% annual interest

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Journal entries

<u>1/1/2020 (initial recognition and measurement)</u>

	Dr	Cr
Dr Bank	R2 000 000	
Cr Bond liability		R2 000 000
(recognise bond issued)		
Dr Bond liability	R50 000	
Cr Bank		R50 000
(capitalise transaction costs to bond)		

Transaction price

<u>31/12/2020 (subsequent measurement)</u>

	Dr	Cr
Dr Interest expense (P/L)	**S24J** R277 680	
Cr Bank		R240 000
Cr Bond liability (bal. figure)		R37 680
(recognise interest at effective rate of 14.24% p.a. on R1.95 million)		

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Journal entries

	Dr	Cr
<u>31/12/2021</u>		
Dr Interest expense (P/L)	R283 046	
Cr Bank		R240 000
Cr Bond liability (bal. figure)		R43 046
(recognise interest at effective rate of 14.24% p.a.)		
<u>31/12/2022</u>		
Dr Interest expense (P/L)	R289 175	
Cr Bank		R240 000
Cr Bond liability (bal. figure)		R49 175
(recognise interest at effective rate of 14.24% p.a.)		
<u>31/12/2023</u>		
Dr Interest expense (P/L)	R296 178	
Cr Bank		R240 000
Cr Bond liability (bal. figure)		R56 178
(recognise interest at effective rate of 14.24% p.a.)		
<u>31/12/2024</u>		
Dr Interest expense (P/L)	R304 178	
Cr Bank		R240 000
Cr Bond liability (bal. figure)		R64 178
(recognise interest at effective rate of 14.24% p.a.)		
Dr Bond liability	R2 200 000	
Cr Bank		R2 200 000
(settlement of bond liability)		

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs

Section 11 *Basic Financial Instruments*

Impairment testing of financial assets

Impairment testing of FA's

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- At end of each reporting period – entity to assess whether objective evidence of impairment of FA's (measured at cost or amortised cost) exists

- If so, recognise impairment loss **in profit or loss**

- **What is objective evidence of impairment?**
  - Significant financial difficulty or issuer or obligor
  - Breach of contract, such as default in interest or principal payments
  - The creditor (based on debtor's financial difficulty) granting concession to debtor that the creditor wouldn't otherwise consider
  - When it becomes probable that debtor will enter bankruptcy or other financial reorganisation
  - Observable data indicating measurable decrease in future cash flows from a group of FA's (even though decrease cannot as yet be allocated to individual FA's within the group) (e.g. adverse national or local economic conditions or adverse changes in industry conditions)
  - Significant adverse changes in technological, market, economic or legal environment in which entity operates (e.g. Covid-19 global pandemic)

Impairment testing of FA’s (2)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- FA’s to be tested **individually** for impairment
  - Investments in equity instruments of another entity
  - Other FA’s that are individually significant
- Remaining FA’s to be tested either individually or grouped based on similar credit characteristics
- Professional judgement to be used

Impairment testing of FA's (3)

- How is the impairment loss measured?

- FA's measured at amortised cost:
  - IL = CA of FA less PV of estimated cash flows discounted at the FA's **original** effective interest rate

- FA's measured at cost less impairment:
  - IL = CA of FA less best estimate of amount receivable should the FA be **sold** at reporting date (amount is an approximation, could be zero)

Impairment testing of FA's (4)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Reversal of impairment loss is allowed/possible
- If the decrease in the impairment loss can be related objectively to an event occurring after the impairment was recognised (e.g. debtor's credit rating improves)
- **The carrying amount of the FA (after reversal of IL) shall NOT exceed the CA of the FA that would have existed had there never been an impairment loss (called the "reversal ceiling")**
- Journal entry:
  - **Dr Financial asset (F/P)** **XXX**
  - Cr Reversal of impairment loss (P/L) XXX

  Or
  - **Dr Allowance for impairment (F/P)** **XXX**
  - Cr Reversal of impairment loss (P/L) XXX

Example of impairment of FA's

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Company A (Pty) Ltd invested in bonds for R5 million with a term of 5 years. The bonds bear coupon interest at 10% p.a. (nominal and pre-tax). Similar bonds also bear coupon interest at 10% p.a. (nominal and pre-tax). The bonds will be redeemed at the end of 5 years (31/12/2024) at a premium of 10% on their par value of R5 million. Interest is calculated and paid annually.

- Step 1: Calculate effective rate of the FA:
  - PV = (R5m) cash outflow
  - FV = R5.5m cash inflow at redemption
  - N = 5 years
  - P/Yr = 1 (compounded annually)
  - Pmt = R500 000 (i.e. 10% x R5m)
  - Thus I/Yr = **11.59%**

Example (continued)

- Step 2: Journalise the transaction in the records of Company A (Pty) Ltd:

	Dr	Cr	
<u>1/1/2020</u>			
Dr Investment in bonds	R5 000 000		
Cr Bank		R5 000 000	
<u>31/12/2020</u>			
Dr Bank	R500 000		
Dr Investment in bonds (bal. figure)	R79 353		
Cr Interest received (P/L)		R579 353	**S24J**
<u>31/12/2021</u>			
Dr Bank	R500 000		
Dr Investment in bonds (bal. figure)	R88 548		
Cr Interest received (P/L)		R588 548	**S24J**

Example (continued)

- Assume at the end of year 2022, objective evidence exists that the holder of the bonds is experiencing financial difficulty and cannot make further coupon payments for two years (being 2022 and 2023). The coupon payments will then be made at R600 000 for the years ending 2024, 2025 and 2026. The bonds will now be redeemed at R5 million + 10% on their par value on 31/12/2026.

- **What is the impairment loss on the bonds?**
  - Step 1: Calculate the PV of the expected future cash flows as at 31/12/2022
    - CF1 (2022) and CF2 (2023) = 0
    - CF3 (2024) and CF4 (2025) = R600 000
    - CF5 (2026) = R6.1 million (being R5.5 million + R600 000)
    - **I/Yr = 11.59 (the original effective interest rate)**
    - Thus new PV = R4 344 636

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Step 2: Calculate the CA of the FA as at 31/12/2022:
  - R5m (Jnl 1) + R79 353 (Jnl 2) + R88 548 (Jnl 3) + R598 808 = **R5 766 709**

- Step 3: Compare CA (step 2) to recoverable amount (step 1)
  - R5 766 709 – R4 344 636 = R1 422 073 265 (impairment loss)
  - Journal entry:
    - Dr Impairment loss (P/L) R1 422 073
    - Cr Investment in bonds (F/P) R1 422 073

    Or
    - *Cr Allowance for impairment (F/P) R1 422 073*
    - *(recognise impairment loss on FA measured at amortised cost)*

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Journal entries for 2021 to 2025 (with revised cash flows and revised term)

Entry	Dr	Cr
<u>31/12/2022 (no cash payment of interest by holder)</u>		
Dr Investment in bonds	R503 416	
Cr Interest received (P/L)		R503 416
<u>31/12/2023 (no cash payment of interest by holder)</u>		
Dr Investment in bonds	R561 747	
Cr Interest received (P/L)		R561 747
<u>31/12/2024 (cash interest payments commence by holder)</u>		
Dr Bank	R600 000	
Dr Investment in bonds	R26 837	
Cr Interest received (P/L)		R626 837
<u>31/12/2025</u>		
Dr Bank	R600 000	
Dr Investment in bonds	R29 947	
Cr Interest received (P/L)		R629 947
<u>31/12/2026</u>		
Dr Bank	R600 000	
Dr Investment in bonds	R33 417	
Cr Interest received (P/L)		R633 417
Dr Bank	R5 500 000	
Cr Investment in bonds		R5 500 000

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Assume on 31/12/2024, objective evidence indicates that the credit rating of the holder of the bonds has improved and the holder can make payment of R750 000 interest for 2025 and 2026 and settle the bonds at a premium of 10% on par value on 31/12/2026. This represents a possible **reversal** of the impairment loss.

- **Step 1: What is the new PV of future cash flows as at 31/12/2023?**
  - Pmt = R750 000 (given)
  - FV = R5.5 million (given)
  - **I/Yr = 11.59% (the original effective interest rate!!)**
  - N = 2 (i.e. 2025 and 2026)
  - P/Yr = 1 (compounded annually)
  - Thus PV = **R5 691 526** (rounded)

Example (continued)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Step 2: What is the CA of the FA at **31/12/2024**?
  - R4 344 636 (previous PV of cash flow) + R503 416 (2022) + R561 747 (2023) + R26 837 (2024) = R5 436 636
- **Step 3: What would the CA of the FA have been, had there never been an IL?**
  - As at 31/12/2024, the CA of the investment in bonds would have been zero (bonds would have been settled). The reversal of the impairment loss may therefore not be recognised.
- *If it is assumed that the original CA of the investment in bonds exceeded R5 691 526 (i.e. new CA) at the date of the reversal of the impairment loss, the reversal of the impairment loss would be done as follows:*
  - *R5 691 526 – R5 436 636 =* ***R254 890 (reversal of impairment loss)***
  - *Journal entry:*
  - *31/12/2023*
  - *Dr Investment in bonds* — *R254 890*

Or

  - *Dr Allowance for impairment* — *R254 890*
  - *Cr Reversal of impairment loss (P/L)* — — *R254 890*

FA's measured at fair value

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- Investments in ordinary (equity) shares or preference shares must be **measured at fair value**, if they are publicly traded or their fair values can be measured reliably *(i.e. it is not a choice, it is a requirement!!)*
  - If both not applicable, the cost less impairment…

- Fair value hierarchy, to determine fair value, is as follows:

  - **Quoted price** for an identical asset in an active market (usually the current bid price)
  - If quoted prices are unavailable, the price of **recent transaction** for an identical asset (as long as no significant changes have taken place in economic circumstances or no significant time lapse)
  - If the market is not active and recent transactions of an identical asset are not a good estimate of fair value, the entity estimates fair value by using a **valuation technique**

FA's measured at fair value (2)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- What is a **valuation technique**?

  - Recent arm's length market transactions for an identical asset between knowledgeable willing parties
  - Reference to the fair value of another asset that is substantially the same as the asset being measured
  - Discounted cash flow analysis
  - Option pricing models
  - Other techniques commonly used by market participants to price the asset and technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, such techniques may be used

- *Use market-inputs as far as possible, rather than entity-inputs…*

FA's measured at fair value (3)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- **What if fair value can no longer be reliably measured/estimated?**
- At the date that the fair value can no longer be measured/estimated reliably, its carrying amount (as at the last date the asset was reliably measured at fair value) becomes its new cost
- The FA will be measured at **cost less impairment,** until a reliably measured fair value becomes available again

IFRS for SMEs

Section 11 *Basic Financial Instruments*

Derecognition of financial assets and financial liabilities

SA ACCOUNTING ACADEMY
Connect. Partner. Succeed

Derecognition of FA's

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- FA's shall be derecognised **only** when:
  - The contractual rights to the cash flows from the FA *expire* or are *settled*; or
  - The entity *transfers* to another party *substantially all of the risks and rewards* of ownership of the FA; or
  - The entity, despite having retained some significant risks and rewards of ownership, *has transferred control* of the FA to another party, and the **other** party has the practical ability to sell the FA in its entirety to an unrelated 3rd party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer. In this case, the first entity shall:
    - Derecognise the FA; and
    - Recognise separately any rights and obligations retained or created in the transfer

Derecognition of FA's (2)

- If a transfer does NOT result in derecognition of a FA because the entity has retained the significant risks and rewards of ownership of the transferred FA, the entity shall continue to recognise the transferred FA in its entirety, and shall recognise a financial liability for the consideration transferred

- The FA and FL shall NOT be offset

- In subsequent periods, the entity shall recognise any income received on the transferred asset and any expense incurred on the financial liability

Derecognition of FA's (3)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- If the transferor provides **non-cash collateral** (e.g. debt or equity instruments) to the transferee, the accounting for the collateral by the two parties depends on whether the transferee has the **right to sell or re-pledge** the collateral and on whether the **transferor has defaulted**

- Accounting is as follows:
  - Transferee has right to sell/re-pledge: transferor reclassifies the FA in the SoFP (e.g. as loaned asset, pledged equity instruments etc.) separately from other assets, but does not derecognise FA
  - Transferee sells collateral pledged to it: transferee recognises the proceeds from sale, and a liability measured at fair value for its obligation to return the collateral, but transferor does NOT derecognise FA
  - Transferor defaults and no longer entitled to redeem collateral: transferor derecognises collateral and transferee recognises collateral as its own asset initially at fair value, or if it has already sold the collateral, derecognises its obligation to return the collateral to the transferor
  - Thus: transferor continues to recognise the collateral and transferee does NOT recognise collateral, UNLESS/UNTIL there is default as in previous point

Derecognition of FL's

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- An entity shall derecognise a FL (or a part of a FL) only **when it is extinguished** (when the obligation specified in the contract has been discharged, cancelled or expired)

- The entity shall recognise in profit or loss any difference between the CA of the FL (or part of a FL) extinguished or transferred to another party and the consideration paid (including non-cash items transferred or liabilities assumed)

Example: derecognition appropriate

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

- An entity sells a group of its **trade receivables** to a bank at less than their face amount. However, the entity continues to handle collections from the debtors on behalf of the bank, including sending monthly statements, and the bank pays the entity a market-rate fee for servicing the receivables. The entity is obliged to remit promptly to the bank any and all amounts collected, but it has *no obligation to the bank for slow payment or non-payment by the debtors*.
- In this case, the entity has transferred to the bank substantially all of the risks and rewards of ownership of the receivables. Accordingly, it removes the receivables from its statement of financial position (derecognises them), and it shows no liability in respect of the proceeds received from the bank. The entity recognises a loss calculated as the difference between the carrying amount of the receivables at the time of sale and the proceeds received from the bank. The entity recognises a liability to the extent that it has collected funds from the debtors but has not yet remitted them to the bank.

Example: derecognition inappropriate

- The facts are the same as the preceding example except that the entity has agreed to buy back from the bank any receivables for which the debtor is in arrears as to principal or interest for more than 120 days.
- In this case, the entity has retained the risk of slow payment or non-payment by the debtors—a significant risk with respect to receivables. Accordingly, the entity does not treat the receivables as having been sold to the bank, and it does not derecognise them.
- Instead, it treats the proceeds from the bank as a loan secured by the receivables.
- The entity continues to recognise the receivables as an asset until they are collected or written off as uncollectible.

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs

Section 11 *Basic Financial Instruments*

Disclosures

Disclosures

SA ACCOUNTING ACADEMY
Connect. Partner. Succeed

- IFRS for SMEs Section 11 par. 11.40 to 11.48 refers…

- **Disclosures** required in respect of:
  - Accounting policies for FI's
  - 6 categories of FA's and FL's and their amounts (notes or in SoFP)
  - Derecognition (i.r.o. transferred FA's that don't qualify for derecognition)
  - Collateral (when FA's have been pledged as collateral for liabilities/contingent liabilities)
  - Defaults and breaches on loans payable (details, if not remedied)
  - Items of income, expense, gains or losses on FI's (details, amounts etc.)

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

IFRS for SMEs

Section 11 *Basic Financial Instruments*

A glimpse into IFRS 9 *Financial Instruments*

Q&A

SA | ACCOUNTING ACADEMY
Connect. Partner. Succeed

Please use the chat sidebar to the right of the video / presentation on the screen to ask your questions.

If you would like to e-mail a question, please use:

technicalquestions@accountingacademy.co.za

SA | ACCOUNTING ACADEMY

Thank you for your participation

SA | ACCOUNTING ACADEMY

Your source for accounting knowledge