IFRS 9	Financial Instruments	05

INTRODUCTION

RELEVANT IFRSs	
IAS 32	Financial Instruments: Presentation (Definition and Compound FI)
IFRS 7	Financial Instruments: Disclosures
IFRS 9	Financial Instruments (Classification and Measurement)
IAS 39	Financial Instruments: Recognition and Measurement (not examinable)

DEFINITIONS	
Financial instruments	is a **contract** that gives rise to ▪ a **financial asset** of one entity; and ▪ a **financial liability or equity instrument** of another entity.
Financial asset	is any asset that is: ▪ cash **e.g.** cash in hand or at bank ▪ an equity instrument of another entity **e.g.** investment in shares or share options ▪ a contractual right to receive cash (or another financial asset) **e.g.** receivables, investment in loan ▪ a contractual right to exchange financial instruments under conditions that are potentially favourable **e.g.** favourable forward contract entered into by a bank
Financial liability	is any liability that is: ▪ a contractual obligation to deliver cash (or another financial asset) **e.g.** payables ▪ a contractual obligation to exchange financial instruments under conditions that are potentially unfavourable **e.g.** unfavourable forward contract entered into by a bank
Equity instruments	is any **contract** that evidences a **residual interest** in the assets of an entity after deducting all of its liabilities **e.g.** equity shares issued by the entity.

SUBSTANCE

Some financial instruments have the legal form of equity but are, in substance, liabilities. For example, an issuer has a contractual obligation to either deliver cash or another financial asset **e.g.** redeemable preference shares.

Therefore, dividend on redeemable preference shares is treated as finance cost in profit or loss while dividend on ordinary shares is presented in statement of changes in equity.

RECOGNITION OF FINANCIAL INSTRUMENTS

An entity shall recognize 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.

A financial asset might be an investment in debt or in equity.

CLASSIFICATION

FINANCIAL ASSETS – INVESTMENT IN DEBT INSTRUMENTS	
At amortised cost	A financial asset must be measured at amortised cost if both of the following conditions are met: ▪ the asset is held within a business model whose objective is to **hold assets** in order to collect contractual cash flows; and ▪ 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 amount outstanding.
Fair value through other comprehensive income (FVTOCI)	A financial asset must be measured at fair value through other comprehensive income if both of the following conditions are met: ▪ the financial asset is held within a business model whose objective is achieved **by both collecting** contractual cash flows **and selling** financial assets and ▪ 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 amount outstanding.
Fair value through profit or loss (FVTPL)	A financial asset must be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through other comprehensive income. A company may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

FINANCIAL ASSETS – INVESTMENT IN EQUITY INSTRUMENTS	
At amortised cost	Not applicable
FVTOCI	For all equity instruments not held for trading, a company can make an irrevocable election at initial recognition to measure an equity investment at fair value through other comprehensive income.
FVTPL	Investments in equity are measured at fair value through profit or loss only if held for trading.

FINANCIAL LIABILITIES	
At amortised cost	At initial recognition, financial liabilities are classified as subsequently measured at amortised cost with specific exceptions including: ▪ derivatives that are liabilities at the reporting date; and ▪ financial liabilities that might arise when a financial asset is transferred but this transfer does not satisfy the derecognition criteria.
At fair value	A company is allowed to designate a financial liability as measured at fair value through profit or loss. This designation can only be made if: ▪ it eliminates or significantly reduces a measurement or recognition inconsistency; or ▪ this would allow the company to reflect a documented risk management strategy. Any such designation is irrevocable.

MEASUREMENT

FINANCIAL ASSETS – INVESTMENT IN DEBT INSTRUMENTS				
Category	**Initial measurement**	**Subsequent measurement**	**Changes**	**Disposal gain/ loss**
Amortised cost	Fair value + transaction costs	Amortised cost	Effective Interest ➔ PL	PL
FVTOCI	Fair value + transaction costs	Fair value (after effective interest)	Effective Interest ➔ PL Change in FV ➔ OCI	PL ***(Note 2)***
FVTPL	Fair value	Fair value (after interest)	Interest ➔ PL Change in FV ➔ PL	PL

Note 1: However, trade receivable is an exception to this treatment. Trade receivable are measured in accordance with IFRS 15.

Note 2: The balance in "Other reserves" i.e. accounted for in OCI is transferred to "**Retained earnings**" in statement of changes in equity. ***(No recycling)***

FINANCIAL ASSETS – INVESTMENT IN EQUITY INSTRUMENTS				
Category	**Initial measurement**	**Subsequent measurement**	**Changes**	**Disposal gain/ loss**
Amortised cost	*Not applicable*			
FVTOCI	Fair value + transaction costs	Fair value	Dividend ➔ PL Change in FV ➔ OCI	PL
FVTPL	Fair value	Fair value	Dividend ➔ PL Change in FV ➔ PL	PL

Note 3: The balance in "Other reserves" i.e. accounted for in OCI is transferred to "**profit or loss**". ***(Recycling of gains)***

FINANCIAL LIABILITIES				
Category	**Initial measurement**	**Subsequent measurement**	**Changes**	**Disposal gain/ loss**
Amortised cost	Fair value – transaction costs	Amortised cost	Effective Interest ➔ PL	PL
Fair value	Fair value	Fair value	Change due to own credit risk ➔ OCI Remaining change ➔ PL	PL

ADDITIONAL POINTS	
Amortised cost	Amortised cost is present value of future cash flows using effective interest rate.
Transaction costs	Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. Examples of transaction costs are: ▪ fees and commissions paid to agents, advisers, brokers and dealers; ▪ levies by regulatory agencies and securities exchanges; ▪ transfer taxes and duties; ▪ credit assessment fees; ▪ registration charges and similar costs. **Transaction costs are expensed in case of FVTPL.** Non-transaction costs are always charged to PL. Examples of costs that do not qualify as transaction costs are financing costs, internal administration costs and holding costs.
Interest	*Nominal interest ➔ Cash = par value x coupon rate* *Effective interest ➔ PL = Outstanding balance x effective rate*

SYLLABUS

Reference	Content/Learning outcome
B1	**IFRS 9 Classification, recognition and measurement of financial assets and liabilities Other than derivatives -Financial Instruments**
LO2.1.1	Apply requirements of IFRS 9 in respect of recognition, classification and measurement of financial assets and liabilities.
Proficiency level: **1** Testing level: **1**	

Past Paper Analysis											
A14	S15	A15	S16	A16	S17	A17	S18	A18	S19	A19	S20
										06	**07**

PRACTICE Q&A

Sr.#	Description	Marks	Reference
INTRODUCTION			
1H	Definitions	05	KA
CLASSIFICATION			
2H	FA Classification	03	ST
3C	FA / FL Classification	07	KA
MEASUREMENT			
4C	Goal Limited: FA – Debt – Amortised cost	04	KA
5C	Ball Limited: FA – Debt – Amortised cost	04	KA
6C	Jack Limited: FL – Amortised cost	07	KA
7H	FA – Equity – FVTOCI	04	ST
8C	XYZ Limited: FA – Equity – FVTPL & FVTOCI	08	KA
9H	Kangaroo Limited – FVTPL & FVTOCI	07	QB
10H	Tokyo Limited: FA – Debt – AC & FVTOCI & FVTPL	12	SBR + KA
11C	Gypsum Limited – Debt AC and FVTPL	06	PE A19
12C	Aji Panca Limited: Shares (including redeemable) issue	08	QB
13H	Passila Limited: Issue of debentures	12	QB
14C	Alpha Limited: Liability at FV (own credit risk issue)	10	Other

QUESTION 01

Identify the following items as a financial asset, a non-financial asset, a financial liability, a non-financial liability or an equity instrument. **(05)**

ITEMS	ANSWER
Creditors	
Investment in loan notes of another entity	
Bank loan obtained	
Ordinary shares issued	
Irredeemable preference shares issued	
Unfavourable forward currency contract	
Share options issued	
Redeemable preference shares issued	
Investment in redeemable preference shares	
Current tax payable	
Inventory	

QUESTION 02

XYZ Limited makes a large bond issue to the market. Three companies (A Limited, B Limited and C Limited) each buy identical Rs. 10,000,000 bonds. How they should classify these financial asset? **(03)**

Company	Business model	Classification of bond?
A Limited	A Limited holds bonds for the purpose of collecting contractual cash flows to maturity	
B Limited	B Limited holds bonds for the purpose of collecting contractual cash flows but sells them on the market when prices are favourable	
C Limited	C Limited buys bonds to trade in them	

QUESTION 03

Identify the most likely classification of following items: **(07)**

ITEMS	ANSWER
FINANCIAL ASSETS	
Investments held for trading purposes.	
Investment in interest bearing debt instruments. The instrument is redeemable in five years. The intention is to collect cash flows (which are interest and principal amounts only)	
Investment in interest bearing debt instruments. The instrument is redeemable in five years. The intention is to collect cash flows (which are interest and principal amounts only). However, the entity may sell the loan notes earlier if any good offer is received.	
A trade receivable	
Derivatives held for speculation purpose	
Investment in equity shares. The entity has no intention of selling these shares in foreseeable future.	
Investment in loan notes. The objective is to collect contractual cash flows which consist of interest, changes in oil prices in next five years and principal amount at the end of year 5.	
Investment in loan notes. The objective is to collect contractual cash flows which consist of interest, changes in oil prices in next five years and principal amount at the end of year 5. However, the entity may sell the loan notes earlier if any good offer is received.	
Investment in convertible debentures	

FINANCIAL LIBILITIES	
A 12% bank loan obtained by A Limited payable in 5 years' time.	
8% loan notes issued by C Limited	
A short-term currency swaps agreement entered into by B4-Bank Limited which is currently unfavourable. These types of transactions are usual feature of B4-Bank Limited's business.	
Trade payable	

QUESTION 04

Goal Limited invested in a debt instrument with a nominal value of Rs.10,000. The instrument is redeemable in two years at a premium of Rs.2,100 and has been classified as 'at amortised cost'. The coupon rate is 0% while the effective interest rate is 10%.

Required:
How will this be reported in the financial statements of Goal plc over the period to redemption? **(04)**

QUESTION 05

Ball Limited invested in a debt instrument with a nominal value of Rs.10,000. The instrument is redeemable in two years at a premium of Rs.1,680 and has been classified as 'at amortised cost'. The coupon rate is 2% while the effective interest rate is 10%.

Required:
How will this be reported in the financial statements of Ball plc over the period to redemption? **(04)**

QUESTION 06

On 1 January 2011, Jack Limited issued a deep discount bond with a Rs.50,000 nominal value. The discount rate was 16% of nominal value, and the costs of issue were Rs.2,000.

Interest of 5% nominal value is payable annually in arrears.

The bond must be redeemed on 1 January 2016 (after 5 years) at a premium of Rs.4,611.

The effective rate of interest is 12% p.a.

Required:
How will this be reported in the financial statements of Jack Limited over the period to redemption? **(07)**

QUESTION 07

An equity investment is purchased for Rs. 30,000 plus 1% transaction costs on 1 January 20X6. It is classified as at fair value through OCI.

At the end of the financial year (31 December) the investment is revalued to its fair value of Rs. 40,000.

On 11 December 20X7 it is sold for Rs. 50,000.

Required
Explain the accounting treatment for this investment. **(04)**

QUESTION 08

On January 01, 2011, XYZ Limited invested Rs. 100 (fair value at that date) in equity shares of another company. XYZ Limited also incurred transaction costs of Rs. 2.

On April 25, 2011 an interim dividend of Rs. 3 was received.

On June 30, 2011 (year-end) the fair value of the investments is Rs. 120.

On August 31, 2011 XYZ Limited disposed off the investment for Rs. 150.

Required:

(a) Pass the journal entries if the investment is classified as FVTPL. **(04)**

(b) Pass the journal entries if the investment is classified as FVTOCI. **(04)**

QUESTION 09

Kangaroo Limited (KL), a Pakistan based company, is preparing its financial statements for the year ended 31 December 2017. Following transactions were carried out during the year:

On 1 May 2017 KL acquired following equity investments:

	Purchase price	Transaction cost	Total
	-------------------- Rs. in million --------------------		
Investment A	100	2	102
Investment B	150	3	153

Investment A was designated as measured at fair value through profit or loss whereas investment B was irrevocably elected at initial recognition as measured at fair value through other comprehensive income.

In October 2017, KL earned dividend of Rs. 12 million and Rs. 9 million on investment A and B respectively.

20% of investment A and 30% of investment B were sold for Rs. 23 million and Rs. 50 million respectively in November 2017. Transaction cost was paid at 2%.

As on 31 December 2017, fair values of the remaining investments are given below:

	Fair value	Transaction cost on disposal	Net amount
	------------- Rs. in million -------------		
Investment A	105	2.1	102.9
Investment B	130	2.6	127.4

Required:

Prepare the extracts relevant to the above transactions from KL's statements of financial position and comprehensive income for the year ended 31 December 2017, in accordance with the IFRSs. **(07)**

QUESTION 10

On 1st January 20X1, Tokyo bought a Rs.100,000, 5% bond for Rs.95,000, incurring issue costs of Rs.2,000. Interest is received in arrears. The bond will be redeemed at a premium of Rs.5,960 over nominal value on 31 December 20X3. The effective rate of interest is 8%.

The fair value of the bond was as follows:

31/12/X1	Rs.110,000
31/12/X2	Rs.104,000

Required:
Explain, with calculation, how the bond will have been accounted for over all relevant years if:

(a) Tokyo's business model is to hold bonds until the redemption date **(04)**
(b) Tokyo's business model is to hold bonds until redemption but also to sell them if investments with higher returns become available. **(05)**
(c) Tokyo's business model is to trade bonds in the short term. Assume that Tokyo sold this bond for its fair value on 31 January 20X2 for Rs. 108,000 **(03)**

QUESTION 11

On 1 July 2018, Gypsum Limited purchased 5,000 debentures issued by Iron Limited at par value of Rs. 100 each. The transaction cost associated with the acquisition of the debentures was Rs. 24,000. The coupon interest rate is 11% per annum payable annually on 30 June. On 1 July 2018, the effective interest rate was worked out at 9.5% per annum whereas the market interest rate on similar debentures was 11% per annum.

As on 30 June 2019, the debentures were quoted on Pakistan Stock Exchange at Rs. 96 each.

Required:
Prepare journal entries for the year ended 30 June 2019 if the investment in debentures is subsequently measured at:

(a) amortized cost **(03)**
(b) fair value through profit or loss **(03)**

QUESTION 12

On 1 January Year 1 Aji Panca Ltd has the following capital and reserves.

Equity	**Rs.**
Share capital (Rs. 1 ordinary shares)	1,000,000
Share premium	200,000
Retained earnings	5,670,300
	6,870,300

During Year 1 the following transactions took place.

1 January	An issue of Rs. 100,000 8% Rs. 1 redeemable preference shares at a premium of 60%. Issue costs are Rs. 2,237. Redemption is at 100% premium on 31 December Year 5. The effective rate of interest is 9.5%.
31 March	An issue of 300,000 ordinary shares at a price of Rs. 1.30 per share. Issue costs, net of tax benefit, were Rs. 20,000
30 June	A 1 for 4 bonus issue of ordinary shares.

Profit for the year, before accounting for the above, was Rs. 508,500. The dividends on the redeemable preference shares have been charged to retained earnings.

Required
Set out capital and reserves and liabilities resulting from the above on 31 December Year 1.

QUESTION 13

On 1 July 2016, Passila Ltd, issued 20,000 8% debentures at Rs. 97.50 (Par value Rs. 100). The security is redeemable in five years' time. The interest on the debentures is payable bi-annually on 30 June and 31 December.

On 31 December 2016, the Company's year-end date, the debentures were quoted on the Karachi Stock Exchange for Rs. 96.00.

The company accountant has suggested each of the following as possible valuation basis for reporting the debentures liability on the statement of financial position as at 31 December 2016:

(i) Face value of the debentures (after deducting discount and issue costs)
(ii) Face value of the debenture plus interest payment for five years.
(iii) Market value on the statement of financial position as at the year end.

Required

(a) Determine the face value of the debentures and the proceeds accruing to the company. **(02)**
(b) Determine the amount and explain the nature of the differences between the face value and the market value of the debentures on 1 July, 2016. **(02)**
(c) Distinguish between nominal and effective rate of interest. **(02)**
(d) Determine the nominal interest payable on the debentures for the year ended 31 December 2016. **(02)**
(e) State arguments for or against each of the suggested alternatives for reporting the debentures liability on the statement of financial position as at 31 December 2016. **(04)**

QUESTION 14

Alpha Limited (AL) regularly invests in assets that are measured at fair value through profit or loss. On January 1, 2018 AL issued 9% debentures at nominal value of Rs. 80,000 to finance a similar investment in assets. The management has decided to classify these debentures to be measured at fair value through profit or loss.

AL's credit rating was also dropped in subsequent years due to some factors. These debentures were revalued to fair value as follows:

Date	***Fair value***	***Change due to own credit risk***
31-Dec-2018	Rs. 88,000	Rs. 3,000
31-Dec-2019	Rs. 82,000	Rs. (5,000)

Required:

(a) Show extracts of statement of comprehensive income and statement of financial position for the year ending December 31, 2018 and 2019.
(b) Journal entries for above transactions for the year 2018 and 2019 **(10)**

ANSWER 01

ITEMS	ANSWER
Creditors	A financial liability
Investment in loan notes of another entity	A financial asset
Bank loan obtained	A financial liability
Ordinary shares issued	An equity instrument
Irredeemable preference shares issued	An equity instrument
Unfavourable forward currency contract	A financial liability
Share options issued	An equity instrument
Redeemable preference shares issued	A financial liability
Investment in redeemable preference shares	A financial asset
Current tax payable	A non-financial liability (statutory obligation)
Inventory	A non-financial asset

ANSWER 02

Company	Business model	Classification of bond?
A Limited	A Limited holds bonds for the purpose of collecting contractual cash flows to maturity	A Limited must measure the bond at amortised cost
B Limited	B Limited holds bonds for the purpose of collecting contractual cash flows but sells them on the market when prices are favourable	B Limited must measure the bond at fair value through OCI
C Limited	C Limited buys bonds to trade in them	C Limited must measure the bond at fair value through P&L

ANSWER 03

ITEMS	ANSWER
FINANCIAL ASSETS	
Investments held for trading purposes.	FVTPL
Investment in interest bearing debt instruments. The instrument is redeemable in five years. The intention is to collect cash flows (which are interest and principal amounts only)	Amortised cost
Investment in interest bearing debt instruments. The instrument is redeemable in five years. The intention is to collect cash flows (which are interest and principal amounts only). However, the entity may sell the loan notes earlier if any good offer is received.	FVTOCI
A trade receivable	Amortised cost
Derivatives held for speculation purpose	FVTPL
Investment in equity shares. The entity has no intention of selling these shares in foreseeable future.	FVTOCI
Investment in loan notes. The objective is to collect contractual cash flows which consist of interest, changes in oil prices in next five years and principal amount at the end of year 5.	FVTPL
Investment in loan notes. The objective is to collect contractual cash flows which consist of interest, changes in oil prices in next five years and principal amount at the end of year 5. However, the entity may sell the loan notes earlier if any good offer is received.	FVTPL
Investment in convertible debentures	FVTPL

FINANCIAL LIABILITIES	
A 12% bank loan obtained by A Limited payable in 5 years time.	Amortised cost
8% loan notes issued by C Limited	Amortised cost
A short term currency swaps agreement entered into by B4-Bank Limited which is currently unfavourable. These types of transactions are usual feature of B4-Bank Limited's business.	FVTPL
Trade payable	Amortised cost

ANSWER 04

Year	Opening balance Rs.	Effective interest 10%	Payments 0% Rs.	Closing balance Rs.
		[profit or loss]	**[cash flows]**	**[SFP]**
1	10,000	1,000	0	11,000
2	11,000	1,100	(10,000 + 2,100)	0

ANSWER 05

Year	Opening balance Rs.	Effective interest 10%	Payments 2% Rs.	Closing balance Rs.
		[profit or loss]	**[cash flows]**	**[SFP]**
1	10,000	1,000	(200)	10,800
2	10,800	1,080	(200+10,000+1,680)	0

ANSWER 06

Initial recognition of liability – net proceeds	**Rs.**
Par value	50,000
Less: Discount 16%	(8,000)
Less: Issue costs	(2,000)
	40,000

Year	Opening balance Rs.	Effective interest 12%	Payments 5% Rs.	Closing balance Rs.
		[profit or loss]	**[cash flows]**	**[SFP]**
2011	40,000	4,800	(2,500)	42,300
2012	42,300	5,076	(2,500)	44,876
2013	44,876	5,385	(2,500)	47,761
2014	47,761	5,731	(2,500)	50,992
2015	50,992	6,119	(2,500+50,000+4,611)	-

ANSWER 07

1 January 20X6

Debit	Financial Asset	Rs. 30,300
Credit	Bank	Rs. 30,300

31 December 20X6

Debit	Financial Asset	Rs. 9,700
Credit	Gain (OCI)	Rs. 9,700

11 December 20X7

Debit	Bank	Rs. 50,000
Credit	Financial Asset	Rs. 40,000
Credit	Profit or loss (gain)	Rs. 10,000

ANSWER 08

Classification	FVTPL	FVTOCI
Date		
01.01.11	Dr. Investment 100 Cr. Cash 100	Dr. Investment 102 Cr. Cash 102
01.01.11	Dr. PL 2 Cr. Cash 2	
25.04.11	Dr. Cash 3 Cr. Dividend income 3	Dr. Cash 3 Cr. Dividend income 3
30.06.11	Dr. Investment 20 Cr. PL 20	Dr. Investment 18 Cr. OCI 18
31.08.11	Dr. Cash 150 Cr. Investment 120 Cr. PL 30	Dr. Cash 150 Cr. Investment 120 Cr. PL 30

ANSWER 09

Kangaroo Limited
Statement of Financial Position
As on 31 December 2017

Assets	**Rs. in million**
Investments (105 + 130) **W1**	235.00

Statement of comprehensive income
For the year ended 31 December 2017

Profit and Loss account	**Rs. in million**
Transaction cost – Investment – A	(2.00)
Dividend income (12 + 9)	21.00
Gain on disposal of investment – A [(23 × 0.98 – (100 × 20%)]	2.54
Gain on disposal of investment – B [(50 × 0.98 – (153 × 0.3)]	3.10
Gain due to increase in fair value – Investment – A **W1**	25.00

Other comprehensive income

Gain due to increase in fair value – Investment – B **W1**	22.90

W1: Investments

	A	B
	--------- Rs. in million -------	
Purchase price	100.00	150.00
Transaction cost		3.00
Total cost	100.00	153.00
Cost of shares 31 Dec 2017 (100 × 80%) ; (153 × 70%)	80.00	107.10
Fair value - 31 Dec 2017	105.00	130.00
Gain	25.00	22.90

ANSWER 10

Part (a)

FV 95,000 + 2,000 Transaction costs

Year	Opening balance Rs.	Effective interest 8%	Payments 5% Rs.	Closing balance Rs.
		[profit or loss]	**[cash flows]**	**[SFP]**
20X1	97,000	7,760	(5,000)	99,760
20X2	99,760	7,981	(5,000)	102,741
20X3	102,741	8,219	(5,000 + 100,000 + 5,960)	0

Part (b)

FV 95,000 + 2,000 Transaction costs

Year	Opening balance	Effective interest 8%	Payments 5% Rs.	Total Rs.	Gain (loss)	Fair value
	Rs.	**[PL]**	**[cash flows]**		**OCI**	**SFP**
20X1	97,000	7,760	(5,000)	99,760	10,240	110,000
20X2	110,000	7,981	(5,000)	112,981	(8,981)	104,000
20X3	104,000	8,219	(5,000 + 100,000 + 5,960)	1,259	(1,259)	0

Part (c)

- Investment to be recorded at FV Rs. 95,000
- Transaction costs expense of Rs. 2,000
- Interest income of Rs. 5,000 at year end
- Gain of Rs. 15,000 on first year end (Change in fair value)
- Disposal leading to derecognition, a loss of Rs. 2,000 in profit or loss.

ANSWER 11

Part (a)

Gypsum Limited

General Journal (at amortised cost)

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
1-Jul-18	Investment in debentures	500,000	
	Bank		500,000
1-Jul-18	Investment in debentures	24,000	
	Bank		24,000
30-Jun-19	Investment in debentures	49,780	
	Interest income (PL) 524,000 x 9.5%		49,780
30-Jun-19	Bank (500,000 x 11%)	55,000	
	Investment in debentures		55,000

Part (b)
Gypsum Limited
General Journal (at FVTPL)

Date	Particulars	Dr. (Rs.)	Cr. (Rs.)
1-Jul-18	Investment in debentures	500,000	
	Bank		500,000
1-Jul-18	Transaction costs (PL)	24,000	
	Bank		24,000
30-Jun-19	Bank (500,000 x 11%)	55,000	
	Interest income (PL)		55,000
30-Jun-19	Loss on FV change (PL) [500,000 – (5,000 x 96)]	20,000	
	Investment in debentures		20,000

ANSWER 12

Capital Reserves and Liabilities

	Share Capital	Share Premium	Retained Earnings	Liability
	Rs.	**Rs.**	**Rs.**	**Rs.**
As given	1,000,000	200,000	5,670,300	
Preference dividend incorrectly charged **W1**			8,000	
Corrected balance			5,678,300	
Issue of preference shares **W1**				164,751
Profit for the year **W2**			493,512	
Issue of shares 31 March	300,000	90,000		
Transaction costs		(20,000)		
Issue of bonus shares (1 for 4)	325,000	(270,000)	(55,000)	
	1,625,000	0	6,116,812	164,751

W1 Redeemable preference shares	**Rs.**
At inception ((100,000 × Rs. 1.60) – 2,237))	157,763
Finance charge at 9.5%	14,988
Interest paid at 8%	(8,000)
Liability at end of year	164,751

W2 Profit for the year	**Rs.**
Original	508,500
Minus: Finance charges	(14,988)
	493,512

ANSWER 13

Part (a)

The face value of the debentures Rs. 100 X 20,000 = Rs. 2,000,000

The amount accrued to the company as proceeds = Rs. 97.5 X 20,000 = Rs. 1,950,000

Part (b)
The difference between the face value and the market value of the debentures is Rs. 50,000. This is as a result of discount allowed on the issue on the debentures. Discount on debentures attracts investors.

Part (c)
Nominal interest rate is the rate based specifically on the face value of the loan capital. In case of Passila Ltd., the nominal interest rate on the debentures is 8% per annum on Rs. 2,000,000.

The effective interest is the rate based on the fair value minus transaction costs. This is the actual value collected on issue which can be at par, discount or premium. For Passila Ltd., the effective interest rate will be 8% of Rs. 1,950,000

Part (d)
The nominal interest payable Rs. 2,000,000 X 8% X 6 months ÷ 12 months = Rs. 80,000

Part (e)

(i) The face value (after deducting discount and issue costs) i.e. amortised cost will be the most appropriate valuation to be disclosed in the Statement of financial position according to IFRSs. This is also the net proceeds from issue of debentures.

(ii) Disclosing the debentures' liability at face value plus interest payment for five years would be wrong being against the accrual concept. The interest should be recognized over five years.

(iii) Market value would be appropriate only if debentures liability is being held for trading, which is unlikely. However, additionally disclosing market value may be useful in decision making by investors.

ANSWER 14

Part (a)

	2019	**2018**
	Rs.	**Rs.**
Statement of profit or loss ➔ gain / (loss)	1,000	(5,000)
➔Interest (expense)	(7,200)	(7,200)
Other comprehensive income ➔ gain / (loss) [85,000 – 87,000]	5,000	(3,000)
Statement of financial position ➔ Financial liabilities	82,000	88,000

Date	**2019**	**2018**
01 Jan		Dr. Cash 80,000 Cr. FL 80,000
31 Dec	Dr. Interest expense 7,200 Cr. Cash 7,200	Dr. Interest expense 7,200 Cr. Cash 7,200
31 Dec	Dr. FL 6,000 Cr. PL 1,000 Cr. OCI 5,000	Dr. PL 5,000 Dr. OCI 3,000 Cr. FL 8,000

ICAP OBJECTIVE BASED QUESTIONS

01. For a debt investment to be held under amortized cost, it must pass two tests. One of these is the contractual cash flow characteristics test.

What is the other test which must be passed?

- **(a)** The purchase agreement test
- **(b)** The amortized cost test
- **(c)** The business model test
- **(d)** The fair value test

02. What is the default classification for an equity investment?

- **(a)** Fair value through profit or loss
- **(b)** Fair value through other comprehensive income
- **(c)** Amortized cost
- **(d)** Net proceeds

03. Diamond Limited purchased 10,000 shares on 1 September 2014, making the election to use the alternative treatment under IFRS 9. The shares cost Rs. 35 each. Transaction costs associated with the purchase were Rs. 5,000.

At 31 December 2014, the shares are trading at Rs. 45 each.

What is the gain to be recognized on these shares for the year ended 31 December 2014?

- **(a)** Rs. 100,000
- **(b)** Rs. 450,000
- **(c)** Rs. 95,000
- **(d)** Rs. 350,000

04. Copper Limited has purchased an investment of 15,000 shares on 1 August 2016 at a cost of Rs. 65 each. Copper Limited intend to sell these shares in the short term and are holding them for trading purposes. Transaction costs on the purchase amounted to Rs. 15,000.

As at the year-end 30 September 2016, these shares are now worth Rs. 77.5 each.

What is the gain on this investment during the year ended 30 September 2016, and where in the Financial Statements will it be recognized?

- **(a)** Rs. 187,500 in Other Comprehensive Income
- **(b)** Rs. 187,500 in Profit or Loss
- **(c)** Rs. 172,500 in Other Comprehensive Income
- **(d)** Rs. 172,500 in Profit or Loss

05. For which category of financial instruments are transaction costs excluded from the initial value, and instead expensed to profit or loss?

- **(a)** Financial Liabilities at amortized cost
- **(b)** Financial Assets at fair value through profit or loss
- **(c)** Financial Assets at fair value through other comprehensive income
- **(d)** Financial Assets at amortized cost

06. If a company had incurred transaction costs in issuing debentures, how should these have been accounted for?

- **(a)** Added to the proceeds of the debentures
- **(b)** Deducted from the proceeds of the debentures
- **(c)** Amortized over the life of the debentures
- **(d)** Charged to finance costs

07. Sodium Limited (SL) purchased a debt instrument which will mature in five years' time. SL intends to hold the debt instrument to maturity to collect interest payments. How should this debt instrument be measured in the financial statements of SL?

- **(a)** As a financial liability at fair value through profit or loss
- **(b)** As a financial liability at amortized cost
- **(c)** As a financial asset at fair value through profit or loss
- **(d)** As a financial asset at amortized cost

08. A 5% debenture was issued on 1 April 2010 at total face value of Rs. 20 million. Direct costs of the issue were Rs. 500,000. The debenture will be redeemed on 31 March 2013 at a substantial premium. The effective interest rate applicable is 10% per annum.

At what amount will the debenture appear in the statement of financial position as at 31 March 2012?

- **(a)** Rs. 21,000,000
- **(b)** Rs. 20,450,000
- **(c)** Rs. 22,100,000
- **(d)** Rs. 21,495,000

09. How does IFRS 9 *Financial Instruments* require investments in equity instruments to be measured and accounted for (in the absence of any election at initial recognition)?

- **(a)** Fair value with changes going through profit or loss
- **(b)** Fair value with changes going through other comprehensive income
- **(c)** Amortized cost with changes going through profit or loss
- **(d)** Amortized cost with changes going through other comprehensive income

10. On 1 January 2011 Oxygen Limited purchased a debt instrument for its fair value of Rs. 500,000. It had a principal amount of Rs. 550,000 and was due to mature in five years. The debt instrument carries fixed interest of 6% paid annually in arrears and has an effective interest rate of 8%. It is held at amortized cost. At what amount will the debt instrument be shown in the statement of financial position of Oxygen Limited as at 31 December 2012?

- **(a)** Rs. 514,560
- **(b)** Rs. 566,000
- **(c)** Rs. 564,560
- **(d)** Rs. 520,800

11. Which of the following are **not** classified as financial instruments under IAS 32?

(a) Share options

(b) Intangible assets

(c) Trade receivables

(d) Redeemable preference shares

12. In order to hold a debt instrument at amortized cost, which TWO of the following tests must be applied?

(a) Fair value test

(b) Contractual cash flow characteristics test

(c) Investment appraisal test

(d) Business model test

13. Nickel Limited is uncertain of how to treat professional fees. For which of the following investments should professional fees NOT be capitalized as part of initial value of the asset?

(a) Acquisition of a patent

(b) Acquisition of investment property

(c) Acquisition of fair value through other comprehensive income investments

(d) Acquisition of fair value through profit or loss investments

14. Iron Limited has 5% Rs. 30 million redeemable preference shares in issue which will be redeemed in 5 years' time.

How should the preference share capital and preference dividend be presented in the financial statements of Iron Limited?

(a) Preference share capital as equity and preference dividend in the statement of changes in equity

(b) Preference share capital as equity and preference dividend in the statement of profit or loss

(c) Preference share capital as a liability and preference dividend in the statement of changes in equity

(d) Preference share capital as a liability and preference dividend in the statement of profit or loss

15. Mercury Limited purchased 1 million shares in Jupiter Limited, a listed company, for Rs. 40 million on 1 January 2017. By the year end, 31 December 2017, the fair value of a Jupiter Limited's share had moved to Rs. 48. If Mercury Limited were to dispose of the shares, broker fees of Rs. 500,000 would be incurred.

What is the correct treatment for shares at year end?

(a) Hold shares in investments at Rs.47.5 million, with Rs. 7.5 million gain being taken to the statement of profit or loss

(b) Hold shares in investments at Rs. 48 million, with Rs. 8 million gain being taken to the statement of profit or loss

(c) Hold shares in investments at Rs. 48 million, with Rs. 8 million gain shown in the statement of changes in equity

(d) Hold shares in investments at Rs. 48 million, with Rs. 7.5 million gain shown in the statement of changes in equity

16. Gold Limited's draft statement of financial position as at 31 March 2018 shows financial assets at fair value through profit or loss with a carrying amount of Rs. 12.5 million as at 1 April 2017.These financial assets are held in a fund whose value changes directly in proportion to a specified market index. At 1 April 2017 the relevant index was 1,200 and at 31 March 2018 it was 1,296. What amount of gain or loss should be recognized at 31 March 2018 in respect of these assets?

Rs. ___________

17. On 1 January 2018 Silver Limited purchased 40,000 Rs. 10 listed equity shares at a price of Rs. 30 per share. An irrevocable election was made to recognize the shares at fair value through other comprehensive income.

Transaction costs were Rs. 30,000. At the year end of 31 December 2018, the shares were trading at Rs. 60 per share.

What amount in respect of these shares will be shown under 'investments in equity instruments' in the statement of financial position as at 31 December 2018?

Rs. ___________

18. An entity acquires a 6% Rs. 1,000 Term Finance Certificate (TFC), a financial asset, for Rs. 970 at the beginning of Year 1. Interest is receivable annually in arrears.

The TFC is redeemable at the end of Year 3 at a premium of 3%. The financial asset is measured at amortized cost. The effective interest rate of the financial instrument has been calculated at 8.1%.

Calculate the closing statement of financial position figure at the end of Year 2. Work to the nearest Rupee.

Rs. ___________

19. Wasim Limited issued Rs. 10 million 5% debentures on 1 January 2019, incurring issue costs of Rs.400, 000. The debentures are redeemable at a premium, giving them an effective interest rate of 8%.

What expense should be recorded in relation to the debentures for the year ended 31 December 2019?

Rs. ___________

20. Platinum Limited issues Rs.100 million 5% debentures on 1 January 2014, incurring issue costs of Rs.3 million.

These debentures are redeemable at a premium, meaning that the effective rate of interest is 8% per annum.

What is the finance cost to be shown in the statement of profit or loss for the year ended 31 December 2015?

Rs. ___________ million (rounded to two decimal points)

OBJECTIVE BASED ANSWERS

01.	**(c)**	The business model test must also be passed, which means that the objective is to hold the instrument to collect the cash flows rather than to sell the asset. The others are irrelevant.
02.	**(a)**	The default position for equity investments is fair value through profit or loss, meaning the investment is revalued each year end, with the gain or loss being taken to the statement of profit or loss.
03.	**(c)**	The investment should be classified as Fair Value through other comprehensive income. As such, they will initially be valued inclusive of transaction costs. Therefore, the initial value is 10,000 × Rs. 35 = Rs. 350,000 + Rs. 5,000 = Rs. 355,000. At year-end, these will be revalued to fair value of Rs. 45 each, therefore 10,000 x Rs. 45 = Rs. 450,000. The gain is therefore Rs. 450,000 – Rs. 355,000 = Rs. 95,000.
04.	**(b)**	Financial Assets held for trading will be valued at Fair Value through Profit or Loss. These are therefore valued excluding any transaction costs (which will be expensed to profit or loss). The initial value of the investment is therefore 15,000 × Rs. 65 = Rs. 975,000 The shares will be revalued to fair value as at year end, and the gain will be taken to profit or loss. The year-end value of the shares is 15,000 × Rs. 77.5 = Rs. 1,162,500, giving a gain of Rs. 187,500. This is recognized within profit or loss.
05.	**(b)**	Transaction costs are included when measuring all financial assets and liabilities at amortized costs, and when valuing financial assets valued at fair value through other comprehensive income. Financial assets valued at fair value through profit or loss are expensed through the profit or loss account on initial valuation and not included in the initial value of the asset.
06.	**(b)**	Deducted from the proceeds of the debentures. The effective interest rate is then applied to the net amount.
07.	**(d)**	As a financial asset at amortized cost
08.	**(d)**	

	Rs. '000
Proceeds (20m – 0.5m)	19,500
Interest 10%	1,950
Interest paid (20m × 5%)	(1,000)
Balance 30 March 2011	20,450
Interest 10%	2,045
Interest paid (20m × 5%)	(1,000)
Balance 30 March 2012	21,495

09.	**(a)**	Fair value with changes going through profit or loss. Fair value through OCI would be correct if an election had been made to recognize changes in value through other comprehensive income. Amortized cost is used for debt instruments, not equity instruments.
10.	**(a)**	**Rs.** 1 January 2011 — 500,000 Interest 8% — 40,000 Interest received (550,000 × 6%) — (33,000) 31 December 2011 — 507,000 Interest 8% — 40,560 Interest received — (33,000) 31 December 2012 — 514,560
11.	**(b)**	Intangible assets. These do not give rise to a present right to receive cash or other financial assets. The other options are financial instruments
12.	**(b) & (d)**	The other options are irrelevant.
13.	**(d)**	Transactions costs including professional fees are expensed in case of investments classified as fair value through profit or loss
14.	**(d)**	Redeemable preference shares will be shown as a liability, with the payments being shown as finance costs.
15.	**(b)**	The default category for equity investments is fair value through profit or loss so the investments should be revalued to fair value (not fair value less costs to sell), with the gain or loss taken to the statement of profit or loss.
16.	**Rs. 1,000,000 gain**	**Rs. '000** Rs. 12,500 × 1,296 / 1,200 — 13,500 Carrying amount — (12,500) Gain — 1,000
17.	**Rs. 2,400,000**	40,000 shares @ Rs. 60 = Rs. 2,400,000
18.	**Rs. 1,009**	**Rs.** 1 January Y1 — 970 Interest 8.1% — 79 Interest received (1,000 × 6%) — (60) 31 December y1 — 989 Interest 8.1% — 80 Interest received (1,000 × 6%) — (60) 31 December Y2 — 1,009

19.	**Rs. 768,000**	The initial liability should be recorded at the net proceeds of Rs. 9.6 million. The finance cost should then be accounted for using the effective rate of interest of 8%. Therefore, the finance cost for the year is Rs. **768,000** (Rs. 9.6 million × 8%).
20.	**Rs. 7.98 million**	Initial recognition Rs. 100 million – Rs. 3 million = Rs. 97 million **Rs. million** 1 January 2014: 97 Interest 8%: 7.76 Interest received (100 × 5%): (5) 31 December 2014: 99.76 Interest 8%: 7.98