**Financial instruments**

1. Which categories of financial instruments are basic ones?
2. cash.
3. fixed-term deposits.
4. commercial paper and commercial bills held.
5. collateralized mortgage obligations.
6. options, futures contracts, forward contracts.
7. trade receivables and payables.
8. bonds.
9. hedging instruments.
10. investments in non-convertible preference shares.
11. Which of the followings are financial instruments?
12. A bank advances an entity a five-year loan. The bank also provided the entity with an overdraft facility for a number of years.
13. An entity (the purchaser) buys goods from a supplier on 60 days’ credit.
14. In a lawsuit brought against an entity, a group of people are collectively seeking compensation for damages to their health as a result of contamination to the nearby land believed to be caused by waste from that entity’s production process. It is doubtful whether the entity is the source of the contamination since many entities operate in the same area producing similar waste and it is unclear who is the source of the contamination.
15. An entity has inventories, property plant and equipment, investment property, acquired patents and licences in its statement of financial position.
16. At the end of the reporting period an entity has an asset for the prepayment of three months of rent on its office building.
17. An entity sells goods to customers and provides a one-year guarantee to repair or replace any defective products.
18. An entity buys gold bullion as an investment.
19. At initial measurement basic financial instruments should be measured at:
20. transaction price including transaction costs unless the arrangement constitutes, in effect, a financing transaction.
21. fair value through profit or loss unless the arrangement constitutes, in effect, a financing transaction.
22. transaction price including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss unless the arrangement constitutes, in effect, a financing transaction.
23. transaction price including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss.
24. At initial measurement other financial instruments should be measured at:
25. fair value.
26. carrying amount.
27. historical cost.
28. transaction price.
29. At subsequent measurement basic financial instruments should be measured at:
30. initially recognized amount minus any repayments of the principal minus the cumulative amortization, and plus, in the case of a financial asset, any reduction for impairment or uncollectibility.
31. initially recognized amount minus any repayments of the principal minus the cumulative amortization, and minus, in the case of a financial asset, any reduction for impairment or uncollectibility.
32. initially recognized amount minus any repayments of the principal minus the cumulative amortization, and plus, in the case of a financial liability, any reduction for impairment or uncollectibility.

Example 1: Initial measurement, fin assets

An entity incurred CU10 broker transaction fees to buy 50 non-puttable ordinary shares for cash of CU500 in:

1. a listed company
2. an unlisted company

What is the recognized value of ordinary shares acquired in case of listed company and in case of unlisted company?

Example 2: Initial measurement, fin assets

An entity provides services to a customer and charges the customer CU200 with payment due within 60 days. Payment terms of 30–90 days are normal in the industry.

What is the recognized value of the receivable?

Example 3: Initial measurement, fin assets

An entity deposits CU20,000 into a 120-day notice deposit account with a bank. The entity will receive fixed interest at 1.644 % for the 120-day period (i.e. equivalent to 5 per cent per year ignoring compounding), payable at the end of the deposit period. The market rate for this type of deposit with the bank is 1.644 % per 120-day period.

What is the recognized value of the deposit?

Example 4: Initial measurement, fin liabilities

An entity buys goods from a manufacturer for CU400 with 120 days’ interest-free credit, the normal business terms in the industry.

What is the recognized value of the payable?

Example 5: Initial measurement, fin liabilities

An entity utilizes CU1,500 of an interest-free overdraft facility it has with a bank to pay an amount outstanding to a supplier. The overdraft is repayable on demand. The bank has not indicated that it will request repayment in the near future. The entity does not expect to pay off the amount during the year.

What is the recognized value of the loan?

Example 6: Initial measurement, fin liabilities

A bank provides an entity with a four-year loan of CU5,000 on normal market terms, including charging interest at

1. a fixed rate of 8 % per year. Interest is payable at the end of each year. The figure of 8 % is considered the market rate for similar four-year fixed-interest loans with interest paid annually in arrears.
2. a variable rate of LIBOR plus 250 basis points, with interest payments receivable annually in arrears.

What is the recognized value of the loan charged at a fixed rate and at a variable rate?

Example 7: Subsequent measurement, fin assets

An entity bought 50 non-puttable ordinary shares during the year for cash of CU500 and incurred broker transaction fees of CU10 in:

1. a listed company. At the year-end the shares are quoted at CU11 per share.
2. an unlisted company. The shares are not publicly traded and the fair value of the shares cannot otherwise be measured reliably.

What is the recognized and subsequently measured value of ordinary shares acquired in case of listed company and in case of unlisted company?

Example 8: Subsequent measurement, fin liabilities

An entity buys goods from a manufacturer for CU400 on 1 November 20X2 with 120 days’ interest-free credit, which are normal business terms in the industry. At the entity’s financial year-end (31 December 20X2) it has not yet paid the manufacturer.

What is the recognized and subsequently measured value of the payable?

Example 9: Subsequent measurement, fin liabilities

An entity has an interest-free overdraft facility with a bank. The overdraft is repayable on demand by the bank. However, the bank has not indicated that it will request repayment in the near future. At the entity’s financial year-end CU2,000 is outstanding on the overdraft. The entity does not expect to pay off the amount during the year.

What is the recognized and subsequently measured value of the loan?

Example 10: Subsequent measurement, fin liabilities (amortized cost)

A bank provides an entity with a five-year loan for CU1,000. The first two years of the loan are interest-free. After that, interest is payable monthly in arrears at the variable quoted market interest rate in the jurisdiction as quoted at the start of each month. The entity is charged an upfront fee of CU70 for the interest-free period.

The estimated annual effective interest rate is 3.695%. What is the recognized and subsequently measured value of the loan?

Example 11: Subsequent measurement, fin assets (amortized cost)

On 1 January 20X0, an entity acquires a bond for CU900, incurring transaction costs of CU50. Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0-31 December 20X4). The bond has a mandatory redemption of CU1,100 on 31 December 20X4.

The estimated annual effective interest rate is 6.9583%. What is the recognized and subsequently measured value of the bond acquired?

Example 12: Impairment loss measurement

At the end of a financial reporting period an entity has an outstanding balance of CU1,000 due from a customer. This balance was not discounted as the transaction took place on normal business terms (short-term credit) with no hidden financing transaction.

1. Because of financial difficulties being experienced by the customer, the entity does not expect the customer to repay any of the CU1,000.
2. The entity has given the customer extra time to pay off the debt. The entity expects the customer will be able to pay about one year after the reporting date.

What is the recognized amount of the impairment loss in both cases?

Example 13: Impairment of fin instruments, reversal

The facts are the same as in previous example, however, in this example, after the prior year financial statements were authorized for issue the entity received CU200 from the customer. The entity does not expect to receive the remaining CU800.

What is the recognized amount of the impairment loss reversal?

Example 14: Valuation techniques

Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of CU10.

1. Entity XYZ's after-tax maintainable profits are estimated at CU70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A’s management estimates that the discount for the lack of marketability of company XYZ’s shares and restrictions on their transfer is 20 per cent. Entity A values its holding of company XYZ shares on the basis of earnings.
2. An entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ’s net asset including those recognized in its statement of financial position and those that are not recognized is CU850,000.

What is the recognized value of the entity A’s investment in company XYZ’s shares in both cases?

Equity and liabilities

1. Equity includes:
2. investments by the owners of the entity plus additions to those investments earned through profitable operations and retained for use in the entity’s operations, minus reductions to owners’ investments as a result of unprofitable operations and distributions to owners.
3. investments by the owners of the entity minus additions to those investments earned through profitable operations and retained for use in the entity’s operations, plus reductions to owners’ investments as a result of unprofitable operations and distributions to owners.
4. investments by the owners of the entity minus additions to those investments earned through profitable operations and retained for use in the entity’s operations, minus reductions to owners’ investments as a result of unprofitable operations and distributions to owners.
5. Which financial instruments are recognized as equity:
6. a financial instrument entitling the holder to a pro rata share of the entity’s net assets in the event of the entity’s liquidation.
7. a financial instrument which is subordinate to all other classes of instruments.
8. a financial instrument entitling the holder to a pro rata share of the entity’s net assets in the event of the entity’s liquidation, however these payments are subject to a maximum amount.
9. a financial instrument entitling the holder to a pro rata share of the entity’s net assets in the event of the entity’s liquidation, and these payments are required to be provided before liquidation (e.g. a mandatory dividend).
10. Ordinary shares issued shall be measured at:
11. at carrying amount of the cash or other resources received or receivable, excluding direct costs of issuing the equity instruments.
12. at carrying amount of the cash or other resources received or receivable, including direct costs of issuing the equity instruments.
13. at fair value of the cash or other resources received or receivable, excluding direct costs of issuing the equity instruments.
14. at fair value of the cash or other resources received or receivable, including direct costs of issuing the equity instruments.
15. Option issued shall be accounted for:
16. as for original issue of ordinary shares and other equity instruments.
17. as for original issue of bonds and other debt instruments.
18. as for original issue of forwards and other derivatives.
19. While accounting for treasury share reaquirement an entity shall:
20. include into equity the fair value of the consideration given for the treasury shares.
21. deduct from equity the present value of the consideration given for the treasury shares.
22. deduct from equity the fair value of the consideration given for the treasury shares.

Example 1: issue of shares

SME A has issued share capital of CU100,000, which was contributed at par value of CU1 per share on incorporation of SME A.

1. At a later date SME A issued further 50,000 ordinary shares at par value CU1 per share and sold them at a price of CU5 per share. The shares are issued for cash.
2. At a later date SME A issued further 50,000 ordinary shares at par value CU1 per share and intended to sell them at a price of CU5 per share. The issue was subscribed by investors in total amount but cash for SME A was not delivered yet.
3. At a later date SME A intended to issue further 50,000 ordinary shares at par value CU1 per share and to sell them at a price of CU5 per share. The additional 50,000 ordinary shares have been subscribed for and paid for, but are yet to be issued. SME A does not have any obligation to refund the cash received.
4. At a later date SME A intended to issue further 50,000 ordinary shares at par value CU1 per share and to sell them at a price of CU5 per share. The additional 50,000 ordinary shares have been subscribed for, but are yet to be issued and paid.

What is the accounting for issue of additional ordinary shares in every of the presented above cases? Compile extracts from the statement of financial position.

Example 2: issue of shares

On 1 January 20X1 SME B issues 150,000 ordinary shares in exchange for 1,000 ounces of gold. The par value of the shares is CU2 per share when gold was trading at CU800 per ounce.

What is the accounting for issue of ordinary shares? Compile extract from the statement of financial position.

Example 3: issue of shares

SME A issues 200,000 ordinary shares at CU1.25 per share. The par value of the ordinary shares of the entity is CU1 per share. The shares are issued for cash and CU1,000 share issue costs are incurred.

What is the accounting for issue of ordinary shares?

Example 4: issue of shares, sales of options

At 31 December 20X0 as a year-end SME A has ordinary share capital of CU100,000, which was contributed at par on incorporation of SME A. The par value of the shares of the entity is CU1 per share.

On 1 January 20X1 the entity issues a further 150,000 ordinary shares at CU5 per share. The shares are issued for cash.

Also on 1 January 20X1, as an incentive to encourage investment, each shareholder is permitted to buy one share option for every share purchased on 1 January 20X1 at CU0.5 per option. Each option allows the holder to buy one share on 31 January 20X2 at CU4 per share. 100,000 share options are purchased.

On 31 January 20X2 100,000 share options are converted into ordinary shares. The commercial law to which the entity is subject requires to account for depletion of share option reserve as share premium.

What is the accounting for conversion of options into ordinary shares? Compile extract from the statement of financial position.

Example 5: treasury shares

On 31 December 20X0 SME A’s statement of financial position included the following:

|  |  |
| --- | --- |
| **Item** | **Value (CU)** |
| Share capital (10,000 ordinary shares at CU10 par value each) | 100,000 |
| Share premium | 500,000 |
| Retained earnings | 600,000 |
| **Total equity attributable to owners** | **1,200,000** |

On 1 January 20X1 SME A reacquires 4,000 shares in itself from its shareholders for cash consideration of CU75 per share.

What is the accounting for treasury shares? Compile extract from the statement of financial position.

Example 6: cash distributions to owners

In 20X1 SME A declares and pays a dividend of CU0.5 per share to the owners of SME A in respect of the year ended 31 December 20X1. SME A has 100,000 ordinary shares in issue.

What is the accounting for cash distributions to owners?

Example 7: non-cash distributions to owners

On 31 December 20X1 SME A declares and distributes to its owner (who owns 100 per cent of SME A) a tract of land (classified as property, plant and equipment) with a carrying amount of CU1,000 and a fair value of CU100,000.

What is the accounting for non-cash distributions to owners?

Example 8: change in a parent’s interest without loss of control

Since SME Z was formed it has been owned 75 per cent by SME A and 25 per cent by SME B. On 31 December 20X5, when the carrying amount of SME Z’s net assets was CU100,000, SME A reduced its holding in SME Z to 60 per cent by selling 15 per cent of SME Z’s shares to SME B for CU20,000.

What is the accounting for change in SME A’s interest in SME Z?