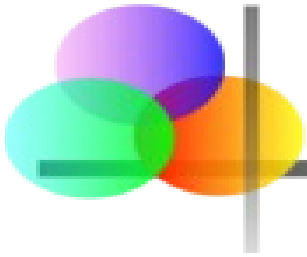
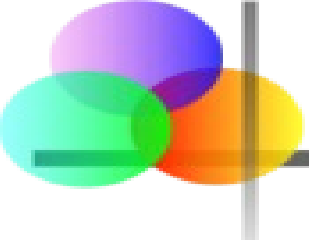


Financial Instrument (Long Term Debt and Investment)



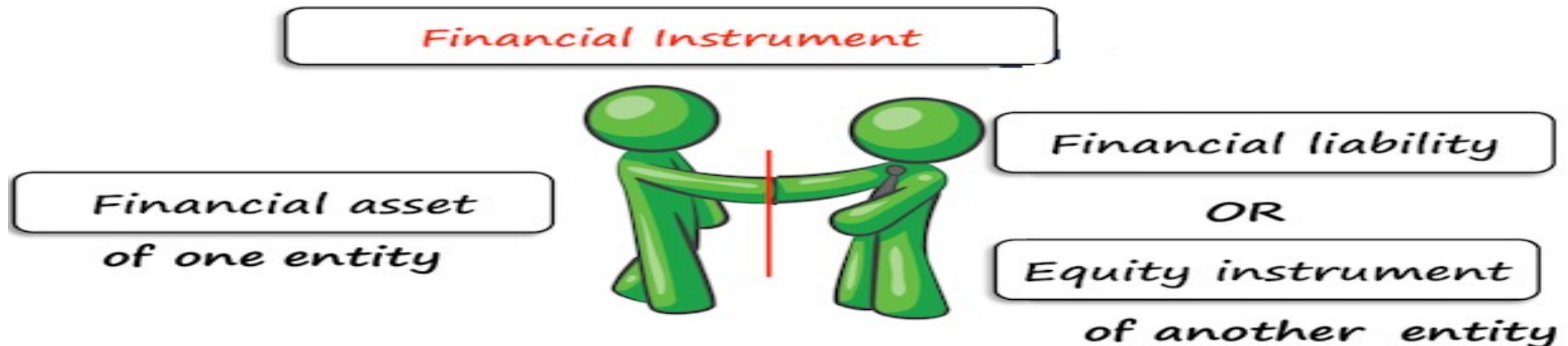


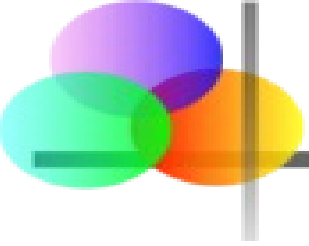
Basic Concepts and Terminologies

▪Financial instrument

➤Any **contract** that gives rise to:

- A financial asset of one entity; and
- A financial liability or equity instrument of another entity



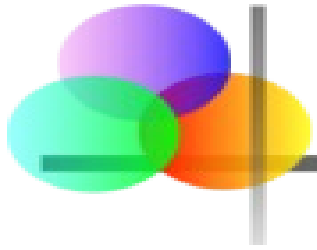


Basic Concepts and Terminologies

▪ Financial asset

- Cash
- A contractual right to receive cash or another financial asset
- A contractual right to exchange financial assets or liabilities with another entity on potentially favourable terms
- An equity instrument (e.g. Ordinary shares of another entity).
- Example: Cash, A/c Receivable, Notes Receivable, derivatives, investments





Basic Concepts and Terminologies

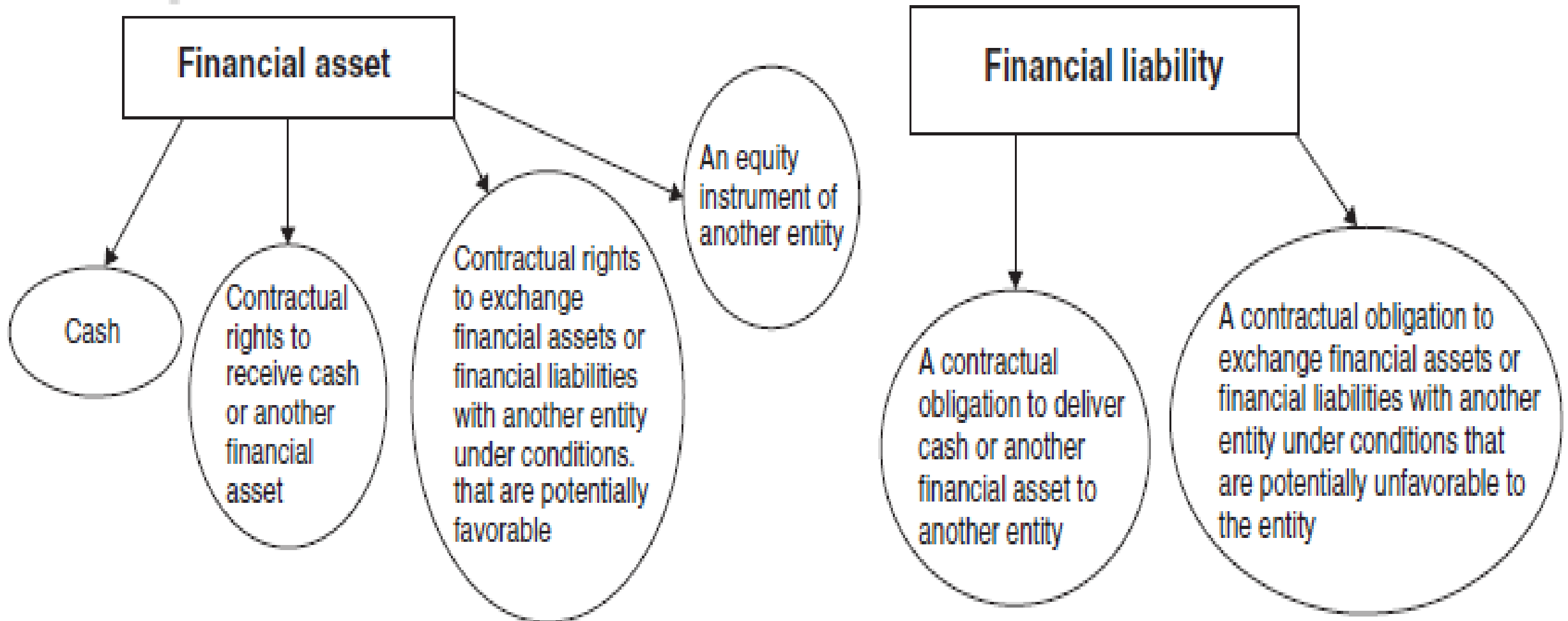
▪ **Financial liability**

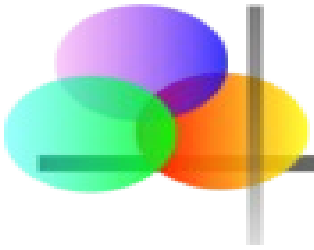
- A contractual obligation to deliver cash or another financial asset
- A contractual obligation to exchange financial assets or liabilities with another entity on potentially unfavourable terms.
- Example: a/c payable, notes payable, bank overdraft, loans payable, certain preference shares, derivatives

▪ **Equity instrument**

- A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
- Example: Ordinary shares, certain preference shares

BASIC CONCEPTS AND TERMINOLOGIES

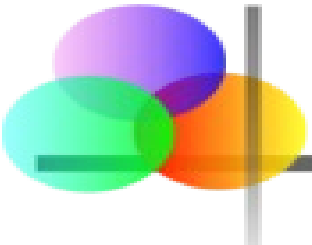




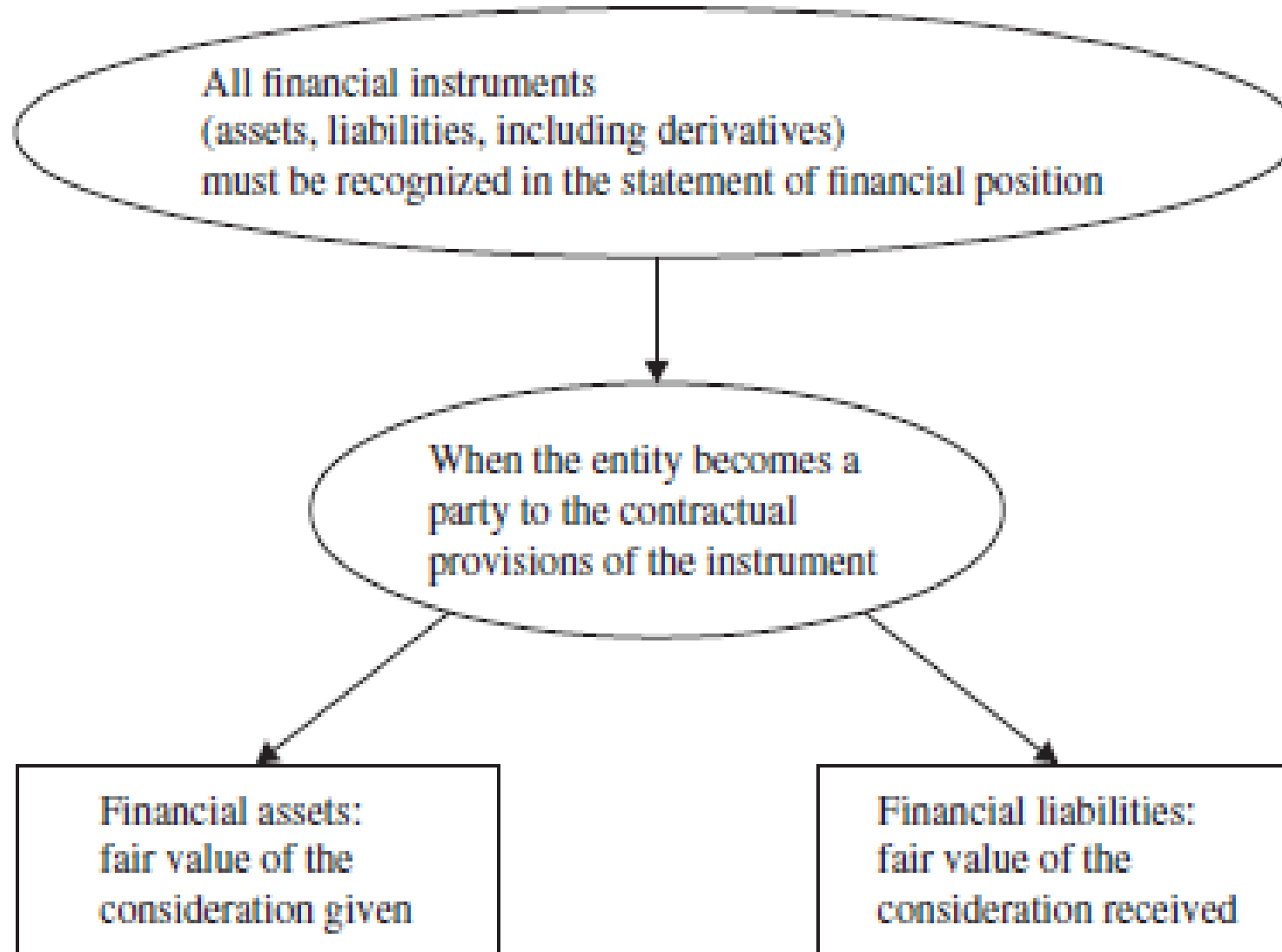
Initial Recognition

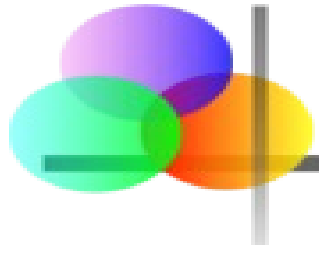
- An entity shall recognise a financial asset/liability in its statement of financial position [SOFP] when, and only when, the entity becomes party to the contractual provisions of the instrument as a consequence, has a legal right to receive/pay cash or another financial instrument.





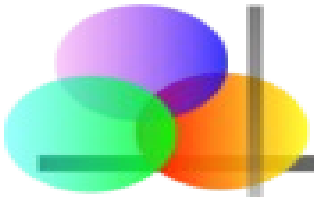
INITIAL RECOGNITION





Classification of Financial Assets

- The initial as well as subsequent measurement of financial assets is subject to their classification.
- Classification category
 1. Financial assets measured at FVTPL
 2. Financial assets measured at fair value through other comprehensive income (FVTOCI)
 - with gains and losses remaining in other comprehensive income (OCI) without subsequent reclassification to profit or loss.
 - with cumulative gains and losses reclassified to profit or loss upon derecognition.
 3. Financial assets measured at amortised cost



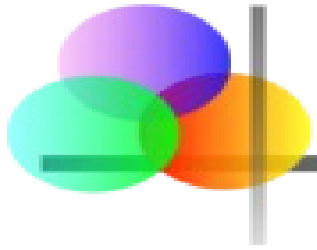
Classification/Measurement Bases of Financial Assets

Criteria	I. Business Model Test			
II. Cash Flows Test	Cash flows are solely payments of principal and interest (SPPI)	Hold to collect	Hold to collect and Sell	Other business model
		Amortised cost	FVOCI	FVTPL
	Other types of cash flows	FVTPL	FVTPL	FVTPL



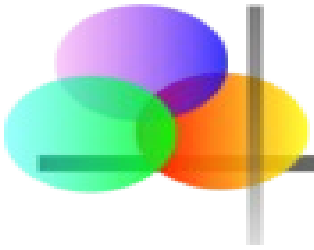
- Adjusted for
transaction
costs





Measurement at Initial Recognition

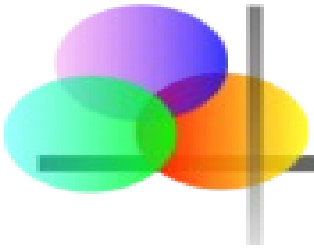
- **Initial recognition** = fair value + transaction costs
- Transaction costs include:
 - Fees and commissions
 - Levies by regulatory agencies and securities exchanges
 - taxes and duties
- Transaction costs do not include:
 - Debt premiums or discounts
 - Financing costs
 - Internal administrative costs



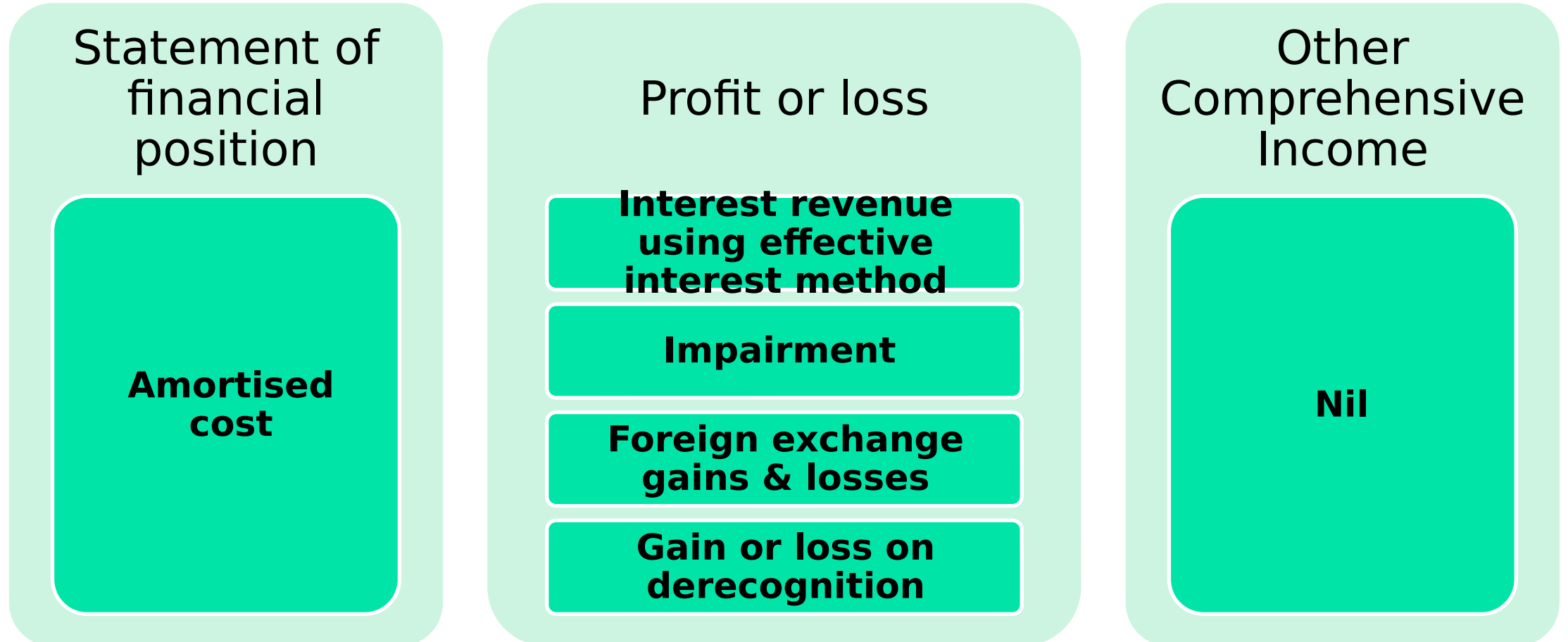
Initial Measurement

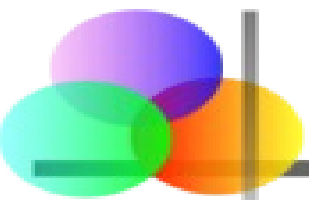
➤ Fair value versus transaction price

- Best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price.
- If fair value at initial recognition differs from transaction price recognise (day 1) the difference between the fair value at initial recognition and the transaction price as a gain or loss if fair value is evidenced by:
 - i. a quoted price in an active market for an identical asset or liability (i.e. Level 1); or
 - ii. based on valuation technique that uses **only** data from observable markets (i.e. some Level 2)



Subsequent Measurement of Financial Asset Amortised Cost (Debt Instruments)





Debt Instruments

Non-current liabilities (long-term debt) consist of an expected outflow of resources arising from present obligations that are not payable within a year or the operating cycle of the company,

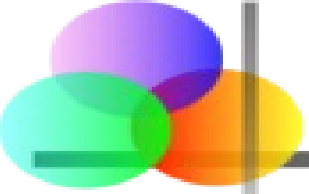
Examples:

whichever is longer.

- ▶ Bonds payable
- ▶ Long-term notes payable
- ▶ Mortgages payable

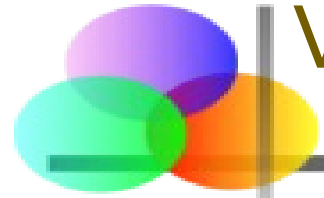
- ▶ Pension liabilities
- ▶ Lease liabilities

Long-term debt has various covenants or restrictions.



Issuing Bonds

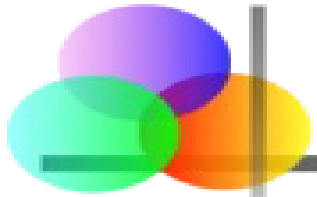
- ◆ Bond contract known as a **bond indenture**.
- ◆ Represents a promise to pay:
 - (1) sum of money at designated maturity date, plus
 - (2) periodic interest at a specified rate on the maturity amount (face value).
- ◆ Paper certificate, typically a €1,000 face value.
- ◆ Interest payments usually made semiannually.
- ◆ Used when the amount of capital needed is too large for one lender to supply.



Valuation of Bonds Payable @ Issuance

Issuance and marketing of bonds to the public:

- ◆ Usually takes weeks or months.
- ◆ Issuing company must
 - ▶ Arrange for underwriters.
 - ▶ Obtain regulatory approval of the bond issue, undergo audits, and issue a prospectus.
 - ▶ Have bond certificates printed.

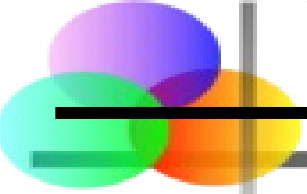


Valuation of Bonds Payable

Selling price of a bond issue is set by the

- ◆ supply and demand of buyers and sellers,
- ◆ relative risk,
- ◆ market conditions, and
- ◆ state of the economy.

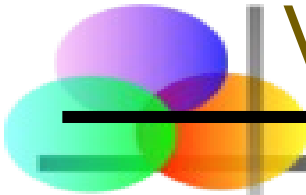
Investment community values a bond at the present value of its expected future cash flows, which consist of (1) interest and (2) principal.



Valuation of Bonds Payable

Interest Rate

- ◆ **Stated, coupon, or nominal rate** = Rate written in the terms of the bond indenture.
 - ▶ Bond issuer sets this rate.
 - ▶ Stated as a percentage of bond face value (par).
- ◆ **Market rate or effective yield** = Rate that provides an acceptable return commensurate with the issuer's risk.



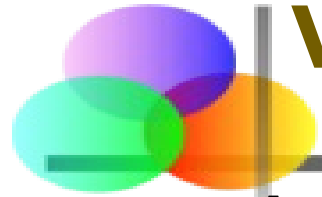
Valuation of Bonds Payable

How do you calculate the amount of interest that is actually paid to the bondholder each period?

(Stated rate x Face Value of the bond)

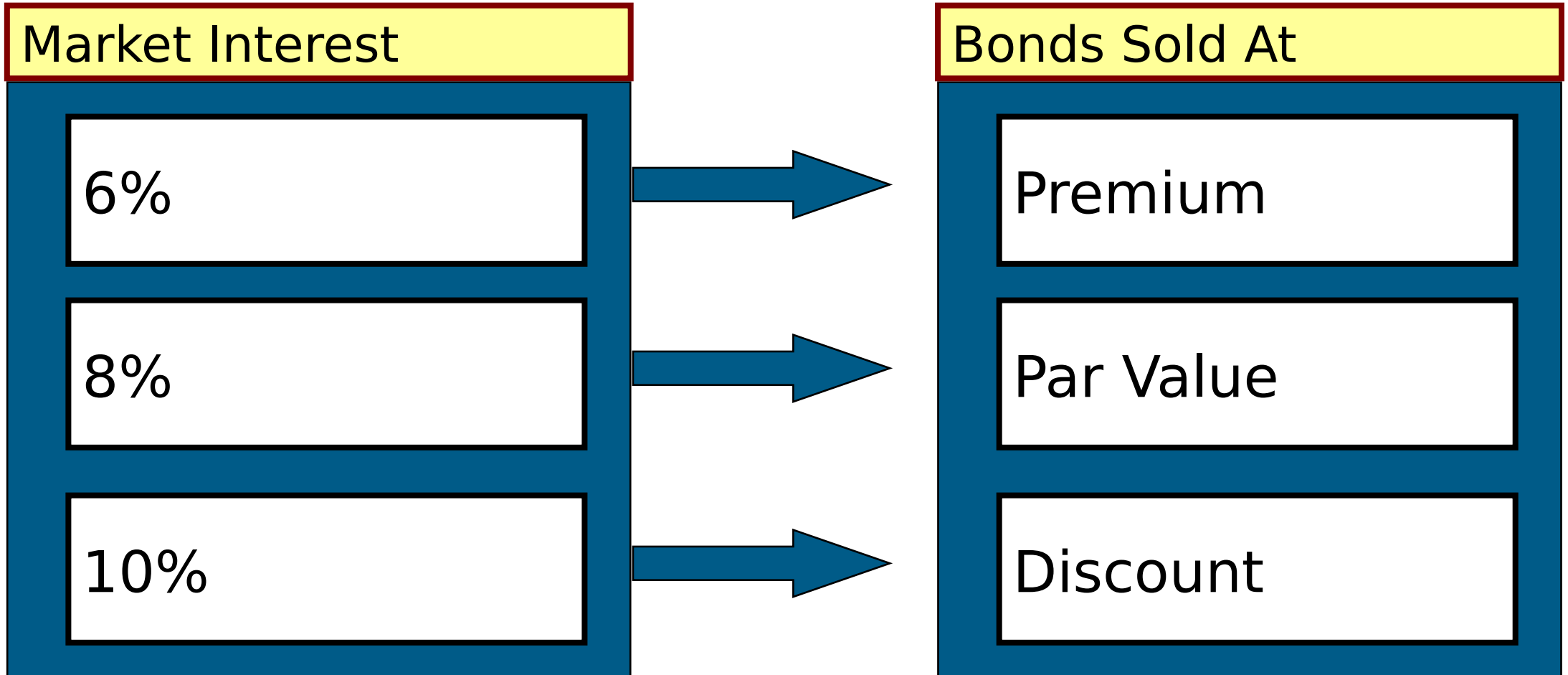
How do you calculate the amount of interest that is actually recorded as interest expense by the issuer of the bonds?

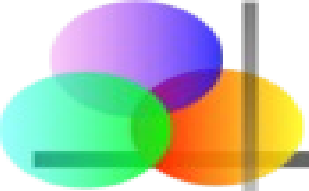
(Market rate x Carrying Value of the bond)



Valuation of Bonds Payable

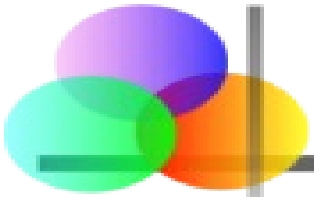
Assume Stated Rate of 8%



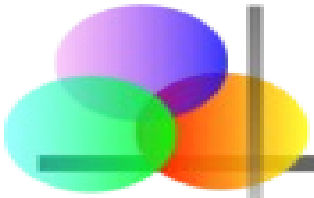


Types of Bonds

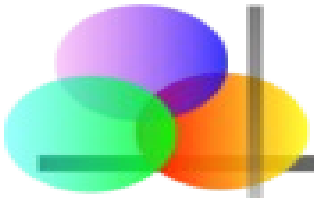
- *Debenture bonds.* Debenture bonds are bonds that are not secured by specific property. Their marketability is based on the general credit rating of the company. Generally, a company must have a long-period of earnings and continued favorable predictions of future earnings and liquidity to sell debenture bonds. Debenture bondholders are considered to be general creditors, with the same rights as other creditors if the issuer fails to pay the interest or principal and declares bankruptcy.
- *Mortgage Bonds.* Mortgage bonds are bonds that are secured by a lien against specific property of the company. If the company becomes bankrupt and is liquidated, the holders of these bonds have first claim against the proceeds of the sale of the assets that secured their debt. If the proceeds from the sale of pledged assets are not sufficient to repay the debt, mortgage bondholders become general creditors for the balance of the unpaid debt.



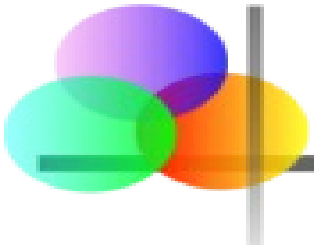
- *Registered Bonds.* Registered bonds are bonds whose ownership is registered with the company. That is, the company maintains a record of the holder of each bond. Therefore, on each interest payment date, interest is paid to the individuals listed on the corporate records as owners of the bonds. When an owner sells registered bonds, the issuer or transfer agent must be notified so that interest will be paid to the proper person.
- *Coupon Bonds.* Coupon bonds are unregistered bonds on which interest is claimed by the holder presenting a coupon to the company. These bonds can be transferred between individuals without the company or its agent being notified.



- *Zero-Coupon Bonds.* Zero-coupon bonds (also called *deep-discount bonds*) are bonds on which the interest is not paid until the maturity date. That is, the bonds are sold at a price considerably below their face value, interest accrues until maturity, and then the bondholders are paid the interest along with the principal at maturity.
- *Callable Bonds.* Callable bonds are bonds that are callable by the company at a predetermined price for a specified period. That is, the company has the right to require the bondholders to return the bonds before the maturity date, with the company paying the predetermined price and interest to date.



- *Convertible Bonds.* Convertible bonds are bonds that are convertible into a predetermined number of shares. That is, the owner of each bond has the right to exchange it for a predetermined number of shares of the company. Thus, upon conversion, the bondholder becomes a stockholder of the company.
- *Serial Bonds.* Serial bonds are bonds issued at one time, but portions of the total face value mature in periodic installments at different future dates. Bonds with several maturities.
- *Term Bonds.* Term bonds are bonds that pay the entire principal on one date, i.e. at the maturity date. Bonds with single maturity.
- *Income (Revenue) Bonds.* These are bonds whose payment of interest is conditional on income.



Subsequent Measurement of Financial Asset Fair Value Through OCI (FVOCI Debt Instruments)

Statement of
financial
position

Fair value

Profit or loss

**Interest revenue
using effective
interest method**

Impairment

**Foreign exchange
gains & losses**

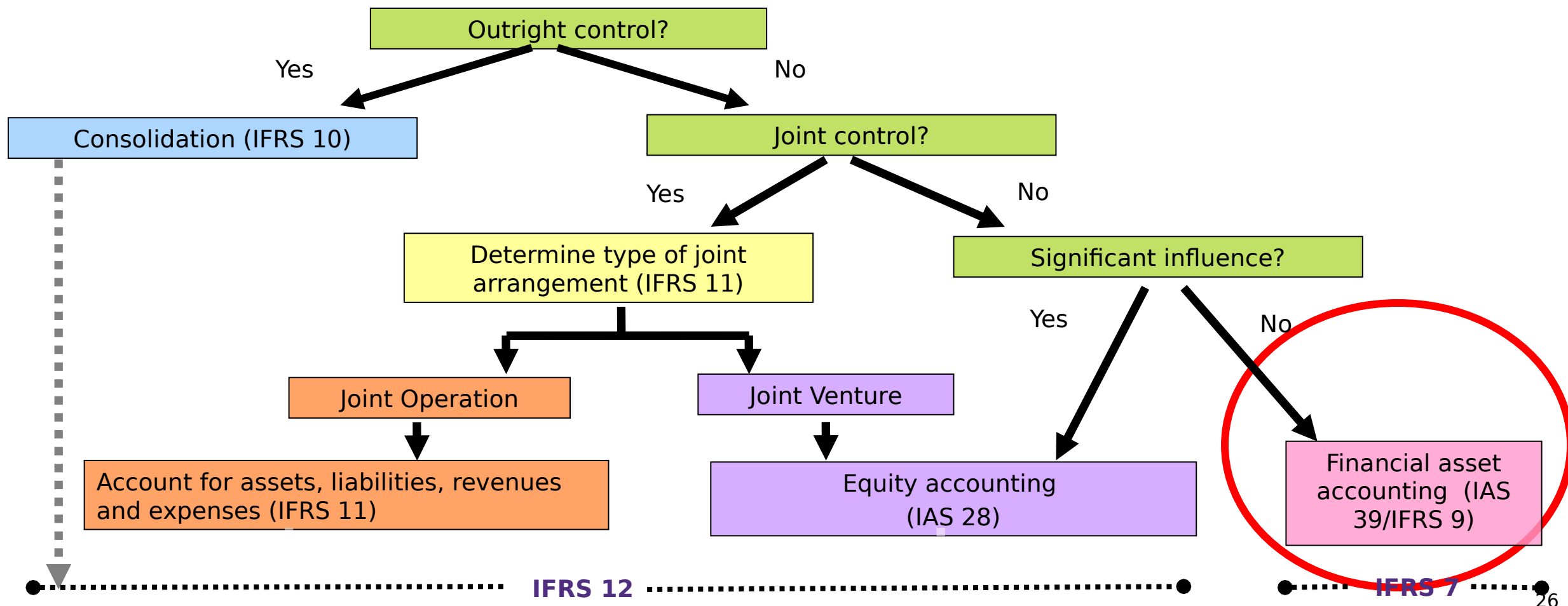
Other
Comprehensive
Income

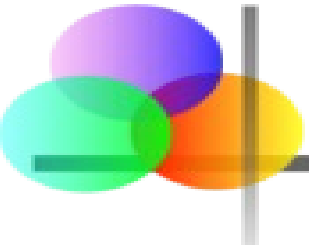
**Fair value change
other than those
recognised in profit
or loss**

**(amounts
accumulated are
recycled to P&L
upon
derecognition)**

Subsequent Measurement of Investments in Equity Instruments

Determining the accounting for interests in other entities (Interaction of IFRS 10, 11, 12 and IAS 28)





Subsequent Measurement of Investments in Equity Instruments

- Fair value through OCI (investments in equity instruments)

Statement of
financial
position

Fair value

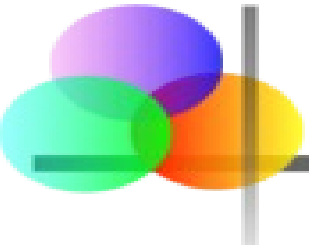
Profit or loss

Dividends

Other Comprehensive
Income

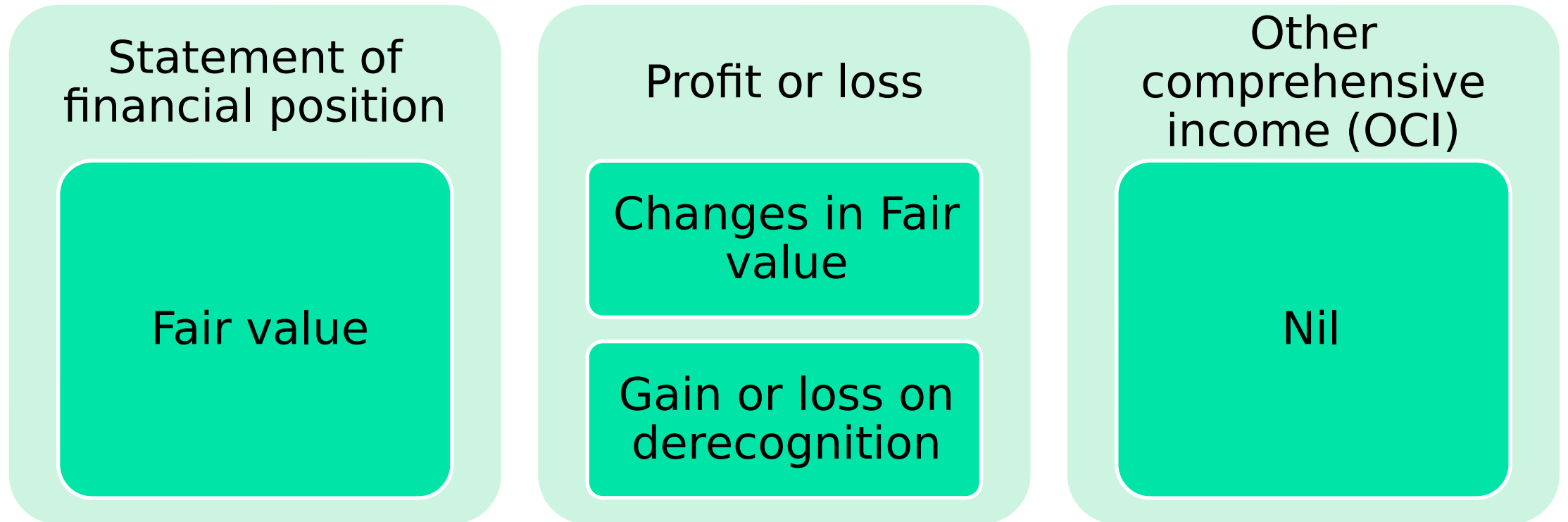
**Changes in fair value and
foreign exchange
component**

**(amounts accumulated
never recycled to P&L →
may be transferred within
equity)**



Subsequent Measurement of Investments in Equity Instruments

➤ Fair value through profit or loss





Derecognition of Financial Assets

- Removal of a previously recognized financial asset from an entity's statement of financial position.

▪ A financial asset is derecognized when and only when:

1. The contractual rights to the cash flows from the financial asset expire; or
2. The financial asset is transferred and the transfer qualifies for derecognition.

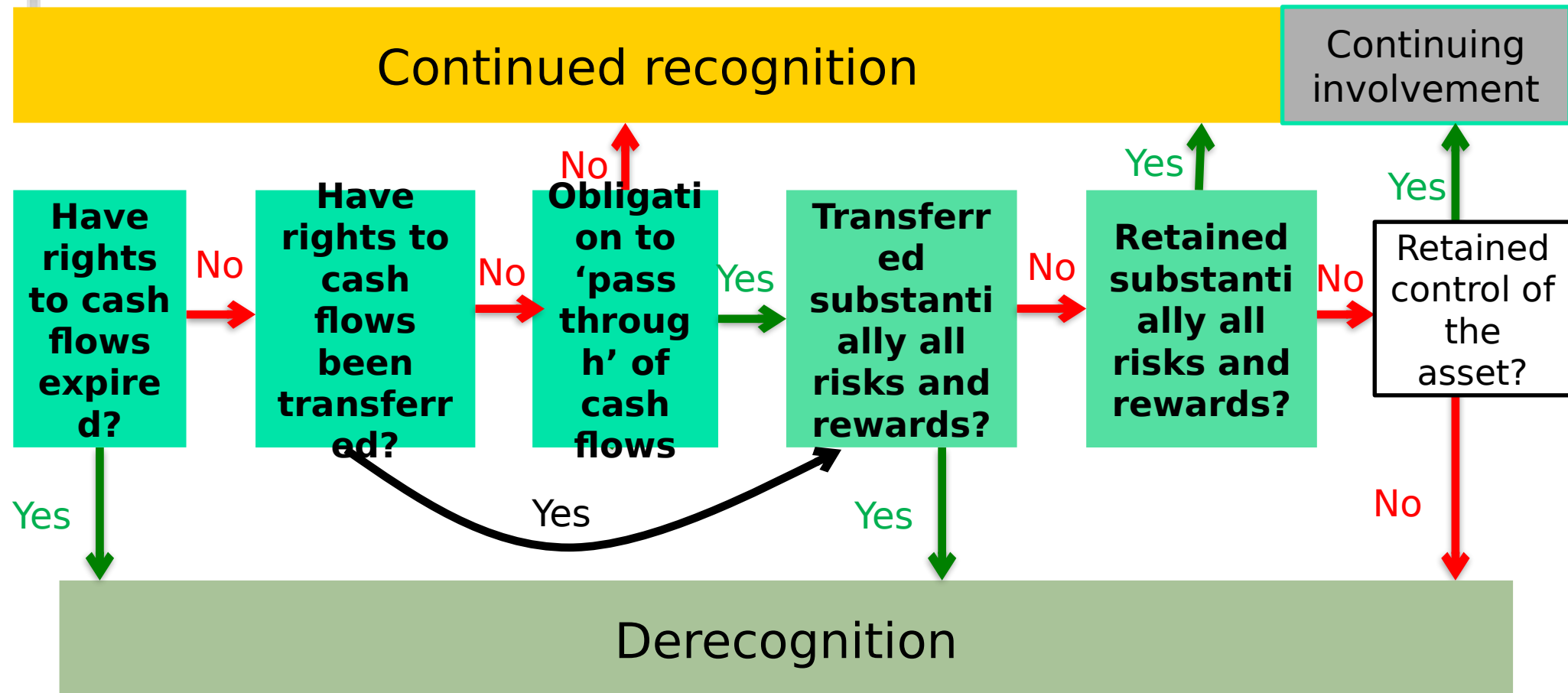
➤ A financial asset is transferred when:

- An entity transfers the contractual rights to receive the cash flows of the financial asset, or
- An entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients (pass through of cash flows);

➤ Transfer of financial asset qualifies for derecognition:

- if the entity transfers substantially all the risks and rewards of ownership of the financial asset, or

Derecognition of Financial Assets



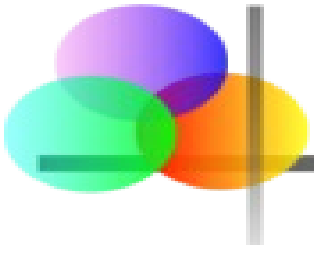


Derecognition of Financial Assets

Cases

- 1. A company sells an investment in shares, but retains the right to repurchase the shares at any time at a price equal to their current value. ()
- 2. If the company sells an investment in shares and enters into an agreement whereby the buyer will return any increases in value to the company and the company will pay the buyer interest plus compensation for any decrease in the value of the investment.

the risks and rewards,



Disclosure

- The purpose of disclosures prescribed by IFRS 7 is to assist users in assessing the nature and extent of *risks* related to financial instruments: ***Qualitative & Quantitative Disclosures about:***
 - Market risk
 - Credit risk
 - Liquidity risk