"Pioneers in Professional Education"

SL-25-1 – Advanced Corporate Reporting

Strategic Level (2025 Curriculum)

- Financial Instruments

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Financial Instruments

LKAS 32, SLFRS 09 and SLFRS 07

Accounting for financial instruments is a complex area, with requirements coming from a number of accounting standards. Therefore, this topic financial instruments will consist of following accounting standards.

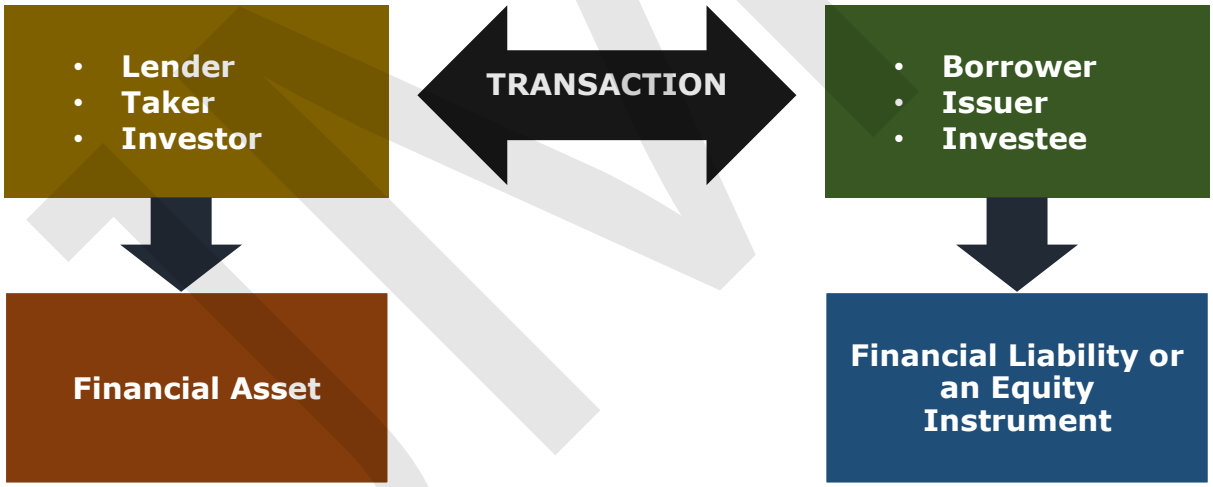
- LKAS 32 Financial Instruments: Presentation
- SLFRS 9 Financial Instruments
- SLFRS 7 Financial Instruments: Disclosure.

1. DEFINITIONS

1.1 Financial Instruments

A financial instrument is **any contract** that gives rise to a financial asset of one entity, and a financial liability or equity instrument of another entity.

This means that items that will be settled through the receipt or delivery of goods or services are not financial instruments, nor typically are tax assets and liabilities as these arise through legal rather than contractual requirements.



1.2 Financial Assets

A financial asset is defined as any asset that is:

- Cash;
- A contractual right;
  - To receive cash or another financial asset from another entity;
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.
- An equity instrument of another entity;

- A contract that will or may be settled in the entity's own equity instruments and is:
  - A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

  - A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, the entity's own equity instruments do not include puttable equity instruments or instruments that include a contractual obligation for the entity to deliver a pro rata share of its net assets only on liquidation, that do not meet the definition of equity but are classified as such under LKAS 32 Financial Instruments: Presentation, nor do they include instruments that are contracts for the future receipt or delivery of an entity's own equity instruments.

1.3 Financial Liabilities

A financial liability is defined as any liability that is:

- A contractual obligation.
  - To deliver cash or another financial asset to another entity;
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity.
- A contract that will or may be settled in the entity's own equity instruments and is:
  - A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, the entity's own equity instruments do not include certain instruments as set out above in the equivalent part of the definition of financial assets.

1.4 Equity Instruments

Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

1.5 Derivative

A financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index

of prices or rates, credit rating or credit index, or other variable (sometimes called the 'underlying');
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- It is settled at a future date.

The **following are points to note** in relation to the **definition of a financial instrument above**:

- The **contract** giving rise to a financial asset and liability **need not be in writing**, but it **must comprise an agreement** that has **'clear economic consequences'** and which the parties to it cannot avoid, usually because the agreement is enforceable in law
- An **'entity'** involved in the contract could be an individual, partnership, company or government agency.

The definitions of financial assets and financial liabilities may seem rather circular, referring as they do to the terms financial asset and financial instrument. The point is that there may be a chain of contractual rights and obligations, but it will lead ultimately to the receipt or payment of cash or the acquisition or issue of an equity instrument.

Financial Assets	**Financial Liabilities**
• Trade receivables • Options • Shares (when used as an investment)	• Trade payables • Debenture loans payable • Redeemable preference (non-equity) shares • Forward contracts standing at a loss

LKAS 32 makes it clear that the **following items are not financial instruments**.

- **Physical assets**, eg inventories, property, plant and equipment, leased assets and intangible assets (patents, trademarks etc)
- Prepaid expenses, deferred revenue and most warranty obligations - Because these assets and liabilities will not make a cash (any other financial asset) inflow or outflow.
- Liabilities or assets that are **not contractual in nature** – For example, Legal obligations such as Tax Liabilities and Assets on court orders.
- Contractual rights/obligations that **do not involve transfer of a financial asset**, eg commodity futures contracts, operating leases for lessors.

2. LIABILITIES AND EQUITY

LKAS 32 requires that financial instruments issued by an entity are presented as financial liabilities or equity according to their substance, not merely their legal form. The **classification** of a financial instrument as a liability or as equity depends on the following.

- The **substance** of the contractual arrangement on initial recognition
- The **definitions** of a financial liability and an equity instrument

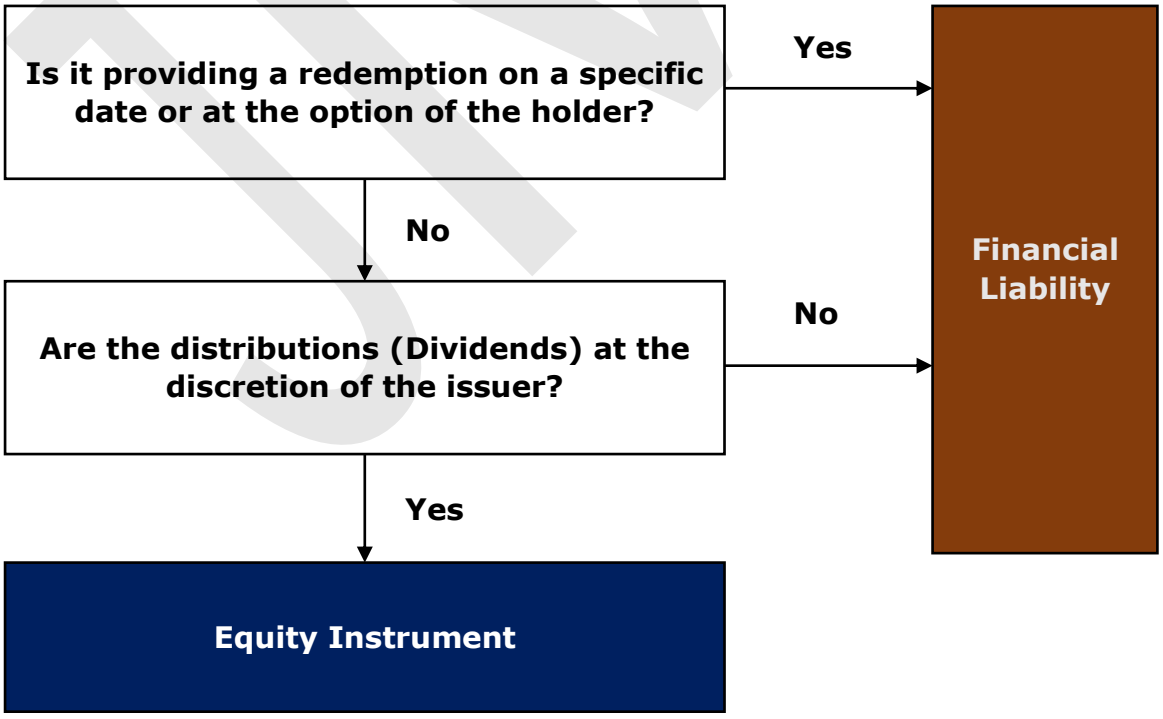
The critical feature of a liability is an obligation to transfer economic benefit. Therefore, a financial instrument is a financial liability if there is a contractual equity, but in substance it is in fact a liability. Other instruments may combine features of both equity instruments and financial liabilities.

If **there is no contractual obligation** to deliver cash or another financial asset to the holder, the financial instrument **is an equity instrument** *(eg ordinary shares are an equity instrument as the issuer has no obligation to pay a dividend).*

2.1 Preference Shares

For preference shares an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability **(Para AG25)**. When evaluating below two characteristics will be mainly evaluated.

- Availability of a guaranteed redemption
- How the distribution are made



- Most preference shares are redeemable and are therefore classified as a financial liability.
- Most irredeemable preference shares do not oblige the issuer to deliver cash and are therefore equity. If, however, an irredeemable preference share carries a non-discretionary dividend this creates an obligation on the issuer to deliver cash and so the shares are classified as liability.

Question 01 – Debt or Equity

Explain with reasons whether following instruments are financial liabilities or equity instruments.

1. Ford issued 40 million non-redeemable USD 1 preference shares at par value. Under the terms attaching to the preference shares, a dividend is payable on the preference shares only if Ford also pays a dividend on its ordinary shares relating to the same period.

2. Ford entered into a contract with a supplier to buy a significant item of equipment. Under the terms of the agreement, the supplier will receive ordinary shares with an equivalent value of USD 5 million one year after the equipment is delivered.

3. The directors of Ford, on becoming directors, are required to invest a fixed agreed sum of money in a special class of USD 1 ordinary shares that only directors hold. Dividend payments on the shares are discretionary and are ratified at the annual general meeting (AGM) of the company. When a director's service contract expires, Ford is required to repurchase the shares at their nominal value.

4. Ford issued 2 million preference shares for USD 2.80 each. No dividends are payable. The preference shares will be redeemed in two years' time by issuing 3 million ordinary shares.

2.2 Compound financial instruments

Some financial instruments contain both a liability and an equity element. In such cases, LKAS 32 requires the component parts of the instrument to be classified separately, according to the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument.

2.2.1 Convertible Debt

One of the most common types of compound instrument is **convertible debt** where **conversion is at the holder's option**. This creates a primary financial liability of the issuer and grants an option to the holder of the instrument to

convert it into an equity instrument (usually ordinary shares) of the issuer. This is the economic equivalent of the issue of conventional debt plus a warrant to acquire shares in the future.

Although in theory there are several possible ways of calculating the split, the following method is recommended ***(Para 28)***.

(a) Calculate the **value for the liability** component as the future cash flows associated with the instrument (assuming redemption) discounted at a market interest rate for similar bonds having no conversion rights.
(b) Deduct this from the instrument as a whole to leave a **residual value for the equity** component.

The **reasoning** behind this approach is that an entity's equity is its residual interest in its assets amount after deducting all its liabilities. The sum of the carrying amounts assigned to liability and equity will always be equal to the carrying amount that would be ascribed to the instrument as a whole.

Question 02 – Compound Instruments

Explain how should the entity account for the instruments according to LKAS 32?

1. An entity issues a convertible bond for Rs.1,000. The bond is convertible into equity shares of the issuer at the discretion of the holder at any time in the next 10 years. The bond converts into a variable number of shares equal to the value of the liability.

2. The entity also issues Rs. 7,000 of 8% convertible redeemable preference shares. In five years' time, the preference shares will either be redeemed or converted into 5,000 equity shares of the issuer, at the option of either the holder or issuer.

Question 03 – Compound Instruments

An entity issued 5,000 8% convertible bonds at par value of Rs.10 on 1 January 2015. Each bond is convertible into three ordinary shares on 31 December 2016. Interest is payable annually in arrears. The entity incurred transaction costs of Rs.1,000. On the date of issue, the market interest rate for similar debt without the conversion option was 10%.

Calculate the liability and equity component of the convertible bond on issue.

2.3 Treasury shares (Para 33 – 34)

If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments.

Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.

2.4 Interest, dividends, losses and gains (Para 35)

As well as dealing with the presentation of financial instruments in the statement of financial position, LKAS 32 considers how financial instruments affect the statement of profit or loss and other comprehensive income (and changes in equity). The treatment varies according to whether interest, dividends, losses or gains relate to a financial liability or an equity instrument.

(a) Interest, dividends, losses and gains relating to a financial instrument classified as a financial liability are recognized as income or expense in profit or loss.
(b) Dividends to equity shareholders are charged directly to equity by the issuer. These will appear in the statement of changes in equity.
(c) Transaction costs of an equity transaction are accounted for as a deduction from equity.

2.5 Offsetting a financial asset and a financial liability (Para 42)

A financial asset and financial liability should only be offset, with the net amount reported in the statement of financial position, when an entity:

(a) Has a legally enforceable right of set off, and
(b) Intends to settle on a net basis, or to realize the asset and settle the liability simultaneously, ie at the same moment.

This will reflect the expected future cash flows of the entity in these specific circumstances. In all other cases, financial assets and financial liabilities are presented separately.

3. RECOGNITION OF FINANCIAL INSTRUMENTS

SLFRS 9 provides guidance on the classification and recognition of financial assets and financial liabilities; it also deals with the measurement of financial instruments, including the impairment of financial assets.

3.1 Recognition

A financial asset or financial liability is recognized in the statement of financial position **when the reporting entity becomes a party to the contractual provisions of the instrument *(Para 3.1.1)***.

For example, if one entity sells goods to another entity, promising to pay at a later date, both entities are party to the sales contract and one recognizes a receivable whilst the other recognizes a payable.

Notice that this is different from the recognition criteria in the Conceptual Framework and in most other standards.

3.2 De-Recognition

Derecognition is the removal of a previously recognized financial instrument from an entity's statement of financial position.

3.2.1 Financial Assets

An entity should **derecognize** a financial asset when:

(a) The contractual rights to the cash flows from the financial asset **expire**, or

(b) It transfers substantially all the risks and rewards of **ownership** of the financial asset **to another party**

For example, a trade receivable is derecognized when payment is collected. In this case, the rights to the cash flow associated with the asset expire (because the cash has been collected) and there is no further exposure to risks and rewards for the entity collecting the cash. *Some more complex transactions may not be so clear-cut; however these are not examinable at Corporate Level*.

3.2.2 Financial Liabilities

An entity should derecognize a financial liability when it is extinguished – ie when the obligation specified in the contract is discharged or cancelled or expires.

3.2.3 Partial Derecognition

It is possible for only part of a financial asset or liability to be derecognized. This is allowed if the part comprises:

(a) Only specifically identified cash flows; or
(b) Only a fully proportionate (pro-rata) share of the total cash flows.

For example, if an entity holds a bond it has the right to two separate sets of cash inflows: those relating to the principal and those relating to the interest. It could sell the right to receive the interest to another party while retaining the right to receive the principal.

3.2.4 Gain or loss on derecognition

On derecognition, the amount to be included in net profit or loss for the period is the difference between the carrying amount of the financial instrument derecognized and the proceeds paid (for a liability) or received (for an asset).

Any accumulated gains or losses that have been recognized in other comprehensive income in respect of debt instruments classified as fair value through other comprehensive income (FVTOCI) (see Section 4) are also reclassified to profit or loss on derecognition of the asset.

Where only part of a financial asset is derecognized, the carrying amount of the asset should be allocated between the part retained and the part transferred based on their relative fair values on the date of transfer. A gain or loss should be recognized based on the proceeds for the portion transferred.

Question 04 – Recognition and Derecognition

(A) **Discuss** whether a financial instrument should be recognised in each of these cases.

An entity has entered into two separate contracts.

(a) A firm commitment (an order) to buy a specific quantity of iron.
(b) A forward contract to buy a specific quantity of iron at a specified price on a specified date, provided delivery of the iron is not taken.

(B) **Discuss** whether the following financial instruments should be derecognized:

(a) Co enters into a stock lending agreement where an investment is lent to a third party for a finite period of time in exchange for payment of a fee.
(b) Co sells title to some of its receivables to a debt factor in exchange for an immediate cash payment of 92% of their value. The terms of the agreement are that B Co has to compensate the factor for any amounts not recovered after 6 months.
(c) Co sells an investment in shares but retains a call option to repurchase those shares at any time at a price equal to their current market value at the date of repurchase.

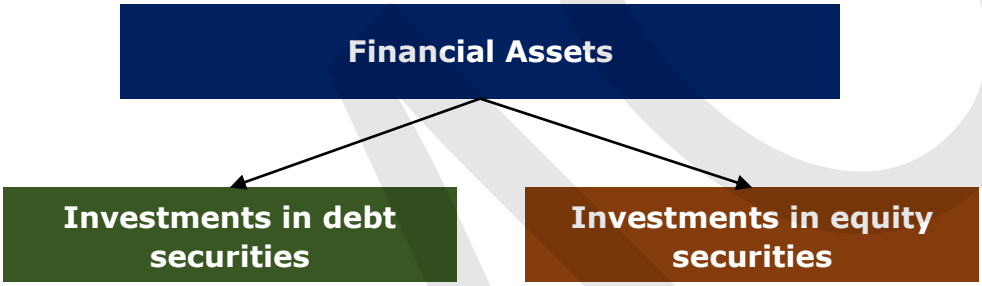
Question 05 – Derecognition

Pacific Plants (Pvt) Ltd purchased loan stock in a listed company for Rs. 30m on 20 February 2016, classifying it as measured at FVTOCI. At 31 December 2016 the loan stock was remeasured to a fair value of Rs. 35m, with an Rs. 5m gain recognized in other comprehensive income. Pacific Plants sold half of the loan stock in August 2017 for Rs. 20m.

Required to **Prepare** extracts from the statement of profit or loss and other comprehensive income for the year ended 31 December 2017 in respect of the disposal.

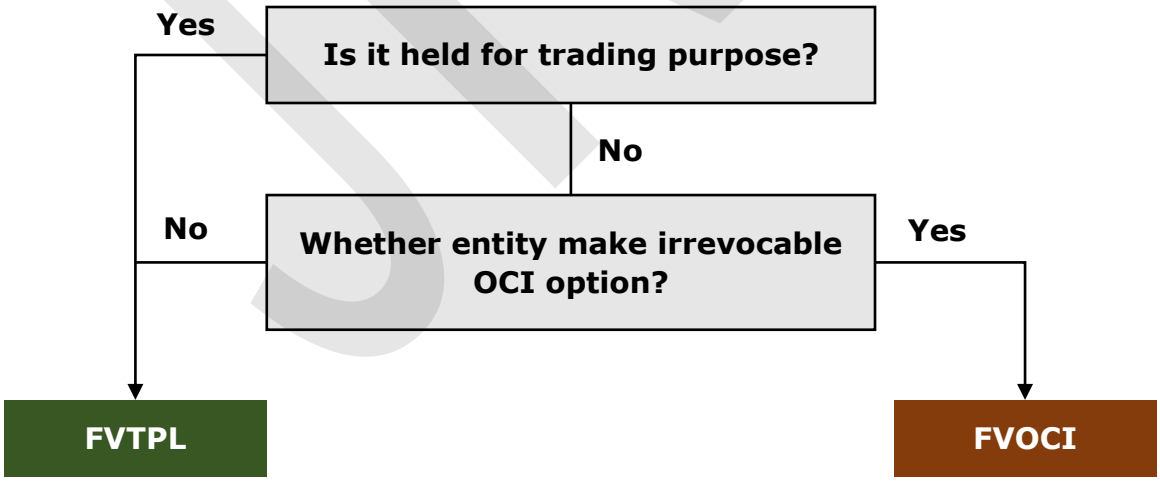
4. CLASSIFICATION OF FINANCIAL INSTRUMENTS

4.1 Financial assets classification



4.1.1 Financial assets on equity securities

To identify correct classification below flowchart can be used.



4.1.1.1 Equity investments at FVOCI

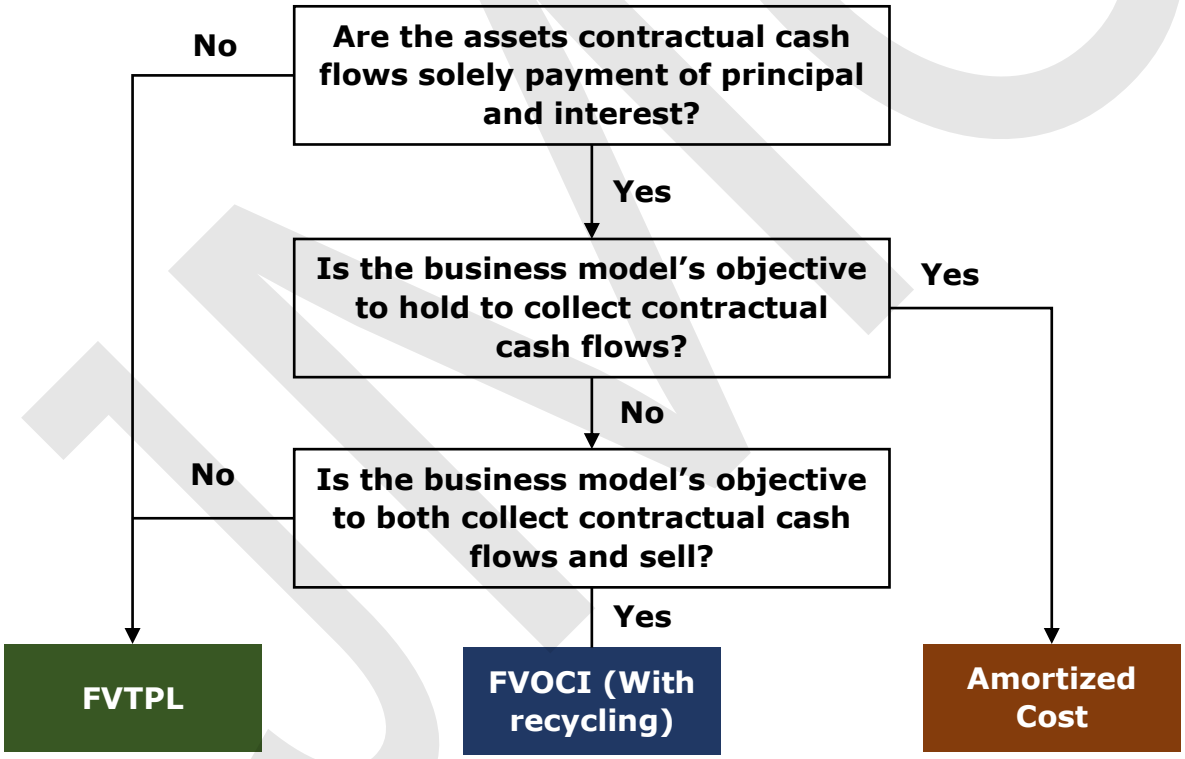
Equity instruments and derivatives are **normally measured at FVTPL**. However, on initial recognition, an entity may make an **irrevocable election** (on an instrument-by-instrument basis) to present in OCI the subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9. This option only applies to instruments that are not held for trading.

Although most gains and losses on investments in equity instruments designated at FVOCI will be recognized in OCI, dividends will normally be recognized in profit or loss.

Meanwhile, gains or losses recognized in OCI are never reclassified from equity to profit or loss. Consequently, there is no need to review such investments for possible impairment.

4.1.2 Financial assets on debt securities

The classification is based on both the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.



Below summarizes the outcome of the thought process depicted above:

		Contractual cash flow characteristics test (SPPI)	
		Fail	Pass
Business Model	Held within a business model whose objective is to hold financial assets in order to collect contractual cash flows	Amortized Cost	FVTPL
	Held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets	FVOCI (with recycling)	FVTPL
	Financial assets which are neither held at amortized cost nor at FVOCI	FVTPL	FVTPL

4.1.2.1 Amortized Cost Financial Assets *(Para 4.1.1)*

A financial asset is classified as subsequently measured at amortized cost under SLFRS 9 if it meets both of the following criteria:

- **'Hold-to-collect' business model** – The asset is held within a business model whose objective is to hold the financial asset in order to collect contractual cash flows; and
- **'SPPI' contractual cash flow characteristics**– The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding on a specified date.

Examples of financial instruments that are likely to be classified and accounted for at amortized cost under SLFRS 9 include:

- Trade receivables
- Loan receivables with 'basic' features
- Investments in government bonds that are not held for trading
- Investments in term deposits at standard interest rates.

4.1.2.2 FVOCI Financial Assets on Debt *(Para 4.1.2)*

A financial asset is measured at fair value through other comprehensive income (FVOCI) under SLFRS 9 if it meets both of the following criteria:

- **'Hold-to-collect and sell'** business model: The asset is held within a business model whose objective is achieved by both holding the financial asset in order to collect contractual cash flows and selling the financial asset, and

- **'SPPI' contractual cash flow characteristics**: 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.

Examples of financial instruments that may be classified and accounted for at FVOCI under IFRS 9 include:

- Investments in government bonds where the investment period is likely to be shorter than maturity
- Investments in corporate bonds where the investment period is likely to be shorter than maturity.

It is unlikely that intercompany loans or trade receivables would be classified in the FVOCI category.

The **accounting requirements** for debt instruments classified as FVOCI are:

- Interest income is recognized in profit or loss using the effective interest rate method that is applied to financial assets measured at amortized cost;
- Foreign exchange gains and losses on the amortized cost are recognized in profit or loss;
- Credit impairment losses/reversals are recognized in profit or loss using the same credit impairment methodology as for financial assets measured at amortized cost;
- Other changes in the carrying amount on remeasurement to fair value are recognized in OCI;
- The cumulative fair value gain or loss recognized in OCI is recycled from OCI to profit or loss when the related financial asset is derecognized.

4.1.2.3 FVTPL Financial Assets on both Debt and Equity

Fair value through profit or loss (FVTPL) is the **residual category** in SLFRS 9. A financial asset is classified and measured at

FVTPL if the financial asset is:

- A held-for-trading financial asset;
- A debt instrument that does not qualify to be measured at amortized cost or FVOCI;
- An equity investment which the entity has not elected to classify as at FVOCI.

Examples of financial assets that are likely to fall into the FVTPL category include:

- Investments in shares of listed companies that the entity has not elected to account for as at FVOCI;
- Derivatives that have not been designated in a hedging relationship, e.g.:
  - Interest rate swaps;
  - Commodity futures/option contracts;
  - Foreign exchange futures/option contracts;
- Investments in convertible notes, commodity linked bonds;
- Contingent consideration receivable from the sale of a business;
- Any other financial assets that fail SPPI.

4.2 Financial liabilities classification

Financial liabilities are classified as either:

- Financial liabilities at amortised cost; or
- Financial liabilities as at fair value through profit or loss (FVTPL).

Financial liabilities are measured at amortised cost unless either:

- The financial liability is held for trading and is therefore required to be measured at FVTPL (e.g. derivatives not designated in a hedging relationship); or
  - *Incurred principally for the purpose of repurchase in the short-term*
  - *Part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit taking*
- The entity elects to measure the financial liability at FVTPL (using the fair value option). If it *eliminates or significantly reduces an accounting mismatch* and/or group of *liabilities is managed, and its performance evaluated on a fair value basis* this option can be used.

In contrast to financial assets, the existing requirements in IAS 39 for the separation of embedded derivatives have been continued for financial liabilities, meaning that financial liabilities to be measured at amortised cost would still need to be analysed to determine whether they contain any embedded derivatives that are required to be accounted for separately at FVTPL.

Examples of financial liabilities that are likely to be classified and measured either at amortised cost or at FVTPL include.

Amortised cost	FVTPL
– Trade payables; – Loan payables with standard interest rates (such as a benchmark rate plus a margin) or the host contract arising from a loan agreement which contains separable embedded derivatives; – Bank borrowings.	– Interest rate swaps (not designated in a hedging relationship); – Commodity futures/option contracts (not designated in a hedging relationship); – Foreign exchange future/option contracts (not designated in a hedging relationship); – Convertible note liabilities designated at FVTPL; – Contingent consideration payable that arises from one or more business combinations.

4.3 Reclassification financial instruments (Section 4.4)

Financial assets are reclassified under SLFRS 9 when, and only when, an entity changes its business model for managing financial assets. The reclassification should be applied prospectively from the reclassification date.

This reclassification applies **only to investments in debt instruments**, as investments in equity instruments are always held at fair value and any election to measure them at fair value through other comprehensive income is an irrevocable one.

An entity shall not reclassify any financial liability. The accounting treatment can be summarized as follows: ***(Refer Section 5.6 and 5.7 for guidelines)***

Old classification	New classification	Initial carrying amount	Treatment of gains or losses arising
AC	FVTPL	FV at date of reclassification	Recognised in profit or loss.
FVTPL	AC	FV at date of reclassification	Recognised in profit or loss.
AC	FVTOCI	FV at date of reclassification	Recognised in other comprehensive income
FVTOCI	AC	FV at date of reclassification	Previous cumulative gains/losses recorded in OCI are removed from equity and adjusted against the fair value of the financial asset at the reclassification date.
FVTPL	FVTOCI	FV at date of reclassification	N/A
FVTOCI	FVTPL	FV at date of reclassification	Previous cumulative gains/losses recorded in OCI are reclassified from equity to profit or loss as a reclassification adjustment at the reclassification date.

5. MEASUREMENT OF FINANCIAL INSTRUMENTS

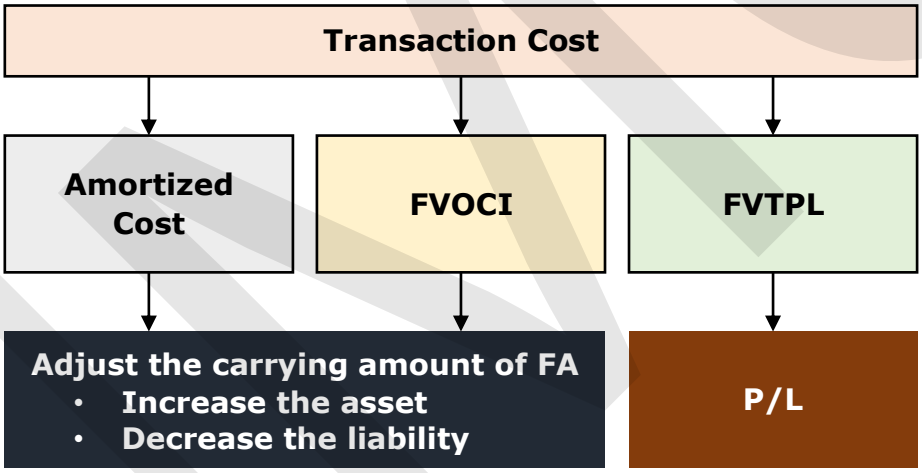
This section explains the initial and subsequent measurement of financial assets and financial liabilities. Subsequent measurement is dependent upon classification, discussed in the previous section.

5.1 Initial measurement

Financial instruments are **initially measured** at the transaction price, that is the **fair value** of the consideration given. An exception is where part of the consideration given (or received) is for something other than the financial asset (or financial liability). In this case the financial instrument is initially measured at fair value evidenced by a quoted price in an active market for an identical asset (an SLFRS 13 level 1 input) or based on a valuation technique that uses only data from observable markets.

The difference between the fair value at initial recognition and the transaction price is recognized as a gain or loss.

5.1.1 Transaction Costs



Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. ***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.

5.1.2 Day one gains and losses

The best evidence of fair value at initial recognition is usually the transaction price, represented by the fair value of the consideration given or received in exchange for the financial instrument. Any **difference between** the **fair value** measured by the entity and **the transaction price** is recognized:

- In profit or loss, if the estimate is measured by a quoted price in an active market or based on a valuation technique that uses only data from observable markets (Level 1 Inputs); and
- Deferred as an adjustment to the carrying amount of the financial instrument in all other cases (Level 2 or 3).

5.2 Subsequent measurement of financial assets

SLFRS 9 requires that financial assets are measured subsequent to recognition in accordance with their classification at:

- Amortised cost, using the effective interest method
- Fair value through other comprehensive income
- Fair value through profit or loss

5.2.1 Financial assets measured at amortised cost (Debt investments)

Amortised cost of a financial asset or financial liability is the amount at which the financial asset or liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the **effective interest method** of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

Effective Interest Method

The effective interest method is a method of calculating the amortised cost of a financial instrument and of allocating the interest income or interest expense over the relevant period. That means this has main 02 purposes.

1. It transforms the initial FV into the final maturity value.
2. It amortizes the total finance charge/income over maturity period

Effective Interest Rate

The **effective interest rate** is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

For the **calculation of the effective interest rate**, an entity estimates the expected cash flows **considering** all contractual terms including any fees, **transaction costs**, and other premiums or discounts. Debt premiums or discounts, financing costs or internal administrative or holding costs **are not eligible transaction costs**. Because transaction costs are included as part of the initial carrying amount of the financial instrument, the recognition of these costs in profit or loss is spread over the term of the instrument through the application of the effective interest method.

The determination of the effective interest rate is based on the estimated cash flows arising from the asset. Expected credit losses are not included as part of the cash flows for the calculation of the effective interest rate method. This is because

the gross carrying amount of a financial asset is adjusted for a loss allowance, which is not part of the effective interest rate calculation.

Changes in the expected cash flows will result in a recalculation of the gross carrying amount of an asset and the amortised cost of a financial liability. **The revised expected cash flows are discounted using the original effective interest rate of the instrument.** Any **difference** from the previous amount is recognised in **profit or loss**.

Question 06 – FA at Amortized Cost

On 1 January 2021, Purijjala Power PLC purchases a debt instrument for its fair value of Rs. 1,000m. The debt instrument is due to mature on 31 December 2025 and Purijjala Power intends to hold it to maturity. The instrument has a principal amount of Rs. 1,250m and the instrument carries fixed interest at 4.72% that is paid annually. The effective rate of interest is 10%.

Required to **demonstrate** how Purijjala Power should account for the debt instrument over its five-year term.

5.2.2 Financial assets measured at FVOCI (Debt Investments)

Where a financial asset on debt instrument is classified at fair value through other comprehensive income, fair value is determined at each reporting date in accordance with SLFRS 13 Fair Value Measurement.

- **Interest** (calculated at the effective interest rate same like in an amortized cost financial assets) is recognised in profit or loss.
- **Changes in fair value** is recognised in other comprehensive income (OCI).
- At the disposal the amounts recognised in OCI are **reclassified (Recycled)** to profit or loss.

Question 07 – FA at FVOCI – Debt Investments

At 1 January 2018 Jaffna Trading Co acquired Rs. 40m 5% loan stock at a cost of Rs. 38m. Interest is payable annually in arrears and the stock will be redeemed at a 5% premium in 3 years' time. The effective interest rate of the stock is 8.49% and its fair value is Rs. 39.1million at 31 December 2018 and Rs. 40.9million at 31 December 2019. The loan stock is classified as measured at FVTOCI.

Required to **Calculate** amounts to be recognised in the financial statements of Jaffna Trading Co for the years ended 31 December 2018 and 2019.

Question 08 – FA at FVOCI – Debt Investments

On 1 July 2021 Kalutara Ltd acquired Rs. 40 million 5% debt instruments at a cost of Rs. 38 million. Further information is as follows:

- Interest is payable annually in arrears.
- The debt will be redeemed at a 5% premium on 30 June 20X4.
- The effective interest rate attached to the debt is 8.49%.

The fair value of the debt is Rs. 38.8 million at 30 June 2022 and Rs. 40.8 million at 30 June 2023. The debt is classified as measured at fair value through other comprehensive income.

Required to Calculate amounts to be recognised in the statement of profit or loss and other comprehensive income of Kalutara Ltd in the years ended 30 June 2022 and 2023.

5.2.3 Financial assets measured at FVOCI (Equity Investments)

An entity may acquire an investment in an equity instrument that is not held for trading. At initial recognition, the entity may make an **irrevocable election** (on an instrument-by-instrument basis) to present in OCI subsequent changes in the fair value of such an investment.

- **Dividends** from such investments should be recognised in **profit or loss** when the right to receive payment is probable and can be measured reliably, unless the dividend clearly represents a recovery of part of the cost of the investment.
- **Fair value gains and losses** (including any related foreign exchange component) are recognised in **OCI**.
- Amounts presented in OCI are **not subsequently transferred** to profit or loss, even on derecognition. But the cumulative gain or loss may be transferred within equity.

Question 09 – FA at FVOCI – Equity Investments

On 8 February 2018 Horana Ltd acquires a quoted investment in the shares of another company with the intention of holding it in the long term. The investment cost Rs. 8.5 million and Horana Ltd paid Rs. 200,000 legal costs at acquisition. At Horana Ltd's year end of 31 March 2018, the market price of an identical investment is Rs. 9 million. Horana Ltd has elected to recognise changes in the fair value of the equity investment in other comprehensive income.

Explain how is the financial asset initially and subsequently measured as per SLFRS 9?

5.2.4 Financial assets measured at FVTPL (Debt Investments)

Financial assets on debt instruments classified as FVTPL are remeasured to fair value at each reporting date. All interest amounts and changes in fair value are recognised in profit or loss.

5.2.5 Financial assets measured at FVTPL (Equity Investments)

Financial assets on equity instruments classified as FVTPL are remeasured to fair value at each reporting date. All dividend amounts and changes in fair value are recognised in profit or loss.

Question 10 – FA at FVTPL

Lanka Linens (Pvt) Ltd acquires the following financial assets in 2015.

1. Five million equity shares in a quoted company, to be held in the medium to long term. The cost of the investment was Rs. 360m and transaction costs amounted to Rs. 2m. Lanka Linens made the irrevocable election to classify the shares at FVTOCI At 31 December 2015 the closing bid price of one of the equity shares was Rs. 76.
2. Equity shares in another quoted company to be held as a short-term investment with the intention of realising a profit on sale. The cost of the investment was Rs. 120m, and transaction costs were Rs. 1.5m. The fair value of the investment at 31 December 2015 was Rs. 115m.

Required to **Prepare** extracts of the financial statements of Lanka Linens for the year ended 31 December 2015 in respect of the two financial asset investments.

5.3 Subsequent measurement of financial liabilities

After initial recognition, financial liabilities are measured in accordance with their classification at amortised cost or fair value through profit or loss.

5.3.1 Financial liabilities measured at Amortized Cost

The definitions of amortised cost, effective interest method and effective interest rate given above are also applicable to financial liabilities.

Question 11 – FL at Amortized Cost

Monara Ltd issues a bond for Rs. 5,037,780 on 1 January 2012. No interest is payable on the bond, but it will be redeemed on 31 December 2014 for Rs. 6 million. The effective interest rate of the bond is 6%.

Required to **calculate** the charge to profit or loss of Monara Ltd for the year ended 31 December 2012 and the balance outstanding at 31 December 2012.

Question 12 – FL at Amortized Cost

On 1 January 2013 Wattala Ltd issued Rs. 6 million loan notes. Issue costs were Rs. 2,000. The loan notes do not carry interest but are redeemable at a premium of Rs. 1,523,890 on 31 December 2014. The effective finance cost of the loan notes is 12%.

Required: What is the finance cost in respect of the loan notes for the year ended 31 December 2014?

Question 13 – FL at Amortized Cost

On 1 January 2021, an entity issued a debt instrument with a coupon rate of 3.5% at a par value of Rs. 60 million. The directly attributable costs of issue were Rs. 1.2 million. The debt instrument is repayable on 31 December 2027 at a premium of Rs. 11 million.

Required: What is the total amount of the finance cost associated with the debt instrument?

5.3.2 Financial liabilities measured at FVTPL

Financial liabilities which are held for trading are re-measured to fair value each year in accordance with SLFRS 13 Fair Value Measurement with any gain or loss recognised in profit or loss unless it is part of a hedging arrangement.

- Specific rules apply to financial liabilities that are designated as measured at fair value through profit or loss. In this case the gain or loss in a period must be classified into:
  - Gain or loss resulting from credit risk (because of changes in the borrower's creditworthiness)
  - Other gain or loss

- The **gain or loss** as a result of **credit risk** is recognised in **other comprehensive income**, unless it creates or enlarges an accounting mismatch in which case it is recognised in profit or loss. The **other gain or loss** (not the result of credit risk) is **recognised in profit or loss**.

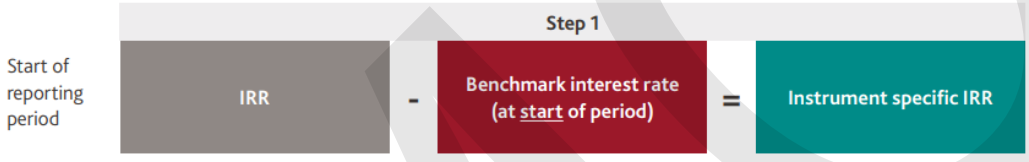
- On derecognition any gains or losses recognised in other comprehensive income are not transferred to profit or loss, although the cumulative gain or loss may be transferred within equity.

An entity determines the amount of the fair value change attributable to changes in its own credit risk either:

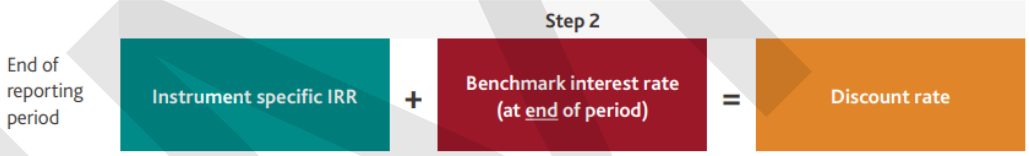
(i) As the amount of the change in the fair value that is not attributable to changes in market conditions that give rise to market risk, which includes changes in:
   - Benchmark interest rates;
   - Prices of other financial instruments;
   - Commodity prices;
   - Foreign exchange rates;
   - Index of prices and rates.

(ii) Using another method if that method more faithfully represents the related portion of the change in fair value.

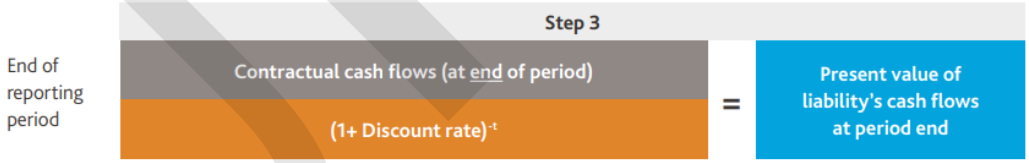
If the only significant relevant changes in market conditions are due to changes in an observed benchmark interest rate, the amount attributable to changes in an entity's own credit risk can be estimated using the default method, which is based on the calculation of the financial instrument's internal rate of return (IRR)



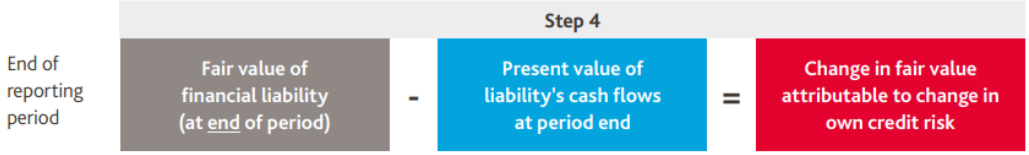
In the first step, the entity computes the liability's IRR at the start of the reporting period using the fair value of the liability and the liability's contractual cash flows at the start of the reporting period. It deducts from the IRR the observed benchmark interest rate at the start of the period. The result is an instrument specific IRR margin.



Secondly, the entity derives the discount rate, which is the sum of the instrument specific IRR margin (calculated in Step 1) and the benchmark interest rate at the end of the reporting period, in order to calculate the present value of the contractual cash flows.



In the third step, the entity determines the present value of the contractual cash flows of the liability at the end of the reporting period, using the discount rate derived in Step 2.



Finally, the entity deducts the present value of the liability's cash flows at the period end as determined under Step 3) from the fair value of the financial liability at the end of the reporting period. The result is the change in the fair value of the financial liability attributable to an entity's own credit risk.

Question 14 – FL at FVTPL

Entity A issued a bond under conditions that qualify for the fair value option in IFRS 9 and decided to designate the liability to be accounted for at fair value through profit or loss (FVTPL). At the end of the financial reporting period, Entity A determines that $ 2 of the change in the fair value of the bond of $ 10 is due to a change in Entity A's credit risk.

Question: How should Entity A account for the fair value change?

6. IMPAIRMENT

6.1 Scope

The following financial instruments are included within the scope of the impairment requirements in SLFRS 9:

- Debt instruments measured at amortised cost, e.g.
  - Trade receivables;
  - Loans receivable from related parties or key management personnel;
  - Deferred consideration receivable; and
  - Intercompany loans in separate financial statements.
- Debt instruments that are measured at fair value through other comprehensive income (FVOCI), e.g. long dated government or corporate bond;
- Issued loan commitments (except those measured at FVTPL);
- Issued financial guarantee contracts (except those measured at FVTPL);
- Lease receivables within the scope of SLFRS 16 Leases;
- Contract assets within the scope of SLFRS 15 Revenue from Contracts with Customers;
- Receivables arising from transactions within the scope of SLFRS 15.

SLFRS 9 applies an 'expected loss' model to impairment, in other words, an impairment, or credit losses, are recognised **when expected** rather than when incurred.

6.2 Key Definitions

Credit loss	The difference between all contractual cashflows that are due to an entity… and all the cash flows that an entity expects to receive, discounted.

Expected credit losses	The weighted average of credit losses with the respective risks of a default occurring as the weights.
Lifetime expected credit losses	The expected credit losses that result from all possible default events over the expected life of a financial instrument
Loss allowance	The allowance for expected credit losses on financial assets.
Past due	A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.

6.3 Approach to Impairment

SLFRS 9 provides 3 approaches to impairment:

(1) A general approach
(2) A simplified approach relevant to trade receivables.

6.4 The General Approach (Para 5.5.1)

On initial recognition of a financial asset and at each subsequent reporting date, a loss allowance for expected credit loss must be recognised. At initial recognition of a financial asset, a loss allowance equal to 12-month expected credit losses must be recognised.

12-month expected credit losses are defined as 'the portion of lifetime expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date' (SIFRS 9: Appendix A).

They are calculated by multiplying the probability of default in the next 12 months by the present value of the lifetime expected credit losses that would result from the default. At each subsequent reporting date, the loss allowance required depends on whether there has been a significant increase in credit risk of that financial instrument since initial recognition.

The ECL Model can be summarized as follows.

	Stage 1	Stage 2	Stage 3
	Credit risk has not increased significantly since initial recognition	Credit risk has increased significantly since initial recognition	There is objective evidence of impairment at the reporting date. (Credit Impaired)
Recognition of Impairment	**12-month** expected credit losses	**Lifetime** expected credit losses	

Recognition of Interest Income	Effective interest on the **Gross** carrying amount of the asset (**Before** deducting ECL)	Effective interest on the **Net** carrying amount of the asset (**After** deducting ECL)

However as a practical expedient, a **simplified model applies for**:

- Trade receivables or contract assets without a significant financing component (or when the IFRS 15 Paragraph 63 practical expedient is applied for the effects of a significant financing component to those with maturities of less than 12 months); and
- Other long-term trade receivables or contract assets with a significant financing component and lease receivables if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses.

In estimating ECLs, **entities must consider a range of possible outcomes and not the 'most likely' outcome**. The standard requires that at a **minimum**, entities must consider the probability that:

- A credit loss occurs; and
- No credit loss occurs.

6.4.1 Recognition of impairment – 12-month expected credit losses

12-month ECLs are calculated by multiplying the probability of a default occurring in the next 12 months by the total (lifetime) ECLs that would result from that default, regardless of when those losses occur. Therefore, **12-month expected credit losses represent a financial asset's lifetime expected credit losses that are expected to arise from default events that are possible within the 12-month period** following origination of an asset, or from each reporting date for those assets in **Stage 1**.

The distinction between 12-month expected credit losses to be calculated in accordance with SLFRS 9 and the cash shortfalls that are anticipated to arise over the next 12 months is important.

- As an example, the death of a credit card borrower does lead, in a number of cases, to the outstanding balance becoming impaired. Linking this to the accounting requirements, the SLFRS 9 model therefore requires the prediction on initial recognition (and at each reporting date) of the likelihood of the borrower dying in the next 12 months and hence triggering an impairment event. Given the very large number of balances, it is likely that this would be calculated on a portfolio basis and not for each individual balance.

6.4.2 Recognition of impairment – Lifetime expected credit losses

Lifetime expected credit losses are the present value of expected credit losses that arise if a borrower defaults on its obligation at any point throughout the term of a lender's financial asset. This requires an entity to **consider all possible default events during the term of the financial asset in the analysis**. Lifetime expected credit losses are calculated based on a weighted average of the expected credit losses, with the weightings being based on the respective probabilities of default.

6.5 Determining Significant Increases in Credit Risk (SICR) (Para 5.5.9)

The transition from recognising 12-month expected credit losses (i.e. Stage 1) to lifetime expected credit losses (i.e. Stage 2) in SLFRS 9 is based on the notion of a **significant increase in credit risk (SICR)** over the remaining life of the instrument in comparison with the credit risk on initial recognition. The **focus is on the changes in the risk of a default**, and not the changes in the amount of expected credit losses.

- *For example, for highly collateralised financial assets such as real estate backed loans, when a borrower is expected to be affected by the downturn in its local economy with a consequent increase in credit risk, that loan would move to Stage 2, even though the actual loss suffered may be small because the lender can recover most of the amount due by selling the collateral.*

At each reporting date, an entity **shall assess** whether the credit risk on a financial instrument has increased significantly since initial recognition. There is a **rebuttable presumption** that the credit risk has increased significantly when contractual payments are more than 30 days past due.

A significant increase in credit risk (moving from Stage 1 to Stage 2) **can include**:

- Changes in general economic and/or market conditions (e.g. expected increase in unemployment rates, interest rates);
- Significant changes in the operating results or financial position of the borrower;
- Changes in the amount of financial support available to an entity (e.g. from its parent);
- Expected or potential breaches of covenants;
- Expected delay in payment (Note: Actual payment delay may not arise until after there has been a significant increase in credit risk).
- An actual or expected downgrade in the borrower's credit rating

The movement from stage 1 to stage 2 is not irreversible; where credit losses have previously been measured at a lifetime amount, at a subsequent reporting date they are measured at a 12-month amount if a significant increase in credit risk is no longer evident.

6.6 Objective evidence of impairment

A financial asset **moves to stage 3** of the model when there is objective evidence of impairment at the reporting date. SLFRS 9 provides examples of evidence of impairment including the following:

(a) Significant financial difficulty of the issuer
(b) A breach of contract, such as a default in interest or principal payments
(c) The lender granting a concession to the borrower that the lender would not otherwise consider, for reasons relating to the borrower's financial difficulty
(d) It becomes probable that the borrower will enter bankruptcy
(e) The disappearance of an active market for that financial asset because of financial difficulties
(f) The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses

It is not always possible to single out one particular event; rather, several events may combine to cause an asset to become credit-impaired.

6.7 Measurement of expected credit losses

An entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes *(Expected credit losses should not be a best or worst-case scenario, but should reflect the possibility that a credit loss will occur, and the possibility that it will not).;*
(b) the time value of money; and
(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

6.8 Calculation of expected credit losses

Present value of principal and interest cash flows that are contractually due to an entity	XXX
(-) Present value of cash flows an entity expects to receive (After considering probability)	(XXX)
Expected Credit Loss	**XXX**

6.9 Treatment for expected credit losses in financial statements

Type of financial asset	Treatment of credit loss
Investments in debt instruments measured at **amortised cost** (AC)	• Recognised in profit or loss • Credit losses held in a separate allowance account offset against the carrying amount of the asset • Carrying amount = Financial asset – allowance for credit losses
Investments in debt instruments measured at fair value through other comprehensive income (**FVOCI**)	• Portion of the fall in fair value relating to credit losses recognised in profit or loss • Remainder recognised in other comprehensive income • No allowance account necessary because already carried at fair value (which is automatically reduced for any fall in value, including credit losses)

Question 15 – ECL General Approach

Tae Ltd advanced an interest-bearing loan to a supplier on 1 January 2015. The following information relates to this loan at 1 January and 31 December 2015:

	01.01.2015 (Rs.)	31.12.2015 (Rs.)
Present value of contractual cash flows	8,000,000	7,650,000
Present value of expected cash flows and associated probability of default within 12 months	8,000,000 – 95% 7,750,000 – 5%	7,650,000 – 85% 5,500,000 – 8% 1,000,000 – 7%

Required: What is the impairment loss at each date, assuming that credit risk has not increased significantly since initial recognition?

Question 16 – ECL General Approach

On 1 January 2014 Pedro Ltd acquired an investment in Rs. 60 million 8% loan stock. The investment is measured at amortised cost. At 1 January 2014 there is a 4% probability that the borrower will default on the loan during 2014 resulting in a 100% loss.

At 31 December 2014 there is 1% probability that the borrower will default on the loan before 31 December 2015 resulting in a 100% loss. At 31 December 2015 the borrower is expected to breach its covenants as a result of cash flow problems. There is a 45% probability of the loan defaulting over the remainder of its term.

At 31 December 2016 the borrower breached its covenants and there is a 75% probability of default over the remainder of the loan term.

Required: What impairment allowance and interest revenue are recognised at initial recognition and in each of the years ended 31 December 2014, 2015 and 2016?

Question 17 – ECL General Approach – FVOCI

An entity purchases a debt instrument for $1,000 on 1 January 2021. The interest rate on the bond is the same as the effective rate. After accounting for interest for the year to 31 December 2021, the carrying amount of the bond is still $1,000.

At the reporting date of 31 December 2021, the fair value of the instrument has fallen to $950. There has not been a significant increase in credit risk since inception so expected credit losses should be measured at 12-month expected credit losses. This is deemed to amount to $30.

Required: Explain how the revaluation and impairment of the financial asset should be accounted for.

6.10 The Simplified Approach (Para 5.5.15)

A simplified approach is permitted for trade receivables, contract assets and lease receivables. For trade receivables or contract assets that do not have a significant SLFRS 15 financing element, the loss allowance is measured at the lifetime expected credit losses, from initial recognition.

The new impairment model allows entities to calculate ECLs on trade receivables using a **provision matrix**. In practice, many entities already estimate credit losses using a provision matrix where trade receivables are grouped based on different customer attributes and different historical loss patterns *(e.g.*

geographical region, product type, customer rating, collateral or trade credit insurance, or type of customer).

Under the new model, entities will need to update their historical provision rates with current and forward looking estimates. A similar approach might be followed for contract assets.

Question 18 – ECL Simplified Approach

Company M has trade receivables of Rs. 30 million at 31 December 2014. The customer base consists of a large number of small clients. In order to determine the expected credit losses for the portfolio, Company M uses a provision matrix. The provision matrix is based on its historical observed default rates, adjusted for forward looking estimates. At every reporting date, the historical observed default rates and forward-looking estimates are updated. Company M estimates the following provision matrix at 31 December 2014:

	Expected Default Rate	Gross Carrying Amount (Rs.)
Current	0.3%	15,000,000
1-30 days past due	1.6%	7,500,000
31-60 days past due	3.6%	4,000,000
61-90 days past due	6.6%	2,500,000
More than 90 days past due	10.6%	1,000,000

One year later, at 31 December 2015, Company M revises its forward looking estimates, which incorporate a deterioration in general economic conditions. Company M has a portfolio of trade receivables of Rs. 34 million in 2015.

	Expected Default Rate	Gross Carrying Amount (Rs.)
Current	0.5%	16,000,000
1-30 days past due	1.8%	8,000,000
31-60 days past due	3.8%	5,000,000
61-90 days past due	7.0%	3,500,000
More than 90 days past due	11.0%	1,500,000

Required: Explain how the loss allowance need to be recognized at each relevant date.

Financial Instruments Disclosures

SLFRS 07

1. INTRODUCTION

SLFRS 7 specifies the disclosures required for financial instruments. The standard requires qualitative and quantitative disclosures about exposure to risks arising from financial instruments and specifies minimum disclosures about credit risk, liquidity risk and market risk.

2. OBJECTIVE

The objective of the SLFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) The significance of financial instruments for the entity's financial position and performance

(b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks

The principles in SLFRS 7 complement the principles for recognising, measuring and presenting financial assets and financial liabilities in LKAS 32 Financial instruments: Presentation and SLFRS 9 Financial instruments.

3. CLASSES OF FINANCIAL INSTRUMENTS AND LEVELS OF DISCLOSURE

The entity must group financial instruments into classes appropriate to the nature of the information disclosed. An entity must decide in the light of its circumstances how much detail it provides. Sufficient information must be provided to permit reconciliation to the line items presented in the statement of financial position.

Disclosure Requirements: Significance of Financial Instruments in Terms of the Financial Position and Performance
Statement of Financial Position
• Total carrying value of each category of financial assets and liabilities on face of the statement of financial position or in the notes • Information on fair value of loans and receivables • Financial liabilities designated as at fair value through profit and loss • Financial assets reclassified • Financial assets that do not qualify for derecognition • Details of financial assets pledged as collateral & collateral held • Reconciliation of allowance account for credit losses

• Compound financial instruments with embedded derivatives • Details of defaults and breaches of loans payable
Statement of Comprehensive Income
• Gain or loss for each category of financial assets and liabilities in the statement of comprehensive income or in the notes • Total interest income and interest expense (effective interest method) • Fee income and expense • Interest on impaired financial assets • Amount of impairment loss for each financial asset
Other
• All relevant accounting policies. Include measurement basis. • Description of hedge, description and fair value of hedged instrument and type of risk hedged • Details of cash flow hedges, fair value hedges and hedge of net investment in foreign operations • Description of the impact of choosing the exception under SLFRS 9 or LKAS 39 for interest rate benchmark reform • Fair value for each class of financial asset and liability • Disclose method and relevant assumptions to calculate fair value • Disclose if fair value cannot be determined

4. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

Disclosure Requirements: Nature and Extent of Risks Arising from Financial Instruments and How the Risks are Managed	
Qualitative Disclosure	**Quantitative Disclosure**
• Exposure to risk and how it arises • Objectives, policies and processes for managing risk and method used to measure risk	• Summary of quantitative data about exposure to risk based on information given to key management • Concentrations of risks

Specific Quantitative Disclosure Requirements	
Liquidity Risk	
Definition: The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities	• Maximum exposure to credit risk without taking into account collateral • Collateral held as security and other credit enhancements • Information of financial assets that are either past due (when a counterparty has failed to make a payment when contractually due) or impaired • Information about collateral and other credit enhancements obtained

Credit Risk	
Definition: The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation	• Maximum exposure to credit risk without taking into account collateral • Collateral held as security and other credit enhancements • Information of financial assets that are either past due (when a counterparty has failed to make a payment when contractually due) or impaired • Information about collateral and other credit enhancements obtained
Market Risk	
Definition: The risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk	• A sensitivity analysis (including methods and assumptions used) for each type of market risk exposed, showing impact on profit or loss and equity • Or if a sensitivity analysis is prepared by an entity, showing interdependencies between risk variables and it is used to manage financial risks, it can be used in place of the above sensitivity analysis

5. FAIR VALUES

SLFRS 7 retains the following general requirements in relation to the disclosure of fair value for those financial instruments measured at **amortised cost**:

(a) For each class of financial assets and financial liabilities an entity should disclose the **fair value of that class of assets and liabilities** in a way that permits it to be compared with its carrying amount.

(b) In disclosing fair values, an entity should group financial assets and financial liabilities into classes but should **offset them only to the extent that their carrying amounts are offset in the statement of financial position**.

It also states that **disclosure of fair value is not required** where:

- Carrying amount is a reasonable approximation of fair value
- For investments in equity instruments that do not have a quoted market price in an active market for an identical instrument, or derivatives linked to such equity instruments

SLFRS 13 – Fair Value Measurement Disclosures

SLFRS 13 provides disclosure requirements in respect of the fair value of financial instruments measured at fair values. It requires that information is disclosed to help users assess:

(a) For assets and liabilities measured at fair value after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) For recurring fair value measurements (i.e. those measured at each period end) using significant unobservable (Level 3) inputs, the effect of the measurements on profit or loss or other comprehensive income for the period.

In order to achieve this, the following should be disclosed as a minimum for each class of financial assets and liabilities measured at fair value:

(c) The fair value measurement at the end of the period.

(d) The level of the fair value hierarchy within which the fair value measurements are categorised in their entirety.

(e) For assets and liabilities measured at fair value at each reporting date (recurring fair value measurements), the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy and reasons for the transfers.

(f) For fair value measurements categorised within Levels 2 and 3 of the hierarchy, a description of the valuation techniques and inputs used in the fair value measurement, plus details of any changes in valuation techniques.

(g) For recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

(h) A reconciliation from the opening to closing balances

a. The amount of unrealised gains or losses recognised in profit or loss in the period and the line item in which they are recognised
b. A narrative description of the sensitivity of the fair value easurement to changes in unobservable inputs

(i) For recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity.

An entity should also disclose its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred.