ANSWER

Financial Assets: Homework Answers

Answer White – classification and accounting treatment

White has purchased an equity investment. The cash flow test is failed as there is no contractual certainty over the receipt of returns. As White has no influence then this is just a mere investment and falls under IFRS9.

All equity investments must be at carried at fair value. The carrying value at the year-end will be $106 million. The PL will always recognise the return on investment of $5 million.

The default classification and accounting treatment is FVTP&L. The transaction costs of $2 million are expensed to profit and not capitalised. The PL will recognise the capital appreciation which is $6 million (106 -100).

If White had at inception made an irrevocable election to classify the investment as FVTOCI then the transaction costs would have been capitalised to give an initial recognition of $102 million. In turn this would have meant that the net gain capital gain of $4 million (106 -102) is recognised in other comprehensive income (OCI) and accumulate in OCE.

Answer Fang – impairment reviews on financial assets

Fang needs to use the available information to assess whether the credit risk on the bond has increased significantly since inception.

It would seem that Changi's performance has declined, and this may have an impact on its liquidity.

The review of Changi's credit rating by the external agencies is indicative of concerns that it may be about to be downgraded.

The fact that market bond prices are static suggests that the decline in Changi's bond price is entity specific. This will be in response to the market perception of Changi's increased credit risk.

Based on the above, it would seem that the credit risk of the bond is no longer low.
As a result, it can be concluded that credit risk has increased significantly since inception.

This means that Fang must recognise a loss allowance equal to a lifetime of expected credit losses on the bond.

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Answer Rowe – derecognition

There seems to be a conflict between the legal form and the economic substance of the transaction. The legal form is a sale of the receivable however a closer examination reveals that Rowe has neither passed the risks or rewards of ownership.

If the customer defaults, then Rowe has to refund the monies received (with an extra payment, implying interest) meaning that Rowe has retained the risk of bad debts.

If the customer does settle in full then a further $5,000 will be due meaning that Rowe has retained the reward of ownership.

In these circumstances what Rowe has not really sold the asset. What it has really done is borrow money against the security of the receivable.

Having an obligation to repay the monies received on account means that the $70,000 represents a liability. The receivable should remain as an asset in the accounts of Rowe. This is a faithful representation of the transaction.