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Academy of Professional Finance 专业金融学院

CFA Level II

Intercorporate Investments 1

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Learning Outcome Statement 17

LOS 17.a: Describe the classification, measurement, and disclosure under International Financial Reporting Standards (IFRS) for 1) investments in financial assets, 2) investments in associates, 3) joint ventures, 4) business combinations, and 5) special purpose and variable interest entities

LOS 17.b: Distinguish between IFRS and US GAAP in the classification, measurement, and disclosure of investments in financial assets, investments in associates, joint ventures, business combinations, and special purpose and variable interest entities.

Learning Outcome Statement 17

Category	Degree of influence	Typical ownership	Account treatment
Investments in financial assets	No significant influence	<20%	Held-to-maturity, available-for-sale, fair value through profit or loss
Investments in associates	Significant influence	20%-50%	Equity method
Business combinations	Control	>50%	Acquisition method
Joint ventures	An entity whereby control is shared by two or more investors		Equity method in general

Key factor: influence & control

Learning Outcome Statement 17

- Examples of significant influence:

1. Board of directors representation.
2. Involvement in policy making.
3. Material intercompany transactions.
4. Interchange of managerial personnel.
5. Dependence on technology.

LOS17- financial assets

- Treatment of financial assets are similar under IFRS and U.S. GAAP.
- IFRS 9 (new standards) became effective since January 1, 2015.
- General rule:

1. the acquisition of financial assets is recorded at cost (i.e. the fair value at time of purchase);
2. 2) any dividend or interest income is recognized in the investor's income statement

LOS17- financial assets

- Held-to-maturity

1. Debt securities with intent and ability to be held until maturity.
2. Balance sheet treatment: reported at amortized cost.
3. Income treatment: interest income (coupon cash flow adjusted for amortization of premium or discount) is recorded in income statement.; but subsequent changes in fair value are ignored.

- Amortized cost, the present value of the remaining cash flows (coupon payments + face value) discounted at the market rate of interest at issuance.

LOS17- financial assets

- Fair value through profit and loss
  - Held-for-trading

1. Debt and equity securities held for the purposes of profiting in the near future, usually less than 3 months.
2. Balance sheet treatment: reported at fair value
3. Income statement treatment: realized and unrealized changes in fair values are reported in the income statement along with any dividend or interest income.

LOS17- financial assets

- Fair value through profit and loss
  - Designated at fair value

1. Debt and equity securities that would otherwise be reported as held-to-maturity or available-for-sale securities at fair value.
2. Balance sheet treatment: reported at fair value
3. Income statement treatment: unrealized gains and losses are recognized on the income statement
4. Why: reducing volatility and inconsistency that result from measuring assets and liabilities using different valuation bases.

LOS17- financial assets

- Available-for-sale

1. Debt and equity securities that are neither held-to-maturity nor held-for-trading
2. Balance sheet treatment: reported at fair value
3. Income statement treatment: only realized gains or losses, and dividend or interest income, are recognized in the income statement.
4. Unrealized gains and losses are reported in "other comprehensive income"; when the securities are sold, the unrealized gains and losses are removed from other comprehensive income and recorded in the income statement.

Example-from Kaplan Schweser Notes

At the beginning of the year, Midland Corporation purchased a 9% bond with a face value of $100,000. The bond was issued for $96,209 to yield 10%. The coupon payments are made annually at year-end. Let's suppose the fair value of the bond at the end of the year is $98,500.

Determine the impact on Midland's balance sheet and income statement if the bond investment is classified as held-to-maturity, held-for-trading (or fair value through profit or loss), and available-for-sale.

Answers

Held-to-maturity

Report on B/S at amortized cost, which is the PV of all future cash flows.

Coupon + amortization of premium/discount is recognized in the I/S

Step 1.

PV	FV	I/Y	Coupon	N
-96,209	100,000	10	9,000	5

Step 2.

PV	FV	I/Y	Coupon	N
-96,830	100,000	10	9,000	4

Step 3.

Interest revenue=9%*100,000+(96,830-96,209)=9,621 recorded on I/S

Answers

Held-for-trading

Step1. Reported on B/S at fair value 98,500

Step2. Changes in fair value (realized & unrealized) + interest income

=(96,830-96,209)+(98,500-96,830)+9%*100,000

=621+1,670+9,000

=11,291

Answers

Available-for-Sale

Step1. Reported on B/S at fair value 98,500

Step2. realized gains or losses + interest income are recorded in the income statement

=(96,830-96,209)+9%*100,000

=9,621

Step3. Unrealized gains or losses are reported in other comprehensive income

=(98,500-96,830)

=1,670

Example-from Kaplan Schweser Notes

Now let's imagine that the bonds are called on the first day of the next year for $101,000. Calculate the gain or loss recognition for each classification.

Gain or loss for each classification depends on the value of the securities recorded on B/S!

Held-to-maturity: A realized gain of $4,170 ($101,000 – $96,830 carrying value) is recognized in the income statement.

Held-for-trading: A net gain of $2,500 ($101,000 – $98,500 carrying value) is recognized in the income statement.

Available-for-sale: The unrealized gain of $1,670 is removed from equity, and a realized gain of $4,170 ($101,000 – $96,830) is recognized in the income statement.

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Thank You!