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速成教育
SPEED UP EDUCATION



BUS 321

Intermediate accounting

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S P E E D U P E D U C A T I O N

Shareholder Equity

Financial Instrument

contracts that create both a financial asset for one party and a financial liability or equity instrument for the other party

Derivatives

- Derivatives have three characteristics:
 1. Their value changes in response to the underlying instrument
 2. They require little or no initial investment
 3. They are settled at a future date
- I F R S identifies and defines various kinds of financial risk:
 - Credit risk—the other party to a financial instrument contract will fail to deliver
 - Liquidity risk—the company itself will not be able to honour a contract due to cash problems
 - Market risk—risk of a change in value and/or cash flows related to market forces
- *derivatives are accounted for using **fair value through net income (FV-NI)**.*

Options and Warrants

- An option or warrant gives the holder the contractual right to acquire or sell an underlying instrument at a specific price within a specific term
 - Exercise price: agreed upon price for settlement
 - Exercise period: the specific term

- Derivatives do not result in transfer of the underlying at the contract's inception; and perhaps not at maturity
- Purchased option gives holder a right, not an obligation

	Call - right buy	Put – right to sell
Written	Sell option for \$ Transfer right to buy shares/underlying	Sell option for \$ Transfer right to sell shares/underlying
Purchased	Pay \$ for option Obtain right to buy shares/underlying	Pay \$ for option Obtain right to sell shares/underlying

Company A purchases a call option from Company B on Jan 2 for \$400. Option gives Company A right to purchase 1,000 Company L shares (the underlying) at \$100 per share (the exercise price) and it expires on April 30. At the time of the transaction, Company L shares are trading at \$100

Example continued: by March 31, L shares market price = \$120.

Options are trading at \$20,100 = $[(\$120 - \$100) \times 1,000] + \$100$

Gain on revaluation of derivatives = \$20,100 – \$400 = \$19,700

Intrinsic value = \$20,000;
Time value = \$100

To record revaluation on March 31:

Derivatives--Financial Assets/Liabilities 19,700

Gain or Loss on Derivatives

19,700

Gain is recorded through net income (FV-NI)

Value reported on SFP: \$400 (from purchase entry) + \$19,700 = \$20,100

Example continued: On April 1 Co. A settles the option in cash (net settlement) rather than taking the shares. Shares are still worth \$120 each

To record the settlement on April 1:

Cash	20,000	
Gain or Loss on Derivatives	100	
Derivatives--Financial Assets/Liabilities	20,100	Derecognizes revalued asset

Net gain on settlement: \$20,000 settlement – \$400 option cost = \$19,600

Example continued: Assume instead that on April 1 Co. A takes delivery of the shares (**gross settlement**). Shares are still at \$120.

To record the settlement on April 1:

FV-NI Investments	120,000	
Gain or Loss on Derivatives	100	Time value loss from settling one month early
Cash	100,000	
Derivatives--Financial Assets/Liabilities	20,100	

Forward Contract

- Under a forward contract, parties commit up-front to do something in the future, for example
 - One party agrees to buy an item (underlying)
 - Other party agrees to sell the item at a specified price on a specified date
 - Price and period are locked in

On Jan 2, Company A agrees to buy US\$1,000 from Bank B for CDN\$1,150 in 30 days. Spot rate: US\$1 = CDN\$1.10. Contract priced such that FV = \$0.

Jan 2

Example continued: On Jan 5, the fair value of the contract is \$50.

To record revaluation on Jan 5

Derivatives -- Financial Assets/Liabilities	50
Gain or Loss on Derivatives	50

Example continued: On Jan 31, the contract moves into a \$30 loss position

To record revaluation on Jan 31

Gain or Loss on Derivatives

80

Derivatives--Financial Assets/Liabilities

80

The \$50 gain from Jan 5 is reversed; an additional loss of \$30 is recognized

Derivatives—Financial Assets/Liabilities would be presented on the SFP as a **liability**.

Example continued:
On the settlement date, US\$1.00 = CDN\$1.05.

To record the net settlement on Feb 1:

Gain or Loss on Derivatives

70

Derivatives--Financial Assets/Liabilities

30

Cash

100

\$1,150 –
(\$1,000 ×
1.05)

To record the gross settlement on Feb 1:

Cash (\$1,000 US × 1.05)

1,050

Derivatives--Financial Assets/Liabilities

30

Gain or Loss on Derivatives

70

Cash

1,150

Derecognize liability account

Future

Hybrid/Compound Instruments

- Financial instruments measured at fair value
- Two approaches to allocating the value to components
 - Residual value approach (incremental method)
 - Relative fair value approach (proportional method)
- I F R S requires residual value approach; debt valued first
- ASPE allows equity component to be valued at zero or the residual method—easier component measured first
- Subsequently, debt is measured at amortized cost
- Classification chosen at inception continues until derecognition

Convertible Debt

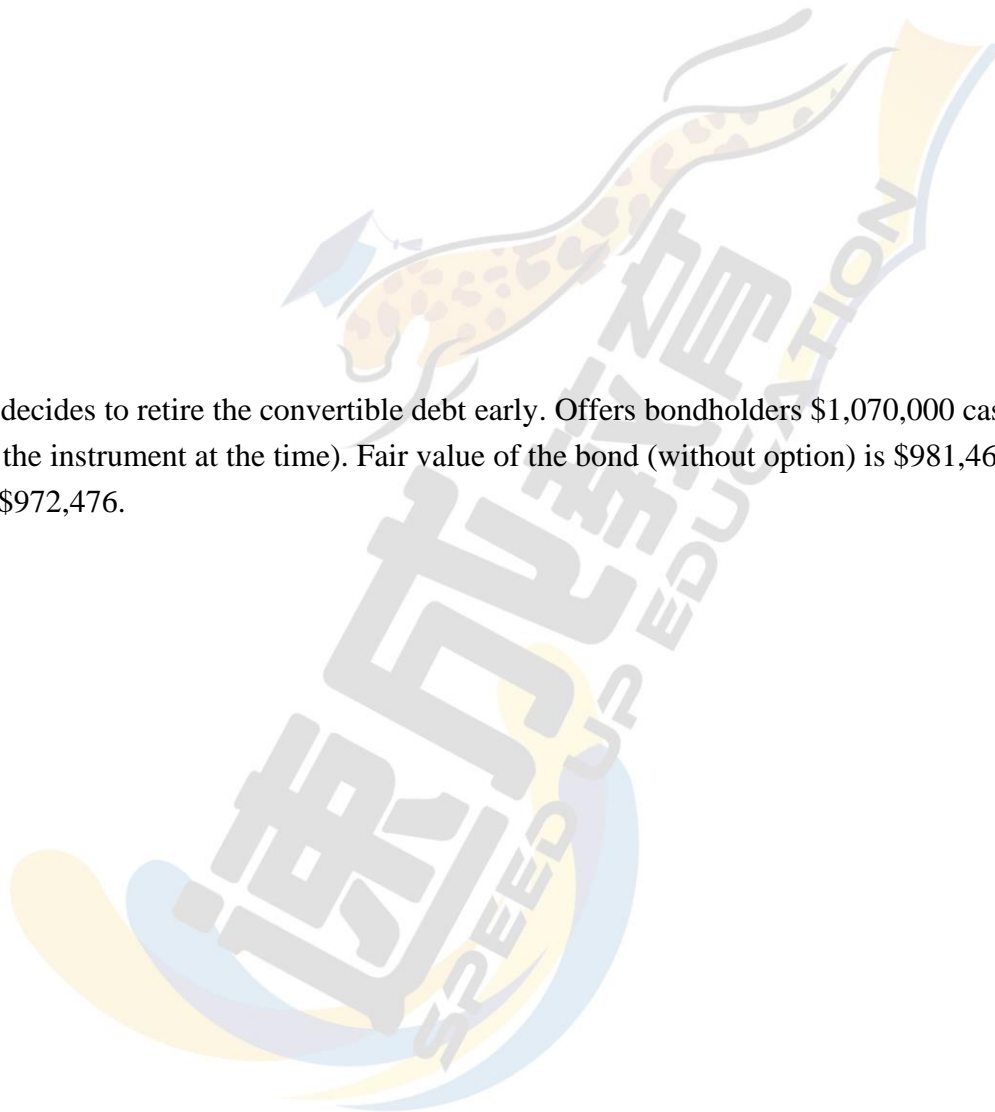
Example: B Corp. offers 3-year, 6% convertible bonds (par \$1,000). Each bond is convertible into 250 common shares, trading at \$3. Similar straight bonds carry an interest rate of 9%. 1,000 bonds are issued at par

Company decides to use the residual value approach and measure debt first (I F R S). For A S P E, company chooses to value equity at \$0.

Holders decide to convert their bonds before the bonds mature. The bond discount will be partially amortized at this point. Assume that the unamortized portion is \$14,058.

What if the company offers an additional cash premium of \$15,000 to the bondholders to convert, at a time when the carrying amount of the debt is \$972,476? The fair value of the bond at this time is \$981,462.

B Corp. decides to retire the convertible debt early. Offers bondholders \$1,070,000 cash (fair value of the instrument at the time). Fair value of the bond (without option) is \$981,462; carrying value is \$972,476.



Share-Based Compensation

E S O Ps: employee stock option or purchase plans

C S O Ps: compensatory stock option plans

CSOP	ESOP
Plans are compensatory	Non-compensatory; employee usually pays for the options
Employees are paid for service	Employee is investing in the company
Salary expense	Charged to equity accounts
Operating transaction	Capital transaction
Income statement	Shareholders' equity
Generally not traded on exchange since holder must be an employee	Generally not traded on exchange since holder must be an employee

Example: A company set up an E S O P that gives employees the option to purchase company shares for \$10 each. The option premium is \$1, and there are 10,000 shares available. On Jan 1, employees purchased 6,000 options. Subsequently, all options were exercised and 6,000 shares were issued.

Jan 1, 2021: Grant date; options to 5 executives to purchase 2,000 of the company's shares at exercise price of \$60; Dec 31, 2022: vesting date; fair value: \$220,000; first exercise date—2 years from the grant date.

20% or 2,000 of the 10,000 options were exercised on June 1, 2024

Assume the remaining options were not exercised and expired.

