



# FINANCIAL REPORTING FOR SACCOS LAICO REGENCY 12<sup>TH</sup> TO 13<sup>TH</sup> MAY 2015

Credibility

Professionalism

AccountAbility

1. Overview of the Principles and Scope
2. Definitions
3. Provisions of IAS 32
4. Questions and discussions

# Overview



Businesses are normally financed using several tools i.e. can raise capital using new shares, issuing loans or buying goods and other assets on credit. The business can also lend if it has surplus funds or sell goods and other assets on credit. All these means of borrowing and lending are referred to as Financial Instruments.



# Overview



Due to financial innovation, Financial Instruments have become complex. The main area of innovation is in the creation of derivatives which have special features and significant impact on a business. Poor accounting treatment and disclosure of derivatives has led to the collapse of some businesses and problems in the financial industries. E.g. Barings Bank in UK.

# Overview – Main stds



Standard	Title
IAS 32	Presentation (Mainly for Borrowers)
IAS 39	Recognition and Measurement (Both Borrowers and Lenders)
IFRS 7	Disclosures (Borrowers and Lenders)
IFRS 9	Financial Instrument (To replace IAS 39)

# Overview – Hints



**1. Have a good knowledge of financial management and valuation of the financial instruments**

2. Have a sound knowledge of accounting principles especially with regards to recognition, measurement and presentation.

3. Be smart enough to know when does financial management start and end and where does accounting begin.

4. Have a good understanding of financial markets and principles especially for derivatives.

# Definitions



**Financial instrument (FI)**: this is a contract that leads to a financial asset to one party and a financial liability or equity to another party. (Financial Asset to the lender and Financial Liability/Equity to the borrower)



# Definitions



**Financial Asset (FA)**: this is either cash or the right to receive cash or any other financial asset e.g. Investment in Shares/ Loan stock, Trade Receivables and Derivatives that have a net cash inflow position.



# Definitions



**Financial liability (FL)**: this is an obligation to deliver cash or any other financial asset e.g. loan stock and redeemable preference shares trade payables derivatives that have net cash outflow.

# Definitions



**Equity (E)**: this is a financial instrument that gives a residual interest in the business i.e. total assets-total liabilities e.g. Ordinary shares and other preference shares.

# Definitions



**Derivative (D)**: is a Financial Instrument whose value depends on another factor (such as exchange rate, interest rate, share price etc), requires little or no initial investment and settlement is at a future date. Main examples include Forwards, Futures, Options and Swaps



# IAS 32 - Objective



To establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities.



# IAS 32 - Scope



It applies to:

1. The classification of financial instruments, from the perspective of the **issuer**, into financial assets, financial liabilities and equity instruments;
2. The classification of related interest, dividends, losses and gains;
3. The circumstances in which financial assets and financial liabilities should be offset

# IAS 32 - Scope



It applies to all the financial instruments that require the settlement by use of cash or another financial instrument.

# IAS 32 - Scope



Does not cover:

Subsidiaries

Associates

Joint Ventures

Post employment benefits

Insurance contracts

Share based payments



# IAS 32 – FL and Equity



A Financial Liability is different from equity because it requires the **DELIVERY** of cash or another Financial Asset.

An amount should be classified as equity if there is no obligation pay until liquidation of entity.



# IAS 32 – Contingent Settlement



If an amount borrowed is to be settled based on the occurrence of certain future events or circumstances then such an amount should be classified as a Financial Liability and not equity.

# IAS 32 – Settlement Options



If a borrower borrows an amount that will be paid in the future either by cash or using equity (Shares), then this amount should be classified as a Financial Liability.

# IAS 32 – Compound F I



A compound financial instrument is a FI with the features of both a Financial Liability and Equity. For example Convertible loan stock. This should be split into equity and liability components



# IAS 32 – Treasury Shares



If a company buys back its own shares (This is not allowed here in Kenya), the buy back and any other expenses should be deducted from share capital and reserves and not an expense. These are called Treasury shares



# IAS 32 – Interest dividends, G & L



Interest and other gains and losses arising from borrowing a loan should be reported in the income statement, while dividends and other gains and losses from issuing new shares should be reported in equity.

# IAS 32 – Offsetting FA & FL



A Financial Asset and a Financial Liability should not be offset unless the company has a legal right to do so or there is intention to settle on a net basis.

# IAS 32 – Puttable FI



The borrower of a puttable financial instrument should classify the amount borrowed as a liability unless there is intention to settle in equity i.e. deliver a portion of ownership. Then this is classified as equity.



# IAS 32 - Questions

