Hi and welcome,

This is a brief sample to provide you with an idea of what my CFA study notes look like.

The style is to provide key content coverage followed by working examples.

Mixed in you will see my ***"Professor's Comments"*** and ***"Exam Tips"***, I've included these to give you my thoughts on how I believe something will show up on the exam or how best to approach learning a concept….or even if I believe you should just skip something altogether.

If you have written the exam before, you can use my materials to get back up to speed very quickly.

If you are a first time writer, you can use my materials to help focus your study efforts and build your knowledge base.

If you have any questions, please do not hesitate to reach out to me by email.

All the best,

Prof Brian Gordon, CFA, CFP, CIM, MBA, FCSI
Director of Learning
Exam Success

Level 2

Financial Reporting & Analysis

- This material fits in well with the Item Set format.
- You should be ready to handle a full Item Set based on Intercorporate Investments.
- I would also expect a full Item Set based on Pensions or a full Item Set based on Currency Translation effects.

READING 13:
INTERCORPORATE INVESTMENTS

READING 14:
EMPLOYEE COMPENSATION: POST-EMPLOYMENT AND SHARE-BASED

READING 15:
MULTINATIONAL OPERATIONS

READING 16:
ANALYSIS OF FINANCIAL INSTITUTIONS

Intercorporate Investments

Companies invest in the debt and equity securities of other companies to add to their profits. The gains, losses and cash flows from these investments can skew the true financial performance.

Intercorporate Investment Categories

- Investments in Financial Assets
- Investments in Associates
- Joint Ventures
- Business Combinations

Investments in Financial Assets (Less than 20% ownership)
Passive investments where the investor cannot exert significant influence or control over the operations of the investee. IFRS and GAAP are similar in their accounting treatment for investments in financial assets.

Investments in financial assets are divided into "amortized cost" or "fair value":

Investment in Financial Assets (IFRS 9)

First off, know that there are three categories based on ***"business model"***:

1) **<u>Amortized Cost (AC)</u>**, use if business model is ***"intent to hold"***.
2) **<u>Fair Value Through Profit or Loss (FVPL)</u>**, use if business model is ***"intent to trade"***.
3) **<u>Fair Value Through Other Comprehensive Income (FVOCI)</u>**, use if business model is ***"intent to trade or hold"***.

<u>Basics:</u>
Know that **Derivatives** are always classified as FVPL (unless they are specifically held for hedging purposes).

Know that **Equity** investments are always classified as FVPL (unless you are told the company has chosen to classify them as FVOCI…this decision is irrevocable).

Know that **Debt** investments can be classified as AC, FVPL or FVOCI and reclassification is possible.

<u>Accounting Rules:</u>

Equity and **Debt** investments classified as FVPL or FVOCI are reported on the balance sheet at their fair value (ie. at market value as of the balance sheet date).

Equity and **Debt** investments classified as FVPL report realized (ie. actual sales) and unrealized (ie. changes in fair value) gains or losses on the income statement (could also say "through income").

Debt investments classified as FVOCI report realized (ie. actual sales) gains or losses on the income statement (could also say "through income") and unrealized (ie. changes in fair value) gains or losses on the balance sheet in OCI.

Equity investments classified as FVOCI report realized (ie. actual sales) gains or losses and unrealized (ie. changes in fair value) gains or losses on the balance sheet in OCI.

Debt investments classified as AC are reported on the balance sheet at their amortized cost.

No matter which classification is used (AC, FVPL or FVOCI) **dividend** and **interest** income is always reported on the income statement.

Equity and **derivative** investments cannot be reclassified.

Debt investments can be reclassified with the changes made prospectively (ie. no prior year restatements).

Exam Tip:

Watch out for the following exception related to Debt investments, if the investment may be sold, look for the wording ***"hold to collect and sell"***, this is your signal to use either fair value through profit or loss or fair value through other comprehensive income.

<u>Quick Example 1:</u>
On January 1, Dixon Corp. purchased a 3 year 6% annual pay bond yielding 9%.

1) **Calculate** the balance sheet carrying value under IFRS and US GAAP:

a) as of January 1 (beginning of the year):

b) as of December 31 (end of the year):

2) **Calculate** the interest income reported in the first year:

3) **Calculate** the cash interest received and briefly describe how it could be reported under IFRS and US GAAP:

Solutions:
The accounting is the same under IFRS and US GAAP:

1) a) Using your financial calculator, calculate the value of the bond:

FV = 1,000, N = 3, I = 9%, PMT = 60, CPT PV = -924.06, so the balance sheet value would be $924.06. <= This is the unamortized cost or the fair value!

b) Using your financial calculator, calculate the value of the bond:

FV = 1,000, **N = 2**, I = 9%, PMT = 60, CPT PV = -947.22, so the balance sheet value would be $942.22.

2) Using the effective rate method: Interest income = ($924.06) x (9%) = $83.16

3) The cash interest is the coupon payment = ($1,000) x (6%) = $60

Under US GAAP this would be classified as an operating cash flow, while under IFRS this may be classified as an operating or investing cash flow.

Note: The interest expense minus the cash interest equals the bond amortization:

Amortization = $83.16 **–** $60 = $23.16 <= notice this is the difference between $947.22 and $924.06!

<u>Quick Example 2:</u>
An Analyst is reviewing the transactions related to an equity investment made by RedSox Co. over the period 2018 and 2019. The Analyst notes the following points:

- On May 1, 2018, RedSox Co. bought 1,000 shares of ABX at a price of $50 per share.
- On October 1, 2018, ABX paid a dividend of $0.25 per share.
- On December 31, 2018, the market price of ABX shares $54.
- On January 20, 2019, RedSox Co. sold its ABX shares at a price of $53 per share.

1. Without any other information, what is the *most likely* way that RedSox Co. would account for its investment in ABX?

   A. Amortized Cost (AC)
   B. Fair Value Through Profit or Loss (FVPL)
   C. Fair Value Through Other Comprehensive Income (FVOCI)

2. Which of the following is *least likely* to be correct concerning 2018?

   A. RedSox Co. reported an unrealized gain of $4,000 through income.
   B. RedSox Co. reported $250 of dividend income on its income statement.
   C. RedSox Co. reported an unrealized gain of $4,000 through other comprehensive income.

3. Which of the following is *most likely* to be correct had RedSox Co. decided to classify its investment in ABX as FVOCI?

   A. In 2019, RedSox Co. would have reported a realized loss of $1,000 through other comprehensive income.
   B. In 2018, RedSox Co. would have reported an unrealized gain of $4,000 through income.
   C. In 2018, RedSox Co. would have reported dividend income of $250 through other comprehensive income.

Solutions: