26. (2.25 points)

A Canadian property and casualty insurance company holds the following three bonds. Assume the company is an income tax exempt corporation and that it has no other investments. All amounts are in thousands of dollars ($000s).

Bond	Classification	Amortized value at 12/31/2014	Market value at 12/31/2014	Coupon received in 2015	Amortized value at 12/31/2015	Market value at 12/31/2015
AAA	Held to maturity	2,000	2,100	50	2,000	2,200
BBB	Available for sale	1,000	900	100	900	950
CCC	Held for trading	1,500	1,600	75	1,400	1,300

a. (0.75 point)

Determine the value of each bond to be shown in its financial statements at 12/31/2015.

b. (1 point)

Calculate the impact of holding these investments on net income and other comprehensive income in 2015.

c. (0.5 point)

Describe the implications of selling $1,500 of the AAA bond.

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QUESTION 26

TOTAL POINT VALUE: 2.25 | **LEARNING OBJECTIVE: D1**

SAMPLE ANSWERS

Part a: 0.75 point

Bond	Classification	Value
AAA bond	Held for maturity	2,000
BBB bond	Available for sale	950
CCC bond	Held for trading	1,300

Part b: 1 point

Net income: ∑ Coupons + Changes in amortized value for Held to maturity and Available for sale + Change in fair value for held for trading assets

Net Income = (50 + 100 + 75) + (2,000 – 2,000 + 900 – 1,000) + (1,300 – 1,600) = -175

Other comprehensive income = Difference between fair value and amortized cost at 12/31/2015 - Difference between fair value and amortized cost at 12/31/2014

Other comprehensive income = (950 – 900) – (900 – 1000) = 150

Part c: 0.5 point

The sale of "more than an insignificant amount" of a Held to maturity asset requires the reclassification of the entire category as available for sale.
or
The consequence for tainting the Held to maturity portfolio is considered a major impediment to using this category because it potentially reduces flexibility in managing the portfolio for rebalancing or strategic benefit, and it creates significant reporting challenges is asset sale/redeployment becomes attractive

EXAMINER'S REPORT

Candidates were expected to be able to identify the classification of each bond and how they should be dealt with in the financial statements.
Candidates generally scored well, see part b for details.

Part a

This appears on exam every year.

Part b

Most candidates were able to identify BBB as contribution to OCI and calculate coupon as part of income. Candidates lost credit over not calculating the change in amortized value for HTM and AFC and the change in fair value for HFT correctly. Candidates also lost credit over not calculating the change in difference between fair value and mortised cost for OCI.

Part c

SAMPLE ANSWERS AND EXAMINER'S REPORT

Most candidates were able to answer part c correctly. Candidates lost credit over reclassifying the HTM to a wrong class after the sale.