Abstract
These instructions provide basic guidelines to help authors prepare their final camera-ready papers for IFRS 7 Financial Instruments Disclosures standard was elaborated in order to review the existing similarities in IAS 32 and in IAS 30, but also to eliminate the redundant and expensive showcases from IAS 32 referring to the risk concentrations of credit risk, liquidity or market, and to erase the commentaries from IAS 30 about contingency, commitments and general banking risks. The appearance of this standard has also marked the rule unification regarding the informational description about the financial instruments, which were found in the IFRS/IAS referential, in more norms, thus this standard is applied to all risks generated by the financial instruments, being used by all entities. The purpose of this article is oriented towards highlighting the importance and the utility of the IFRS 7 standard, especially for the entities who utilize financial instruments.

Key words: IFRS 7, financial instruments, financial assets, derivations, evaluation.

JEL Classification: M41

I. INTRODUCTION

Under the current conditions in which the economic environment is marked by continuously more rapid and complex changes, in view of a continuous development of the Romanian capital market, domestic firms will increasingly resort to financial instruments. Thus, accounting for them, disclosing and describing information on individual or consolidated accounts, and analyzing the impact of their use on the performance and financial position of entities become topical subjects for Romanian accountants, for whom the issues addressed in this paper are becoming more and more useful.

The need to develop standards on financial instruments, implicitly on financial assets and liabilities, has emerged in the context of the explosion of the use of derivatives and markets on which they are traded, as well as the numerous financial scandals that have shook the US and Europe over the last decade. They were based, among other things, on the inappropriate use of derivatives and the concealment of the disastrous effects of their poor management by keeping them out of balance and not providing related information in the explanatory notes of the financial statements.

Additionally, in view of the spectacular evolution of risk assessment and management techniques related to financial instruments, as well as the wider use of the risks associated with financial instruments and the wider use of new risk management concepts, the IASB has understood the need to improve the way in which information on these instruments is presented in the financial statements and has initiated a project to enhance the transparency of risk descriptions. Thus, in August 2005, the project became IFRS 7 "Financial Instruments: Information to Provide". The objective of this Standard is to provide information that enables users to assess the significance of the financial instruments for the enterprise's performance and financial position, the nature and extent of associated risks to which the entity is exposed before and at the balance sheet date, and the capital of the reporting firm. The benefits are related to monitoring and decision-making after a close analysis of the financial statements (Socoliuc et al., 2017; Cosmulese, 2017).

IFRS 7 encompasses both firms with a small number of instruments (such as production companies for which the most used financial instruments are liabilities and financial debts) and those that use a large volume of such instruments adequately (in this category being the financial institutions). However, the level of detail of the information depends on the level of use of the tools and the exposure to risk (IFRS, 2015).

Compared to IAS 32, IFRS 7 adds supplementary requirements to improve the disclosures in the balance sheet, profit and loss account and notes, requires qualitative and quantitative information on exposure to the risks arising from the use of financial instruments and extends the scope to instruments which were previously subject to IAS 32. In addition, IFRS 7 incorporates the disclosure requirements for financial assets/liabilities designated under the fair value option. The modification brought by IFRS 7 constitute a specific rundown of the just value hierarchy, namely the fact that entities need to correctly defined three levels of just value and must subsequently
report them (Socoliuc and Grosu, 2014). IFRS 7 "Financial Instruments: Information to Provide" requires information to be provided on two aspects, as it can be seen in Figure 1.

![Figure 1 – Information to Provide Required by IFRS 7](Source: Adaptation after Oprea, 2010)

Qualitative information to provide describes management objectives, risk management policies and processes, and quantitative information disclosures provide the opportunity to measure entity exposure to risk based on information provided internally by key management personnel of the entity (see Figure 1). Together, these disclosures provide an overview of how the entity uses the financial instruments and the risk exposures it generates. Generally speaking, "IAS/IFRS standards have been perceived as a potentially more effective instrument to ensure a healthy functioning of the capital market, providing the beneficiaries of annual financial statements with the information they need to make economic decisions and protect investors through an effective comparability of data provided by companies " (Grosu, 2010).

VII. SPECIFIC TERMS

For a better understanding of the information presented in this paper, we consider it appropriate to define a few terms specific to IFRS 7. We will begin with the notions of the standard name, namely "financial instruments", which are any contract that simultaneously generates a financial asset for an entity and a financial liability or an equity instrument for another entity (Constantin, 2013).

It should be noted that the funds absorbed at national, community or even international level are also of particular importance from the perspective of financial instruments, because there are no different accounting and tax treatments (Cosmulese and Ciubotariu, 2017). Financial assets are treated as rights on the real assets. Their value does not arise from physical form but from contractual relations, they facilitate the transfer of funds between their holders and those in their search. They are financial assets only to the extent that they reflect the entity's right to receive cash or other financial assets from a third party. A financial asset is any asset that signifies: "treasury; an equity instrument of an entity; a contractual right (to receive cash or another financial asset from another entity / to exchange assets or financial liabilities with another entity under conditions that are potentially favorable to the entity); a contract that will or may be settled in its own equity instruments (this is a non-derivative financial instrument for which the entity is or may be required to receive a variable number of equity instruments or a derivative that will or may be settled otherwise than by the change of fixed amounts in cash or other financial assets for a fixed number of equity instruments of the enterprise) " (Oprea, 2009).

Financial liabilities are considered to be the counterpart of financial assets. They are created by the issuer of a financial asset and consist of the fulfillment of the obligations related to the issued asset. Financial liabilities are only to the extent that they reflect the entity's obligation to pay a cash or other financial asset to a third party (Lepâdatu). The categories of financial assets can be seen in Figure 2.

![Figure 2- Categories of financial assets](Source: Adaptation after Grigore, 2017)
An asset or a financial liability is classified by the company as financial assets at fair value through profit or loss if it has been principally acquired for hedging purposes (to generate short-term profit).

A classification of financial instruments can be seen in Figure 3.

![Figure 3 - Types of financial instruments](source: Adaptation after Lepădatu, 2010)

Primary financial instruments are those whose values are determined directly on the market and do not derive from that of another instrument. This category includes assets, commercial and financial liabilities/debts, trade effects (bill of exchange, promissory note, check), debt securities and equity instruments (shares).

Derivatives, as the name calls them, are different from primary instruments because the way their price behaves derives in the manner in which the price of the underlying asset evolves (www.bvb).

Synthetic financial instruments have emerged as a result of the combination of different assets in order to obtain new products for the availability of funds.

### VIII. DERIVATIVE FINANCIAL INSTRUMENTS

As presented in the introduction of the paper, over the past decade, there have been many financial scandals in the US and Europe that have led to inappropriate use of derivatives and concealing the disastrous effects of their poor management. By doing so, we emphasize the need for the standard on financial instruments, especially to avoid such scandals, which bring with them, besides the huge financial losses, the decrease in public trust in entities, but also in the economic-accounting field in general.

The use of financial instruments has become frequent following the cessation of the Bretton Woods Agreement, concluded in 1944, in order to maintain interest rate and exchange rate stability, during which a widespread state of instability in the global financial markets and commodities was observed. The purpose of derivatives is to provide protection against adverse movements in prices, exchange rates and interest rates. The price of a derivative is determined based on the asset price/rate and time.

The forward contract is the simplest derivative risk protection instrument and represents a commitment to buy or sell an asset at a certain price and at a future date. It is a non-standard contract, which ends outside the regulated market through direct negotiation (Lepădatu, 2010).

**Example no. 1:** An X company will receive over 6 months in exchange for the receivables held, € 50 million that it will have to exchange in dollars to make certain payments to an external supplier. To cover itself against exchange rate risk, the company will contact a bank and negotiate a contract to set a delivery price of $ 0.95/Euro to sell the € 50 million. The company has a short position open and will sell its assets for $ 47.5 million. The bank is in a long position buying the 50 million euros with $ 47.5 million over 6 months. No cash flow takes place at the date of the conclusion of the contract.

- If the spot price is $ 0.87 / Euro at maturity, the bank has a loss of $ 4 million = € 50 million * ($ 0.87/€ - $ 0.95/€) and the company will have a profit $ 4 million.
- If at the maturity of the spot price is $ 1.05 / Euro, the bank has a profit of $ 5 million = € 50 million * ($ 1.05/€ - $ 0.95/€) and the company will have a $ 5 million loss.

Under the forward contract, one of the parties agrees to purchase the underlying at a specified future date at a certain price, the other party selling the asset on the same date and at the same price, called the delivery price. The forward contract does not involve any real or monetary flow at the time of its conclusion during its term of validity, only on maturity. The two parties involved are at risk: the risk that the price of the underlying asset will evolve in an unfavorable direction and the risk of insolvency of the contract partner.

Futures contracts are a complex form of the forward contract. This contract creates an obligation for a party to sell or to buy a standardized asset that ends within the regulated market - the stock or commodity market.
The gain or loss determined by futures contracts is given by the difference between the spot trading price and the price of the previous day.

Example no. 2: A Romanian importer buys in December 200X from a partner in Germany products worth 50,000 EURO, and will immediately receive them and pay for them in 2 months. He sells the imported products on the domestic market at the price of 300,000 RON. When signing the contract, the importer cannot accurately estimate the profit due to the RON/EURO exchange rate (he pays the merchandise in euros and sells it in RON). At the time of signing the import contract the EURO/RON rate is 4.2 RON/euro. To eliminate the risk of depreciation of the national currency vis-à-vis the euro, he will buy 50 Euro/RON futures contracts at the rate of 4.25 RON/euro, the margin required to open a long position on the futures market is 125 RON/contract, commission fee 3 RON/contract. If in 2 months, the Euro/RON rate is:

a) 4.1 RON / euro
b) 4.3 RON / euro

Solution:

a) Commercial Transaction = 300,000 - 4.1R1ON / euro * 50,000 Euro = 95,000
Futures trading = 50 * 1000 * (4.1 - 4.25) - 3 * 50 * 2 = -7,800 RON
Res. cumulated transaction = 95,000 - 7,800 = 87,200 RON

b) Commercial Transaction = 300,000 - 4.3 RON / euro * 50,000 Euro = 85,000
Futures trading = 50 * 1,000 * (4.3 - 4.25) - 3 * 50 * 2 = 2,200 RON
Total Transaction = 85,000 + 2,200 = 87,200 RON

Futures are heavily used today for speculative, hedging, and arbitrage purposes, their markets providing investors with information about current and future economic trends, their use having both advantages and disadvantages.

Option is a contract between two parties (seller and buyer) in which the buyer obtains, in return for a sum of money called a premium, the right, but not the obligation, to buy / sell a determined quantity of an asset at a price agreed, called exercise price, and during or at the end of a defined time period. While the buyer may or may not exercise the right to sell or buy the asset, the seller remains tributary to the choice of the first one.

There are two distinct types of option contracts:

- purchase (call). The buyer of a call option will always have a long position and he hopes that the market price of the underlying asset will increase. The seller of a call option will have a short position and he hopes that the market price of the underlying asset will remain constant or fall.
- sale (put). The buyer of a put option will always have a long position and he hopes that the market price of the underlying asset will drop. The seller of a put option will always have a short position and he hopes that the market price of the underlying asset will remain constant or increase.

Example no. 3: An investor buys an European (American) CALL option on a RON/USD futures contract with an exercise price of 3.12 RON/$ and a premium of 0.3 RON/share. A RON/USD futures contract consists of 1,000 USD. If at maturity of options (or for US option to maturity), the course is:

a) 3.18 lei / $;
b) 3.12 lei / $;
c) 3.10 lei / $;

What will be the result of the investor in the three situations?

- If the rate at (to) maturity ≤ the exercise price → the contract is abandoned by the buyer and the loss is equal to the premium paid to the seller.
- If the rate at (to) maturity> the exercise price → the contract is exercised by the purchaser of the option that purchases the currency at the exercise price, he sells it on the day of maturity (C) and pays the premium further.

For an option, the relationship is opposite.

- at the money - the exercise price = the underlying asset exchange rate
- out of the money - the exercise price> the underlying asset's exchange rate for call options. For a put option, the relationship is opposite (Socoliuc, 2017).

Depending on the position of the exercise price to that of the underlying, the options are of three types:

- in money - the exercise price being lower than the underlying asset, in the case of call options. For a put option, the relationship is opposite.
- at the money - the exercise price = the underlying asset exchange rate
• out of the money - the exercise price > the underlying asset’s exchange rate for call options. For a put option, the relationship is opposite (Socoliuc, 2017).

IX. ASSESSMENT OF FINANCIAL INSTRUMENTS

First of all, it is necessary to define the terms "amortized cost" and "fair value". The amortized cost of an asset or financial liability is:

- The value at which the financial asset or financial liability is assessed at initial recognition
- Principal refunds
- + / - Cumulative amortization using the effective interest method for each difference between the original value and the maturity value
- Any reduction for impairment or inability to recover (Oprea, 2009).

Fair value is "the amount at which an asset could be exchanged or to which a debt could be extinguished between knowledgeable and interested parties in a transaction conducted on objective terms" (ceccar.ro).

An important issue that should be considered is the need not to confuse the concept of fair value with market price, a very diffused error in practice. When IFRS 7 requires information disclosures by the class of financial instrument, an entity will group financial instruments in classes that are appropriate to the nature of the information presented and will take into account the characteristics of those financial instruments. An entity will provide enough information to allow reconciliation with the line items presented in the balance sheet.

The classes of financial instruments are those specified at the beginning of the paper, but can also be seen in Figure 4 (categories of financial instruments); the help determining the way in which financial instruments are valued and how fair value changes are recognized.

To determine classes of financial instruments, an entity must at least:

a) distinguish the instruments valued at amortized cost from those valued at fair value;
b) treat as separate class or classes those financial instruments that are outside the scope of the Standard (Oprea, 2010).

Depending on its particular circumstances, an entity decides how much detail it provides to meet the requirements of IFRS 7, how much it focuses on different aspects of the requirements, and how it aggregates the information to present the overall picture without combining information that has different characteristics.
X. CONCLUSIONS

Accounting the financial instruments according to the rules contained in IFRS 7 is completed by presenting and describing the related information in the summary documents. Based on this information, certified by auditors, interested users appreciate the impact of using financial instruments on the entity’s financial position and performance and make economic decisions.

Of great importance is a realistic valuation of assets, including sensitivity to future events and adverse evolutions and a fair recognition of income and expense. That is why we wanted to highlight the importance of evaluating financial instruments, but also the need to correctly and accurately establish each category of such instruments. The obligation to present derivatives in the balance sheet as financial assets or liabilities and the imposition of detailed information about financial risks, fair value, nature and contractual conditions of financial instruments, risk management policies, etc., are key contributions from IFRS 7 in avoiding any situation similar to financial scandal or other events that could affect the image of the entities, but also of the professional accountant.

Finally, we believe that the disclosure requirements required by this standard must be accompanied by active legislation to ensure enforcement - and possibly even anti-fraud laws - to ensure that the information described is complete, on time and not intentionally mistaken.

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