APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) IN DERIVATIVE-INSTRUMENT ACCOUNTING IN VIETNAM - OPPORTUNITIES AND CHALLENGES

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Abstract: ***Vietnam's fast-growing, globally integrated economy has spurred rapid development of its financial markets. Adopting the International Financial Reporting Standards (IFRS) package on financial instruments in Vietnam presents major opportunities for deeper economic cooperation with the rest of the world, yet also poses significant challenges. Enterprises must overhaul recognition and measurement practices and critically assess the current adoption roadmap in order to devise solutions that raise the effectiveness of IFRS-based accounting for derivative financial instruments in line with international norms.***

• Keywords: *IFRS, accounting, derivative financial instruments.*

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1. Introduction

The global trends of economic globalisation and trade liberalisation have fundamentally altered international capital flows. At the same time, fluctuations in commodity prices, interest rates and exchange rates have created major challenges for businesses. Corporate operations are becoming ever more complex, while competitive pressure and latent risks continue to rise. To cope with these changes, enterprises must devise measures that prevent and mitigate the risks and uncertainties that may affect their activities. Many studies emphasise that one of the most useful and increasingly essential economic tools for firms in an era of integration is the derivative financial instrument. Using derivatives can offset inherent business risks (Danthine, 1978), generate significant economic benefits (Sajjad et al., 2013), enhance firm value (Froot et al., 1993), reduce potential risk (Stulz, 2022), lower borrowing costs and stabilise income (Barton, 2001). Accounting for derivative financial instruments is inseparable from trading them. Establishing timely, consistent and rigorous accounting regulations for derivatives is crucial for enterprises and for all related stakeholders preparers, users, auditors and regulators. When enterprises apply derivatives, sound accounting rules help ensure the quality and reliability of information directly linked to those instruments, enabling stakeholders to recognise the benefits of their use. Conversely, the absence of appropriate accounting guidance undermines information quality and reliability and creates considerable difficulties for all parties concerned. A dedicated legal framework for accounting for derivative financial instruments is lacking, making it difficult for companies to recognise, measure, present, disclose and publish information on financial instruments in general and on derivatives in particular.

2. Research methods

- *Method of theoretical analysis and synthesis:* Analysis involves studying diverse documents and theoretical sources by breaking them into constituent parts to gain a deep understanding of the subject. Synthesis links the individual facets and pieces of information that have been analysed, creating a new, comprehensive theoretical framework for the subject.

- *Method of classification and systematisation of theory:* Classification arranges scientific materials by grouping together aspects, units or issues that share essential characteristics and follow a common line of development. Systematisation organises knowledge into a coherent structure based on an underlying theoretical model, thereby producing a more complete understanding of the subject.

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3. Results and discussion

3.1. Overview of Accounting for Derivative Financial Instruments

Key concept

Fair value: According to IFRS 13.BC29, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability between knowledgeable, willing parties in an orderly transaction on the measurement date. IFRS 13.9 provides a similar definition, emphasising that it is an exit price (as clarified in IFRS 13.BC36).

Financial instrument: A financial instrument is any contract that gives rise to a financial asset for one entity and a financial liability or an equity instrument for another entity (IAS 32.11). In Vietnam, the terminology and concepts explained in IAS 32 are also provided in Circular 210/2009/TT-BTC dated 6 November 2009.

Derivative financial instrument: A derivative financial instrument is a financial instrument or other contract within the scope of IAS 39 or IFRS 9 (Appendix A) that simultaneously has the following characteristics: (i) its value changes in response to changes in an underlying variable, such as interest rates, financial-instrument prices, commodity prices, foreign exchange rates, price indices, interest rate indices, credit ratings, credit indices or other specified variables; if the variable is non-financial, it must not be specific to one of the contract's counterparties; (ii) it requires no initial net investment, or requires an initial net investment that is much smaller than would be required for other contracts expected to have a similar response to market changes; and (iii) it is settled at a future date (IAS 39.9; IFRS 9 Appendix A).

Embedded derivatives is an embedded derivative is a component of a hybrid (combined) contract that includes a non-derivative host. The embedded derivative causes some or all of the cash flows of the host contract to vary in a manner similar to a stand-alone derivative. Currently, the concept of embedded derivatives has not been defined in Vietnam.

Derivative accounting is accounting for derivatives involves collecting, processing and presenting information on derivative financial instruments in value terms. It provides information that helps assess how derivative activities affect the enterprise's financial position and performance.

Derivative contracts: According to IAS 32.AG15-19, derivative financial instruments include contracts such as forwards, futures, options and swaps. Specifically:

Forward contracts (IAS 39.B.9, IFRS 9.B.9): A forward contract is a legally binding agreement between two parties to buy or sell a specified asset, liability or financial instrument at a future date for a price agreed upon on the transaction date.

*Futures contracts (*IAS 39.B.10, IFRS 9.B.10): A futures contract is a standardised variant of a forward contract that is traded on an exchange and cleared through a clearing house.

Option contracts (IAS 39.AG11, IFRS 9.BA.3): An option contract grants the holder the right, but not the obligation, to buy or sell a specified asset (underlying asset) at a predetermined price, either within a certain period or on a specified future date.

Swap contract (IAS 39.B.9, IFRS 9.B.9): A swap contract is a private legal agreement between two parties to exchange cash flows or obligations over a specific period, based on interest rates, foreign exchange rates or prices defined in the contract. It is not exchange-traded; therefore, the parties may bear certain risks because the obligations are not guaranteed by an exchange.

To encourage the use of derivatives and develop the derivatives market, the Vietnamese government issued Decree 42/2015/NĐ-CP dated 5 May 2015, which defines derivative contracts. However, these definitions are limited to derivative securities and do not cover the broader types of financial derivatives mentioned above.

International Accounting Standards and Vietnamese Guidance on Derivative-Instrument Accounting

Relevant international standards: IAS 32 Financial Instruments: Presentation; IAS 39 Financial Instruments: Recognition and Measurement; IFRS 7 Financial Instruments: Disclosures and IFRS 9 Financial Instruments (effective 1 January 2018, replacing IAS 39)

The Ministry of Finance issued Circular 210/2009/TT-BTC (6 November 2009), which adopts IAS 32 and IFRS 7 for presentation and disclosure. Matters that fall under IAS 39 or IFRS 9 have not yet been covered.

3.2. Application of International Financial Reporting Standards (IFRS) in derivative-instrument accounting in Vietnam - opportunities and challenges

In Vietnam, under Circular 210/2009/TT-BTC, the regulations on derivative financial instruments (CCTCPS) have not been given specific, detailed

guidance; several topics are still unaddressed or require additions and updates to align with current international accounting and financial-reporting standards. As a result, the existing rules for accounting for financial instruments in general, and derivatives in particular, are complex, hard to identify, difficult to understand and difficult to apply. Yet, from another viewpoint, Yagoubi (2014) points out that: (i) from an economic perspective, derivative accounting facilitates efficient capital flows in the market, performs a measurement function and serves as a system for valuing goods and services; (ii) from an institutional perspective, accounting provides a legal framework, monitors economic processes and deciphers economic values, while enhancing the informational role and relevance of information through presentation and disclosure in financial statements; (iii) from a social perspective, accounting contributes to social benefit and the maintenance of sustainable development through improved information. Thus, accounting can be viewed as an effective control and management tool. With this understanding, accounting supplies methods for measurement, disclosure and presentation that are practical to implement. Accordingly, to reduce business risk, promote social development and advance toward integration and harmonisation with international accounting, derivative accounting in Vietnam should also be carried out through: classification - Initial recognition - Derecognition - Measurement - Presentation - Disclosure (notes) - Accounting accounts.

3.2.1. Opportunities when applying IFRS on financial instruments in Vietnam:

Adopting IFRS is receiving much attention because Vietnamese credit institutions are still using VAS. Enterprises gain various opportunities by applying the IFRS package on financial instruments. Specifically, using a broad and suitable range of financial instruments can strengthen financial capacity, diversify income sources, enhance risk management and optimise costs.

By applying the IFRS set for financial instruments, enterprises can take advantage of instruments such as shares, bonds, investment funds, securities-backed credit and other derivatives to increase income and reinforce financial strength. For example, purchasing derivatives can protect against market risk and improve financial capacity.

Moreover, applying IFRS helps businesses optimise costs through other financial forms such as lending and bond issuance. By setting strict lending conditions, they can mitigate risk and increase returns on lending activities. However, applying IFRS to derivatives also brings certain challenges; instruments such as options may require specialised skills and knowledge for effective management.

3.2.2. Challenges when applying IFRS on financial instruments in Vietnam:

Although applying the IFRS package on financial instruments offers many opportunities for enterprises in Vietnam, it also poses numerous challenges. The main ones are as follows:

First, economic organisations and businesses in Vietnam have not yet presented their financial health transparently through VAS - based financial statements. This situation partly creates a barrier for investors - especially foreign investors - who hesitate and harbour doubts when approaching the market. Consequently, obtaining FDI from abroad entails significant costs for converting VAS financial statements to IFRS. This shows that a considerable gap still exists between VAS and IFRS, and VAS is increasingly revealing limitations and shortcomings in financial reporting.

Second, VAS aims to record assets and liabilities at historical cost rather than fair value (market value). Credit institutions - particularly banks - operate in the monetary field and provide banking services. Their primary items are financial instruments whose values fluctuate constantly with market prices. Therefore, these instruments need to be recognised and disclosed at their true value. However, VAS does not yet allow assets and liabilities to be re-measured at fair value at the reporting date. This greatly affects the verification of assets and liabilities classified as financial instruments, reducing the reliability of financial statements and making them inconsistent with IFRS. Users of the financial statements cannot fully assess the capacity, financial potential or risks that credit institutions may face.

Third, enterprises encounter difficulties while adopting IFRS. The Ministry of Finance issues accounting standards for all businesses, which leads to general rules without specifics for each entity or business type - especially specialised enterprises. Although guidance circulars exist, in practice there are instances of inconsistency between standards and sectoral accounting regimes. If a credit institution opts to follow the sectoral regime, the role of the standards system becomes less important, and vice versa, leaving businesses confused during implementation.

At present, there is a large gap between VAS and IFRS, particularly IFRS 9, the standard that

will have the greatest impact on credit institutions. Understanding the differences between IFRS 9 and current Vietnamese accounting regulations is crucial for devising solutions and moving toward effective IFRS adoption for derivative accounting in Vietnamese enterprises.

4. Conclusion and solution

The Ministry of Finance plays an important role in the application of IFRS in Vietnam. To mitigate limitations and maximise the benefits of IFRS, the Ministry needs clear directions. First, the Ministry of Finance should actively disseminate information and raise awareness about IFRS adoption among businesses in general and those using financial instruments in particular. Second, the Ministry should improve the economic environment and legal framework to align with IFRS. The State should enact policies that enhance the business environment, including the financial market, the medium- and long-term capital market, and the derivatives market, thereby facilitating transparent trading in assets. In addition, the Ministry must devise a specific IFRS implementation strategy, working with enterprises to establish a basis for determining estimates such as fair value and recoverable amount, thereby increasing consistency in applying IFRS to derivative financial instruments in Vietnam.

First, build a legal system for derivative-instrument accounting: the legal framework and regulations directly related to derivatives remain incomplete, leaving enterprises without a basis for certain techniques in derivative trading and accounting (recognition of fair value for some assets and liabilities, investment property, biological assets, etc.). In particular, the historical-cost principle still exists in Vietnamese rules, while no Vietnamese standards correspond to international standards on financial instruments (for example, IAS 32, IFRS 7, IFRS 9, IFRS 13); likewise, there is no Vietnamese accounting standard on financial instruments, so derivative accounting lacks a systematic foundation. Moreover, the legal systems for accounting, taxation, the derivatives market and related areas are not synchronised; enforcement and legal validity are low because regulations are general and lack specific guidance on recognising, measuring, presenting, disclosing and reporting derivative transactions. As a result, accounting for derivatives records only realised gains or losses, whereas at reporting dates unrealised gains or losses at market value are not recognised.

Second, raise managers' awareness of derivative financial instruments: in practice, executives lead in recognising the role of derivative accounting and decide whether departments will adopt it. If management makes derivative accounting a priority, adoption accelerates. When managers understand the benefits and usefulness of derivative accounting, they plan to use it to hedge risks and uncertainties. In Vietnam many managers focus on financial accounting for preparing statements to regulators, shareholders and creditors, so derivative accounting receives insufficient attention in decision-making. Furthermore, managers often lack awareness of the benefits, nature and importance of derivatives for assessing and managing risk. Most enterprises, constrained by limited funds, lack policies for training and disseminating knowledge to internal staff about derivatives and derivative products.

Third, improve accountants' expertise: accounting for financial instruments in general and derivatives in particular is complex and difficult to apply. In Vietnam most accounting personnel lack deep expertise and specialised training; few experts and auditors understand derivative accounting. Accountants affect the organisation of accounting work and the processing of information for timely, accurate decisions. Therefore, accountants need education, knowledge and experience through professional training to facilitate derivative accounting. Although many universities, colleges and short courses cover basic to advanced accounting and chief accountant certificates, training programmes mainly focus on financial accounting under domestic rules with little emphasis on derivative accounting. Consequently, many accounting practitioners have knowledge only of domestic financial accounting and lack expertise in derivative accounting, creating difficulties for adoption in Vietnamese enterprises.

Fourth, the role of professional associations.

In Vietnam, the Ministry of Finance drafts and issues accounting standards, while professional associations merely participate in drafting committees and thus are not central to standard setting or practice. These organisations need to fully exercise their role in promoting, guiding and training through courses, seminars and workshops on derivative accounting and its benefits.

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