

Decoding Ind AS 109

The Art & Science of Financial Instruments

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1. Objective and Scope
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Objectives and Scope

Under Ind AS, three Standards deal with accounting for financial instruments

Ind AS 32 *Financial Instruments: Presentation:*

Deals with the presentation and classification of financial instruments as financial liabilities or equity and sets out the requirements regarding offset of financial assets and financial liabilities in the balance sheet.

Ind AS 107 *Financial Instruments:*

Sets out the disclosures required in respect of financial instruments.

Ind AS 109 *Financial Instruments:*

Contains guidance on the recognition, derecognition, classification and measurement of financial instruments, including impairment and hedge accounting

Summary of the transaction outside the scope Financial Instruments:

Sl. No.	Particulars	Covered under Ind AS 109	Covered under Ind AS 32	Under Ind AS 107	Applicable Ind AS
1	Interest in subsidiaries (At Costs)	No	No	No	Ind AS 27
2	Interests in associates (At Costs)	No	No	No	Ind AS 27
3	Interest in joint ventures (At Costs)	No	No	No	Ind AS 27
4	Rights and obligations under leases	No	No	Yes	Ind AS 116
5	Employers' rights and obligations under employee benefit plans	No	No	No	Ind AS 19
6	Rights and obligations under an insurance contract	No	No	No	***Ind AS 117***
7	Forward contract arising within the scope of business combination	No	No	Yes	Ind AS 107
8	Loan commitment other than covered under Ind AS 109 and Ind AS 32	No	No	Yes	Ind AS 107
9	Shared based payments	No	No	No	Ind AS 102
10	Reimbursement right in respect of provision	No	No	Yes	Ind AS 37 and Ind AS 107
11	Rights and obligations under revenue for contracts with customers	No	No	Yes	Ind AS 115 and Ind AS 107

WHAT ARE FINANCIAL INSTRUMENTS?

1

A **financial instrument** is any **contract** that gives rise to a **financial asset** of one entity and a **financial liability** or **equity instrument** of another entity.

- ***contract*** refers to an agreement between two or more parties
- Contracts need not be in writing and may take a variety of forms.

2

Financial instruments include:

(a) Primary instruments (such as receivables, payables and equity instruments) and

(b) Derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps).

Financial Assets and Liabilities

FINANCIAL ASSETS-

01 Cash

02 Equity instruments of other entity. (Equity shares.)

03 Contractual right:

(i) to receive financial asset from another entity. (Trade receivable & Loan)\

(ii) To exchange financial assets or financial liabilities with other entities that are potentially favourable to the entity (options)

04 a contract that will or may be settled in the entity's own equity instruments

(i) a non-derivative for which the entity is or may be obliged to receive a variable (non fixed) number of entity's own equity instruments

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

FINANCIAL LIABILITIES-

01

Contractual Obligation:

(i) To deliver cash or financial asset to another entity. (Loan payable.)

(ii) To exchange financial assets or financial liabilities with other entities that are potentially unfavourable to the entity (options)

02

A contract that will /may be settled using the entity's own shares can fall into two categories:

(i) If the company has to deliver a variable number of its own shares→ this is NOT equity.

(ii) Derivative contracts, If the derivative is settled other than by exchanging :a fixed amount of cash or financial asset for a fixed number of shares.

But it is equity if:

- It gives the right to acquire a fixed number of shares,
- For a fixed amount,
- In any currency (Ind AS carve-out),
- And such rights/options are offered pro-rata to all shareholders of the same class.

It should be noted that the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency.

This is a deviation from IAS 32 *Financial Instruments: Presentation* where a conversion option to acquire a fixed number of equity shares for a fixed amount of cash in entity's functional currency only is treated as equity.

Thus, a conversion option embedded in foreign currency convertible bonds is treated as embedded derivative which is not the case under IndAS 32



CARVE OUT

□ Whether it is Financial Assets?

S. No.	Particulars	FA or Not	Key Remark
1	Investment in bonds / debentures	**FA**	Contractual right to receive cash
2	Loans & receivables	**FA**	Contractual right to receive cash
3	Deposits given	**FA**	Contractual right to receive cash
4	Trade & other receivables	**FA**	Contractual right to receive cash
5	Cash & cash equivalents	**FA**	Specifically included in definition
6	Bank balance	**FA**	Contractual right to receive cash
7	Investment in equity shares	**FA**	Equity instrument of another entity
8	Perpetual debt instruments	**FA**	Contractual right to interest/principal
9	Physical assets (PPE, inventory)	**Not FA**	No right to receive cash
10	Right-of-use (ROU) assets	**Not FA**	Provides use of asset, not cash
11	Intangibles (patents, trademarks)	**Not FA**	No right to receive cash
12	Prepaid expenses	**Not FA**	Right to goods/services, not cash
13	Advances for goods/services	**Not FA**	Right to goods/services, not cash

Whether it is Financial Liability?

S. No.	Particulars	FL or Not	Remarks
1	Loans payable / Bank loan	**FL**	Contractual obligation to pay cash
2	Trade & other payables	**FL**	Contractual obligation to pay cash
3	Bills payable / Acceptances	**FL**	Contractual obligation to pay cash
4	Deposits received	**FL**	Contractual obligation to pay cash
5	Mandatory redeemable preference shares	**FL**	Redemption creates contractual obligation to pay cash
6	Financial guarantee given	**FL**	Obligation to pay cash upon certain events

Equity instruments

- Issued warrants to issue fixed number of shares at fixed price against each warrant
- Other instruments convertible into fixed number of equity shares for fixed amount per share, etc.
- **Equity instruments have *no contractual obligation* for payment or distribution** to holders at any time. **Puttable financial instruments** may still be classified as *equity* if they meet the **specific conditions** laid down in the Standard.
- Instruments that obligate the issuer to deliver a **pro rata share of net assets *only on liquidation*** can also be classified as *equity*, if the requisite criteria are fulfilled.

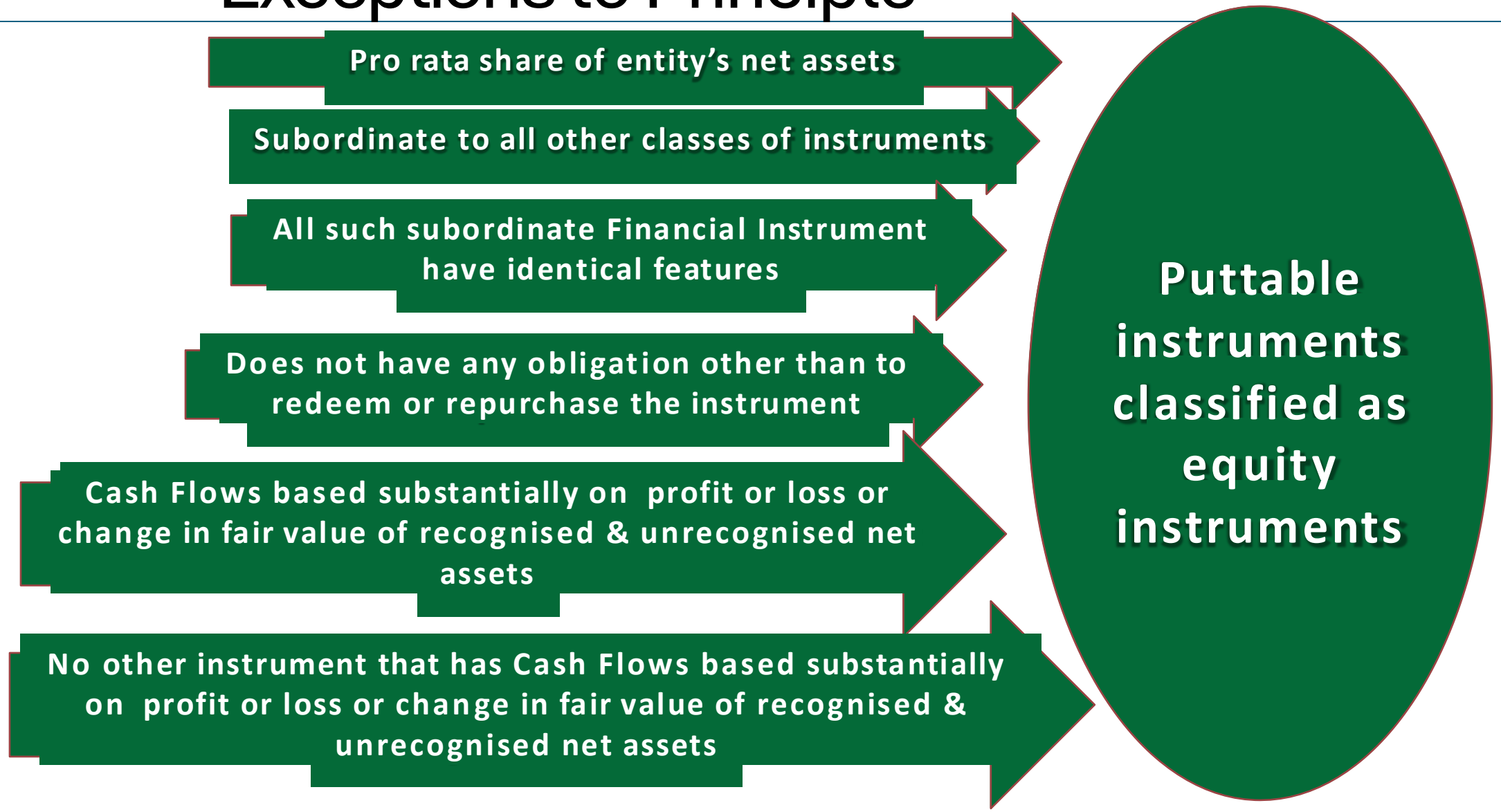
Puttable Financial Instrument – Example

Units of a mutual fund where investors can "put" (redeem) their units back to the fund at fair value.

Why Equity (if conditions met):

Because the holders get a **proportionate share of net assets** and certain strict criteria under the Standard are satisfied

Exceptions to Principle



Evaluation of Preference Shares - Classification Principle

•Preference shares may be classified as **Financial Liability** or **Equity**, based on:

- Rights attached
- Redemption terms
- Return features

•Assessment depends on whether the instrument contains a **contractual obligation** (Financial Liability) or represents a **residual interest** (Equity).

Scenario	Obligation Exists?	Classification
Redemption at a fixed date	Yes – issuer must redeem regardless of funds or restrictions	**Financial Liability**
Redemption at holder's option	Yes – holder can demand cash redemption	**Financial Liability**
Redemption at issuer's option	No – issuer controls the decision	**Equity**

Case Study : Non-derivative contract to be settled in own equity instruments

A Ltd. invests in compulsorily convertible preference shares (CCPS) issued by its subsidiary –B Ltd. At 1,000 each (` 10 face value + ` 990 premium). Under the terms of the instrument, each CCPS is compulsorily convertible into one equity share of B Ltd at the end of 5 years. Such CCPS carry dividend @ 12% per annum, payable only when declared at the discretion of B Ltd. Evaluate this under definition of financial instrument.

Aspect	Details
Instrument Issued	Compulsorily Convertible Preference Shares (CCPS) by B Ltd.
Key Terms	• Mandatory conversion into **1 equity share per CCPS** (fixed-for-fixed) • **Non-cumulative** dividends, payable only when declared
Ind AS 32 Assessment	**No contractual obligation** to deliver cash or financial asset (dividends discretionary) **Fixed number** of equity shares issued on conversion
Conclusion	Meets **equity** definition as per Ind AS 32
Final Classification	**Classified as Equity** in the books of B Ltd.

COMPOUND FINANCIAL INSTRUMENTS

Compound instruments that have both liability and equity characteristics are split into these components.

The split is made on initial recognition of the instruments and is not subsequently revised.

The equity component of the compound instrument is the residual amount after deducting the fair value of the liability component from the fair value of the instrument as a whole.

No gain / loss arises from initial recognition



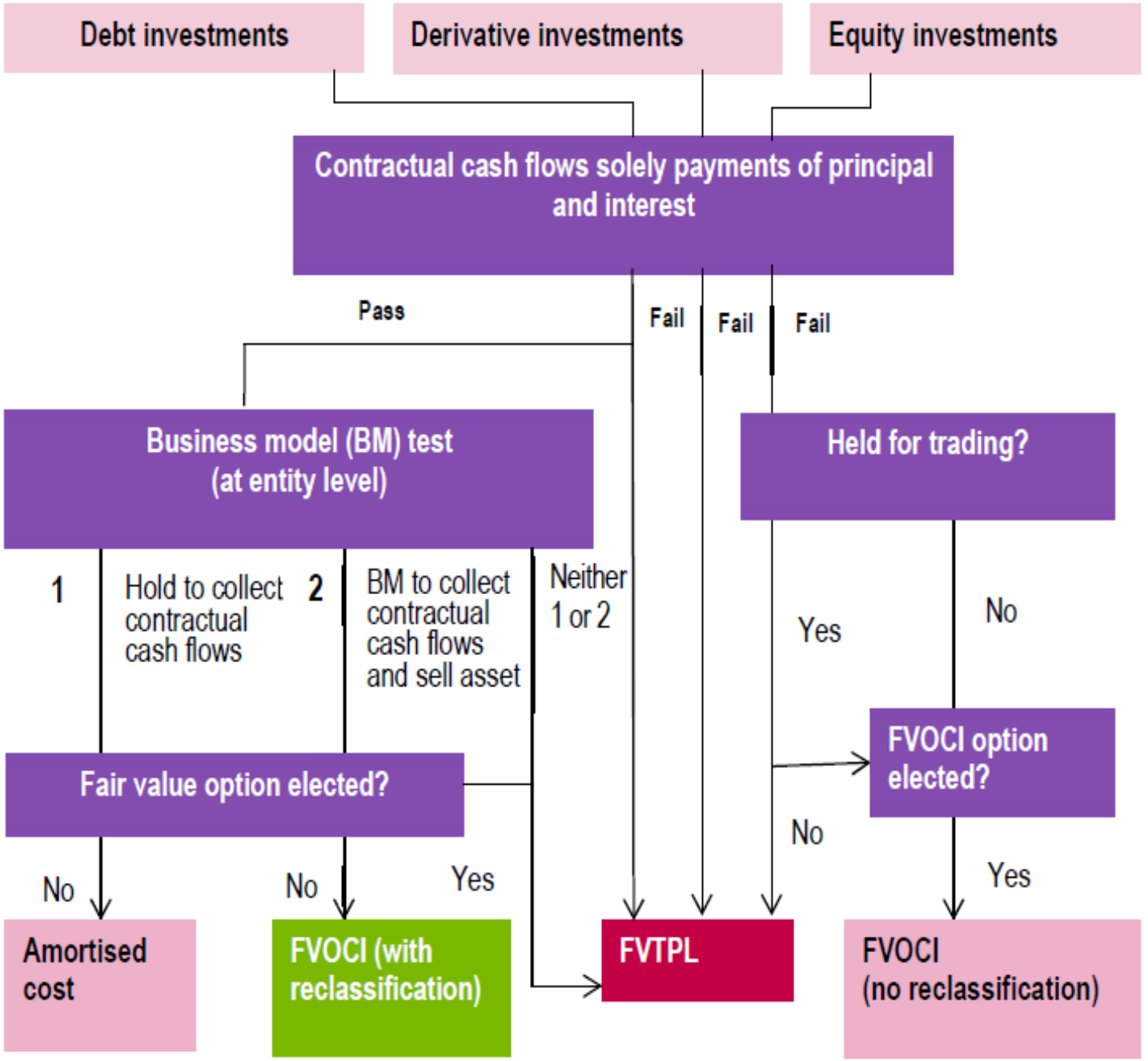
White Ltd. issues 2000 convertible bonds as on 01/04/08 having a 10 yr. term, face value of Rs.1000/- per bond & int. @6% p.a. each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion option is 9%. How should the entity recognise the instrument?

Solution

Calculation of fair value of bond and equity:			
Year	**Cash flows**	**Discount @9%**	**Present Value**
1	1,20,000	0.9174	1,10,092
2	1,20,000	0.8417	1,01,002
3	1,20,000	0.7722	92,662
4	1,20,000	0.7084	85,011
5	1,20,000	0.6499	77,992
6	1,20,000	0.5963	71,552
7	1,20,000	0.5470	65,644
8	1,20,000	0.5019	60,224
9	1,20,000	0.4604	55,251
10	21,20,000	0.4224	8,95,511
Fair Value of a Bond			**16,14,941**
Consideration received			20,00,000
Fair Value of Equity			**3,85,059**

Classification of Financial Assets and Liabilities

Decision Tree



Knowledge Check



CLASSIFICATION OF FINANCIAL ASSETS UNDER IND AS 109 DEPENDS MAINLY ON:



A. CREDIT RATING



B. MANAGEMENT INTENTION



C. BUSINESS MODEL AND SPPI TEST



D. NATURE OF COUNTERPARTY

C. Business model and SPPI test

Ind AS 109, paragraph 4.1.1 –
"An entity shall classify financial assets on the basis of both the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset."

Knowledge Check

A debt instrument held to collect contractual cash flows and sell is measured at:

A. Amortised cost

B. FVTPL

C. FVOCI

D. Cost

- C. FVOCI

(Ind AS 109): Paragraph 4.1.2A –

A financial asset shall be measured at fair value through other comprehensive income if it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest.

Knowledge Check

Equity investments are measured at FVTPL unless:

A. They are listed

B. They are strategic

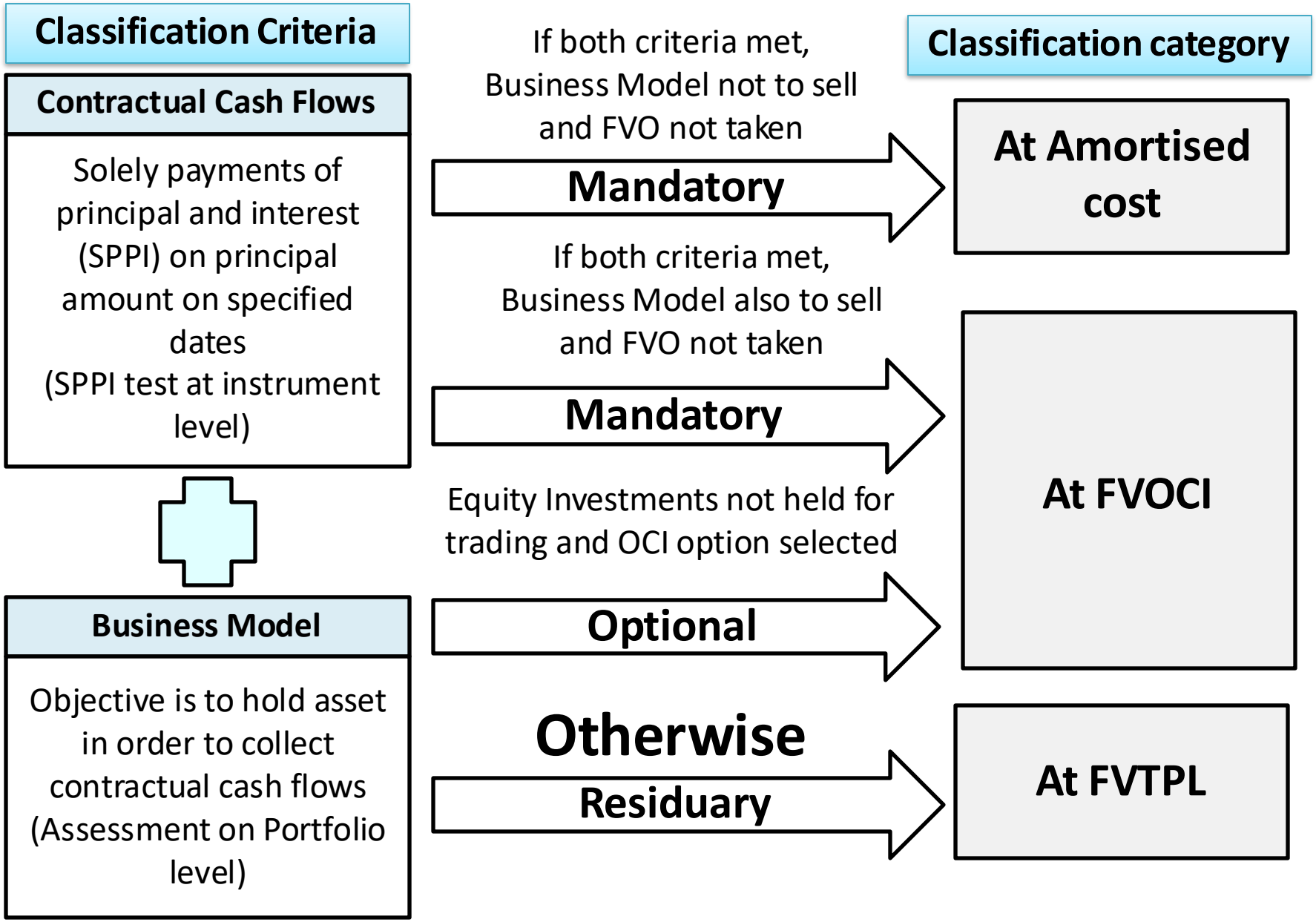
C. Entity irrevocably elects FVOCI

D. Dividend yield is fixed

- C. Entity irrevocably elects FVOCI

(Ind AS 109): Paragraph 5.7.5 –
An entity may make an irrevocable election at initial recognition to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

Classification of Financial Assets





SPPI or contractual cash flow test – Case study

SPPI test for loan with zero interest and no fixed repayment terms

Parent H Ltd. provides a loan to its Subsidiary S Ltd. The loan is classified as a current liability in Subsidiary S's financial statements and has the following terms: Interest free loan.No fixed repayment terms Repayable on demand of Parent H Ltd.

Does the loan meet the 'SPPI' or contractual cash flows characteristic test?

Yes. The terms for the repayment of the principal amount of the loan on demand satisfies the criterion of SPPI.

Hold-to-collect' business model test- Case study

- **An entity purchased a debt instrument for 1,00,000. The instrument pays interest of 6,000 annually and has 10 years to maturity when purchased. The entity intends to hold the asset to collect the contractual cash flows. Evaluate the business model test.**
- Entity's objective is to hold the asset to collect the contractual cash flows and not to sell the assets before the maturity period.
- Thus, the debt instrument would meet the '**hold-to-collect' business model test**.
- **In the above question after Six years have passed and the entity is suffering a liquidity crisis and needs to sell the asset to raise funds. Evaluate the business model test.**
- Since the sale of financial assets was not expected on initial classification and therefore, does not affect the classification (i.e. there is no retrospective reclassification). Thus, the debt instrument would still meet the '**hold-to-collect' business model test.**

Amortized Cost

Amortised cost is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

Financial asset (FA) shall be classified at amortised cost if it meets both of following criteria:

1. '**Hold-to-collect**' business model test - Objective is to hold the financial asset in order to **collect contractual cash flows**;

AND

2. **'SPPI' contractual cash flow characteristics test** - Contractual terms give rise to cash flows that are Solely Payments of Principal and Interest (SPPI) on the principal amount outstanding.

Examples of Financial assets classified and accounted for at amortised cost:

- Trade receivables
- Investments in government bonds (not held for trading)
- Investments in term deposits (at standard interest rates)
- Loan receivables with 'basic' features

Investment in Equity instrument can never be classified at amortized cost.

Security Deposits – Amortized Costs – Case Study

- **A Ltd. (the 'Company') has obtained the premises from B Ltd. on lease to carry on its business. The lease contract period is 5 years. As per the lease agreement, A Ltd. has paid security deposits to B Ltd. amounting to 10 Lac which is refundable after the expiry of lease agreement.**
- **How would such deposits be treated in books of the A Ltd. ?**

Point	Summary
Financial Asset?	Yes — A Ltd. has a **contractual right to receive cash**.
Business Model	**Hold to Collect (HTC)** — deposit held to collect cash flows till maturity.
SPPI Test	Cash flows = **principal + interest** → SPPI met.
Classification	**Amortised Cost** under Ind AS 109.

- For SPPI, "interest" doesn't mean only contractual interest paid by the lessor. Under Ind AS 109, interest includes: time value of money, credit risk, liquidity risk, other basic lending costs.

- 👉 So, when A Ltd. discounts the interest-free deposit to PV, the unwinding of discount over the tenure is treated as **imputed interest.**

Financial Assets at Fair Value at Other Comprehensive Income

A. Accounting for debt instruments when it is classified as FVOCI

Test	Meaning
1. Hold-to-Collect and Sell (HTC&S) Business Model	• Objective achieved by **collecting contractual cash flows and selling** the financial asset. • Entity may sell the asset **before maturity**.
2. SPPI Test	• Contractual cash flows represent **Solely Payments of Principal and Interest (SPPI)** on the outstanding principal.

Examples of Financial Assets at FVOCI:

- Investments in **government bonds** where holding period is shorter than maturity.
- Investments in **corporate bonds** held with intention to sell before maturity.

Case Study – Debt Instrument – Hold-to-collect' or 'hold-to-collect & sell' business model test

- Entity A has INR 50 million surplus funds and temporarily invests in 5-year government bonds to earn interest. A expects to sell the bonds early if a suitable business acquisition opportunity arises — which is likely before maturity. Which business model does this investment meet?
- Hold-to-Collect (HTC)?
- Hold-to-Collect & Sell (HTC&S)?

Assessment	Conclusion
Hold-to-Collect?	❌ **No** — because Entity A is *likely to sell* the bonds well before maturity.
Hold-to-Collect & Sell?	✓ **Yes** — objective is to collect interest income **and** sell the asset when a better opportunity arises.

Financial Assets at Fair Value at Other Comprehensive Income

B. Equity instrument when it is classified as FVOCI

Topic	Summary
Measurement Requirement	All equity investments must be measured at fair value under Ind AS 109.
Default Treatment	Changes in fair value are recognised in Profit or Loss (FVTPL).
FVOCI Election	For non-trading equity investments, the entity may make an irrevocable election at initial recognition to classify them as FVOCI.
FVOCI Accounting	• **Fair value changes → OCI** • **Dividends → Profit or Loss**
On Disposal	Cumulative fair value changes stay in OCI (no recycling to P&L).
Equity Transfers	Amounts can be transferred within **equity (FVOCI reserve → retained earnings).**

Financial Assets at profit and loss

Category	Explanation
Definition	FVTPL is the **residual measurement category** under Ind AS 109.
When Classified as FVTPL?	• Financial asset is **held-for-trading** • **Debt instrument** that does **not** qualify for Amortised Cost or FVOCI (fails Business Model or SPPI test) • **Equity investment** where **FVOCI option not taken**
Examples	• **Derivatives** not designated as hedges: – Interest rate swaps – Commodity futures/options – FX futures/options • **Equity shares** measured at FVTPL (no FVOCI election)

Initial Measurement of Financial Assets

Item	Summary
Initial Measurement	At **fair value** (normally = transaction price).
Off-Market Instruments	When terms differ from market (e.g., **interest-free long-term loan**).
Fair Value Basis	**PV of future cash flows**, discounted at **market rate** for similar instruments.
Difference (FV vs. Transaction Price)	Recognised as **expense** or **reduction of income**, unless another asset.
Transaction Costs (Included)	Broker/agent fees, regulatory levies, transfer taxes.
Transaction Costs (Excluded)	Premiums/discounts, financing costs, internal admin costs.
Treatment of Transaction Costs	• Added to/deducted from fair value if **not FVTPL** • **Expensed immediately** if the asset/liability is **FVTPL**

Measurement of FA

Ind AS 109 category	*Initial measurement*	*Subsequent B/S measurement*	*Changes in carrying amounts- P/L or OCI ?*
FVTPL	Fair Value	Fair Value	Profit or Loss – ***same treatment of both gain or loss***
Amortized cost – (FA)	**Fair value plus transaction costs**	**Amortized cost**	Profit or Loss *(Interest based on **Effective Interest Method**)*
Debt Instruments FVOCI		Fair Value	P/L- Interest & Impairment like Amortized Cost category OCI- All other changes to carrying amount
Equity investments - OCI	Fair Value	Fair Value	• Dividend recorded in P&L • Gains / losses recorded in OCI

Knowledge Check

Transaction costs for instruments measured at amortised cost are:

A. Expensed immediately

B. Ignored

C. Included in EIR calculation

D. Taken to OCI

- C. Included in EIR calculation

- (Ind AS 109): Paragraph 5.1.1 –

Requires transaction costs to be included in initial measurement for instruments not measured at FVTPL.

- Appendix A (Definition of Amortised Cost) –

Amortised cost is calculated using the effective interest method, which includes transaction costs.

Knowledge Check

Transaction costs for financial assets measured at FVTPL are:

A. Capitalised

B. Amortised

C. Expensed immediately

D. Adjusted against equity

- C. Expensed immediately

(Ind AS 109): Paragraph 5.1.1 –
At initial recognition, an entity shall measure a financial asset at its fair value plus or minus transaction costs that are directly attributable to the acquisition or issue of the financial asset, except for financial assets measured at fair value through profit or loss.

Case Study:

Deposit carrying – off market rate of interest

- **Customers lease containers from Containers Ltd for 3 years. Each customer pays a ₹10,000 refundable security deposit per container. Deposit is interest-free and refunded at end of contract. Market interest rate for a 3-year loan = 7% p.a.**
- Fair Value on Initial Recognition : Since the deposit is interest-free, its fair value is the present value of the amount refundable after 3 years.Fair value = 10,000 / $(1.07)^3$ = Rs. 8,163Day-1 Difference = 10,000 – 8,163 = ₹1,837
- Treatment of Day-1 Difference Two scenarios under Ind AS 109
- If fair value uses Level 1 or observable inputs→ Difference **recognised in P&L**.
- If fair value uses unobservable inputs→ Difference recognised in P&L **unless it meets definition of an asset/liability.**
- Security deposit is based on unobservable inputs → Scenario 2 applies.
- The ₹1,837 represents lost interest (economic cost) for giving an interest-free deposit. This provides access to the container **→ treated as Prepaid Lease Payment (part of ROU asset).**

Equity instruments – where FV not determinable

Topic	Summary
General Rule	All equity investments and related contracts must be measured at **fair value**.
Exception (Rare)	**Cost** may be used **only when it is the best estimate of fair value**, usually due to **insufficient or no recent information**.
When Cost Is NOT Representative of Fair Value	Indicators include: (a) Major changes in investee performance vs. plans/budgets (b) Changes in likelihood of technical/product milestones (c) Significant market changes for investee or its products (d) Economic/environmental changes affecting the investee (e) Movements in performance/valuations of comparable entities (f) Internal issues: fraud, disputes, litigation, management changes (g) Evidence from recent equity transactions (new issues or transfers)
Requirement	If such indicators exist → **Cost is not appropriate** → Entity must measure **fair value**.
Important Note	Cost is **never** the best estimate of fair value for **quoted equity instruments**.

Financial Assets — Subsequent Measurement

Category	Conditions	Measurement Approach
Amortised Cost	• Business Model: **Hold to Collect (HTC)** • Cash flows meet **SPPI** (Solely payments of principal & interest)	**Initial:** FV ± transaction costs **Subsequent:** Adjust for principal repayments + **EIR-based interest**
FVOCI (Debt Instruments)	• Business Model: **Hold to Collect & Sell (HTC&S)** • Cash flows meet **SPPI**	Measured at **fair value** • FV changes → **OCI** • Interest, impairment → **P&L**
FVOCI (Equity Instruments)	• Equity not held for trading • **Irrevocable election** at initial recognition	Measured at **fair value** • FV changes → **OCI** • **No recycling** to P&L on disposal
FVTPL	Applies to **all assets not meeting** criteria for Amortised Cost or FVOCI	**Fair value** with all changes → **P&L**

Measurement of Financial Liability

Ind AS 109 category	*Initial Measurement*	*Subsequent Measurement*	*Changes in carrying amounts- P/L or OCI ?*
FVTPL	Fair Value	Fair Value	Change due to own credit risk – OCI if it does not increase accounting mismatch Other changes to Profit or Loss Derivatives – All changes in Profit or Loss
Amortized cost – (FL)	**Fair value plus transaction costs**	**Amortized cost**	Profit or Loss
FGC (Financial Guarantee Contract) and Loan Commitments	Fair Value	Higher of (i) loss allowance and (ii) amount initially recognised less cumulative amount of income	Profit or Loss
Contingent consideration in a Business Combination	Fair Value	Fair Value	Profit or loss

Summary

- The classification and measurement of financial instruments are summarized as below :

	Financial Assets			Financial Liabilities		Equity
Classification	**Amortised Cost**	**FVTOCI**	**FVTPL**	**Amortised Cost**	**FVTPL**	**-**
Basis of Classification	▪ BM test to collect ▪ SPPI test	▪ BM test to collect & sell ▪ SPPI test	▪ Held for trading (SPPI or BM test fail)	▪ Default criterial	▪ If held for trading ▪ Entity elects FVTPL (using fair value option)	-
Initial recognition	▪ Fair Value plus or minus transaction costs	▪ Fair Value plus or minus transactio n costs	▪ Fair Value	▪ Fair Value plus or minus transaction costs	▪ Fair Value	▪ Fair Value
Subsequent recognition	▪ Amortised Cost	▪ Fair Value	▪ Fair Value	▪ Amortised cost	▪ Fair Value	▪ No Re-measur ement

Case Study: Issue of borrowings with fixed rate of interest

- A Ltd has borrowed from RBC Bank 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for 500 and loan is payable after 5 years in bullet repayment of principal. Details are as follows:

Initial Measurement (Day 1)	
Item	**Amount**
Loan proceeds	10,000
Less: Processing fees	(500)
Initial carrying amount	**9,500**

EIR Concept EIR = rate at which PV of future cashflows equals initial carrying value (₹9,500).Using interpolation between 10% and 13%, EIR = 11.42%.

Case Study :Amortized cost schedule - Subsequent Measurement (Using EIR 11.42%)

Year	Opening Balance	Interest @11.42%	Interest Paid	Closing Balance
1	9,500	1,085	(1,000)	**9,585**
2	9,585	1,095	(1,000)	**9,679**
3	9,679	1,105	(1,000)	**9,785**
4	9,785	1,117	(1,000)	**9,902**
5	9,902	1,098*	(11,000)**	

- *Balancing figure for amortisation**₹10,000 principal + ₹1,000 interest.
- Loan is measured at amortised cost under Ind AS 109.Interest recognised using EIR, not contractual rate.
- Principal repaid in bullet in year 5.

Derecognition of Financial Assets and Liabilities

When risks and rewards are neither substantially transferred nor retained:

A. Derecognise asset

B. Continue full recognition

C. Apply control test

D. Recognise OCI

C. Apply control test

(Ind AS 109): Paragraph 3.2.6 –
If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred financial asset, the entity shall determine whether it has retained control of the financial asset.

De-recognition Test

- Step 1: Has the asset been transferred?
- Step 2: Has substantially all risks and rewards been transferred?If Yes → DerecogniseIf No → Continue recognising (unless control is lost)
- Step 3: Has control been transferred?If control is lost → DerecogniseIf control is retained → Continue recognizing.

De-recognition of Financial Assets

- Derecognition of a financial asset means removing it from the balance sheet when certain conditions are met.

When to De- recognise a Financial Asset

- A financial asset is derecognised when either:
- ✓ 1. Contractual rights to cash flows expire, or
- ✓ 2. Asset is transferred and the **transfer** qualifies for derecognition.

A **transfer** occurs when:

- The entity transfers the contractual rights to receive cash flows, or
- The **entity retains the rights** but assumes an **obligation to pass cash flows to another party**.

De-recognition of Financial Liabilities

To be de-recognised only when the obligation specified in the contract is

- Discharged
- Cancelled
- Expires

Exchange between existing borrower and lender with substantially different terms or substantial modification of terms of FL

- Original FL to be de-recognised and new FL to be recognized

Impact of De-Recognition

Category	Derecognition Term	OCI Treatment	Gain/Loss
Amortised Cost	Derecognise carrying amount	None	P&L
FVOCI – Debt	Derecognise carrying amount	Recycle OCI to P&L	P&L
FVOCI – Equity	Derecognise carrying amount	OCI retained in equity	No recycling
FVTPL	Derecognise carrying amount	None	P&L
Financial Liability	Derecognise because obligation extinguished	Not applicable	P&L

De-Recognition– Case Study

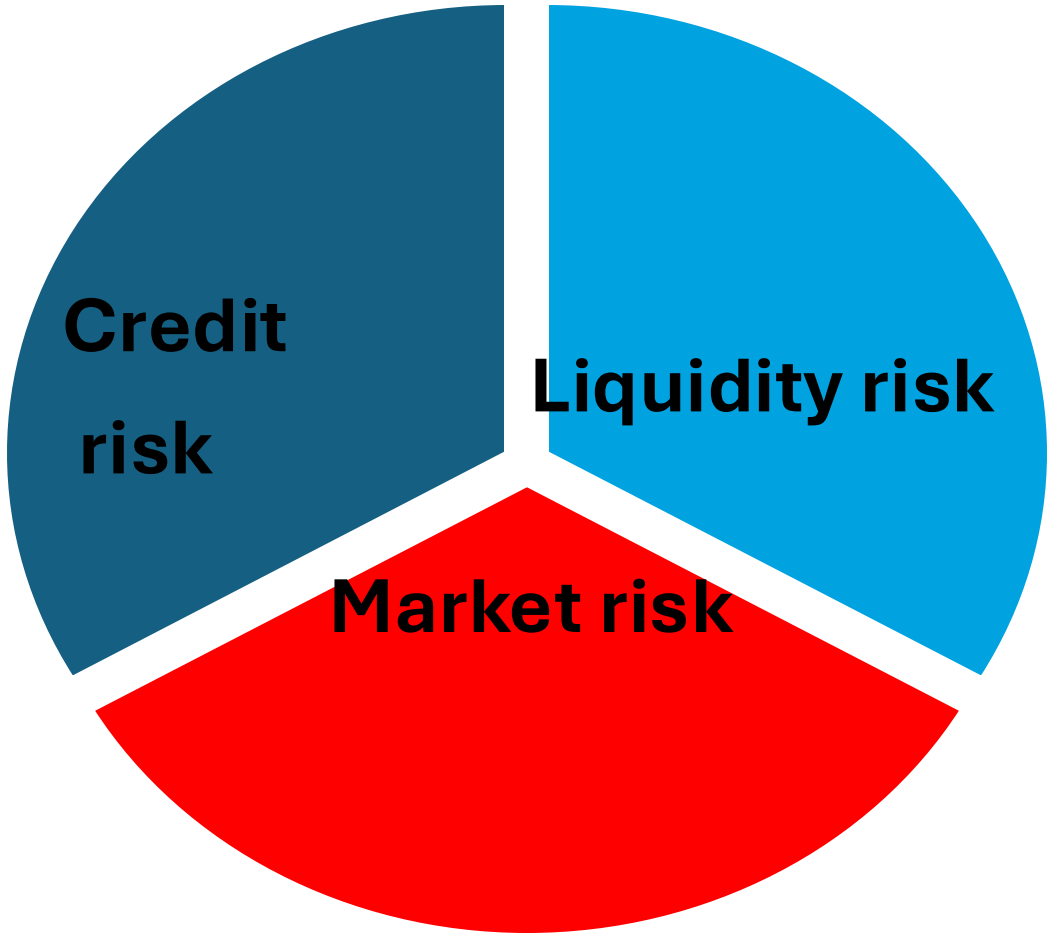
Entity A, a non-financial business, holds 1,000 equity shares of Company X with a carrying amount of Rs 300,000. It agrees to sell these shares for Rs 350,000 under a contract that requires Entity A to buy them back after six months.

Particulars	Case 1: Sale WITHOUT Buy-Back	Case 2: Sale WITH Buy-Back Obligation
Description	Entity A sells shares for Rs 350,000 with NO further rights/obligations.	Entity A sells shares for Rs 350,000 but must repurchase them after 6 months for Rs 360,000.
Transfer of risks (price risk)	✓ Fully transferred to buyer	✗ Not transferred — Entity A still bears market risk due to repurchase at fixed price
Transfer of rewards (dividends, upside)	✓ Buyer gets all future gains/dividends	✗ Entity A indirectly retains benefits by fixing future buy-back price
Continuing involvement	✓ None	✗ Yes — repurchase obligation
Nature of transaction	True sale	Secured borrowing (shares used as collateral)
IFRS 9 conclusion	Derecognition **allowed**	Derecognition **NOT allowed**
Journal entry	Dr Cash 350,000 Cr Investment 300,000 Cr Gain 50,000	Dr Cash 350,000 Cr Liability 350,000
Balance sheet effect	Shares removed	Shares remain on books; liability recorded
Why? (simple)	Entity A does NOT expect to get shares back → risks & rewards transferred	Entity A MUST take shares back → risks & rewards NOT transferred

Impairment /Expected Credit Loss

Nature and extent of risks arising from

financial instruments



Impairment Models

Incurred loss model (Before)

Impairment occurs and impairment losses incurred, only on –

- Occurrence of 'loss' event after initial recognition
- Impact on future cash flows
- Reliable estimation of the impact possible

Specific prohibition on recognition of impairment losses at the time of initial recognition

Expected loss model (Now)

Major differences

- Requires an entity to recognise 'expected' credit losses at all times
- Does not wait for occurrence of a 'trigger' event
- Effects of possible 'future' credit loss events (forecasts) required to be considered, along with historical and current events

Scope of Impairment

- An entity shall recognise a loss allowance for expected credit losses on the following:
  a) financial assets measured at amortised cost
  b) a financial asset (debt instruments) that is measured at fair value through other comprehensive income
  c) a lease receivable,
  d) Trade receivables
  e) a financial guarantee contract.
- **The impairment model does not apply to:**
- (a) All financial assets that are equity instruments (because these are measured either at FVTPL or FVTOCI),
- (b) Financial assets that are debt instruments and are measured as at FVTPL,
- (c) Any other financial instrument measured as at FVTPL.

Credit Loss Allowance =	**Contractual Cashflow that are due**	**XXX**
	Less cash flows that the entity expects to receive	**(XXX)**
	(Cash shortfall)	

Impairment Approaches for Financial Assets

Feature	General Approach	Simplified Approach
Where Applied	Most financial assets (loans, debt instruments)	Mandatory for Trade receivables, lease receivables, contract assets (no significant financing component)
ECL Type Used	12-month ECL **or** Lifetime ECL	**Lifetime ECL only**
Credit-Risk Tracking	**Yes**, required to assess significant increase in credit risk	**No tracking required**
Interest Revenue Basis	Based on **gross carrying amount**	Based on **gross carrying amount**
Day-1 Loss Allowance	3 stage - Refer next slide	Lifetime ECL from Day 1
Suitable For	Long-term loans, debt securities	Large volume of receivables

ECL Model – General Approach

CRITERIA	STAGE 1	STAGE 2	STAGE 3
When?	Initial recognition	Significant increase in credit risk	Credit-impaired
Credit Risk Level	Low	Moderate to High	Significant deterioration
ECL Model	12-Month ECL	Lifetime ECL	Lifetime ECL
Interest Recognition	Interest on Gross Carrying Amount	Interest on Gross Carrying Amount	Interest on Amortised Cost (i.e., net of loss allowance)

Determination of Significant Credit Risk

- Credit risk is the possibility that a borrower will cause financial loss by failing to meet obligations.

When do we assess SICR?

- Entities assess if credit risk has significantly increased since initial recognition to decide whether to recognise:12-month ECL, or Lifetime ECL (if credit risk has increased significantly).

Key Indicators of SICR (Non-exhaustive):

- Higher credit spreads or changes in pricing due to increased risk & Tightening of terms (more collateral, stricter covenants)
- Market indicators (CDS spreads, bond prices) & Internal/external credit rating downgrades
- Deterioration in financial or economic conditions & Decline in borrower performance (revenues, margins, cash flows)
- Reduced support from parent/guarantor & Weakening collateral or guarantees
- Adverse changes in borrower behaviour (delays, missed payments)

30-Days Past Due Rule:

- If payments are >30 days past due, credit risk is presumed to have increased — rebuttable with evidence.

When is a Financial Asset "Credit-Impaired"?

An asset is credit-impaired when one or more events have already occurred that negatively affect expected future cash flows.

Indicators of Credit-Impairment:

- Significant financial difficulty of borrower
- Breach of contract (e.g., default, past due)
- Lender granting concessions due to financial difficulty
- Borrower likely to enter bankruptcy/restructuring
- Disappearance of an active market due to financial distress
- Asset purchased at a deep discount reflecting credit losses
- Often, multiple events together lead to credit-impairment rather than one single event.

Expected Credit Loss (ECL) Model & Quantitative Components

- ECL reflects: Probability-weighted outcomesTime value of money Reasonable & supportable information (past, present, forward-looking)
- Core Components Used in ECL Calculation:

1. Probability of Default (PD):The likelihood that the borrower will default over a given time horizon.

  - 12-month PD → used in Stage 1
  - Lifetime PD → used in Stage 2 & Stage 3

2. Loss Given Default (LGD): The percentage of exposure expected to be lost if default occurs. Considers collateral, recovery rates, guarantees, cure rates.

3. Exposure at Default (EAD): The expected outstanding amount at the time of default. Includes principal, interest, undrawn commitments, and expected utilisation.

ECL = PD × LGD × EAD(Probability of default × Amount expected to be lost × Exposure at time of default)

PD computation



Through-the-Cycle (TTC PD)

TTC PD **predicts the average default** rate over an economic cycle.

Captures only risk characteristics of borrower.

A simple/**weighted average** of PIT PDs across past years will form a TTC PD.

Unlike PIT PD, it does not vary across years as it is estimated by covering an entire macro-economic cycle.



Point-in-time (PIT) PD

PIT PD assesses the **likelihood of default** at a particular point in time.

Captures both current macro-economic conditions & **risk characteristics** of borrower.

An **observed default rate** obtained from year **migration matrix** is known as PIT PD.

PIT PD will be volatiie in nature depending on macroeconomic condition and recent trends.



Forward Looking Adjustments (FLI)

FLI helps enhance the model's ability to assess the credit risk under varying macroeconomic scenarios and conditions.

It incorporates information about potential future events or changes into the model to better predict credit risk.

This could include **economic indicators, market trends, or other factors** that may impact the PD in the future.

ECL Example

- A customer has an outstanding exposure of ₹10,00,000 on a credit facility.

Stage 1 –

- No SICRPD (12-month): 5%
- LGD: 40%
- EAD: ₹10,50,000 (exposure expected at possible default)
- ECL = PD × LGD × EAD= **0.05** × 0.40 × 10,50,000= ₹21,000

Stage 2 – SICR Identified Customer's financial results decline, internal rating downgraded, and delays become more frequent → SICR triggered.(Significant Increase in Credit Risk)

- Lifetime PD: 25% **(increased from 5% to 25%)**
- LGD: 40%
- EAD: ₹10,70,000
- Lifetime ECL = **PD × LGD × EAD**=

  0.25 × 0.40 × 10,70,000= ₹1,07,000

- **Key Insight: SICR causes a shift from short-term (12-month) to long-term (lifetime) default expectations — resulting in a substantial increase in ECL.**

ECL – Case study

- Company M, a manufacturer operating in a single geographical region, has trade receivables totalling Rs. 30 million for the year 20X1. The customer base consists of many small clients with similar risk characteristics, and the receivables do not contain a significant financing component in accordance with Ind AS 115.
- As required by Ind AS 109 (Simplified Approach – Para 5.5.15), Company M must measure lifetime expected credit losses (ECL) for all trade receivables using a provision matrix. The receivables are aged into five buckets, and Company M has established forward-looking adjusted default rates for each ageing category based on historical loss experience and expected economic deterioration. Using the ageing information and default rates provided, determine the lifetime ECL allowance for each ageing bucket and compute the total ECL for the Rs. 30 million portfolio.

ECL –Case study

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Ageing Category	Gross Carrying Amount (Rs.)	Default Rate
Current	15,000,000	0.3%
1–30 days past due	7,500,000	1.6%
31–60 days past due	4,000,000	3.6%
61–90 days past due	2,500,000	6.6%
More than 90 days past due	1,000,000	10.6%
Total	**30,000,000**	—

ECL -Solution

- To determine the expected credit losses for the portfolio, Company M uses a provision matrix. The **provision matrix is based on its historical observed default rates** over the expected life of the trade receivables and is adjusted for forward-looking estimates. **At every reporting date** the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.

Ageing Bucket	Gross Carrying Amount (CU)	Default Rate	Lifetime ECL (Rs.)
Current	15,000,000	0.3%	45,000
1–30 days past due	7,500,000	1.6%	120,000
31–60 days past due	4,000,000	3.6%	144,000
61–90 days past due	2,500,000	6.6%	165,000
More than 90 days past due	1,000,000	10.6%	106,000
Total	**30,000,000**	—	**580,000**

Financial Guarantee – Case Study

A promise by Company P to pay Bank B if Subsidiary S fails to repay a loan.

Loan Amount: ₹1,000 (in Rs. Crores) , Term: 3 years,

Interest Rate Charged: 7% (because P guaranteed the loan)

Market Rate Without Guarantee: 10%

Guarantee Fee Charged by P to S: Nil

Under **Ind AS 109**, FGC is recognised at initial **fair value** and

subsequently measured at **higher of**:	• Amortised carrying amount, or • Expected Credit Loss (ECL).
Default Probabilities:	• Year 1 :1% probability of default; no recovery expected. • Year 2 : 4% probability of default; no recovery expected.

Financial Guarantee – Case Study

Initial Measurement : How is the fair value calculated?

Component	Year 1	Year 2	Year 3	Total (in Rs.Crores)
Interest at market rate 10% (A)	100	100	100	300
Interest at subsidised rate 7% (B)	70	70	70	210
Interest benefit (A–B)	**30**	**30**	**30**	**90**
Discounted at 10%	27	25	23	75

Fair Value at Year 1 – Rs. 75 crores

Entry in the books of P

Investment in Subsidiary A/c Dr Rs. 75

To Financial Guarantee Liability Rs. 75

Financial Guarantee – Case Study

Subsequent Measurement at the end of Year 1:

FGC is measured at **the higher** of:

1. Amortised (unwound) amount, OR
2. Expected Credit Loss (ECL)

Year	Opening	10% Interest	Benefit Provided (Gain)	Closing
Year 1	75.00	7.50	(30.00)	**52.50**
Year 2	52.50	5.30	(30.00)	**27.80**

Evaluation of Impairment at the end of Year 1:

- 12 month ECL – 1 % * 1000 =-Rs.10
- Amortized amount at the end of year 1 - Rs.52.5

Carrying amount is whichever is higher – Rs.52.5

Financial Guarantee – Case Study

Subsequent Measurement at the end of Year -2 :

FGC is measured at **the higher** of:

1. Amortised (unwound) amount, OR
2. Expected Credit Loss (ECL)

Year	Opening	10% Interest	Benefit Provided (Gain)	Closing
Year 1	75.00	7.50	(30.00)	**52.50**
Year 2	52.50	5.30	(30.00)	**27.80**

Evaluation of Impairment at the end of Year 2:

- 12 month ECL – 4 % * 1000 -Rs.40
- Amortized amount at the end of year 2 - Rs.27.80

Carrying amount is whichever is higher – Rs.40

Journal Entry:

Impairment loss A/c Dr Rs. 12.5

To FGC liability Rs.12.50

Reclassification – Financial Asset & Liability

🧠 Knowledge Check

Financial liabilities are reclassified:

- A. Frequently
- B. Only on fair value change
- C. Never under Ind AS 109
- D. On management approval

C. Never under Ind AS 109

(Ind AS 109): Paragraph 4.4.2 – An entity shall not reclassify any financial liability.

Reclassification of Financial asset

When Is Reclassification Allowed?

- Allowed ONLY if the entity changes its business model for managing financial assets.
- Such changes are very rare, significant, and decided by senior management.
- Must be observable externally (e.g., shutting down a business line).

Examples of Valid Business Model Change

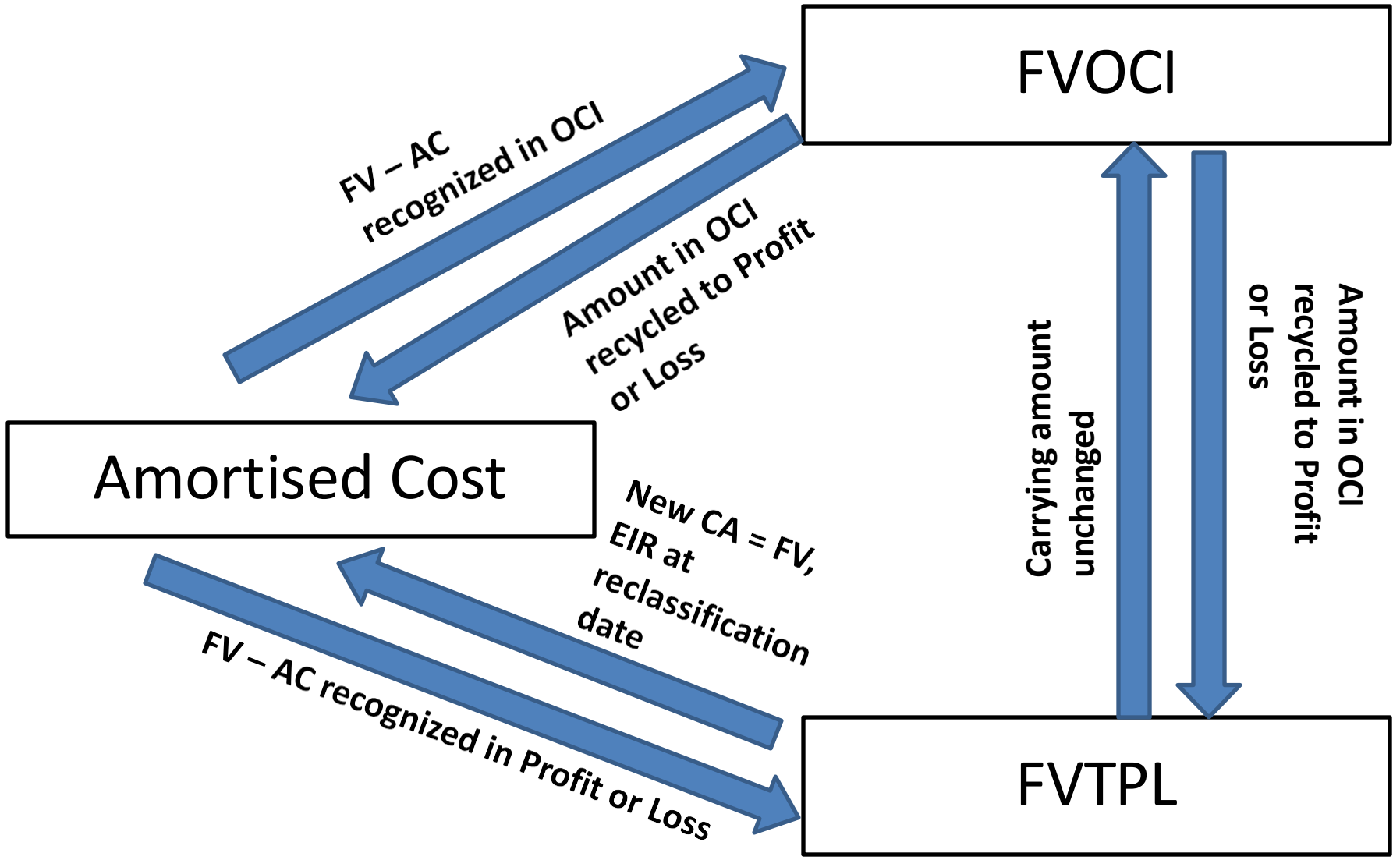
- Portfolio previously held for sale → now held to collect contractual cash flows after acquiring a loan-management business.
- Retail mortgage business closed → no new loans, existing portfolio marketed for sale.

Accounting Rules for Reclassification

- Reclassification is done prospectively from reclassification date. Must stop activities related to previous business model before reclassification. No restatement of prior:
  - gains or losses
  - Interest
  - Impairment

Reclassification applies only to financial assets, not financial liabilities.

Reclassification of FA



Reclassification of financial assets

For each reclassification	• **Date** of reclassification • Detailed **explanation of change in business model** and **qualitative description of its effect** on the financial statements • **Amount reclassified into and out of each category**
Assets reclassified from FVTPL to AC/FVTOCI	• **EIR determined** on the **date of reclassification**; and • **Interest revenue** recognized
Assets reclassified from **- FVTOCI to AC or** **- FVTPL to AC/FVTOCI**	• **Fair value** of the financial assets at period end • **Fair value gain/loss** that would have been recognized in **OCI/PNL** had there been no reclassification

What is NOT a Change in Business Model (Ind AS 109)

NOT a Business Model Change.

- Change in intention for specific financial assets.
- Temporary disappearance of a market
- Internal transfer of financial assets between divisions with different business models.
- **NOT a Reclassification Event**
  - Hedge instrument loses hedge effectiveness
  - Item becomes a designated hedging instrument
  - Entity designates an instrument at FVTPL due to a credit-risk management strategy (e.g., use of credit derivatives).
- Financial Liabilities: **Financial liabilities can NEVER be reclassified under Ind AS 109.**

Other Key Factors to be considered

Deferred Tax impact to be considered since IND AS 109 insist for Fair valuation and Income Tax is as per Historical cost.

Classification of Financial Assets and Liabilities to be done at High Aggregation Level and not at the Instrument level.

Knowledge Check

- Regular-way purchases of financial assets are recognised on:
- A. Settlement date only
- B. Trade date or settlement date (policy choice)
- C. Invoice date
- D. Approval date

Knowledge Check

B. Trade date or settlement date (policy choice)

(Ind AS 109): Paragraph 3.1.2 –

An entity shall recognise a regular way purchase or sale of a financial asset on the trade date or settlement date.

🧠 Knowledge Check

- Reclassification between amortised cost and FVOCI requires adjustment of:
- A. Equity only
- B. OCI balance
- C. Effective interest rate
- D. Contractual cash flows

B. OCI balance

- **(Ind AS 109): Paragraphs 5.6.5–5.6.7 –**
These paragraphs prescribe that on reclassification to or from FVOCI, the entity makes the necessary adjustment to OCI, without restating prior periods or changing EIR.

🧠 Knowledge Check

- FVOCI is best described as:
- A. Intermediate category
- B. Measurement choice
- C. Specific business-model driven category
- D. Temporary classification

- C. Specific business-model driven category

- **(Ind AS 109): Paragraph 4.1.2A –**

A financial asset shall be measured at fair value through other comprehensive income if it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets…

Knowledge Check

On 1 January 2024, XYZ Ltd issues a new instrument with the following characteristics. Face value Rs.100 and issue price Rs. 90. Cumulative dividend payable at 5% per annum for 10 years. After 10 years, the dividend is payable at the discretion of the issuer. The holder of the note has the option to convert to ordinary shares of XYZ Ltd. after 10 years, and conversion will be 10 ordinary shares for each instrument. The holder can demand redemption for the face value at any time, with six months' notice up until the end of 10 years. After 10 years, redemption is at the discretion of the issuer. There is no fixed maturity date. How should the instrument be classified by XYZ Ltd. in the first 10 years?

a. As equity
b. As a liability
c. As either equity or liability
d. As a compound instrument

- Because the instrument contains:
- A liability component (redeemable on demand for cash)An equity component (fixed-for-fixed conversion option)
- ➡️ Ind AS 32 Para 28–32:When a financial instrument contains both liability and equity components,

it must be classified as a compound financial instrument.

Knowledge Check

An entity holds debt instruments primarily to collect contractual cash flows. However, during the year, it sold some instruments due to liquidity pressure. The assets should be classified as:

a. FVTPL
b. Amortised Cost
c. FVOCI
d. Classification changes automatically due to sale

Ind AS 109 (Paras B4.1.3A & B4.1.3B) states that occasional or infrequent sales, including those due to liquidity needs, do not change the business model of “hold to collect”.

Therefore, the debt instruments continue to be classified as: ✅ Amortised Cost

Knowledge Check

A loan allows borrower to prepay outstanding principal plus accrued interest without penalty. Answer whether the transaction would satisfy the criteria of SPPI : -

a. Fails SPPI
b. Passes SPPI
c. Fails unless compensation paid
d. Automatically FVTPL

- Ind AS 109 Para B4.1.11(b) – A prepayment amount that substantially represents unpaid principal + accrued interest meets SPPI.

- ✅ Answer: b. Passes SPPI

Knowledge Check

A company enters into a cash-flow hedge of a forecasted purchase. The effective portion of the hedge's fair-value change is:

a. Recognised immediately in profit or loss.
b. Recognised in OCI and never re reclassed.
c. Recognised in OCI and re reclassed to profit or loss when the forecasted transaction occurs.
d. Disallowed under Ind AS 109.

- For a cash-flow hedge of a forecasted purchase, the effective portion of the hedge’s fair-value change is:Recognised in OCI initiallyReclassified to P&L when the forecasted transaction affects profit or lossInd AS referenceInd AS 109 para 6.5.11(d) – Effective portion of a cash-flow hedge → OCI, then reclassified to P&L when the hedged item affects earnings.

- ✅ Answer: c. Recognised in OCI and reclassified to profit or loss when the forecasted transaction occurs.

Knowledge Check

5. When an entity repurchases a financial asset that it previously classified as FVOCI, the cumulative gain or loss previously recognised in OCI is:

a. Reversed from OCI to profit or loss.

b. Remains in OCI forever.

c. Recognised as a dividend.

d. Transferred to equity.

- Ind AS 109 Para 5.7.10 — On derecognition of a FVOCI debt instrument, the OCI balance is recycled to P&L.

- ✅ Correct option: a. Reversed from OCI to profit or loss.

🧠 Knowledge Check

6. A bond's interest is linked to EBITDA of the issuer. Principal is fixed. Does it pass SPPI?

a. Yes, because principal is fixed
b. Yes, because it is a debt instrument
c. No, because return is not consideration for time value and credit risk only
d. Depends on management intention

- Ind AS 109 – Paras B4.1.7A & B4.1.9

- SPPI fails if cash flows include exposure to equity-like or performance-linked risks.

- ✅ Correct option: c. No, because return is not consideration for time value and credit risk only.

Knowledge Check

7. A parent provides a financial guarantee for subsidiary's loan without charging fee. How is it initially recognised?

a. Nil Value
b. At Amortised Cost
c. At Fair Value
d. At nominal value of guarantee

- Ind AS 109 para 5.1.1 → All financial liabilities, including financial guarantees, are initially recognised at fair value. When issued to a subsidiary for free, the fair value is treated as an equity contribution under Ind AS 27.

- ✅ Final Answer: c. At Fair Value

Knowledge Check

8. From the below list of instruments held by ABC Limited as at 31.03.2022, identify the financial instrument which does not meet the contractual cash flow characteristics test as per the provisions of Ind AS 109 : -

a. Variable rate instrument with a stated maturity date that permits the borrower to choose to pay three-month LIBOR for a three-month term or one- month LIBOR for a one-month term
b. A fixed term variable market interest rate bond where the variable market interest rate is capped.
c. A financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments
d. A financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level

- The SPPI test under Ind AS 109 requires that contractual cash flows are only:Principal, andInterest = compensation for time value of money + credit risk + liquidity risk + costs + profit marginAny exposure to equity risk or market performance fails SPPI.
- Ind AS 109 B4.1.7A & B4.1.9: Cash flows tied to equity or commodity prices fail SPPI.

Knowledge Check

9. Entity A holds a portfolio of debt securities. They are held to collect contractual cash flows, however, the risk management team is allowed to sell up to 20% of the portfolio annually to manage duration risk. The contractual cash flows represent solely payments of principal and interest (SPPI). How should the portfolio be classified under IND AS 109?

a. Amortised Cost
b. FVOCI – Debt Instruments
c. FVTPL
d. Either Amortised Cost or FVOCI depending on management choice

- Ind AS 109 para 4.1.2A – Debt instruments are measured at FVOCI if the objective is both collecting contractual cash flows and selling.Regular, planned sales for risk management still meet this business model.

- ✅ Final answer: b. FVOCI – Debt Instruments

🧠 Knowledge Check

10. A company has borrowed ₹20 crore for five years at 10% per annum. Due to financial strain, the lender modifies the contractual terms by reducing the interest rate to 7% and extending the loan tenor by one additional year. The modification does not meet the criteria for substantial modification under the 10% test. Therefore, the original liability is not derecognised. Instead, the entity is required to revise the carrying amount of the existing liability by discounting the modified contractual cash flows using the original effective interest rate. The resulting gain or loss arising from this remeasurement is recognised in profit or loss. What should the company do?

a. Derecognise old liability and recognise a new one
b. Continue old liability, adjust carrying amount using revised cash flows discounted at original EIR
c. Change the EIR prospectively
d. Recognise gain/loss in OCI and amortise

Continue old liability, adjust carrying amount using revised cash flows discounted at original EIRInd AS 109 refs:

Paras B5.4.6–B5.4.8 — for non-substantial modifications, remeasure the carrying amount by discounting modified cash flows at the original EIR and recognise the gain/loss in profit or loss.

Issues

- White ltd. issues 100 preference shares for Rs.100 each. The preference shares are to be mandatorily redeemed by White Ltd. for Rs.500 each after 10 years. No dividend is payable.

Solution

Calculation of IRR:	
Year	Cash Flows
0	10000
1	0
2	0
3	0
4	0
5	0
6	0
7	0
8	0
9	0
10	-50000
	17%

Amortised cost calculation of preference shares:				
Year	Opening Balance	Interest	Cash Flows	Closing Balance
0				
1	10,000	1,746	-	11,746
2	11,746	2,051	-	13,797
3	13,797	2,409	-	16,207
4	16,207	2,830	-	19,037
5	19,037	3,324	-	22,361
6	22,361	3,905	-	26,265
7	26,265	4,586	-	30,852
8	30,852	5,387	-	36,239
9	36,239	6,328	-	42,567
10	42,567	7,433	50,000	-

Issues

- White Ltd. has given interest free loan of Rs.10 lac to its employee for housing purposes to be repaid in 10 equal yearly installments. Had the employee obtained the loan from a bank / financial institution, the interest rate would be 10% on the loan. Show the amortised cost of the loan for the entire period of the loan.

Solution

Calculation of fair value of employee loan:			
Year	**Cash Flows**	**Discount @10%**	**Present Value**
1	100000	0.9091	90909
2	100000	0.8264	82645
3	100000	0.7513	75131
4	100000	0.6830	68301
5	100000	0.6209	62092
6	100000	0.5645	56447
7	100000	0.5132	51316
8	100000	0.4665	46651
9	100000	0.4241	42410
10	100000	0.3855	38554
Fair Value of Employee Loan			**614457**
Amount Given as loan			1000000
Day 1 loss on fair valuation			**385543**

Solution (contd.)

Amortised cost of Employee Loan:				
Year	Opening Balance	Interest	Cash Flows	Closing Balance
1	6,14,457	61,446	1,00,000	5,75,902
2	5,75,902	57,590	1,00,000	5,33,493
3	5,33,493	53,349	1,00,000	4,86,842
4	4,86,842	48,684	1,00,000	4,35,526
5	4,35,526	43,553	1,00,000	3,79,079
6	3,79,079	37,908	1,00,000	3,16,987
7	3,16,987	31,699	1,00,000	2,48,685
8	2,48,685	24,869	1,00,000	1,73,554
9	1,73,554	17,355	1,00,000	90,909
10	90,909	9,091	1,00,000	-
		3,85,544		

White Ltd. Purchased a fixed rate bond at a discount with the terms mentioned here:

Issues

	Bond Terms
Purchase Price	Rs.98 lacs
Purchase Date	1 April 2015
Notional	Rs.100 lacs
Maturity	3 years
Coupon	10% annually, 30/360basis
FV on 31 March 2016	Rs.97 lacs
FV on 31 March 2017	Rs.101 lacs

Solution

Calculation of IRR	
Year	Cash Flows
0	-98
1	10
2	10
3	110
	11%

Amortised cost of Bond				
Year	Opening Balance	Interest in Profit or Loss	Cash Flows	Closing Balance
1	98.00	10.60	10.00	98.60
2	98.60	10.66	10.00	99.26
3	99.26	10.74	110.00	0.00

Amount to be recognised in OCI					
Year	Fair Value	Amortized Cost	FVOCI Reserve	Opening Balance of FVOCI Reserve	Recognized in OCI during the period
1	97	98.60	-1.60	-	-1.60
2	101	99.26	1.74	-1.60	3.34
3	100	100	-	1.74	-1.74

Issues

- White Ltd. manages its loan portfolio on fair value basis. White Ltd. obtained a loan of Rs.10 lac from Black Ltd. requiring a bullet payment of Rs.12 lac after 10 years. The market rate for such a loan for an entity with a similar credit rating of White Ltd. is 8%. After 3 years, the credit risk of White Ltd. increases and hence the comparable interest rate increase to 12%. At what value would the loan be recognised in White Ltd.'s books and what would be effect of decrease in credit rating of White Ltd.

Solution

Calculation of Fair Value of Loan:			
Year	**Cash Flows**	**Discount @8%**	**Present Value**
1	-	0.9259	-
2	-	0.8573	-
3	-	0.7938	-
4	-	0.7350	-
5	-	0.6806	-
6	-	0.6302	-
7	-	0.5835	-
8	-	0.5403	-
9	-	0.5002	-
10	12,00,000	0.4632	5,55,832
Fair Value of Bullet Payment Loan			**5,55,832**

Solution (contd.)

Calculation of Amortised Cost of Loan:				
Year	Opening Balance	Interest	Cash Flows	Closing Balance
1	5,55,832	44,467	-	6,00,299
2	6,00,299	48,024	-	6,48,323
3	6,48,323	51,866	-	7,00,188
4	7,00,188	56,015	-	7,56,204
5	7,56,204	60,496	-	8,16,700
6	8,16,700	65,336	-	8,82,036
7	8,82,036	70,563	-	9,52,599
8	9,52,599	76,208	-	10,28,807
9	10,28,807	82,305	-	11,11,111
10	11,11,111	88,889	12,00,000	-

Calculation of Fair Value of Loan on increase in Credit Risk:			
Year	**Cash Flows**	**Discount @ 12%**	**Present Value**
1	-	0.8929	-
2	-	0.7972	-
3	-	0.7118	-
4	-	0.6355	-
5	-	0.5674	-
6	-	0.5066	-
7	12,00,000	0.4523	**5,42,819**
Amortised Cost at the end of 3rd year			7,00,188
Gain due to increase in credit risk			**1,57,369**

Solution (contd.)

FRRB Observations

Principle: An entity shall recognize a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).”

Extract from FS

- The relevant abstract of Note on Loans given in the Annual Report of a company, reads as follows:

Particulars	As at 31 March 20XX	As at 31 March 20YY
Unsecured, Considered Doubtful		
Loans to others (Business Advance)	---	---"

Observation

- It was observed from the given note that the company has given unsecured business advance which has been considered ‘doubtful’. It was also observed that all the loans were carried at amortised cost. However, despite of the fact that these advances were doubtful, the company has not recognized any allowance towards the expected credit loss as required by Indian Accounting Standard 109. It was viewed that non-recognition of allowance for expected credit loss on doubtful business advances, the profits as well as financial assets of the company have been overstated to that extent. Accordingly, it was viewed that the requirements of Indian Accounting Standard 109 have not been complied with in preparation and presentation of the financial statements.

Principle: A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form.

Extract from FS

- The contingent liabilities of a company included letter of comfort to banks against credit facilities / financial assistance availed by subsidiaries and corporate guarantee given to banks against credit facilities/ financial assistance availed by its associate company.

Observation

- In accordance with the above, it may be noted that a significant feature of a letter of comfort and corporate guarantee contract is the contractual obligation to make specified payment in case of default by the credit holder. As such, the contract may not necessarily be called as financial guarantee contract and it may take any name or legal form, however, the accounting will be same as that of a financial guarantee contract. If a contract legally meets these requirements, then it would be accounted for as the financial guarantee contract as per Ind AS 109. **Accordingly, in the given case, it was viewed that both the letter of comfort and corporate guarantee by their nature, are financial guarantees and therefore, the same should have been recognized as financial guarantee as per the requirement of Ind AS 109.** Similar view was taken by the ITFG, ICAI under issue 64 given in the Compendium of ITFG Clarification Bulletins, December 2018 edition

Principle: An entity shall recognise in profit or loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard

Extract from FS

- In the note to the financial statements of a company on Trade Receivables, no provision for doubtful trade receivables was created

Observation

- It was noted from the note on trade receivables that the trade receivables have been shown as doubtful. It was viewed that when trade receivables are shown as doubtful, the company shall disclose the amount of credit loss that is expected on those receivables. As per Ind AS 109, the company is required to recognize a loss allowance (i.e. Impairment) for expected credit losses on financial assets including trade receivables. Loss allowance is presented as separate line item as deduction from gross carrying amount of trade receivable. **It was noted that the provision for expected credit loss has not been created for doubtful trade receivables.** Accordingly, it was viewed that the requirements of Division II to the Schedule III to the Companies Act, 2013 as well as Ind AS 109 have not been complied with.

Principle: A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A.However an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income.

Extract from FS

- Abstract of accounting policy of a company on Sale of securities read as follows: —Gain/loss from trading in derivatives has been recognised only upon settlement of trade. The Mark to Market margins have not been charged to revenue.

Observation

- It was noted from the stated policy that any gain/ loss from trading in derivatives was recognized only upto settlement. Any gain/ loss on MTM (Marked to market) transactions was also not charged to the Statement of Profit and loss. As per the requirements of **Ind AS 109, all derivatives, other than those parts of hedging, which do not meet the criteria for classification as subsequently measured at Amortised Cost or Fair Value through Other Comprehensive Income (FVOCI) are measured at fair value at each reporting date and all gains and losses are recognised in the Statement of Profit or Loss.** Accordingly, it was viewed that the stated policy of the company is not in line with Ind AS 109

Principle: An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

Extract from FS

- Financial Instruments disclosure relating to Risk Management Strategy and other related disclosures were not given in the Financial Statements.

Observation

- The Board noted from the financial statements that nature and extent of risks arising from the financial instruments including the **credit risk, liquidity risk and market risk** have not been disclosed in the financial statements. Accordingly it was viewed that the requirements of Ind AS 107 was not complied with in the preparation and presentation of the financial statements.

Principle: Ind AS 109: Financial Instruments

Paragraph 5.5.1 An entity shall recognize a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d)."

"Note on Joint Venture

ABC JV has a total exposure of Rs XXX in RRR Metro Rail Ltd. (RRR) which includes trade receivables of Rs XXX and unbilled receivables of Rs XXX.

ABC JV has put a Rs XXX variations on RRR which are pending at different stages of arbitration.

XYZ Limited has undertaken sub-contracting work of Rs XXX from ABC JV for RRR Metro Rail Ltd. and as at 31st March 20YY, total receivable due from ABC JV is Rs XXX. An amount of Rs XXX is pending towards subcontracting work and the balance Rs XXX is pending towards advances given to ABC JV. XYZ Limited is not the party to the arbitration/claims, and the recovery of this amount is dependent upon finalization of arbitration award and clearance /acceptance of claims by RRR."

Impairment of financial assets

...The Company applies the expected credit loss model for recognising impairment loss on financial assets measured at amortised cost, lease receivables, trade receivables, other contractual rights to receive cash or other financial asset

Observation

- It was noted from the notes to accounts that the company has a material amount of trade receivables (current assets) whose realization is based on arbitration outcome. It was viewed that as the realization of the outcome is not certain and being a financial asset, allowance for expected credit loss (ECL) should have been made as required by Indian Accounting Standard.
- 109. Non-provisioning for ECL led to overstatement of financial assets as well as overstatement of profits of the company.
- Accordingly, it was viewed that the requirements of Indian Accounting Standard 109 have not been complied with in the preparation and preparation of financial statements.


Any
QUESTIONS?



Thank you

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