
# [Ind AS 32,109,&107]

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# Financial Instruments- Overview & scope

# Financial Instruments Overview

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Financial Instruments- Presentation

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# Financial Instruments Overview-Trio

- Classification as Liability v/s Equity
- Offsetting financial asset & financial liability

**Ind AS 32**
Financial Instruments- *Presentation*

- Recognition of financial assets &financial liabilities
- Measurement of financial assets and financial liabilities
- De-recognition financial assets & financial liabilities
- Impairment model (viz. Expected Credit Losses)
- Hedge accounting

**Ind AS 109**
Financial Instruments

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Financial Instruments - *Disclosures*

- Disclosures relating to financial Instruments required in the financial statements

# Objective & Scope-Ind AS 32

**Objective**

The objective of this Standard Ind AS 32 is to establish principles for **presenting** financial instruments as **liabilities or equity** and for **offsetting** financial assets and financial liabilities.

It applies to the classification of financial instruments, from the perspective of the issuer, in to financial assets, financial liabilities and equity instruments; **the classification of related interest, dividends, losses and gains**; and the circumstances in which financial assets and liabilities should be offset.

**Scope**

- The Standard **shall be** applied to all types of financial instruments **except:**

➢ those **interest in subsidiaries,** associates or joint venture that are accounted for in accordance with *Ind AS 110, Ind AS 27, Ind AS 28.* However, in some cases, entities using the above standards shall apply the requirements of this standard. Entities shall also apply this Standard to all derivative linked to interest in subsidiaries, associates or joint ventures.

➢ **employer's right and obligation** under employee benefit plan to which Ind AS 19 applies.

# Objective & Scope-Ind AS 32

**Scope**

- **insurance contracts** and financial instruments that are within the scope of Ind AS 104. However, this standard applies to derivatives that are embedded in insurance contracts.

- financial instruments, contracts and obligations under **share-based payment** transactions to which Ind AS 102 applies **except for**;

- contracts within the scope of this standard, to which this standard applies.
- Treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans,

- This Standard **shall be applied** to those contracts to buy or sell a non-financial item that can be settled **net in cash or another financial instruments**, or **by exchanging financial instruments**, as if the contracts were financial instrument.

  - However, this Standard **shall not apply to** contracts that were entered in to for the purpose of receipt or delivery of non-financial item as per expected purchase, sale and usage requirements.

  - This Standard shall be applied to those contracts that an entity designates as measured at **fair value through profit or loss**.

# Non Financial Assets-Example

- **Example**

XYZ limited enters into a fixed price forward contract to purchase one million kilograms of copper in accordance with its expected usage requirements. The contracts permits XYZ to take physical delivery of copper at the end of twelve months or net settle it in cash based on changes in the fair value of copper. XYZ intends to take delivery and has no history for similar contracts of settling net in cash or of taking delivery of the copper and selling it within a short period after delivery. Is the contract within the scope of Ind AS 32/ 109 ?

- **Analysis**

The contract is **outside the scope** of Ind AS 109. Accordingly, it will be accounted for as normal purchase contract. If the contract is onerous, an appropriate provision will be made as per Ind AS 37. However, XYZ may designate the contract as at FVTPL, if doing so eliminates or significantly reduces an 'accounting mismatch' that would otherwise arise. Such designation is required at the inception of the contract and is irrevocable

# Definition-Financial Instrument

**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.

**Contractual rights**

**Contractual obligations**

Financial Instrument

Financial Asset

Equity

Financial Liability

Financial Instrument

Primary financial instruments

- ✓ Receivables
- ✓ Payables
- ✓ Equity Instruments

Derivative financial Instruments

- ✓ Financial options
- ✓ Futures and forwards
- ✓ Interest rate swaps

# Definition-Financial Liability

**Financial Liability is**

**A**

**A contractual obligation**

- to deliver cash or other financial assets to another entity

**OR**

- to exchange financial assets/liabilities under potentially unfavorable conditions

***Example***, *A ltd has issued a call option (i.e. an option to buy) to Mr. X to subscribe to A ltds equity shares at price of 50 per share. And this call option is to be settled on a net basis i.e. there need not be a physical delivery of the shares. Now if at the balance sheet date, the MV of the equity shares of A ltd is 55 per share., A ltd will be obliged to pay Mr. X Rs. 5 to settle the option. Such a condition is potentially unfavourable to A ltd and hence Rs. 5 represents a financial Liabilty for A Ltd*

**B**

**A contract that will or may be settled in the entity's own equity instrument and is:**

- a non-derivative for which the entity is or may be obliged to deliver a variable number of entity's own equity instruments

**OR**

- 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.

# Definition-Financial Asset

**Financial Asset is**

Cash

An equity instrument of another entity

A contractual right

- to receive cash or other financial assets to another entity
- to exchange financial assets/liabilities under favourable conditions

A contract that will or may be settled in the entity's own equity instrument and is:

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

**OR**

- 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

# Definition-Equity

**Equity**

***A***

**No contractual obligation**

- to deliver cash or other financial assets to another entity

***OR***

- to exchange financial assets/liabilities under potentially unfavorable conditions

***B***

**A contract that will or may be settled in the entity's own equity instrument and is:**

- a non-derivative for which no contractual obligation deliver a variable number of entity's own equity instruments

***OR***

- a derivative that will or may be settled by exchanging of a fixed amount of cash *Or*

  another financial asset for a fixed number of the entity's own equity instruments.

- 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.

*Carve out- Ind AS vs IFRS*

# Examples

| Item | FA/FL | Reasons |
|---|---|---|
| • Investments in equity shares | FA | Fulfils definition |
| • Investment in bonds | FA | Fulfils definition |
| • Bank balance | FA | Fulfils definition |
| • Inventories | Not a FI | Does not fulfils definitions |
| • Prepaid Expenses | Not a FI | Does not fulfill definition. Right to receive service or product, but no right to receive cash or financial instrument |
| • Advance given for goods and service | Not a FI | Right to receive service or product, but no right to receive cash or financial instrument |
| • Deferred Revenue | Not A FI | Does not fulfil definition. No contractual obligation to pay cash or another financial asset |
| • Income taxes | Not a FI | Income taxes are statutory assets or liability. |
| • Financial guarantee | FA/FL | Contractual right/ obligation |
| • Trade and other payable | FL | Fulfills definitions |

# Equity or liability distinction

**Why does it matter?**

- Presentation in statement of financial position- Ind AS 32
- Initial and subsequent measurement (scope of Ind AS 109)
- Treatment of Interest, dividends etc.

- An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities

# Financial Instruments-Liability Vs. Equity Classification

Financial instrument is an **equity instrument** only if both criteria are met:

- There is **no obligation to deliver cash** or another financial asset or to exchange financial assets or financial liability; and
- The issuer will exchange **fixed amount of cash** or another financial asset for a **fixed number** of its own equity instruments

**Does the entity have an unavoidable contractual obligation?**

Yes → **Liability**

No → **Equity**

# Equity and Liability Classification

**Features of a liability:**

- Obligation to pay cash
- Mandatory redemption
- Puttable instruments @ NAV
- Only a conditional right to avoid
- Indirect obligation
- Settled in a variable number of shares
- Contingent settlement provisions

**Features of equity:**

- Discretion over cash payments (i.e. no obligation)
- **Fixed** amount of cash for a **fixed** amount of shares -the fixed-for-fixed criteria
- Not dependent on:
  - Ability to make distributions
  - Intention to make distributions
  - Negative impact on ordinary shares
  - Amount of issuer’s reserves
  - Expectation of profits for the period

# Examples

| Type of instrument | Liability | Equity |
|---|---|---|
| • Non-redeemable shares with discretionary dividends ('ordinary shares') | | ✓ |
| • Shares that are redeemable at the option of the holder ('puttable shares') | ✓ | |
| • Shares that are redeemable at the option of the issuer ('callable shares') | | ✓ |
| • Irredeemable preference shares with contractual dividends payable @4% p.a. | ✓ | |
| • Redeemable shares with discretionary dividend | ✓ | |
| • Contract to deliver as many of the entity's own equity instruments as are equal to INR 100 | ✓ | |
| • Contract to deliver 100 of entity's own equity instruments for INR 100 | | ✓ |

# Compound instruments

**Compound instruments:**

Instrument whose terms indicate that it contains **both a liability and an equity** component

**'split accounting'**

**liability component**

**equity component**

- must meet the definition of equity
- calculated as a residual

# Compound instruments-Example

**From the perspective of the issuer**

| Instrument | Liability Component | Equity Component |
|---|---|---|
| 1) Redeemable Preference shares with discretionary dividends | Principal redemption liability | Discretionary dividend |
| 2) Convertible bonds-conversion option with the holder in to fixed number of shares | Principal redemption and interest payment liability | Convertibility option to the holder-convert in to fixed number of equity shares |

- **Issuer** of a non-derivative financial instrument to evaluate the terms of the financial instrument to determine **whether it contains both a liability and an equity component**. If such components are identified, they must be **accounted for separately** as financial liabilities, financial assets or equity, and the liability and equity components shown separately on the balance sheet.

# Compound instruments-Separation

**Convertible Debt**

**Liability:** Fair value using rate for non-convertible debt

**+**

**Equity:** Balancing figure

**The transaction costs are allocated to the liability and equity components in the same proportion as above.**

# Compound instruments - Example

Q:

- ABC PLC issues 2,000 convertible bonds.
- The bonds have a 3 year term, and are issued at par with a face value of Rs.1,000 per bond, giving total proceeds of INR 2,000,000.
- Interest is payable annually in arrears at a nominal annual interest rate of 6% (i.e. INR.120,000 per annum).
- 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 options is 9% per annum.

**How should ABC PLC classify the bond?**

# Compound instruments-Example

A:

| Year | Particulars | Cash flow (INR) | Discount Factor (@9%) | NPV of cash flows |
|---|---|---|---|---|
| 1 | Interest | 120,000 | 1/1.09 | 110,092 |
| 2 | Interest | 120,000 | 1/1.09^2 | 101,002 |
| 3 | Interest & principal | 2,120,000 | 1/1.09^3 | 1,637,029 |
| | Total liability component | | | 1,848,122 |
| | Total equity component (balance) | | | 151,878 |
| | **Total proceeds** | | | **2,000,000** |

# Treasury Shares

- If an entity **reacquires its own equity instruments**, those instruments **('treasury shares')** shall be **deducted from equity.**

- No gain or loss shall be recognised in profit or loss on the purchase, sale, issue, or cancellation of an entity's own equity instruments.

- Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.

- However, when an entity hold its **own equity on behalf of others**, e.g. a financial institution holding its own equity on behalf of a client, **there is an agency relationship** and as a result those holding are not included in the entity's balance sheet.

- Ind AS 1 requires the amount of treasury shares to be disclosed separately either on the face of the balance sheet within the equity caption or in the notes. In addition Ind AS 24 *Related Party Disclosures* requires an entity to make disclosures where it reacquires its own equity instruments from related parties. There is a similar requirement in Ind AS 107.

# Interest, dividends, loss and gains

- **Interest, dividends, losses and gains**, relating to a financial instruments or a component that is a financial liability shall be recognised as income or expense in **profit or loss**.

- Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs *(incremental costs directly attributable to the equity)* of an equity transaction shall be accounted for as **deduction from equity**.

- **The classification of a financial instrument** as a financial liability or an equity instruments determines whether interest, dividends, losses and gains relating to that instruments are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as expenses in the same way as interest on a bond.

- Changes in the fair value of liabilities are recognised in profit or loss, whereas, changes in the fair value of an equity instruments are not recognised in the financial statements.

- Dividends classified as an expense may be presented in the statement of profit and loss either with interest on other liabilities or as a separate item.

# Offsetting a financial asset and a financial liability

- Offsetting arrangements allow market participants to manage counterparty **credit risk**, and **manage liquidity risk.** In particular netting arrangements generally reduce the credit risk exposures of market participants to counterparties relative to their gross exposures.

- A financial asset and a financial liability **shall be offset** and the net amount presented in the balance sheet when, and only when, an entity:

- Currently has a **legally enforceable right to set off** the recognised amounts; and

- **Intends** either **to settle on a net basis**, or to realise the asset and settle the liability simultaneously.

- Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount **differs from the derecognition** of a financial asset or a financial liability. Although offsetting does not give rise to recognition of an gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the balance sheet but also may result in recognition of a gain or loss.

- An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a **‘master netting arrangement’** with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreements in the event of default on, or termination of, any one contract.

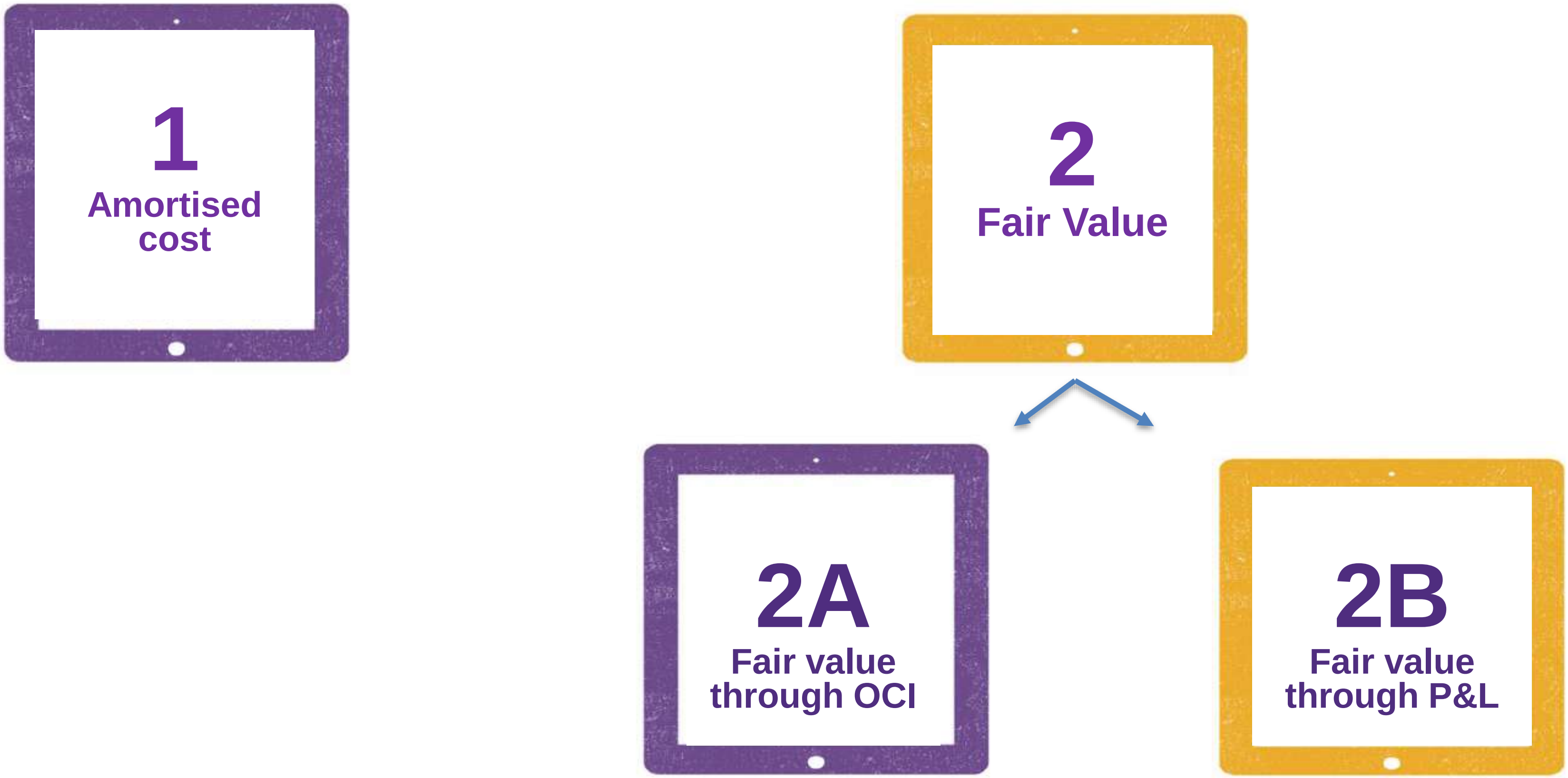
# Offsetting a financial asset and a financial liability

- A debtor (A) may have legal right to apply an amount due from a third party (B) against an amount due to a Creditor (C), provided that there is an agreement among A,B and C that clearly establishes A's right to set off amounts due from B against those due to C.

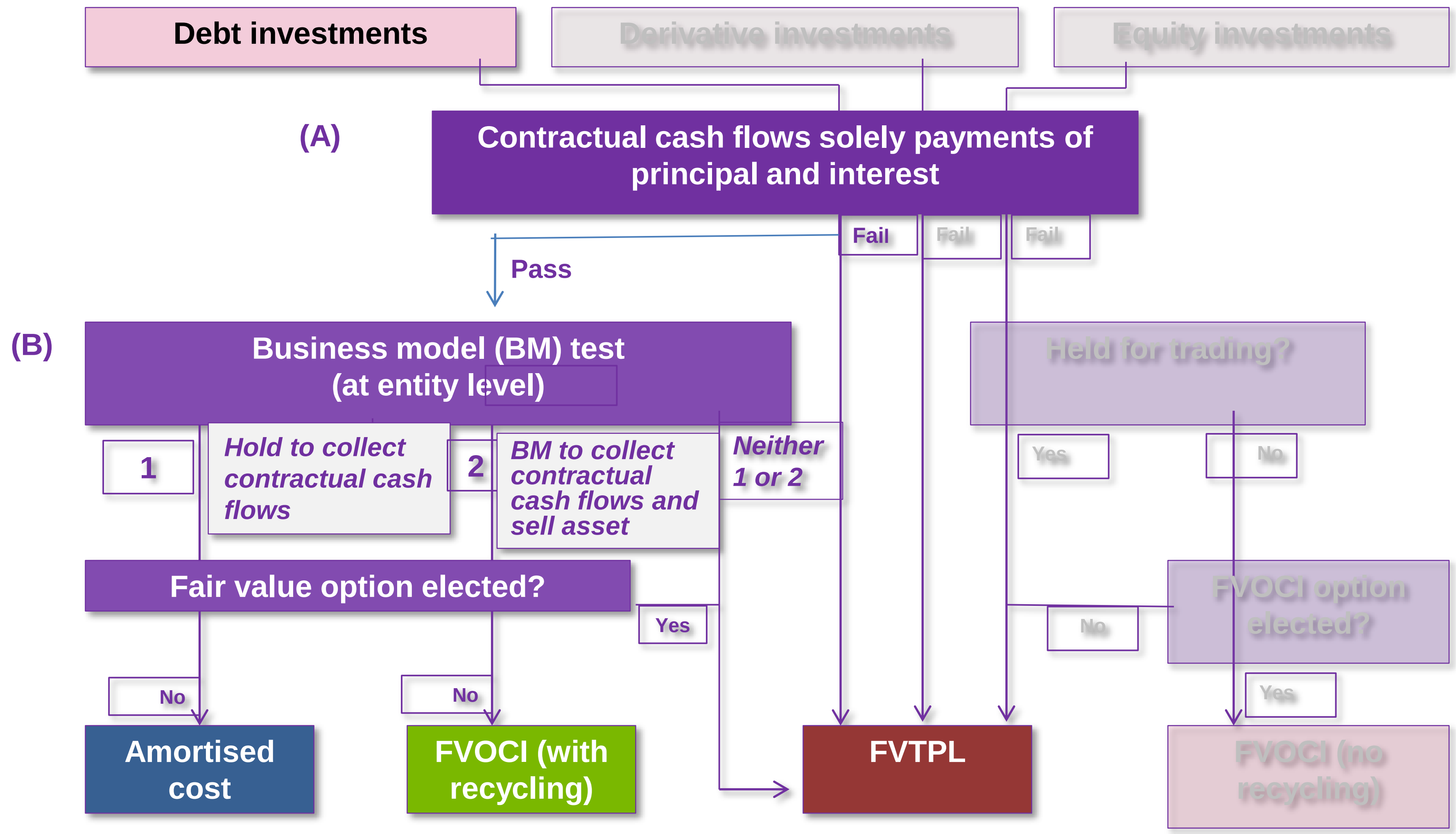
- A foreign branch of US bank makes a loan to foreign subsidiary of a US parent with the parent required to deposit an amount equal to the loan in the US bank for the same term. The terms of the transactions may give the bank a legal right to set off the amounts due to the parent against the amount owned by foreign subsidiary.

# Classification & Measurement- Ind AS 109

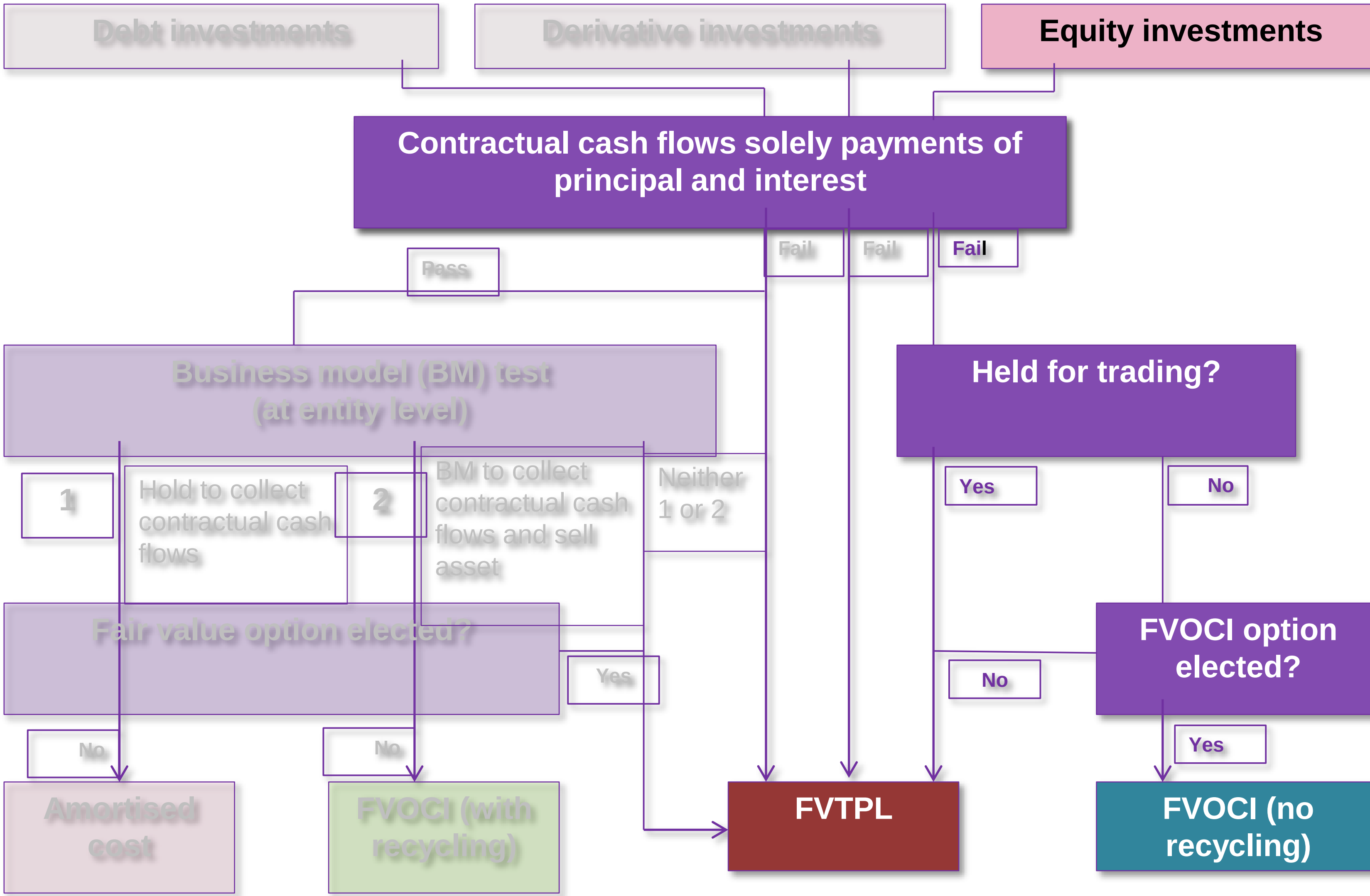
# Categories of financial assets-based on subsequent measurement



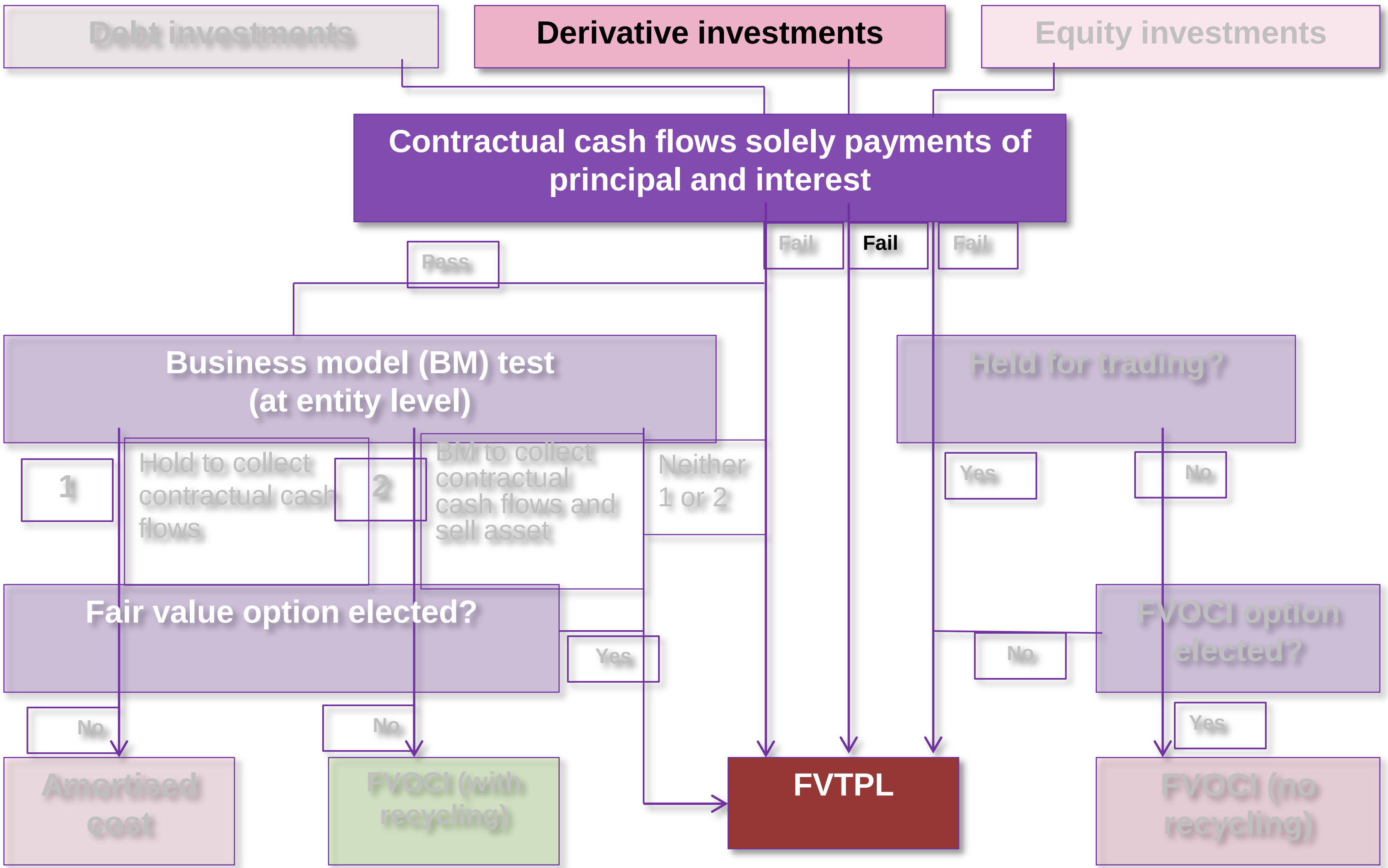
# Application to investments in debt securities



# Application to equity investments



# Application to derivatives



# Classification of financial assets

- To decide whether a financial asset is a **debt instrument** or an **equity instrument**, the holder needs to look at **the issuer's classification**. 'Equity instruments' are the ones that meet definition of 'equity' from the 'issuer's perspective under Ind AS 32.To be considered as an 'equity instrument' for the holder, the instrument should meet the definition of the term equity instrument for it issuer.

- Financial assets which are not equity instruments or derivative will be debt instruments for the holder. **This implies that:**

⇨ An investment in a debenture/ bond issued by another company is a debt instrument for its holder.

⇨ An investment in equity shares of another company will be an equity instrument for the holder.

# FVTOCI Categorization- Debt vs. Equity instruments

- Ind AS 109 allows FVTOCI categorization for debt and equity instruments, there are significant differences between the two. **For example**
- For **'debt' instruments'** meeting the prescribed criteria, FVTOCI categorization is compulsory. In contrast,' FVTOCI' category is optional for **equity instruments** which are not held for trading.
- For **debt instrument** categorized as at FVTOCI, interest income, impairment gains/ losses and foreign exchange gains/ losses are recognized in the P&L. In the case of **equity instruments** categorized as at FVTOCI, only dividend income is recognized in the P&L. All other gains/losses are recognized directly in the OCI.
- On the derecognition of **debt instrument**, cumulative gains or losses previously recognised in the OCI are reclassified from equity to P&L. Such reclassification **is not allowed** in the case of **equity instruments** classified as at FVTOCI.

# Business model assessment

- An entity's business model refers to how an entity manages its financial assets so at **to generate/ realise cash flows**. In other words, business model is concerned with whether an entity will collect contractual cash flows by **holding them to maturity or sell those financial assets or both.**

- An entity may have one of the following models for its **debt** instruments:

  **a) Hold- to- collect contractual cash flows**

  **b) Hold-to-collect contractual cash flows and selling financial assets**

  **c) Other business model**

- An entity's business model for managing the financial asset is a **matter of fact and not merely an assertion.**

- Assessment is **not an instrument-by-instrument analysis**'; rather it should be determined on a **higher level of aggregation**.

# 'Hold to collect' business model

**Objective**

- collect contractual payments over life of the instrument
- entity manages the assets held within the portfolio to collect **those particular** contractual cash flows

**Factors to consider**

- **Frequency of sales in prior periods**
- **Value of sales in prior periods**
- **Timing of sales in prior periods**
- **Reason for such sales**
- **Expectations about future**

**Examples of exceptions**

- policy to sell assets when there is an increase in the asset's credit risk or to manage credit concentration risk
- sales close to maturity of the assets where proceeds approximate remaining contractual cash flows
- increased sales in a particular period if the entity can explain the reasons for the sales

# 'Hold to collect' business model-Example

**Sales in a held-to-collect business model**

**Example**

Entity A has a portfolio of financial assets which is part of a held-to-collect business model. Due to change in legal requirement, entity A has sell some of the assets and has to significantly rebalance its portfolio.

Whether, business model needs to be assessed or changed

**Solution**

No, as the selling activity is considered an isolated or one time event.

However, if the rules require entity A to routinely sell financial assets from its portfolio and the value of assets sold is significant, entity A's business model would not be held-to-collect.

# 'Hold to collect and sell' business model

- Key Management Personal's decision – **both:**

  - collecting contractual cash flows and
  - selling financial assets

  are **integral** to achieving the objective of the business model

- compared to 'hold to collect' business model, this business model will typically involve greater **frequency** and **value** of sales

- no threshold for the frequency or value of sales

- **Examples** of **objectives consistent** with 'hold to collect and sell' business model:

  - manage everyday liquidity needs
  - maintain a particular interest yield profile
  - match the duration of the financial assets to the duration of the liabilities that those assets are funding

# 'Hold to collect and sell' business model-Example

**Holding investments in anticipation of capital expenditure**

**Example**

Entity A is planning a capital expenditure in five years. For funding the expansion, entity A invested, funds in financial assets. However the maturity of financial assets does not match with the period of capital expenditure.

Entity A might hold the financial assets, till its maturity or will sell before maturity, if they fetch higher returns. Remuneration of the portfolio's managers is based on return from the assets.

**Solution**

Entity A's objective for managing the financial assets is achieved by both collecting contractual cash flows and selling financial assets.

# 'Other' business models- the residual category

- Financial assets are measured at fair value through profit or loss if they **are not** held within a business model whose objective is:
  - to hold assets to collect contractual cash flows, or
  - achieved by both collecting contractual cash flows and selling financial assets

- **Examples**
  - assets managed with the objective of realising cash flows through sale
  - a portfolio that is managed, and whose performance is evaluated, on a fair value basis
  - a portfolio that meets the definition of ‘held-for-trading’

# 'Solely payment of principal and interest' ('SPPI') test

- Ind AS 109 requires an entity to determine whether the asset's contractual cash flows are s**olely payments of principal and interest on the principal amount outstanding**.

- SPPI test is required to decide whether an instrument structured as' debt instrument' actually has the **'basic lending arrangement'**. Both under the 'amortised cost' or FVTOCI' categories, interest is the key source of income reported in P&L. Ind AS 109 allows amortization or FVTOCI measurement category only for the **debt instruments** which satisfy the SPPI test.

- **Principal** is the fair value of the financial asset at initial recognition – principal amount may change over the life of the financial asset (for example, if there are repayments of principal)

- **Interest elements** – consideration consistent with basic lending arrangement:
  - time value of money
  - credit risk
  - other basic lending risks (example, liquidity risk)
  - costs associated with holding the financial asset for a particular period of time
  - profit margin that is consistent with a basic lending arrangement

# Consideration for time value of money

| Time value of money | → | Element of interest that provides consideration for only the passage of time |
|---|---|---|

- in order to assess whether the element provides consideration for only the passage of time, an entity:
  - applies **judgment**
  - considers relevant factors such as
    - currency in which the financial asset is denominated
    - period for which the interest rate is set
  - assesses nature of **modification** to time value of money element. An entity need to determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified.

# SPPI test- terms inconsistent with basic lending arrangement

- Contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to **changes in equity prices or commodity prices**, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

  - **Examples**

    (a) Interest rate is linked with equity index
    (b) A simple loan Interest is linked with gold index

- leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest.

  - **Examples**

    (a) Interest is leveraged – say 3 times of risk free rate
    (b) Indian loan interest rate is 5 times of EPS of the company
    (c) Forward, Swap Contracts

# SPPI test-Example

- **Example**

- Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.

- **Analysis**

The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.

However, if the interest payments were indexed to another variable such as the debtor's performance or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement.

# Reassessment of business models

- An entity should reassess its business models at each reporting period.
- Reclassification of financial assets is required when, and only when, an entity changes its business model for managing the assets.

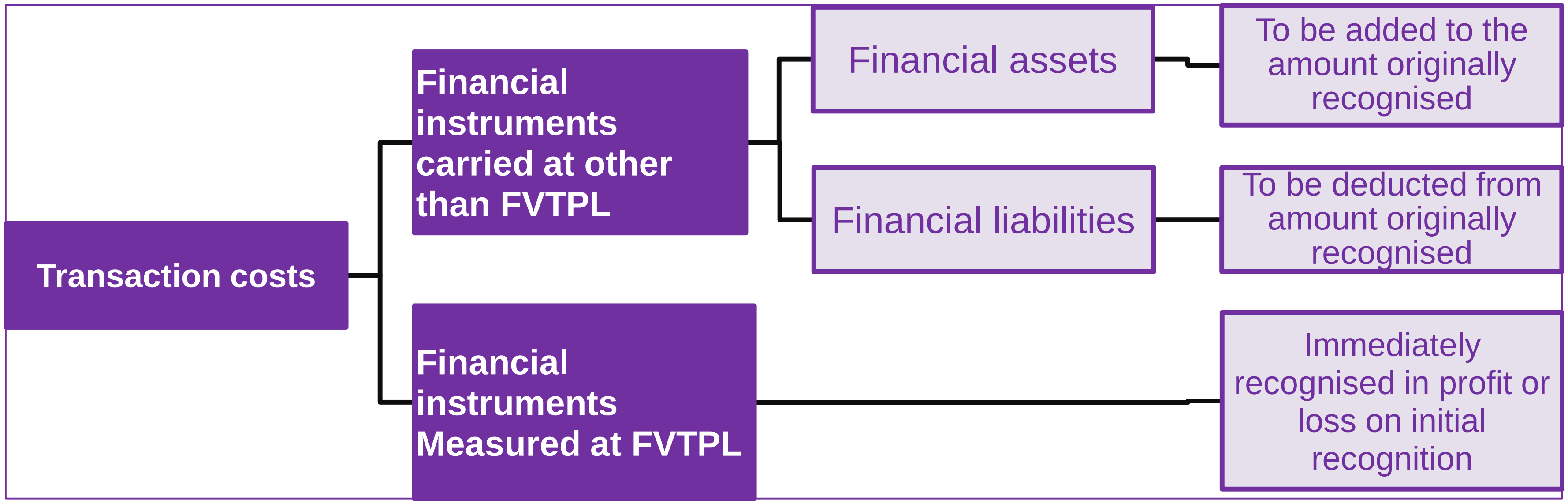
| Scenario | Scenario Change of business model? |
|---|---|
| • Entity A holds a group of debt assets originally intending to collect all the contractual cash flows. As a result of a cash shortage management decides to sell half the assets |  |
| • Entity B holds a portfolio of debt assets for trading and classifies them at FVTPL. Due to a severe financial crisis the market in these assets disappears. |  |
| • Entity C is a financial services firm with a large retail domestic mortgage business. As a result of a strategic review management decides to close this business and commences a programme to sell the loans |  |

# Classification and measurement principles- Financial liabilities

| 1<br>**Amortised cost** | 2<br>**FVTPL** |
| --- | --- |

- Financial liabilities are classified as at **FVTPL** when they meet the definition of held for trading (includes all derivatives) are measured at fair value. Further, an entity may designate a financial liability as at **FVTPL** when either:
- It eliminates or significantly reduces a measurement or recognition inconsistency (' accounting mismatch').
- A group of financial liabilities, or financial assets and financial liabilities is managed and its **performance** is evaluated on a **fair value basis**.
- All other financial liabilities are classified under the 'amortised cost' measurement category.

# Initial measurement -transaction costs




- Transaction costs **are incremental costs that are directly attributable** to the acquisition or issue or disposal of a financial asset or financial liability.

- Example of transaction cost are regulatory and registration fees, loan processing fees, brokerage, etc.

Note : Transaction costs expected to be incurred on a financial instrument's transfer or disposal are not included in the financial instrument's measurement.

# The concept of amortised cost -financial assets

The amortised cost a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus 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.

**Amortised cost** = **Amount initially recognised** - **Principal repayments** +/- **cumulative amortisation using EIR** - **Impairment**

- Effective interest rate is the rate that exactly discounts the expected stream of future cash payments or receipts through maturity to the net carrying amount at initial recognition.

No option to use straight line method

# The concept of amortised cost- financial Liability

| | | | | | | |
|---|---|---|---|---|---|---|
| **Amortised cost** | = | **Amount initially recognised** | - | **Principal repayments** | +/- | **cumulative amortisation using EIR** |

**Use effective interest rate method**

**No option to use straight line method**

# Amortised cost- Example

- **Example**

- Entity A purchases a debt instrument with five years remaining to maturity for its fair value of INR 1,000 (including transaction costs). The instrument has a principal amount of INR1,250 and carries fixed interest of 4.7% that is paid annually *(INR 1,250*4.7%=INR 59* per year). The contract also specifies that the borrower has an option to prepay the instrument and that no penalty will be charged for prepayment . At inception, the entity expects the borrower not to prepay. Calculate the effective interest rate ?

- Effective interest rate would be @ 10%

| Year | Amortised cost at the beginning (a) | Interest income-10% (b) | Cash flows (c) | Amortised cost at the end (d= a+b-c) |
|---|---|---|---|---|
| 20x1 | 1000 | 100 | 59 | 1,041 |
| 20x2 | 1,041 | 104 | 59 | 1,086 |
| 20x3 | 1,086 | 109 | 59 | 1,136 |
| 20x4 | 1,136 | 113 | 59 | 1,190 |
| 20x5 | 1,190 | 119 | 1250+59 | - |

# Initial measurement rules

- When a financial asset or financial liability is recognised **initially**, an entity should measure it as follows:

  - A financial asset or financial liability as at FVTPL is measured at **fair value** on the date of acquisition or issue.

  - Other financial assets/ liabilities are measured at the **fair value plus/ minus transaction cost directly attributable** to the acquisition or issue of a financial asset / liability.

- The fair value of a financial instrument on initial recognition is normally **the transaction price** (i.e, the fair value of the consideration given or received). However, if an entity determines that the fair value at initial recognition differs from the transaction price, the entity accounts for that instrument at that date as follows:

- If the fair value is evidenced by **quoted price** in an active market for an identical asset or liability (i.e, a level 1 input) the entity will recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss in **the P&L.**

- In all other cases, the entity **cannot recognise upfront fain/ losses.** Rather, the fair value of the financial asset/ liability at initial recognition is adjusted to defer the difference between the fair value and the transaction price. In other words, the transaction price is treated as the fair value at its initial recognition.

# Gains / Losses on subsequent measurement- Financial assets

| Classification | Amortised cost | FVTOCI (Debt) | FVTPL | FVTOCI (Equity) |
|---|---|---|---|---|
| Instrument type | Debt | Debt | All (Debt, equity and derivative) | Equity |
| • Balance sheet measurement | Amortised cost | Fair Value | Fair Value | Fair Value |
| • Transaction costs- initial recognition | Added to initial recognition amount | Added to initial recognition amount | Charge to P&L | Added to initial recognition amount |
| • Transaction costs- subsequent recognition | Amortised to P&L using EIR | Transferred to OCI and amortised in P&L using EIR | NA | Transferred to OCI |
| • Recognition of fair value- gain/ loss | NA | OCI | P&L | OCI |
| • Interest and dividend | P&L using EIR | P&L using EIR | NR | Dividend in P&L |

# Gains / Losses on subsequent measurement - Financial assets

| Classification | Amortised cost | FVTOCI (Debt) | FVTPL | FVTOCI (Equity) |
|---|---|---|---|---|
| • Impairment losses | P&L | P&L | NA | OCI |
| • Foreign Exchange gain / loss | P&L | P&L | NR | OCI |
| • Gain/ loss on sale / derecognition | P&L | Gains/ Loss plus amount parked in OCI are transferred to P&L | NR | OCI. Recycling to P&L is not allowed. |

# Subsequent measurement –financial liabilities

**Subsequent measurement - financial liabilities**

- At fair value through Profit or loss → Carried at fair value, changes taken to income statement
- Other Liabilities → Carried at amortised cost

- For most non-derivative financial liabilities designated as at FVTPL, the element of gains or loss attributable to changes in **own credit risk** should normally be recognised in the **OCI** with the remainder recognised in P&L.

- Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge the obligation.

# Financial Instruments: Disclosures [Ind AS 107]

# Financial Instrument: Disclosures

- An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance

- **Balance Sheet**
- **Categories of financial assets and financial liabilities**

- Financial assets measured at fair value through profit or loss
- Financial liabilities at fair value through profit or loss
- Financial assets measured at amortised cost
- Financial liabilities measured at amortised cost
- Financial assets measured at fair value through other comprehensive income

- **Reclassification**
- An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets :
- The date of reclassification
- A detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.
- The amount reclassified into and out of each category.

# Financial Instrument: Disclosures

- **Offsetting financial assets and financial liabilities**

- The other disclosure requirements of this Ind AS and are required for all recognised financial instruments that are set off in accordance with Ind AS 32.

- **Collateral**
- The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified.
- When an entity holds collateral and it should disclose the fair value of the hedge.

- **Default and breaches**

- Details of any defaults during the period of principal, interest or redemption terms of those loans payable.
- The carrying amount of the loans payable in default at the end of reporting period.
- Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for the issue.

# Financial Instrument: Disclosures

- **Statement of profit and loss:**

- Net gains or net losses on:
- Financial assets or financial liabilities measured at fair value through profit or loss
- Financial liabilities measured at amortised cost
- Financial assets measured at amortised cost.
- Investment in equity instruments designated at fair value through other comprehensive income.
- Financial assets measured at fair value through other comprehensive income in showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified upon derecognition from other accumulated comprehensive income to profit or loss for the period.
- Total interest revenue and total interest expense (using effective interest method) that are not measured at fair value through profit or loss.
- Fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets and financial liabilities that are not at fair value through profit or loss;

# Financial Instrument: Disclosures

- **Other disclosures**
- **Hedge accounting**

- An entity's risk management strategy and hot it is applied to manage risk
- How the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- The effect that hedge accounting has had on the entity's balance sheet, statement of profit and loss and statement of change in equity.

- **Risk arising from financial instruments**

- 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 reporting period.

- **Credit Risk**
- An entity shall explain its credit risk management practices and how they relate to recognition and measurement of expected credit losses

# Financial Instrument: Disclosures

- Quantitative and qualitative information about amounts arising from expected credit losses

- To explain the changes in the loss allowance and the reasons for those changes, an entity shall provide, by class of financial instruments, a reconciliation from the opening balance to the closing balance of the loss allowance.

- **Credit risk exposure**

- To enable users of financial statements to assess an entity's credit risk exposure and understand its significant credit risk concentrations, an entity shall disclose, by credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitment and financial guarantee contracts.

- **Liquidity risk**

- An entity shall disclose:
- A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities

# Financial Instrument: Disclosures

- **Maturity risk**

- Sensitivity analysis for each type of market risk to which the entity is exposed at the end at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at the date.

- Transfers of financial assets

- A  entity shall present the disclosures required in a single note in its financial statements. An entity shall provide the required disclosures for all transferred financial asset that are not derecognised and for any continuing involvement in a transferred asset.

- **Thank You**
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