AS 30, 31 & 32 review – Financial Asset

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Particulars
Financial Asset (Para 7 AS 31) a. Cash b. Contractual right to receive cash or another financial asset from another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity c. a contract that will or may be settled in the entity's own equity instruments and is: - a non-derivative for which the entity is or may be obliged to receive a variable number of the 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. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments. *The major difference between financial asset and other assets is that financial asset gives present right to receive cash or another financial asset whereas other assets give opportunity to generate future cash flows.*
Classification of Financial Assets: a. Held at fair value through P&L (Assets) - Intention to sell in near term. - Derivatives except hedging transactions (if they satisfy hedge conditions then accounted as per specific rules in that regard) - Unquoted instrument – should not be classified as 'held at fair value' - If a financial instrument contains embedded derivative which cannot be separated then the asset or liability is held at fair value. - Disclosure: Description as to why an asset is classified under this category w.r.t. entity's risk management strategy should be mentioned in the notes. b. Loans and receivables: - Fixed payment - Non derivative - Non quoted - Eg. Unquoted debentured - Trade receivables can also meet the definition of this category Exceptions to above list: - The entity classifies it as 'Held for sale' initially - The entity intends to sell it immediately after acquiring it.

c. Held to maturity investments (HTM)
  - Non derivative
  - Should have fixed maturity period and payment
  - Entity intends to hold it till maturity
  - The intention to hold to maturity should be evaluated on every Balance Sheet date.

Other issues:

An investment which the entity intends to hold for indefinite period, an equity instrument and perpetual debt instruments without maturity date cannot be classified as HTM. To be called HTM asset it should have both fixed maturity period and fixed payments

d. Available for sale financial assets
  - Residual category
  - Financial assets without fixed payment or without maturity date but not held for trade will fall under this category.

<u>Reclassification & its measurement:</u>

a. Reclassification of HTM assets:
  - Reclassification occurs either when HTM assets are sold before maturity or when they cease to fall under HTM category due to certain other factors. In such case they cannot be taken to assets HAFV but will have to be classified as AFS. These assets will be re-measured at fair value and the difference between 'Fair value' and 'carrying amount' will be transferred to 'Investment Revaluation Reserve'.
  - However every sale of HTM assets does not qualify for reclassification. In certain genuine cases exemption has been provided under the standard – Appendix A42 page 63.
  - Same will be the case when more than insignificant amount of HTM will be sold before maturity (exceptions in this case refer point 8.3 from AS 30).
  - Once HTM are classified as AFS all the assets from HTM will become AFS for 2 years. The entity cannot have HTM category in its books for 2 years.
  - When the assets are under AFS, they are valued at fair value and any change from previous year is booked under 'Investment Revaluation Reserve'.
  - After 2 years, if there are any assets which fulfill HTM conditions then they can be reclassified as HTM. Here the fair value carrying amount on the date of reclassification becomes the amortised cost thereafter.
  - From the date conversion to HTM from AFS, the amount in Investment Revaluation Reserve will be amortised over the life of the asset if it has a fixed maturity period. If there's no maturity period, it will be transferred from reserve to P&L only at the time of de-recognition. In both the cases when there's impairment, amount from reserve is recognised in P&L to the extent of impairment.

Measurement:

a. Initially

- Should be measured at fair value through P&L.
- For loans, effective interest method should be used.
- However, if the asset is held for a short period and discounting is immaterial then invoice value should be used. Discounting is not required in this case
- In case of HTM asset and 'loans and receivables' transaction costs are added the fair value while initial recognition using effective rate of interest method. Available for sale assets, such costs are accounted for in 'Investment Revaluation Reserve' and amortized over the life of the asset if it has maturity date, if not then this cost is taken to P&L when the asset derecognized or impaired. Whereas for all other assets (including assets held for a short period), transaction cost should not be added to its value at initial recognition.
- Expected costs to dispose the asset are not included in the asset's value.

b. Subsequently

- Loans & receivables, HTM and unquoted shares should be held at amortized cost. These should be evaluated for impairment (refer point 65 on page 37 of AS 30) at every reporting date.
- Other financial investments should be carried at fair value. Gain or loss on assets HAFV will be taken to P&L whereas in case of AFS it'll be taken to 'Investment Revaluation Reserve'.

De-recognition:

- Financial Asset: On de-recognition of a financial asset in its entirety, the difference between:
  (a) the carrying amount and
  (b) the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised directly in an equity account, say, Investment Revaluation Reserve Account (see paragraph 61(b))

Impairment:

- There should be a past loss event and not future expected event even if its occurrence is certain in the future. Reduction in the market value of a company's securities is not the impairment but a sign for possibility of impairment in future.
- HTM and Loans & receivables: if objective evidence exist, impairment loss = carrying amount less present value of future cash flow discounted at effective rate of interest (rate initially assessed). Loss is either reduced directly from the asset or parked under 'allowance / provision' account and taken to P&L. If the amount of impairment loss decreases then the previously recognised loss should be reversed and taken to P&L (debiting the asset directly or those which cannot be individually assessed for impairment should be included in the group of assets which can be collectively assessed.

- Other Financial Assets held at cost: Assets for eg. Unquoted investments for which fair value cannot be ascertained, derivative instrument linked to such unquoted instrument. These assets are maintained in the books at cost. If any objective evidence for impairment is observed, then the impairment loss should be recognised in profit & loss account. This loss is calculated as follows –

  Impairment loss = Carrying amount – PV of estimated future CF discounted at current market rate.

  Difference in treatment of such assets and HTM or loans and receivables is that in case assets held at cost, an option to take the impairment loss to allowance account is not available. Also Such loss cannot be reversed.
- Available for sale: impairment loss = (acquisition cost net of amortization and principal repayment) – current fair value. Increase in fair value is parked under Asset Revaluation Account. In case of impairment an amount equal to impairment loss should be reduced from the allowance account and passed to P&L a/c.

  Any reversal in equity instruments classified under this category should not be reversed through P&L. However, in case of debt instruments the reversal should be recognised in P&L.

Other issues:

- Gain or loss from change in fair of assets HAFV should be taken to P&L.
- Gain or loss on AFS will be parked in 'Investment Revaluation Reserve'
- The amount in Investment Revaluation Reserve will be amortised over the life of the asset if it has a fixed maturity period. If there's no maturity period, it will be transferred from reserve to P&L only at the time of de-recognition. In both the cases when there's impairment, amount from reserve is recognised in P&L to the extent of impairment.
- Interest and dividend will go to P&L.
- In case settlement date accounting change in fair value of assets held at amortised cost, from trading date to settlement date is not accounted for.

Following items do not fall under financial asset category since they do not give a right to receive cash or financial asset:

Sr. No.	Particulars
1.	Balance with tax authorities
2.	Prepaid expenses
3.	Preliminary expenses
4.	Miscellaneous expenses not written off

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