

Classification & Measurement of financial Assets

Classification :-

An entity shall classify financial assets depending on the following two criteria:-

- (a) the entity's Business Model (BM) for managing the financial assets and
- (b) the Contractual Cash flow Characteristics (CCFC) of the financial asset

(I) Business Model Test :-

- It refers to how an entity manages its financial assets in order to generate cash flows.

- Factors to consider for BM Test

- (1) Frequency of sales in prior periods
- (2) Value of sales in prior periods
- (3) Timing of sales in prior periods
- (4) Reasons for such sales
- (5) Expectations about future.

(II) Contractual Cash flow characteristics (CCFC) Test :-

- Contractual cash flows that are solely payments of principal & Interest (SPPI) on the principal amount outstanding are consistent with a basic lending arrangement.

- In a basic lending arrangement,

(a) consideration for time value of money and

(b) credit risk

are typically the most significant elements of interest.

- Interest elements can also include -

(a) consideration for other basic lending risks (ex: liquidity risk)

(b) costs (ex: Administrative costs) associated with holding the financial asset for a particular period of time; and

(c) Profit margin that is consistent with a basic lending arrangement.

- Examples of contractual terms that result in contractual cash flows that are SPPI on the principal amount outstanding:

(a) Variable interest rate

(b) contractual term that permits the issuer (i.e., debtor) to prepay a debt instrument or permits the holder (i.e., creditor) to put a debt instrument back to the issuer before maturity & the prepayment

amount substantially represents unpaid amounts of principal & interest on the principal amount owing, which may include reasonable additional compensation for the early termination of the contract.

Example - SPPI test for loan with prepayment option

Entity D lends Entity E ₹25 million at a fixed interest rate. The loan is repayable in 5 years. Entity E has the option to repay the loan at any time at ₹25 million plus any accrued interest plus a prepayment penalty fee of 2.5% which reduces by 0.5% for each complete period of 1 year during which the loan has been owing. Does the loan meet the SPPI contractual cash flows characteristic test?

Ans: Yes. The prepayment option is not contingent on any future event.

The prepayment penalty is considered to be reasonable additional compensation for early termination of the contract.

- Ⓒ Contractual term that permits the issuer or the holder to extend the contractual term of a debt instrument (i.e., an extension option) and the terms of the extension option result in contractual cash flows during the extension period that are SPPI on the principal amt owing, which may include reasonable additional compensation for the extension of the contract.

Example - SPPI test for loan with extension option (with rate reset)

Company K lends company L ₹10 million at a fixed market interest rate. The loan is repayable in 5 years. Company L has the right to extend the term for another 3 years. If company L decides to extend the loan, a variable market interest rate will be charged from year 6 to 8.

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

Ans: Yes. Extension options meet the SPPI test if the terms result in contractual cash flows during the extension period that are SPPI on the principal amount owing, which may include reasonable additional compensation for the extension of the contract.

SPPI test for loan with extension option (with no rate reset)

Company M lends company N ₹10 million at fixed market interest rate. The loan is repayable in 5 years. Company N has the right to extend the term for another 3 years at the original fixed interest rate of 5%.

Does the loan meet SPPI CFC test during extension period?

Ans: Yes. This is because the coupon rate is fixed at inception of the loan, and the rate is not leveraged. The contractual terms of the loan requires the principal amount to be advanced at inception & repaid on maturity. There are no other cash flow or contingent features.

Examples of terms inconsistent with basic lending arrangement

- (1) contractual terms that introduces exposure to risks or ^{volatility} in the contractual cash flows that is unrelated to basic lending arrangement, such as exposure to changes in equity prices or commodity prices.

Examples

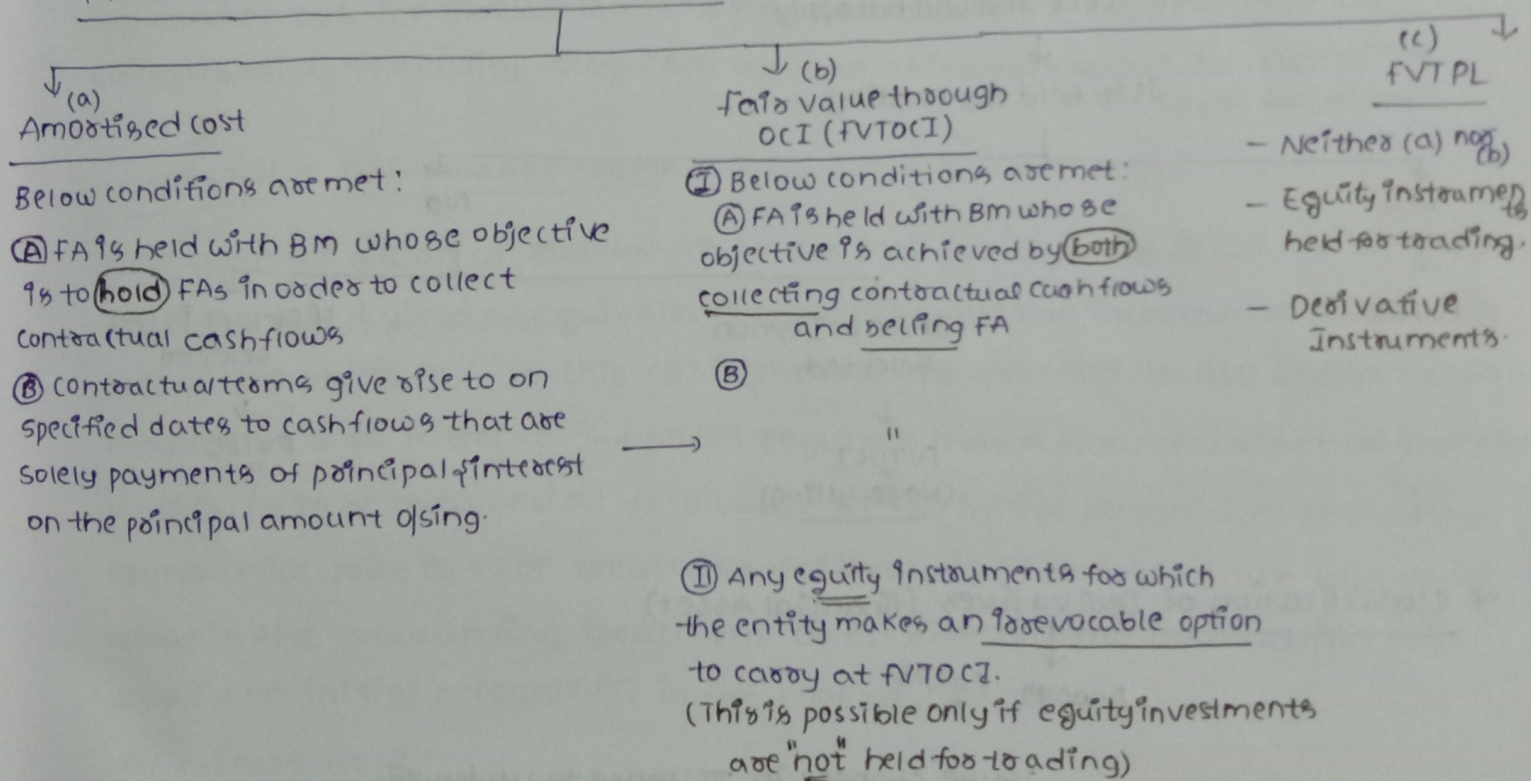
- Interest rate is linked with equity index
- Simple loan interest is linked with gold index.

- (2) Leverage increases the variability of the contractual cash flows with the result that they do not have economic characteristics of interest

Examples

- Interest is leveraged - say 3 times of risk free rate.
- Indian loan interest rate is 5 times of EPS of the company.
- options, forward & swap contracts

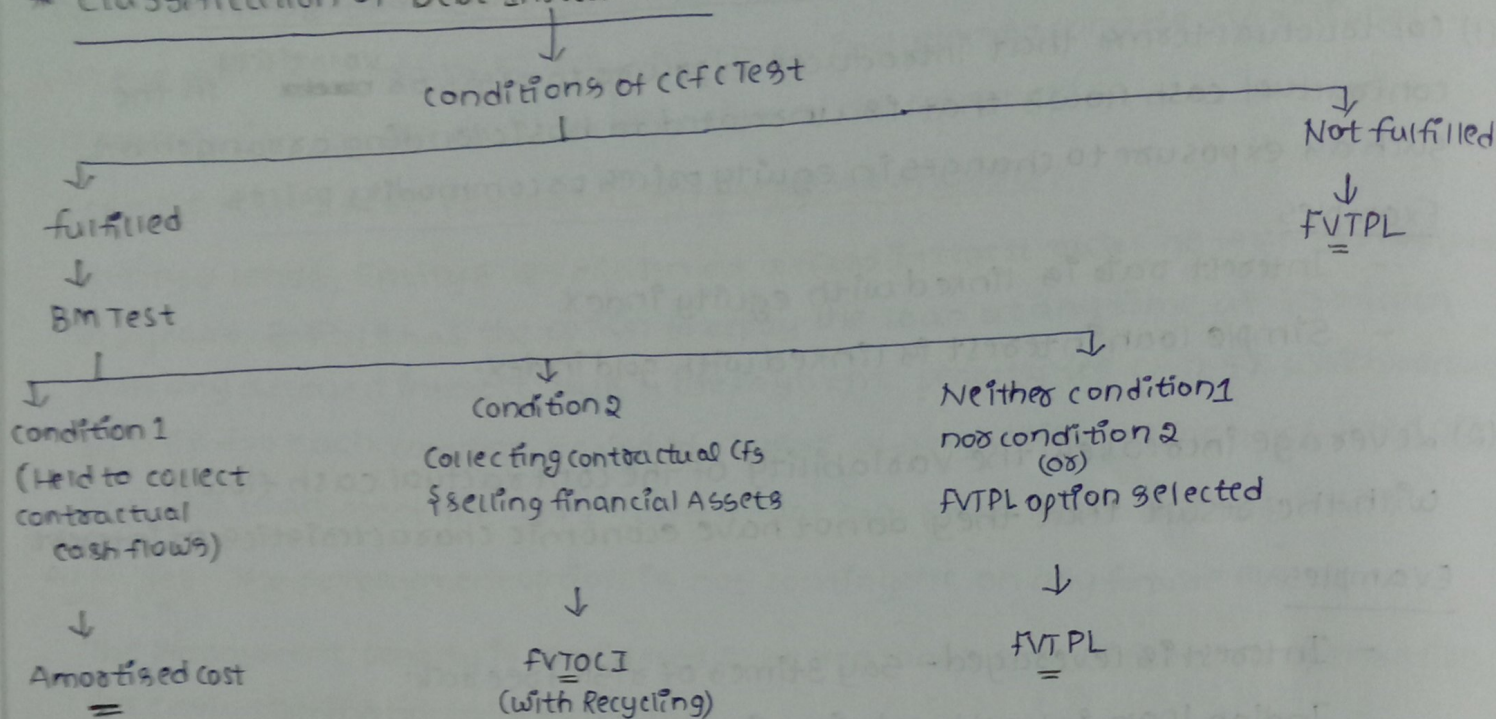
Measurement of financial assets:



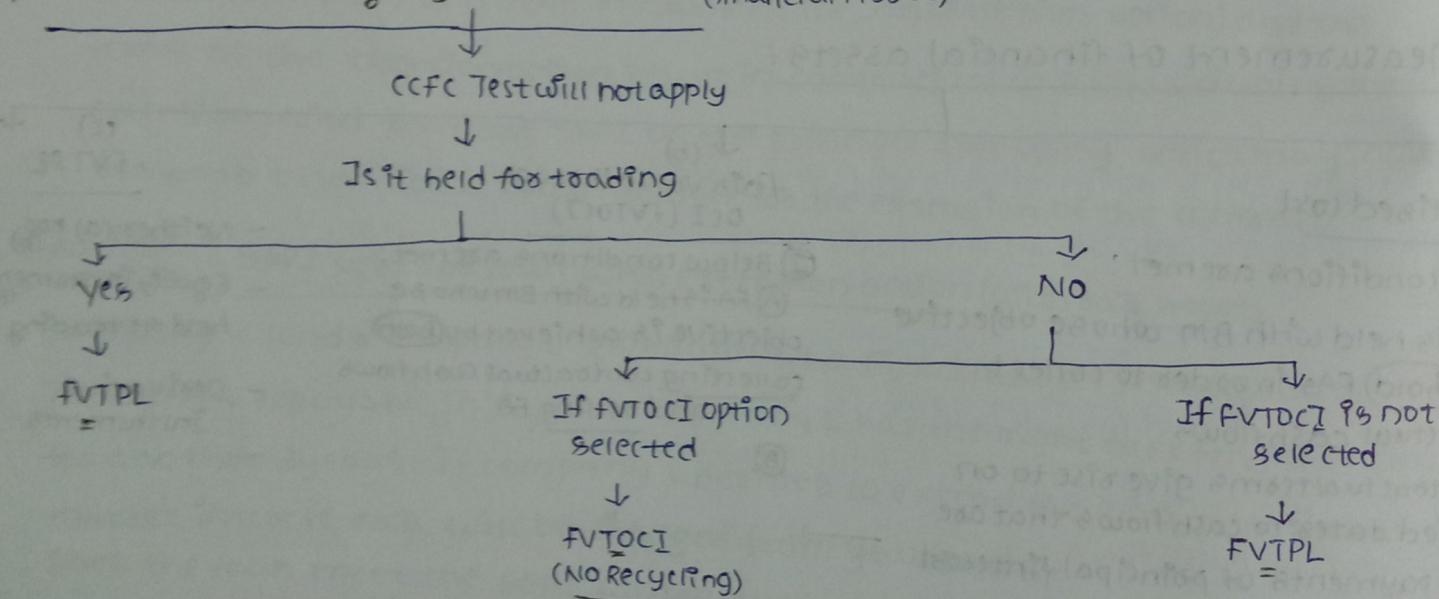
Held for Trading ÷ A financial asset or liability that:

- (1) is acquired or incurred principally for the purpose of selling or buying it in the near term.
- (2) on initial recognition is part of a portfolio of identified financial instruments that are managed together & for which there is evidence of a recent actual pattern of short-term profit-taking; or
- (3) is a derivative (except for a derivative that is a financial guarantee contract or a designated & effective hedging instrument)

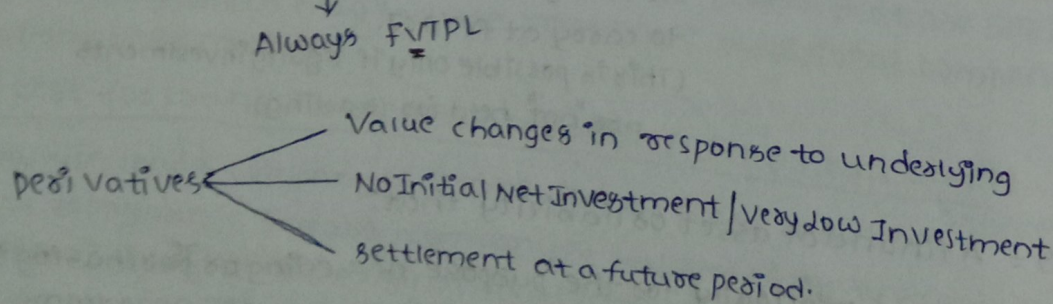
* Classification of "Debt Instruments" (financial Asset)



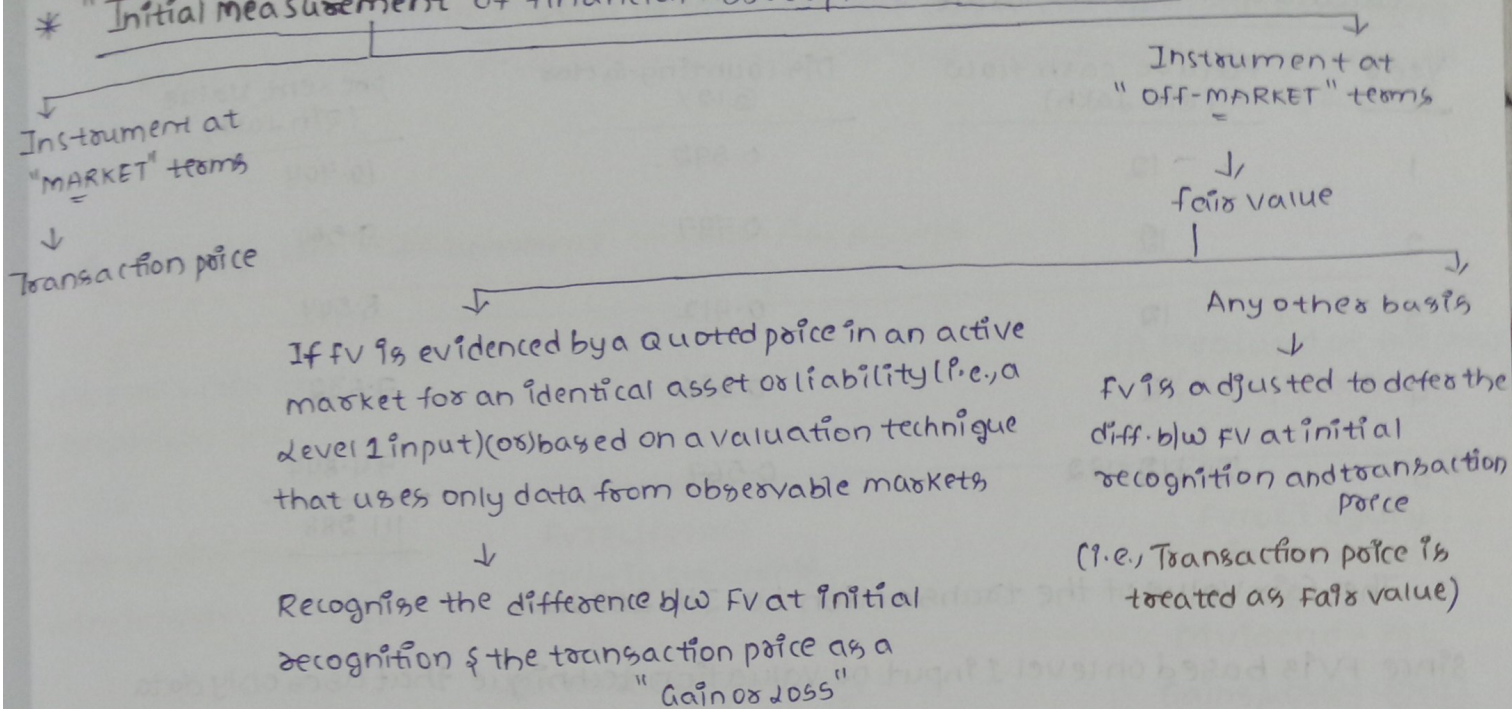
* Classification of "Equity Instruments" (financial Asset)



* classification of "Derivatives" (financial Asset)



* "Initial measurement" of financial Assets / financial Liabilities



* If an entity originates a loan that bears an off-market interest rate (eg., 5% when the market rate for similar loans is 8%) and receives an upfront fee as compensation, the entity recognizes the loan at its fair value, i.e., net of the fee it receives.

Illustration - Off-market terms

NAV_{Ltd} granted a loan of ₹20 Lakhs to OLD Ltd for 5 years @ 10% p.a which is Treasury bond yield of equivalent maturity. But the incremental borrowing rate of OLD Ltd is 12%. In this case, the loan is granted to OLD Ltd at below market rate of interest. Ind AS 109 requires that a financial asset or financial liability is to be measured at fair value at the initial recognition. Should the transaction price is to be treated as fair value? If not, find out fair value. What is the accounting treatment of the diff. b/w the transaction price and FV on initial recognition in the book of NAV Ltd?

PV factors at 12%:

Year	1	2	3	4	5
PVF	0.892	0.797	0.712	0.636	0.567

(CA Final New, Nov 2018 (Exams) 4 marks)

Ans: Since the loan is granted to OLD Ltd at 10% i.e., below market rate of 12%. It will be considered as loan given at off market terms. Hence, the fair value of transaction will be lower from its transaction price.

<u>Calculation of fair value</u>			present Value (₹ in Lakh)
Year	Future cash flow (₹ in Lakh)	DFs (counting factor @ 12%)	
			10.704
1	12	0.892	9.564
2	12	0.797	8.544
3	12	0.712	7.632
4	12	0.636	7.4844
5	120 + 12 = 132	0.567	<u>111.288</u>

The fair value of the transaction be ₹ 111.288 Lakh.

Since FV is based on level 1 input or valuation technique that uses only data from observable markets, diff. b/w fair value & transaction price will be recognized in profit & loss as FV loss = $120 - 111.288 = ₹ 8.712$ Lakhs.

* Transaction costs:

These are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

Includes

Do not include

- (i) Fees & commission paid to agents (including employees acting as selling advisers, brokers & dealers agents),
- (ii) Levies by regulatory agencies & security exchanges
- (iii) Transfer taxes & duties

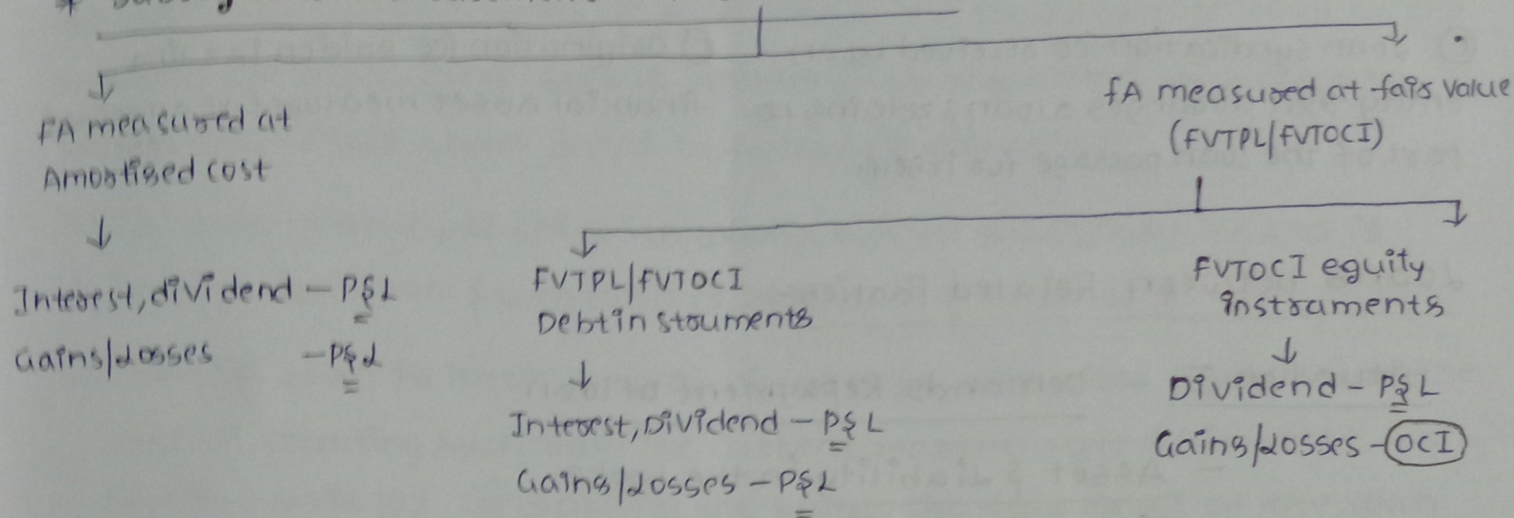
- (i) debt premiums or discounts
- (ii) financing costs
- (iii) Internal administrative costs
- (iv) Holding costs.

Transaction costs for Initial Recognition

- (i) Financial Instruments (FA or FL) measured at FVTPL → Charged to P&L
- (ii) Financial Assets at FVTOCI or Amortised cost → Added to Initial Recognition Amount
- (iii) Financial Liabilities at Amortised cost → Deducted from amount of liability originally recognised.

Transaction costs on disposal or transfer are not included in measurement of all categories of financial assets or financial liabilities. These are charged to P&L

* "Subsequent measurement" of financial Assets



* Amortised cost

$$\text{Amortised cost} = \text{Amount initially Recognised} - \text{principal repayments} +/- \text{cumulative Amortisation using Effective Interest Rate method} - \text{Impairment}$$

* Effective Interest method

In applying effective interest method, fees that are integral part adjusted in effective interest rate are then amortized over the expected life of instrument.

Fees that are not an integral part of effective interest rate

fees that are integral part of effective interest rate

① fees charged for servicing a loan

① origination fee received by the entity relating to creation or acquisition of a FA. Such fees may include compensation for activities such as

- evaluating borrower's financial condition
- evaluating & recording guarantees, collateral & other security arrangements
- negotiating the terms of the instrument
- preparing & processing documents & closing the transaction

ⓑ Commitment fee to originate a loan when it is unlikely that a specific lending arrangement will be entered into

ⓑ Commitment fee received by the entity to originate a loan where it is probable that the entity will enter into a specific lending arrangement

ⓒ Loan syndication fee received by an entity that arranges a loan & retains no part of the loan package for itself

ⓒ Origination fee paid on issuing financial asset measured at amortised cost

Loans between Related Parties:

Situation I — Demands Repayment of loan

- Asset & Liability in the books
- Difference b/w fair value on Initial Recognition & transaction price is "DIVIDEND RECEIVED / PAID"

Situation II — No demand for Repayment of loan

- Asset & Liability in the books
- Difference b/w FV on Initial Recognition & transaction price is "INVESTMENT / EQUITY"

Situation III — Loan not at commercial terms

Assess whether the loan is on commercial terms $\xrightarrow{\text{yes}}$ No special considerations

$\downarrow$ No

Split into a "below-market" element & a "loan element"
 $\downarrow$ Amortised cost

Below-market =
Element

Diff. b/w FV on Initial Recognition

—
Transaction price

$\downarrow$
"Investment / Equity"

Illustration - Loan b/w Related Parties

① (A) KK Ltd has granted an interest free loan of ₹10,00,000 to its wholly owned subsidiary YK Ltd. There is no transaction cost attached to the said loan. The company has not finalised any terms & conditions including the applicable interest rates on such loans. The Board of Directors of the company are evaluating various options & has requested your firm to provide your views under Ind AS in following situations:

- (i) The loan given by KK Ltd to its wholly owned subsidiary YK Ltd is interest free loan & such loan is repayable on demand.
- (ii) The said loan is interest free & will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. considering the same, the fair value of the loan at initial recognition is ₹8,10,150.
- (iii) The said loan is interest free & will be repaid as & when the YK Ltd has funds to repay the loan amount.

Based on the same, KK Ltd has requested you to suggest the accounting treatment of the above loan in the Stand-alone FSS of KK Ltd & YK Ltd and also in the consolidation of FSS of the group. Consider interest for only one year for the above loan.

(B) Further the company is also planning to grant interest free loan from YK Ltd to KK Ltd in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS?

Ans:

[CA Final (New), RTP May 2019]

(A) Scenario (i)

Since the loan is repayable, it has fair value equal to cash consideration given. KK Ltd & YK Ltd should recognize financial asset & liability, respectively, at the amount of the loan given (assuming that loan is repayable within a year). Upon repayment, both the entities should reverse the entries that were made at the origination.

Journal Entries in books of KK Ltd

At origination

Loan to YK Ltd A/c Dr ₹10,00,000
TO Bank A/c ₹10,00,000

On repayment

Bank A/c Dr ₹10,00,000
TO Loan to YK Ltd A/c ₹10,00,000

Journal Entries in books of YK Ltd

At origination

Bank A/c Dr ₹10,00,000
TO Loan from KK Ltd A/c ₹10,00,000

On repayment

Loan from KK Ltd A/c ₹10,00,000
TO Bank A/c ₹10,00,000

In the consolidated FSs, there will be no entry in this regard since the loan receivable & loan payable will get set off.

Scenario (ii)

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (i.e., different from market terms for a similar instrument if exchanged b/w market participants).

If a long-term loan or receivable that carries no interest while similar instruments if exchanged b/w market participants carry interest, then FV of such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The diff. in FV & transaction price will be treated as "Investment in subsidiary YK Ltd."

Both KK Ltd & YK Ltd should recognise financial asset & liability, respectively, at fair value on initial recognition i.e., the PV of ₹10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as ₹8,10,150, the same has been considered. The diff. b/w the loan amount & its fair value is treated as an "equity contribution to the Subsidiary". This represents a further investment by the parent in the subsidiary.

Journal Entries in the books of KK Ltd (for one year)

At origination

Loan to YK Ltd A/c Dr ₹8,10,150

Investment in YK Ltd A/c Dr ₹1,89,850

TO Bank A/c ₹10,00,000

During periods to repayment - to recognise interest

Year 1 - charging of Interest

Loan to YK Ltd A/c Dr ₹81,015

TO Interest Income A/c ₹81,015

Transferring of Interest to profit & Loss

Interest Income A/c Dr ₹81,015

TO profit & Loss A/c ₹81,015

On repayment

Bank A/c Dr ₹10,00,000

TO Loan to YK Ltd A/c ₹10,00,000

Note:- Interest needs to be recognised in statement of profit & Loss. The same cannot be adjusted against capital contribution recognised at origination.

Journal Entries in the books of YK Ltd (for one year)

At origination

Bank A/c	Dr	₹10,00,000	
			TO Loan from KK Ltd A/c
			₹8,10,150
			TO Equity contribution in
			KK Ltd A/c
			₹1,89,850

During periods to repayment - to recognise interest

Year 1 - charging of Interest

Interest Expense A/c	Dr	₹81,015	
			TO Loan from KK Ltd A/c
			₹81,015

Transferring of Interest

			to P&L A/c
P&L A/c	Dr	₹81,015	
			TO Interest Expense A/c
			₹81,015

on repayment

Loan from KK Ltd A/c	Dr	₹10,00,000	
			TO Bank A/c
			₹10,00,000

In the consolidated fss, there will be no entry in this regard since loan & interest income/expense will get set off.

Scenario (iii)

Generally, a loan which is repayable when funds are available, cannot be stated as loan repayable on demand. Rather the entity needs to estimate the repayment date & determine its measurement accordingly by applying the concept prescribed in scenario (ii).

In the consolidated fss, there will be no entry in this regard since loan & interest income/expense will get set off.

(B)

In case the subsidiary YK Ltd is planning to grant interest free loan to KK Ltd then the diff. b/w the fv of the loan on initial recognition & its nominal value should be treated as "dividend distribution" by YK Ltd & "dividend income" by the parent KK Ltd.

classification of financial Assets

- ② Croton Ltd is engaged in the business of trading commodities. The company's main asset are investments in equity shares, preference shares, bonds, non-convertible debenture (NCD) & mutual funds.

The company collects the periodical income (i.e., interest, dividend etc) from the investments & regularly sells the investment in case of favourable market conditions. Such investments have been classified as non-current investments in the financial statements.

Also, the company buys & sells equity shares of companies for earning short term profits from the stock market.

The CFO of company classified all the non-current investments as FVTOCI & all the current investment as FVTPL.

Croton Ltd raised the following queries:

- (a) Can the company classify the equity shares previously held under current investment as FVTOCI if the company decides to hold them for more than 1 year (i.e., classify it as non-current)?
- (b) The company had classified NCDs with a maturity period of less than 12 months from the reporting period as current. This has been classified as FVTPL by the CFO of the company. The company wants to know whether these NCDs can be recognized as FVTOCI?

(CA Final New, MTP October 2019)

Ans:

- (a) It seems that the equity shares are acquired for the purpose of selling it in the near term & therefore are held for trading. Such investments have been appropriately classified as subsequently measured at FVTPL. Such investments in equity shares cannot be classified as subsequently measured at FVTOCI. The option to measure investment in equity shares at FVTOCI has to be made at initial recognition. Therefore, equity shares that were held for trading previously cannot be ^{re}classified to FVTOCI due to change in business model to not held for trading.

(b) In the absence of contractual terms of NCDs, it is assumed that the contractual terms give rise on specified dates to cash flows that are solely payment of principal & interest on the principal outstanding. The business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVTOCI. Therefore, such NCD investments shall be classified as subsequently measured at FVTOCI. The classification does not change based on whether the investment is current or non-current at the end of the reporting period. It seems the company has previously classified these investments at FVTPL. The company must rectify this by reclassifying as FVTOCI.

classification & measurements of financial Asset

- ③ On 1 April 2014, Delta purchased 1 million options to acquire shares in Epsilon, a listed entity. Delta paid ₹0.25 per option, which allows Delta to purchase shares in Epsilon for a price of ₹22 per share. The exercise date for the options was 31 December 2014. On 31 December 2014, when the market value of a share in Epsilon was ₹2.60, Delta exercised all its options to acquire shares in Epsilon. In addition to the purchase price, Delta incurred directly attributable acquisition costs of ₹100,000 on the purchase of 1 million shares in Epsilon. Delta regarded the shares it purchased in Epsilon as part of its trading portfolio. However, Delta did not dispose of any of the shares in Epsilon b/w 31 Dec 2014 & 31 March 2015. On 31 March, 2015 the market value of a share in Epsilon was ₹2.90.

(ACCA Global Exam Q5)

Ans:-

As per Ind AS 109, the option to acquire shares in Epsilon would be regarded as a derivative financial instrument.

This is because the value of the option depends on the value of an underlying variable (Epsilon's share price), it requires a relatively small initial investment & it is settled at a future date.

A derivative financial instrument is initially measured at its fair value.

In this case fair value will be the price paid - which is ₹250,000 at 1 April, 2014.
(1 million × 0.25)

Derivative financial instruments are remeasured to fair value at the reporting date & gains or losses on remeasurement recognised in P&L A/c.

However, in this case the derivative is derecognised on 31 Dec 2014, when the option is exercised.

On 31 Dec 2014, the investment in Epsilon's shares would be regarded as a financial asset.

Under Ind AS 109, financial assets are initially measured at fair value, so the initial carrying amount of the shares in the books of Delta will be ₹22.6 million ($1 \text{ million} \times ₹22.60$).

The difference b/w the carrying amount of the new asset (₹22.6m) and the price paid plus the derecognised derivative i.e. ₹22.25m ($₹2m + ₹20.25m$) will be taken to profit or loss (₹0.35m) for the year ended 31 March 2015 as investment income. In this case ₹350,000 will be included as investment income.

Because the investment in Epsilon is an equity investment, it will continue to be remeasured to fair value at each year end.

Because the investment is part of a trading portfolio, the investment is measured at FVTPL.

Therefore the acquisition costs of ₹100,000 must be recognised as an expense in the P&L A/c for the year ended 31 March 2015.

The investment is included in the balance sheet at 31 March 2015 as a current asset at its fair value of ₹22.9m.

The increase in fair value of ₹300,000 ($₹22.9m - ₹22.6m$) is taken to P&L A/c.

Classification of Financial Assets

- ④ On 1 April 2013, Delta subscribed for 40 million ₹1 loan notes in Epsilon. The loan notes were issued at ₹0.90 & under the terms of issue redeemable at ₹1.20 on 31 March 2018. Interest is payable on 31 March in arrears at 4% of par value. This represents an effective annual rate of return for Delta of 9.9%. Delta's intention is to hold the loan notes until redemption.
- Reporting ended on 30th September (ACCA Global Exam Ques)

Ans: As per Ind AS 109, financial assets are measured at either amortised cost or fair value, depending on the reason for holding them & the nature of the expected returns from the asset.

Here amortised cost is because Delta's objective is to hold the assets to collect the contractual cash flows, & those cash flows consist solely of the repayment of principal & interest by Epsilon.

On 1 April 2013 the asset is recognised at its fair value of ₹36M ($₹40M \times 0.90$)

The finance income recognised in profit or loss for 6 months to 30th September 2013 is ₹1.782M ($₹36M \times 9.9\% \times 6/12$)

At 30 Sep 2013, the asset's carrying amount is ₹37.782M ($₹36 + 1.782M$)

This asset will be split into its current & non-current positions

The interest payment due on 31 March 2014 of ₹1.6M ($₹40M \times 4\%$) will be a current Asset

The remaining asset of ₹36.182M ($₹37.782 - ₹1.6M$) will be non-current.

⑤ On 1 October 2016, Gamma purchased 200,000 equity shares in entity A, a key supplier. Entity A's shares are listed on the local stock exchange. This share purchase did not give Gamma control or significant influence over entity A but Gamma intends to retain the shares in entity A as a long-term strategic investment.

Gamma paid ₹2.40 per share for these shares. This amount represents that FV at the date of purchase. Additionally, brokers charge a fee of 2% of the amounts paid to buy or sell a share on the stock exchange on which entity A's shares are quoted.

On 31 March 2017, entity A paid a dividend of ₹0.25 per share. For the last few years entity A has made just one dividend payment each year, in the month of March.

On 30 September 2017, information received from the local stock exchange regarding entity A's share price was:

- Broker's bid price (the price the broker will pay to buy a share) - ₹2.70 per share

- Broker's ask price (the price which the broker requires when selling a share) - ₹2.90 per share

Explain & show how the above event would be reported in the fss of Gamma for the year ended 30 September 2017.

Ans: Alternative-1 → No Irrevocable Election

As per Ind AS 109, Equity Investments must be measured at fair value because the contractual terms associated with the investment do not entitle the holder to specific payment of interest & principal

The fair value of the investment in entity A at the date of purchase is ₹480,000
($200,000 \times ₹2.40$)

The amount actually paid for the shares (incorporating broker's fee) in entity A on 1 October 2016 was ₹489,600 ($480,000 \times ₹1.02$)

The difference b/w the price paid for the shares & their fair value is ₹9,600.

This difference is regarded as transaction cost by Ind AS 113 - fair value measurement. ($489,600 - 480,000$)

Ind AS 109 would normally require equity investments to be measured at FVTPL where financial assets are measured at FVTPL, transaction costs are recognised in profit or loss as incurred. Therefore in this case, ₹9,600 would be taken to P&L A/c on 1 October 2016.

As per Ind AS 113 "Fair value measurement", the fair value of an asset is the amount which could be received to sell the asset in an orderly transaction. Where the asset is traded in an active market (as is the case for the investment in entity A), then FV should be determined with reference to prices quoted in that market.

∴ FV of the investment in entity A at the year end is ₹540,000 ($200,000 \times ₹2.70$)

The year-end FV of ₹540,000 is unaffected by the broker's fees which would be incurred if the shares were to be sold - these fees are not a component of FV measurement.

change in FV of ₹60,000 ($540,000 - 480,000$) b/w 1 Oct 2016 & 30 Sep 2017 would be taken to P&L A/c at the end of year.

Dividend received of ₹50,000 ($200,000 \times 0.25$) would be recognised as income in P&L A/c at 31 March 2017.

Alternative-2 → Irrevocable Election

Because the shares in entity A are not held for trading, Gamma has the option to make an irrevocable election on 1 Oct 2016 to measure the shares at FV/TOCI.

Where this election to be made, then the transaction would be included in the initial carrying amount of the financial asset, making this ₹489,600.

The diff. b/w closing FV of the investment & its initial carrying amount is

₹50,400 (540,000 - 489,600). This is recognised in OCI.

The dividend income of ₹50,000 is still recognised in P&L A/c regardless how the financial asset is measured.

⑥ Epsilon prepares FSS to 31 March each year. The following events have occurred which are relevant to the year ended 31 March 2018:

(i) On 1 April 2017, Epsilon loaned ₹30 million to another entity. Interest of ₹1.5 million is payable annually in arrears. An additional final payment of ₹35.3 million is due on 31 March 2020. Epsilon incurred direct costs of ₹250,000 in arranging this loan. The annual rate of interest implicit in this arrangement is approximately 10%. Epsilon has no intention of assigning this loan to a third party at any time.

(ii) On 1 April 2017, Epsilon purchased 500,000 shares in a key supplier - Entity X. The shares were purchased in order to protect Epsilon's source of supply & Epsilon has no intention of trading in these shares. The shares cost ₹2 per share & the direct costs of purchasing the shares were ₹100,000. On 1 January 2018, the supplier paid a dividend of ₹0.30 per share. On 31 March 2018, the FV of a share in Entity X was ₹2.25.

(iii) On 1 January 2018, Epsilon purchased 100,000 call options to purchase shares in Entity Y - an unconnected third party. Each option allowed Epsilon to purchase shares in Entity Y on 31 December 2018 for ₹6 per share. Epsilon paid ₹1.25 per option on 1 January 2018. On 31 March 2018, the FV of a share in Entity Y was ₹8 & the FV of a share option purchased by Epsilon was ₹1.60. This purchase of call options is not part of a hedging arrangement.

Explain & show how the three events should be reported in the FSS of Epsilon for the year ended 31 March 2018. Assume that Epsilon only measures financial assets at FVTPL when required to do so by Ind AS 109.

(ACCA Global Exam Ques)

Ans:

- (i) Since the business model is to collect the contractual cash flows & the cash flows consist solely of the repayment of principal & interest, this asset is measured at amortised cost.

The initial carrying amount of the financial asset will be ₹30.25 million (₹30 million fair value + ₹250,000 transaction costs)

The finance income recorded under investment income category in the statement of profit or loss for the year ended 31 March 2018 will be $(₹30.25 \times 10\%) = ₹3.025$ million

The carrying amount of the financial asset in the balance sheet at 31 March 2018 will be ₹31.775 million $(₹30.25 + ₹3.025 - ₹1.5M)$

- (ii) Since this is an equity investment which Epsilon has no intention of selling, Epsilon can measure the investment at FVTOCI (provided irrevocable election on initial recognition has been made)

Since the financial asset is measured at FVTOCI, the transaction cost (agent's commission) is included in the initial FV of shares $(500,000 \times ₹22 + ₹100,000)$

The carrying amount of the financial asset in balance sheet at 31 March 2018 will be ₹1.125 million based on FV of shares at the year end $(50,000 \times ₹22.5)$

The difference (fair value gain) of ₹25,000 $(₹1.125M - ₹1.1M)$ will be recognised in OCI.

Dividend income of ₹150,000 $(500,000 \times 0.30)$ will be recognised as other income in the statement of profit or loss.

- (iii) The call option cannot be measured at amortised cost or FVTOCI, so it must be measured at FVTPL.

The initial carrying value of the call option will be ₹125,000 $(100,000 \times ₹1.25)$

At the year end, the call option will be re-measured to its fair value of ₹160,000 $(100,000 \times ₹1.60)$

The fair value gain of ₹35,000 $(₹160,000 - ₹125,000)$ will be recognised in the statement of profit or loss.

⑦ Kappa prepares fss to 30 September each year. During the year ended 30 September 2016 Kappa entered into the following transactions:

- (i) on 1 October 2015, Kappa made an interest free loan to an employee of ₹800,000. The loan is due for repayment on 30 September 2017 & Kappa is confident that the employee will repay the loan. Kappa would normally require an annual rate of return of 10% on business loans.
- (ii) on 1 October 2015, Kappa made a 3-year loan of ₹10 million to entity X. The rate of interest payable on the loan was 8% per annum, payable in arrears. On 30 September 2018, Kappa will receive a fixed no. of shares in entity X in full settlement of the loan. Entity X paid the interest due of ₹800,000 on 30 September 2016 & entity X has no liquidity problems. Following payment of this interest, the fair value of this loan asset at 30 September 2016 was estimated to be ₹10.5 million.
- (iii) on 1 October 2015, Kappa purchased an equity investment in entity Y for ₹12 million. The investment did not give Kappa control or significant influence over entity Y but the investment is seen as a long-term one. On 30 September 2016, the fair value of Kappa's investment in entity Y was estimated to be ₹13 million.

Explain & show how the above transactions would be reported in the fss of Kappa for the year ended 30 September 2016.

(ACCA Global Exam Qus)

Ans:

- (i) The loan is a financial asset which would initially be recognised at its fair value on 1 October 2015.

Given the fact that Kappa normally requires a return of 10% p.a on business loans of this type, the loan asset should be initially recognised at ₹661,157 ($2800,000 / (1.10)^2$)

An amount of ₹138,843 ($2800,000 - 2661,157$) would be charged to profit or loss at 1 October 2015

Because the business model & the contractual cash flows, this loan asset will subsequently be measured at amortised cost.

Therefore, ₹66,116 ($₹66,157 \times 10\%$) will be recognised as finance income in the year ended 30 September 2016. The closing loan asset ₹727,273 will be ($₹66,157 + ₹66,116$). This is shown as a current asset since repayment is due on 30 September 2017.

(ii) Since the loan is at normal commercial rates, the loan would initially be recognised at ₹10 million - the amount advanced.

The interest received & receivable of ₹800,000 would be credited to profit or loss as finance income.

In this case, the contractual cash flows are not solely payments of principal & interest on the principal amount outstanding. Therefore, the asset would be measured at FVTPL.

A fair value gain of ₹500,000 ($₹10.5\text{m} - ₹10\text{m}$) would be recognised in profit or loss.

The loan asset of ₹10.5 million would be shown as a non-current asset.

(iii) The equity investment would be initially recognised at its cost of purchase - ₹12 million.

The contractual cash flows relating to an equity investment are not solely payments of principal & interest on the principal amount outstanding.

Therefore, the asset would normally be measured at FVTPL. This would result in a gain on remeasurement to FV of ₹1 million ($₹13\text{m} - ₹12\text{m}$) being recognised in profit or loss.

Since the equity investment is being held for the long-term, rather than as part of a trading portfolio, it is possible to make an irrevocable election on 1 October 2015 to classify the asset as FVTOCI. In such circumstances, the remeasurement gain of ₹1 million would be recognised in OCI rather than profit or loss.

⑧ In January 2016, Wolf purchased 10 million, ₹1 listed equity shares in Hall at a price of ₹5 per share. Transaction costs were ₹3 million. Wolf's year end is 30 November.

At 30 November 2016, the shares in Hall were trading at ₹6.50. On 31 October 2016 Wolf received a dividend from Hall of ₹0.20 per share.

Show the fss extracts of Wolf at 30 November 2016 relating to the investment in Hall on the basis that:

- (i) The shares were bought for trading
- (ii) The shares were bought as a source of dividend income & were the subject of an irrevocable election at initial recognition to recognise them at FVTOCI.

Ans:

(i) Statement of Profit or Loss & OCI (Extract)

<u>Profit or Loss for the year</u>	<u>₹ million</u>
Investment Income ($10 \times (6.5 - 5)$)	15
Dividend Income (10×0.20)	2
Transaction costs	(3)

Balance Sheet (Extract)

Investments in equity instruments (10×6.5)	65
--	----

(ii) Statement of Profit or Loss & OCI (Extract)

<u>Profit or Loss for the year</u>	<u>₹ million</u>
Dividend Income	2

OCI

Gain on Investment in Equity Instruments ($65 - 53$)	12
--	----

Balance Sheet (Extract)

Investments in equity instruments (10×6.5)	65
--	----

In accordance with Ind AS 109, transaction costs added to the fv of all financial assets (other than those measured at FVTPL) on initial recognition, so the shares are initially recorded at ₹53 million. A gain of ₹12 million is recorded on subsequent measurement.

Classification & Measurement of Financial Liabilities

Initial Measurement

- * At initial recognition, an entity shall measure a financial liability at its fair value ^{financial asset} plus or minus, in case of a financial liability not subsequently measured at FVTPL, transaction costs that are directly attributable to the acquisition or issue of the financial asset/financial liability
- * Transaction costs on disposal or Transfer are not included in measurement of all categories of financial assets/financial liabilities. These are charged to profit or loss.

Transaction costs for Initial Recognition

FL measured at FVTPL — charged to P&L A/c

FL measured at Amortised cost — Deducted from amount of liability originally recognised.

Subsequent measurement

Amortised cost

FVTPL

FLs Subsequently measured at Amortised cost

An entity shall classify all FLs as subsequently measured at amortised cost except as discussed below.

FLs Subsequently measured at FVTPL

(a) FLs at FVTPL

Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value

(b) "Financial guarantee contracts"

(c) commitments to provide a loan at a "below-market" interest rate

(d) FLs that arise when a transfer of a financial asset does not qualify for de-recognition or when the continuing involvement approach applies

(e) "Contingent consideration" recognised by an acquirer in a business combination to which Ind AS 103 applies. Such contingent consideration shall subsequently be measured at FV with changes recognised in profit or loss.

Financial Guarantee Contracts



- Recognised as a "financial liability" at the time guarantee is issued
- Initially measured at FV
- It is 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
- The FV of a guarantee contract is the PV of the difference b/w
 - net contractual cash flows required under a debt instrument
 - {
 - net contractual cash flows that would have been required without the guarantee

Note: PV is calculated using a risk-free rate of interest.

- At the end of each subsequent reporting period, financial guarantees are measured at the higher of:

(a) The amount of loss allowance

(b) amount initially recognised ^{(ies) where appropriate,} - cumulative amortisation of income recognised in accordance with Ind AS 115

- The amount of loss allowance at each subsequent reporting period initially equal to "12-month expected credit losses."

However, where there has been a significant increase in the risk that the specified debtor will default on the contract, the calculation is for "lifetime expected credit losses"

- Expected credit losses for a financial guarantee contracts are the "Cash shortfalls" adjusted by the risks that are specific to the cashflows.

- Cash shortfalls are the difference between:

(a) Expected payments to reimburse the holder for a credit loss that it incurs; and

(b) Any amount that an entity expects to receive ^{from} the holder, the debtor or any other party

Illustration - Financial Guarantee Contract

on 1 January 2018, company A guarantees a ₹1,000 loan of subsidiary B which Bank XYZ has provided to subsidiary B for 3 years at 7%. The capital amount advanced will be repaid at the end of 3 year term.

If company A had not issued a guarantee Bank XYZ would have charged subsidiary B an interest rate of 10%.

on 1 January 2018, 31 December 2018 & 2019, the lifetime probabilities that subsidiary B will default ^{on} the loan are 3.5%, 3% & 3% respectively. on 31 December 2018 & 2019, the probabilities that the subsidiary ^B will default on the loan in the next 12 months are 2% & 3% respectively.

How should company A account for the financial guarantee contract under Ind AS 109?

Ans: 1 January, 2018

The financial guarantee contract is initially measured at its fair value.

The FV of the guarantee is ₹75, being the PV of the diff. b/w:

- Net contractual cash flows that would have been required without the guarantee

$$= ₹1000 \left(\frac{100}{1.1} + \frac{100}{1.1^2} + \frac{1100}{1.1^3} \right)$$

- Net contractual cash flows required under the loan

$$= ₹925 \left(\frac{70}{1.1} + \frac{70}{1.1^2} + \frac{1070}{1.1^3} \right)$$

Investment in subsidiary A/c Dr ₹75

To financial liability A/c ₹75

(Being FV of the guarantee on initial recognition)

31 December, 2018

In order to assess whether there has been a significant increase in credit risk, Ind AS 109 requires a comparison to be made of the probability of default over the expected life of the financial instrument at the reporting date, in comparison with the probability of default at initial recognition.

In this case, the absolute probability of default has declined from 3.5% to 3%; this indicates that the probability of default has remained relatively stable because the longer the period to maturity of a particular financial instrument, the greater the probability of default for a given level of risk. Consequently, company A will provide for 12-month expected credit losses.

There is a 2% probability that subsidiary B will default on the loan in the next 12 months. If subsidiary B does default, company A does not expect to recover any amount from subsidiary B. The 12-month expected credit losses are therefore $₹20 (₹1000 \times 2\%)$.

The initial amount recognised less cumulative amortisation is $₹52.50 (₹75 - ₹22.50)$, which is higher than the 12-month expected credit losses ($₹20$).

The financial liability is adjusted to $₹52.50$ as follows:

Financial Liability A/c Dr $₹22.50$

To Profit or Loss A/c $₹22.50$

(Amortisation of the financial liability recognised for the financial guarantee)

31 December 2019

There is still a 3% probability that subsidiary B will default on the loan in the next 12 months. If the subsidiary B does default, company A does not expect to recover any amount from subsidiary B. company A determines that, overall, there has not been a significant increase in credit risk & therefore continues to recognise 12-month expected losses of $₹30 (₹1000 \times 3\%)$.

The initial amount recognised less amortisation is $₹27.50 (₹52.50 - (₹30))$.

Financial Liability A/c $₹27.50$

To Profit & Loss A/c $₹27.50$

(Amortisation of the financial liability recognised for the financial guarantee)

The 12 month expected credit losses (230) are higher than the initial amount less cumulative amortisation (227.50)

Profit or loss A/c Dr 22.50 (230 - 227.50)

To financial liability A/c 22.50

(Record the financial liability at the amount of the loan loss allowance)

Revision of Estimates of cash flows

- for revisions of estimates of cash flows for floating rate financial assets & floating rate financial liabilities with a variable market rate of interest, the re-estimation of the cash flows driven by the movements in the market rate of interest will affect & change the effective interest rate. However, the re-estimation of the cash flows does normally not significantly affect the carrying amount of asset or liability. For practical reasons, the carrying amount is therefore typically not updated at each reporting date.
- This is different from the accounting for a change in the estimated cash flows for financial instruments with either:
 - (a) A fixed rate of interest; or
 - (b) A variable rate that does not represent a market rate.

Examples of such instruments includes loans with interest payments linked to future revenue, production output or profit. In this case the entity recalculates the carrying amount by computing the PV of the estimated future cash flows at the financial instrument's original effective interest rate. The resulting adjustment to the carrying amount is recognised as a gain or loss in profit or loss.

Illustration - Adjustment of the carrying amount of a loan with interest linked to EBITDA

- ① On 1 January 2015, Entity A takes out loan with Entity B for ₹1000 for 3 years. The interest payments on the loan are 10% of Entity A's EBITDA. On 1 January 2015, Entity A expects the following EBITDA figures

<u>Year</u>	<u>EBITDA</u>	<u>10% of EBITDA</u>
31/12/2015	₹1000	₹100
31/12/2016	₹2500	₹250
31/12/2017	₹3000	₹300

(a) What is the Entity A's initial journal entry on 1 January 2015?

(b) What is the effective interest rate of the loan?

Ans:

(a) 1 January 2015

Cash A/c Dr 21000

To Loan payable A/c 21000

(Recognise the loan at its initial carrying amount)

(b) The effective interest rate of loan is 20.4%, being the interest rate that discounts the expected cash flows to the initial carrying amount of 21000

$$\frac{100}{1+x} + \frac{250}{(1+x)^2} + \frac{1300}{(1+x)^3} = 21000$$

$$\therefore x = 20.40\%$$

② Suppose on 31 December 2015, Entity A's actual EBITDA for the year is ₹1200. Entity A makes a payment of ₹120 to Entity B. Entity A also ^e estimates its expected EBITDA for the next 2 years.

<u>Year</u>	<u>EBITDA</u>	<u>10% of EBITDA</u>
31/12/2016	22800	2280
31/12/2017	23500	2350

Ans:

31 December 2015

Interest Expense A/c Dr 2204 (21000 × 20.4%)

To cash A/c 2120

To Loan payable A/c 284

As at 31 December 2015, Entity A recalculates the carrying amount of the loan based on the revised expected future ^{or} payments

<u>Year</u>	<u>EBITDA (₹)</u>	<u>Repayments (₹)</u>	<u>Discounted at 20.4% EIR (₹)</u>
31/12/2016	2800	280	233 (280/1.204)
31/12/2017	3500	350	241 (350/1.204 ²)
31/12/2017	-	1000	690 (1000/1.204 ²)

Revised carrying amount of loan at 31/12/2015 = 1164

calculation of the difference of the revised carrying amount

Revised carrying amount of loan at 31/12/2015	<u>₹</u> 1164
carrying amount before recalculation (1000+84)	1084
	<u>80</u>

Profit & Loss A/c Dr ₹80

To Loan payable A/c ₹80

(Recognise the change in estimates of cash flows)

Effective Interest rate for floating rate instruments

For floating rate instruments, the effective interest rate is required to be updated when cash flows are re-adjusted for changes in the market rate of interest.

Two approaches are usually applied in practice to calculate the effective interest rate:

- using the actual benchmark interest rate set for the relevant period; or
- Taking into account expectations about future interest rates & changes in the expectations.

Illustration

Entity A issues a debt instrument at a principal amount outstanding of ₹100 at the beginning of 2011, which matures in 3 years (2013). The coupon rate of the instrument is defined as 12-month LIBOR + 2%.

The 12-month LIBOR at initial recognition is 2% & expected to be 3% in 2012 & 4% in 2013.

What is the EIR for the floating rate instrument?

Ans: Two approaches to calculate the EIR for floating rate instruments:

- Actual benchmark interest rate for the period

Initial effective interest rate is 4% (2% + 2%)

- Expectations about future interest rates

The initial effective interest rate is approximately by 5% $\rightarrow \left[\frac{4}{1+x} + \frac{5}{(1+x)^2} + \frac{6}{(1+x)^3} = 100 \right]$

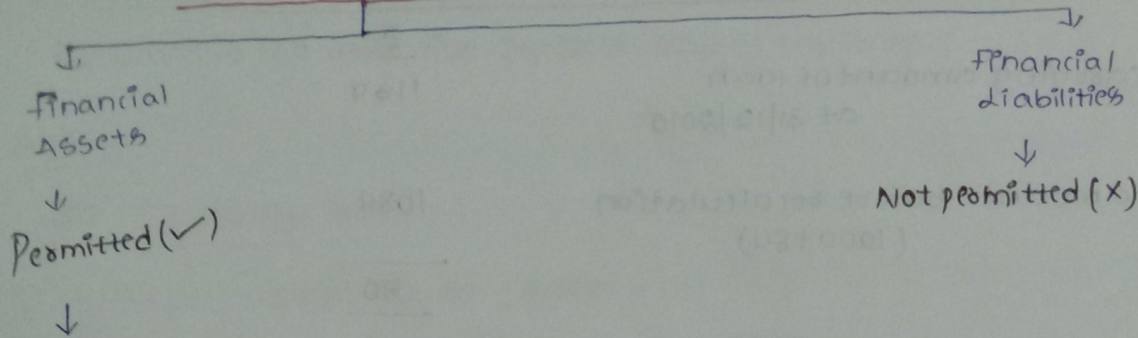
Being the internal rate of return of:

- Expected coupons to be received (₹4, ₹5, ₹6); and

- Principal amount repayable at maturity of ₹100

$\therefore x = 5\%$

Reclassification of financial Assets & financial Liabilities



- An entity shall reclassify financial assets, only if the entity changes its business model for managing those financial assets.
- Accordingly, a change in an entity's business model will occur only when an entity either begins or ceases to perform an activity that is significant to its operations.
- for example, when the entity has acquired, disposed of or terminated a business line.
- If an entity reclassifies the financial assets, it shall apply the reclassification prospectively from the reclassification date.
- The entity shall not restate any previously recognised gains, losses or interest.

Amortised cost TO

FVTPL

fair value

P&L A/c

- Measurement at reclassification date

- Gain or loss at reclassification date

FVTOCI *

fair value

OCI

* EIR & measurement of expected credit losses are "not" adjusted as a result of reclassification.

FVTPL TO

Amortised cost

fair value becomes
New gross carrying amount

- measurement at reclassification date

- Gain or loss at reclassification date

FVTOCI

fair value

FVTOCI TO

Amortised cost *

fair value

Removed from equity &
adjusted against the fair value

- measurement at reclassification date

- cumulative gain or loss previously
recognised in OCI

FVTPL

fair value

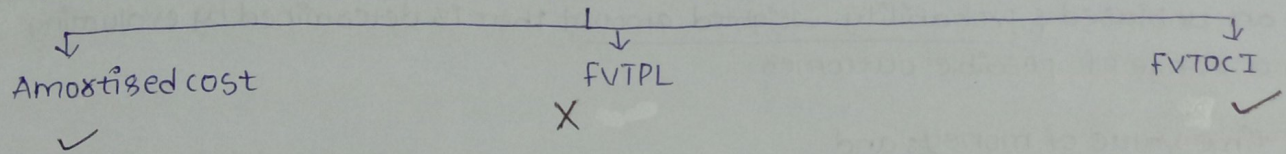
Reclassified from equity
to P&L A/c.

* EIR & measurement of expected credit losses are "not" adjusted as a result of the reclassification.

Impairment of financial Assets

* All entity shall recognise a "Loss Allowance" for "expected credit losses" on the following:

(a) financial asset that is measured at



(b) Lease Receivable

(c) Contract asset or loan commitment

(d) Financial Guarantee contract

* Credit Loss Allowance

for financial assets, a credit loss is the present value of the difference between:

(a) contractual cash flows that are due to an entity under the contract; &

(b) cash flows that the entity expects to receive (i.e., cash short falls) discounted at original effective interest rate.

* Accounting guidance

Is the asset credit impaired at initial recognition

↓ NO

Yes → Recognise the changes in "lifetime" expected credit losses.

Is the asset a trade receivable or a contractual right to receive cash or another financial asset?

↓ NO

Yes →

Is the asset a lease receivable for which the entity has elected to measure impairment based on lifetime expected credit losses?

↓ NO

Yes →

Has there been a significant increase in credit risk since initial recognition?

↓ NO

Yes →

Recognise "12-month" expected credit losses.

Recognise "lifetime" expected credit losses.

* Measurement of Expected credit Losses:-

An entity shall measure expected credit losses of a financial instrument in a way that reflects:

- (a) an unbiased & probability-weighted amount that is determined by evaluating a range of possible outcomes
- (b) time value of money; and
- (c) reasonable & supportable information that is available without undue cost or effort at the reporting date about past events, current conditions & forecasts of future economic conditions.

* 30 days past due rebuttable presumption:-

There is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

Note:- A financial asset is past due when a counterparty has failed to make a payment when that payment was contractually due.

* Stages of Impairment

Three stages to determine the amount of impairment recognised as expected credit losses at each reporting date as well as amount of interest revenue to be recorded in future periods.

	<u>Stage 1</u>	<u>Stage 2</u>	<u>Stage 3</u>
When? →	credit risk has <u>not</u> increased significantly since initial recognition	credit risk has <u>increased</u> significantly since initial recognition	credit <u>impaired</u> (objective evidence of impairment)
Credit losses Recognised →	12 month ECLs	Lifetime ECLs	Lifetime ECLs
calculation of effective interest →	on gross carrying amount	on gross carrying amount	Net carrying amount (Net of loss allowance) (Illustration: 3)
Approach →	General Approach	Simplified Approach	purchased (or) originated credit-impaired Approach

* Recognition of Impairment

↳ Recognised in "Profit or loss" & adjustment to carrying amount in the balance sheet.

* Adjustment of Loss Allowance

Entity must 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.

* Loss Allowance for financial Assets measured at FVTOCI

↓
Recognised in "P&L" shall not reduce the carrying amount of the financial asset in the balance sheet.
(Refer Illustration 2)

* Undrawn loan commitments

Ind AS 109 states that expected credit losses model also applies to the undrawn portions of overdraft, credit card & other approved but undrawn facilities.

<u>Stage</u>	<u>Apply to</u>	<u>Recognise</u>
No significant increase in credit Risk	Expected portion to be drawn down within the next 12 months	12 month ECLs
Significant increase in credit Risk	Expected portion to be drawn down over the remaining life of the facility	Life time ECLs

Illustration

undrawn loan commitments

① Debita Bank applies the expected loss impairment model under Ind AS 109. At 30 September 2014, the bank approved a total of ₹10 million overdraft facilities which have not yet been drawn.

Debita Bank considers that ₹8 million has no significant increase in credit risk. Of that ₹8 million, ₹4 million is expected to be drawn down within the next 12 months, with a 3% probability of default over the next 12 months.

Debita Bank considers that credit quality has significantly deteriorated on ₹2 million of overdraft facilities & ₹2 million is expected to be drawn down over the remaining life of the facilities, with a probability of default of 10%.

Required

calculate the additional allowance in respect of the undrawn overdraft facilities, taking account of the above information.

Ans:

<u>Stage</u>	<u>Expected credit loss (₹)</u>	
No significant increase in credit risk	120,000	(24M x 3%)
Significant increase in credit risk	200,000	(22M x 10%)
	<u>320,000</u>	

As per Ind AS 109, Debita Bank would recognize the loss allowance of ₹320,000 for the undrawn portion of its overdraft facilities.

- ② An entity purchases a debt instrument with a fair value of ₹1000 on 15th March, 2011 & measures the debt instrument at FVTOCI. The instrument has an interest rate of 5% over the contractual term of 10 years & has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset.

On 31 March 2011 (the reporting date), the fair value of the debt instrument has decreased to ₹950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition & the ECL should be measured at an amount equal to 12 month ECL, which amounts to ₹30.

On 1 April 2011, the entity decides to sell the debt instrument for ₹950, which is its fair value at that date.

Pass journal entries for recognition, impairment & sale of a debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided.

(CA Final Nov 2019 RTP)

Ans: On Initial Recognition

Financial Asset - FVTOCI A/c Dr 21000
To Cash A/c 21000

On Impairment of debt Instrument

Impairment expense (P&L) A/c Dr 230

Other comprehensive Income A/c Dr 220

To financial Asset - FVTOCI A/c 50

The cumulative loss in OCI at the reporting date was ₹220. That amount consists of the total FV changes of ₹50 (₹1000 - ₹950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (₹30).

On Sale of Debt Instrument

Cash A/c Dr 2950

To financial Asset - FVTOCI A/c 2950

Loss on sale (P&L) A/c Dr 220

To Other comprehensive Income A/c ₹220

Note: For debt instruments measured at FVTOCI, the expected credit losses do not reduce the carrying amount in the balance sheet, which remains at fair value.

- ③ On 1st April 2017, A Ltd lent ₹2000000 to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost of the company ₹10 Lakhs. The company has agreed not to charge interest on this loan to help the supplier's short-term cash flow but expected the supplier to repay ₹2.40 Lakhs on 31st March 2019. As calculated by the finance team of the company, the effective annual rate of interest on this loan is 6.9%. On 28th February 2018, the company received the information that poor economic climate has caused the supplier significant problems & in order to help them, the company agreed to reduce the amount repayable by them on 31 March 2019 to ₹2.20 Lakhs. Suggest the accounting entries as per applicable Ind AS.

(CA Final NOV 2018 RTP)

Ans: - The loan to the Supplier would be regarded as a financial asset. The relevant accounting standard Ind AS 109 provides that the financial assets are normally measured at fair value.

- If the financial asset in which only expected future cash inflows are the receipts of principal & interest and the investor intends to collect these inflows rather than dispose of the asset to a third party, then Ind AS 109 allows the asset to be measured at amortised cost using effective interest method.
- If this method is adopted, the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value ₹2,10,00,000.
- Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due. The income recognised in the current period is ₹14,49,000 ($₹2,10,00,000 \times 6.9\%$).
- In the absence of information regarding the financial difficulties of the supplier the financial asset at 31st March, 2018 would have been measured at ₹2,24,49,000 ($₹2,10,00,000 + ₹14,49,000$). The information regarding financial difficulty of the supplier is objective evidence that the financial asset suffered impairment at 31 March, 2018.
- The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be ₹2,05,79,981 ($₹2,20,00,000 / 1.069$). The reduction in carrying value of ₹18,69,019 ($₹2,24,49,000 - ₹2,05,79,981$) would be charged to profit or loss in the current period as an impairment of a financial asset.
- Therefore, the net charge to profit or loss in respect of the current period would be ₹4,20,019 ($18,69,019 - 14,49,000$).

* Purchased or originated credit-impaired financial assets

- A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred.
- Evidence that a financial asset (on purchase or origination) is credit-impaired includes observable data about such events.
- List of such events include:
 - (a) Significant financial difficulty of the issuer or the borrower
 - (b) A breach of contract, such as default or past due event
 - (c) The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession that the lender would not otherwise consider
 - (d) It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation.
 - (e) The disappearance of an active market for that financial asset because of financial difficulties
 - (f) The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

Interaction b/w FVTOCI & Foreign currency denomination, FV Hedge Accounting & Impairment

An entity purchases a debt instrument (a bond) denominated in a foreign currency (FC) for its FV of FC 100,000 on 1 January 2010 & classifies the bond as measured at FVTOCI. The bond has 5 years remaining to maturity & a fixed coupon of 5% over its contractual life on the contractual par amount of FC 100,000. On initial recognition the bond has a 5% effective interest rate. The entity's functional currency is its local currency (LC). The exchange rate is FC 1 to LC 1 on 1st January 2010. At initial recognition the entity determines that the bond is not purchased or originated credit-impaired. In addition, as at 1 January, 2010, the 12 month ECL are determined to be FC 1200.

The entity has the following risk exposures Hedging

(a) FV Interest rate risk in FC ↓ — Interest Rate swaps ↓

(b) Foreign Exchange Risk

Ans:

1 January 2010

Financial Asset - FVTOCI	LC
A/c	100,000
To cash A/c	LC 100,000

(Recognise the bond at its fair value)

Impairment Loss (P&L) A/c	LC 1200
To OCI A/c	LC 1200

(Recognise the 12 month ECLs)

Swap A/c Dr	—
To cash A/c	—

(Recognise the Swap at its fair value)

Suppose at 31 December 2010 (reporting date), the fvo of the bond decreased from FC 100,000 to FC 96,370 because of an increase in market interest rates. The fvo of swap increased to FC 1,837. As at 31 December 2010, the exchange rate is FC 1 to LC 1.4.

Ans:

	<u>1 January 2010</u>	<u>31 December 2010</u>
<u>Bond:</u>		
Fair value (FC)	100,000	96,370
Fair value (LC)	100,000	134,918 (96,370 x 1.4)
Amortised cost (FC)	98,800 (100,000 - 1200)	98,800
Amortised cost (LC)	98,800	138,320 (98,800 x 1.4)
<u>Interest rate swap:</u>		
Interest rate swap (FC)	—	1837
" (LC)	—	2572 (1837 x 1.4)
<u>Impairment-loss Allowance:</u>		
Loss Allowance (FC)	1200	1200
Loss Allowance (LC)	1200	1680 (1200 x 1.4)
Foreign currency Rate (FC:LC)	1:1	1:1.4

Notes: Gain recognised in P&L due to foreign exchange rates = LC 138,320 - LC 98,800
(change in Amortised cost in LC) = LC 39,520.

Change in fair value of bond in LC = LC 134,918 - LC 100,000
(Recognised as an adjustment to carrying Amount) = LC 34,918

Loss Recognised in OCI = fvo of the bond - Amortised cost
= LC 134,918 - LC 138,320 = LC 3,402

∴ change in cumulative loss recognised in OCI during 2010 = LC 3402 + LC 1200
= LC 4602

Financial Asset - FVTOCI A/c Dr LC 34,918

OCI A/c Dr LC 4,602

To profit or loss A/c LC 39,520

(Recognise the foreign exchange gain on the bond, the adjustment to its carrying amount measured at fv in LC & the movement in the accumulated impairment amount due to changes in foreign exchange rates)

Swap A/c Dr LC 2,572

To profit or loss A/c LC 2,572

(Remeasure the swap at fair value)

profit or loss A/c LC 2,572

To OCI A/c LC 2,572

(Recycle the change in fv of the swap)

Suppose as at 31 December 2011, the fv of bond decreased to FC 87,114 because of an increase in market rates & increase in credit risk of the bond. The fv of the swap increased by FC 255 to FC 2,092. The estimate of life time ECLs as at 31 December 2011 is FC 9,700. As at 31 Dec 2011, Exchange rate is FC 1 to LC 1.25.

Ans:-

	<u>31 Dec 2010</u>	<u>31 Dec 2011</u>
<u>Bond:-</u>		
Fair Value (FC)	96,370	87,114
Fair Value (LC)	134,918	108,893 (87,114 x 1.25)
Amortised cost (FC)	98,800	90,300 (100,000 - 9,700)
Amortised cost (LC)	138,320	112,875 (90,300 x 1.25)
<u>Interest rate swap:-</u>		
IRS (FC)	1837	2,092
IRS (LC)	2572	2615 (2,092 x 1.25)
<u>Impairment - loss Allowance:-</u>		
Loss Allowance (FC)	1200	9700
Loss Allowance (LC)	1680	12,125 (9700 x 1.25)
Foreign currency Rate	1:1.4	1:1.25

which is the change in gross carrying amount of the bond on the basis of amortised cost during 2011 in LC, adjusted for impairment loss

$$\begin{aligned} &= \text{LC } 3982 + \text{LC } 10,625 - \text{LC } 3402 \\ &= \text{LC } 11,205 \end{aligned}$$

* This amount consists of the changes in fv of the swap, the accumulated impairment amount & changes in foreign exchange rates recognised in OCI
 $= \text{LC } 2572 + \text{LC } 1200 + \text{LC } 43 + \text{LC } 10,625 - \text{LC } 4,602 - \text{LC } 11,205 = \text{LC } 1367$, which is recycled as a loss in P&L A/c.