Ind AS 109 "Financial Instruments"

An entity shall classify Financial Assets & Financial Liability at Transaction value at Initial Recognition at fair value ***plus or minus***, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Most Important :- *if 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. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.*

Classification & Subsequent measurement of Financial Assets:- After initial recognition, an entity shall measure a financial asset in accordance with:-

Amortised cost	*Fair value through OCI*	*Fair value through P/l*
if both of the following conditions are met: • the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and • cash flows that are solely payments of principal and interest on the principal amount outstanding. • To calculate Amortized cost the Financial Assets is calculate interest as Effective interest rate Method (EIR) and adjusted for any principal and interest payment received. • The transaction cost is added in Amortized cost Method in case of Financial Asset.	if both of the following conditions are met: • the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and selling Financial assets • cash flows that are solely payments of principal and interest on the principal amount outstanding. • Fair value determined periodically • For equity instruments – cost may represent fair value in some situations	• It is residual category • When Financial Assets is neither measured at Amortized cost or Fair value through OCI then it is measured through Fair value through Profit and loss A/c. • Fair value determined periodically • *Normally Investment in Equity instruments of other entity is Measured through FVTPL.* • *But, entity can choose irrevocable option to measure Equity shares as FVTOCI under category not Reclassified to P/l.*

Treatment of Interest, dividend, Gains/losses arising out of Financial Assets

FA measured at Amortized cost - Interest, dividend, Gains/losses ***recorded in P&l.***

FA which is not Equity instruments measured at FVTOCI:- Interest ***recorded in P&l and*** Gain/losses Recorded in OCI under Classified to P&L . When the gains are realized then Transfer to P&L as reclassification adjustemnts.

FA Equity Instruments measured at FVTOCI:- Dividend Recorded in P&L ***and*** Gain/losses Recorded in OCI under Not reclassified to P&L. When gains/losses are realized then No need to transfer to P&L.

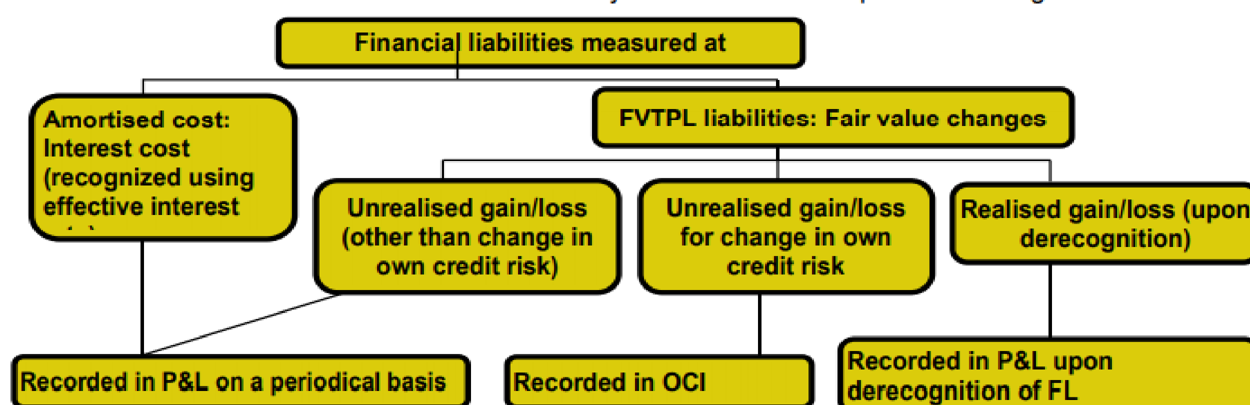
FA measured at FVTPL:- Interest, dividend, Gains/losses ***recorded in P&l.***

Classification & Subsequent measurement of Financial Liabilities:-

Upon initial recognition, all financial liabilities are measured at fair value. Subsequently, per Ind AS 109 – the classification of financial liabilities shall be as follows:

- ***Measured at Amortised cost :-*** *An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for which are measured at FVTPL.*

- ***Measured at fair value through profit or loss:***
  1. *Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value. (**means which meet the definition of Held for trading**)*
  2. *Contingent consideration recognized by an acquirer in a business combination*



Modifications of Financial Assets

- **If it does not result in derecognition, then Re-calculate the gross carrying amount as the present value at the original effective rate.**
- **Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.**
- **Any gain or loss on modifications charged to P&L.**

Most Important: - When an entity gives loan to its wholly owned subsidiary which involves no interest or low interest as compared to market interest then the The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

RECLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

An entity shall not reclassify any financial liability.

If an entity reclassifies financial assets, it shall apply the reclassification prospectively from the reclassification date.

S.no	From	To	Prospective effects
1	*Amortised cost*	*FVTPL*	its fair value is measured at the reclassification date. Any gain or loss is recognised in P/L.
2	*FVTPL*	*Amortised cost*	its fair value is measured at the reclassification date. Any gain or loss is recognised in P/L.

3	*Amortised cost*	*FVTOCI*	its fair value is measured at the reclassification date. Any gain or loss is recognised in OCI.
4	*FVTOCI*	*Amortised cost*	its fair value is measured at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset at the reclassification date
5	*FVTPL*	*FVTOCI*	The financial asset continues to be measured at fair value. Gain or loss recognised in P&L.
6	*FVTOCI*	*FVTPL*	its fair value is measured at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from OCI to P&L.

Impairment

An entity shall recognise a loss allowance for expected credit losses on the following:

a financial asset that is measured at amortised cost	a financial asset that is measured at FVTOCI	a lease receivable,
a contract asset(as defined in Ind AS 115)	a financial guarantee contract	or a loan commitment;

For Financial Assets , a credit loss is the present value of difference between

- **the contractual cash flows that are due to an entity under the contract; and**
- **the cash flows that the entity expects to receive (,ie, cash short falls) discounted at original effective interest rate**

12-month expected credit losses:- **The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.**

So now the Question is when to apply Life time expected credit losses or 12 month Expected losses.

- ***If there are significant credit risk for any FA that qualifies the recognition then apply Life time.***
- ***If FA is trade receivables , lease receivables or contract asset then apply life time.***
- ***Any another FA in which there is no significant credit risk then apply 12 month expected method.***

Derivate and Held for Trading

Financial assets and liabilities held for trading are defined as those that:

i. are acquired or incurred principally for the purpose of sale or repurchase in the near term;

ii. on initial recognition are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

iii. are derivatives.

Meaning of Derivative

- its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, etc
- it requires no initial net investment
- it is settled at a future date

Embedded derivatives is a component of hybrid instruments that also includes a Non derivate contract. And if to be separated from the host contract and accounts separately if the entity thinks that it is significant in nature.(Remember accounting is only notional)

Mostly Derivatives whether they are Financial Asset or Financial Liability are measured fair value through P&L and Recognise any gain or loss in the P&L when there is some changes in the fair value.

These Financial assets are purchased or sale under any contract whose terms require delivery of assets within time framed. So its Accounting two methods:-

Trade date accounting	Settlement date accounting
Trade date = date that an entity commits itself to purchase or sell an asset	Settlement date = date that an asset is delivered to or by an entity
When trade date accounting is applied, the buyer of a financial asset recognises the financial asset and its liability to pay on the trade date itself.	When settlement date accounting is applied, a buyer of financial asset accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date
Correspondingly, the seller derecognises the financial asset and recognises any gain or loss on sale on the trade date.	assets measured at amortised cost - change in value is not recognised; assets measured at FVTPL – changes recognised in P&L assets measured at FVOCI – changes recognised in OCI

Derecoginition of Financial Assets

In simple words , removing the Financial Assets from balance sheet of the entity. So when the right to cash flow from assets expired or when entity doesn't retain the control of Financial assets then derecognise.

Derecoginition of Financial Liabilities.

An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires. Any difference recognised in P&L over derecognition of Financial Liabilities.

Exchange of financial liability instruments

Substantial difference Terms Means :- When the difference between the

- ***present value of cash flow under the new terms using original effective interest rate (Including any fees paid and net of fees received)***
- ***discounted present value of remaining cash flow with original effective interest rate***

is greater than or equal to 10 % or more.

Substantial modification of existing debt or replacement of existing debt with new debt having substantially different terms

Yes- extinguishment accounting	*No-modification accounting*
If the 10% test is passed, principle of "extinguishment accounting" are applied, that is: • de-recognition of the existing liability • recognition of the new or modified liability at its fair value (not to include of any fees incurred directly related to the new liability) using new discount rate. • recognition of a gain or loss equal to the difference between the carrying value of the old liability and the fair value of the new one and minus fees incurred	***Ind AS 109 is not clear as to the accounting treatment if the 10% test is failed. Two alternate approaches are therefore possible:*** *Approach 1:- The difference between the present value of new cash flow and existing cash flow using original discount rate is recognised in P&L. any fees paid is also recognised in P&L.* *Approach 2:- the fees or costs incurred are netted against the existing liability; and revised IRR is calculate then apply Amortisation method.*

Types of hedging relationships:

i. ***Fair Value hedge:-*** A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss. ***It shall be accounted as follows.***

*Is the hedged item an equity instrument designated as FVOCI – **Yes***	*Gain/ loss* recognized in OCI as Reclassification adjustment*
*Is the hedged item an equity instrument designated as FVOCI – **No***	*Gain/ loss recognized in P&L*
Hedging gain/ loss on hedged item	*Adjusted in carrying amount of hedged item*

ii. ***Cash Flow hedge:-*** A cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable debt), or a highly probable forecast transaction, and could affect profit or loss. ***Where a cash flow hedge meets the qualifying criteria, it shall be accounted as follows:***

Step – 1	On spot date the difference between the Spot rate and forward rate is measured and Termed it as Hedging Forward points
Step -2	On the end of every reporting period the changes in the fair value of Forward is treated as derivate (FA or FL) through the Cash flow hedging reserve from OCI as Reclassification adjustment.
Step -3	On the end of every reporting period calculate gain or loss as per Ind AS 21(if it is foreign transaction) on the instruments and transfer such gain or loss from Profit & Loss to cash flow hedge reserve.
Step 4	In Step -1 the hedging points , being reclassification adjustments in respect of Amortisation of forward element over the tenure of forward contract.`
Step -5	Now repeat step 1 to 4 every year.

iii. ***Hedge of net investment in foreign operation:-*** Hedge of a net investment in foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, shall be accounted for similarly to cash flow hedges. ***It shall be accounted as follows***

Portion of gain/loss on hedging instrument that is determined to be effective hedge	*Gain/ loss recognized in OCI (Foreign currency translation reserve)*
Ineffective portion	*Gain/ loss recognized in P&L*

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