IND AS 109
FINANCIAL INSTRUMENTS

Flow of Discussion

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- Scope
- Recognition of Financial Asset and Financial Liability
- Classification & Measurement of Financial Asset
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- Trade and Settlement Date Accounting
- Derecognition of Financial Asset
- Reclassification
- Embedded Derivative
- Impairment of Financial Instrument
- Hedge accounting
- Extinguish of Financial Liability with Equity instrument
- Exemptions available under IND AS 101 for first time adopter

Introduction

What Is Financial Instrument-

A Contract giving rise to –

- Financial Assets (FA) of one entity, and
- Financial Liability (FL) or Equity to another entity

Introduction

- Financial Asset (FA)-

An asset that is

a. Cash, or
b. Equity Instrument of another entity, or
c. A Contractual right
   I. To receive cash or another FA of another entity
   II. To exchange FA or FL with another entity under potentially favorable conditions to the entity.
d. A contract that will or may be settled in entity's own equity instruments and is-
   I. Non derivative for which the entity is or may be obliged to receive variable number of the entity's own equity instruments, or
   II. A derivative which will or may be settled other than by exchange of a fixed amount of cash or another FA for a fixed number of entity's own equity instrument.

Introduction

Financial Liability (FL)-

FA & FL

Is any liability that is

a. A contractual obligation –

I. to deliver cash or another FA, or

II. To exchange FA or FL with another enterprises, for terms which are potentially unfavorable to the entity.

b. A contract that will or may be settled in entity's own equity instruments and is-

I. Non derivative for which the entity is or may be obliged to deliver variable number of the entity's own equity instruments, or

II. A derivative which will or may be settled other than by exchange of a fixed amount of cash or another FA for a fixed number of entity's own equity instrument.

Introduction

- **Derivatives-** Is a financial instrument or other contacts which has all these three Characteristics-

I. It's value changes in response to the change in underlying like; specific interest rate, foreign exchange rate, commodity price etc.

I. Requires no or very small initial investment.

II. It is settled in a future date.

SCOPE

IND AS 109 establishes principles for the accounting for FA or FL. This Standard applies to all types of entities and financial instruments other than –

- Investments in equity shares of subsidiary associate or Joint venture- covered in IND AS 110, IND AS 28 and IND AS 27.
- Rights and obligations under lease to which IND As 17 applies.

SCOPE

- Employers' rights and obligations arising from employee benefit plans, IND AS 19 applies.

- Financial Instruments issued by the entity that meets the definition of an equity instrument, IND AS 32 specifies it's classification, however this standard applies to entity holding this instrument.

- Rights and Obligations arising out of Insurance Contracts, IND AS 104 applies.

SCOPE

- Forward Contracts to buy or sell an acquiree, between an acquirer and a selling shareholder in a business combination, to which IND AS 103 applies.

- Financial Instruments, contracts and obligations under share-based payment transactions to which IND AS 102 applies.

- Rights to payments to reimburse the entity for expenditure that is required to make to settle a liability that it recognizes as a provision during the current or earlier period , in accordance with IND AS 37 .

SCOPE

- Rights and obligations within the scope of IND AS 115 that are financial instruments, except for those that IND AS 115 specifies are accounted for in accordance with this standard.

- Loan commitments other than following to which this standard apply-
  - ✓ Loan commitments that entity designates as financial liability through Profit or loss(FVTPL).
  - ✓ Loan commitments that can be settled net in cash or by delivering or issuing other financial instrument (Derivative).

  However Impairment and derecognition of loan commitments will be done as per this standard, even if for loan commitments which are not falling within this standard.

Recognition of FA and FL

FA or FL is recognized when and only when entity becomes party of the contractual provisions of the instruments.

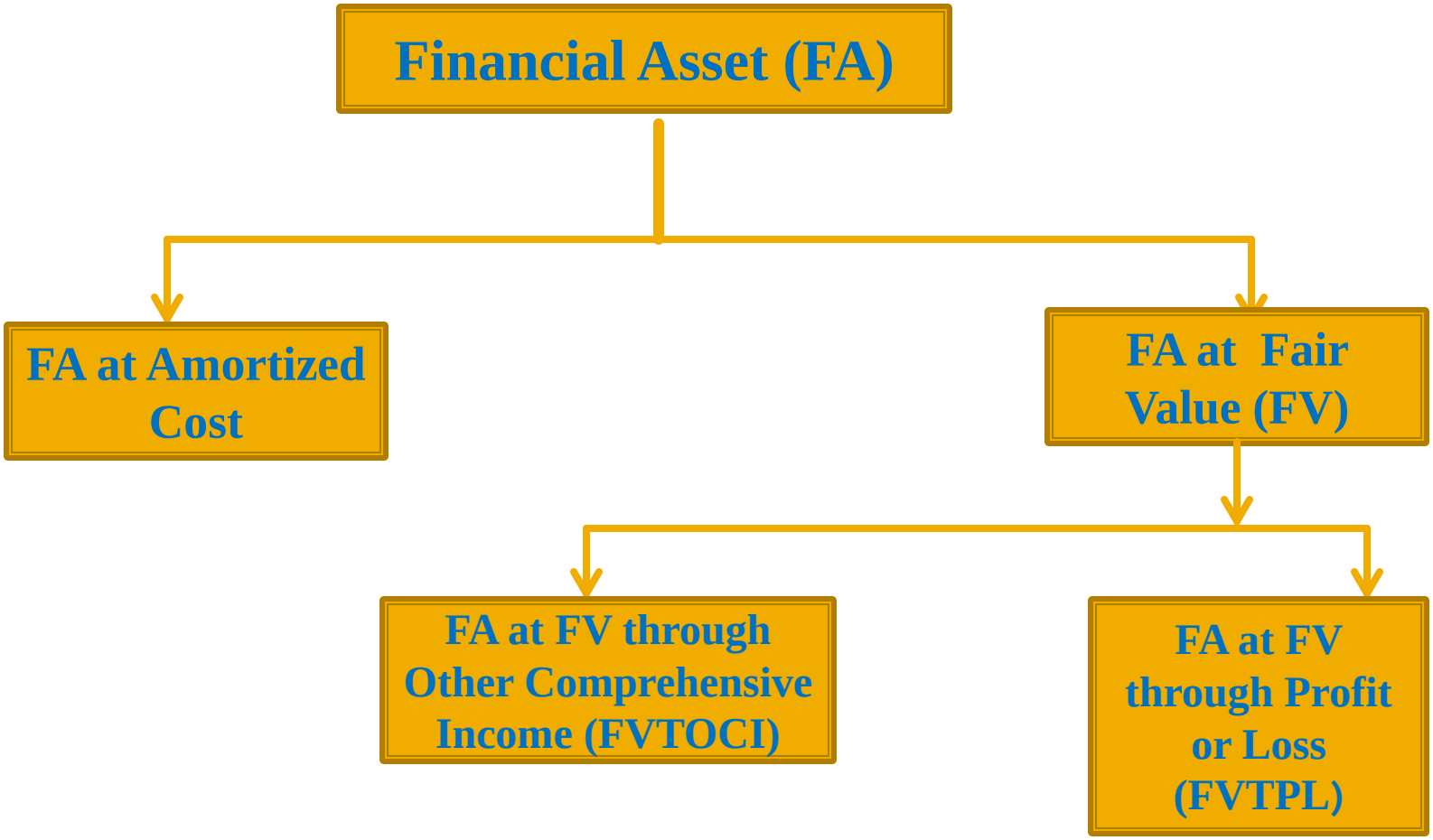
At initial recognition measured at Fair value on acquisition.

Recognition of FA and FL

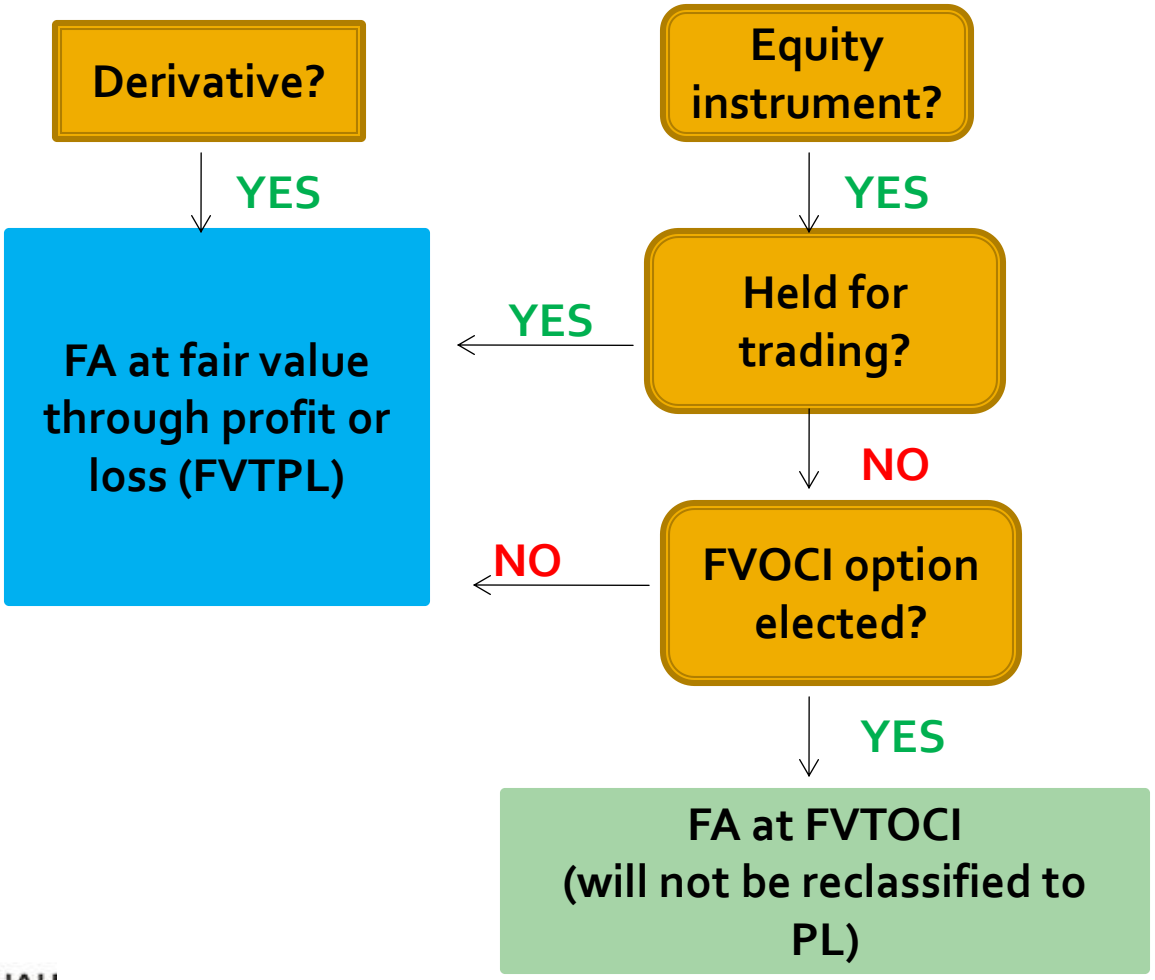
Examples on timing of recognition-

- Unconditional receivables and payables- on becoming party of the contract.
- Assets to be acquired or Liabilities to be incurred as a result of firm commitment- Not recognized until at least one of the parties has performed under the agreement. But, those firm commitments which are derivatives because of net settlement clause are recognized immediately on entering into the contract.
- A forward contract is recognized on the date of contract not on the date of settlement, however on the date of contract the fair value of the contract is often zero.
- Option contracts are recognized when the holder or writer becomes party to the contract. Option premium paid or received is recognized as FA or FL at initial recognition.

Classification of Financial Assets



Classification of Financial Assets



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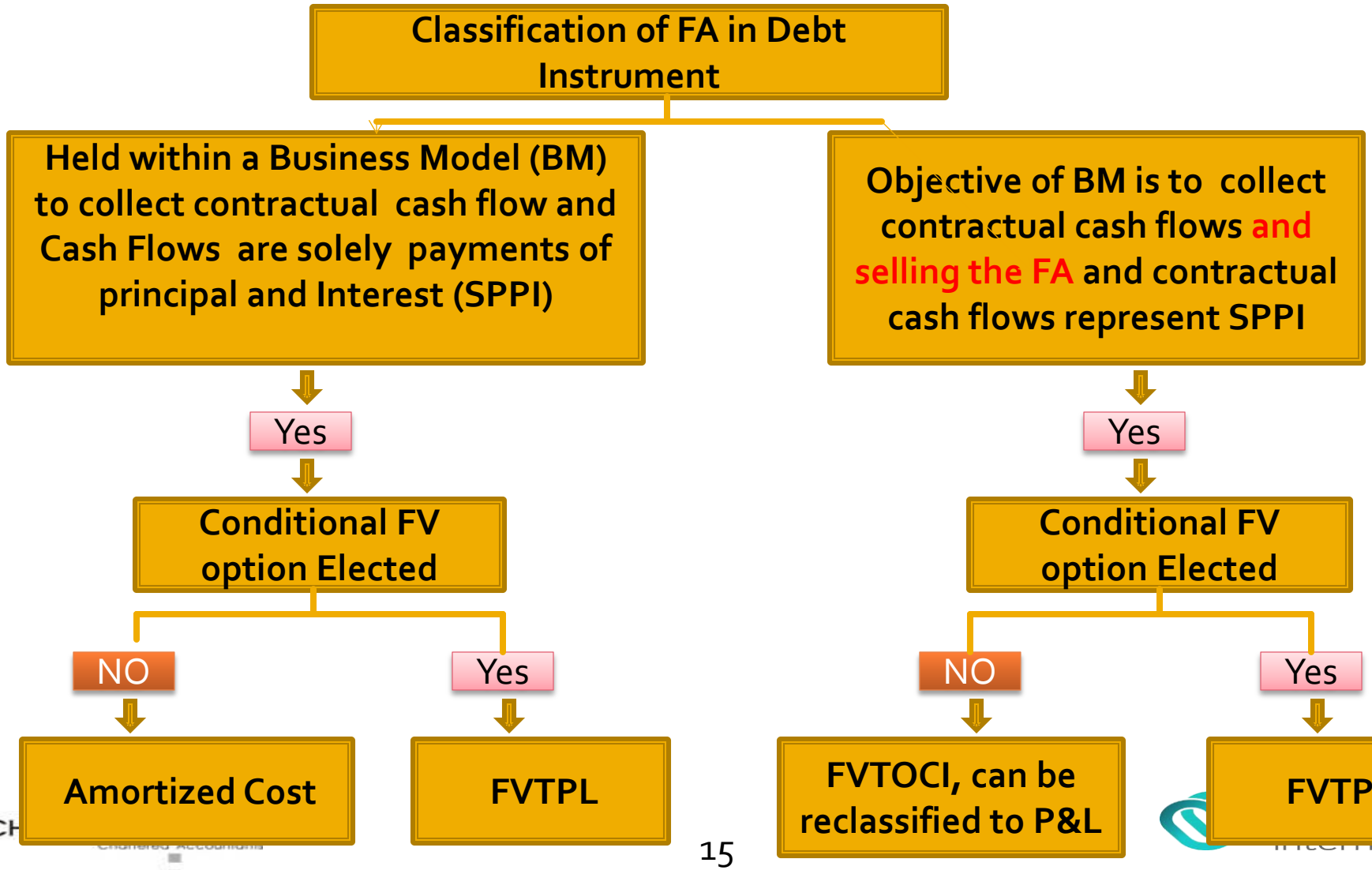

Classification of Financial Assets

Conditional Fair Value Option-

Investment in Debt Instruments should be designated at amortized cost or FVTOCI, however if designating at amortized cost or FVTOCI creates accounting mismatch it can be designated at FVTPL.

Example of Accounting Mismatch-

An entity has financed a specified group of loans by issuing traded bonds. The entity regularly buys and sells such bonds and measures it at FVTPL. So, there will be accounting mismatch if the loans are accounted at FVTOCI.

Classification of Financial Assets

- Amortized Cost=Amount Initially recognized (generally on transaction value + transaction cost) (less)principal repayments add/less cumulative amortization of any differences between the initial amount and the maturity amount using effective interest method less any loss allowances

- Effective Interest Rate= Rate at which PV of expected future cash flows through the **expected life** of the instrument is equals to gross carrying amount of FA or amortized cost of FL

Classification of Financial Assets

- Examples of Financial Assets at Amortized Cost (FAAC):
  - Trade receivables
  - Loan receivables
  - Investments in government bonds that are not held for trading
  - Investments in term deposits at standard interest rates

Classification of Financial Assets

- Examples of financial Assets through Profit or Loss Account (FVTPL):
  - Investments in shares of listed companies that the entity has not elected to account for it as at FVTOCI
  - Derivatives that have not been designated in a hedging relationship (interest rate swaps, commodity futures/options contracts, foreign exchange futures/options contracts)
  - Investments in commodity linked bonds
  - Contingent consideration receivable from the sale of a business

Classification of Financial Assets

- 'Hold-to-collect' **business model test** -Characteristics
  - The entity's objective is to hold the financial asset to collect the contractual cash flows from the financial asset, done at an aggregate level.
  - IND AS 109 does not require that the financial asset is always held until its maturity.
  - Key management personnel (KMP) determine whether a financial asset meets the business model test (facts and circumstances, how an entity is managed, type of information provided to management).

Classification of Financial Assets

- Solely Payment of Principal & Interest('SPPI') contractual cash flow characteristics test-
  - Contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding on specified dates , done at an instrument level.
  - Interest is deemed to be the consideration for the time value of money and credit risk.

Measurement of FA

Classification	Amortized Cost	FVTOCI (Debt)	FVTPL	FVTOCI (Equity)
Instrument Type	Debt	Debt	All (Debt, Equity and Derivative	Equity
Balance Sheet Measurement	Amortized Cost	Fair Value	Fair Value	Fair Value
Transaction cost on Initial Recognition	Added to Initial Recognition Amount	Added to Initial Recognition Amount	Charge to P&L	Added to Initial Recognition Amount
Transaction Cost on Subsequent Accounting	Amortized to P&L using EIR	Transferred to OCI and amortized in P&L using EIR	Not Applicable	Transferred to OCI

Measurement of FA

Classification	Amortized Cost	FVTOCI (Debt)	FVTPL	FVTOCI (Equity)
Recognition of Fair Value Gain or Loss	Not Applicable	OCI	P&L	OCI
Interest & Dividend	P&L Using EIR	P&L Using EIR	P&L	Divided in P&L
Impairment Losses	P&L	P&L	P&L	OCI
Foreign Exchange Gain / Loss	P&L	P&L	P&L	OCI
Gain/Loss on sale/derecognition of the asset	P&L Amortized Cost	Gain/Loss and amount parked in OCI are transferred to P&L	P&L FA @FVTPL & FVTOCI	OCI. Recycling to P&L is not allowed.

Classification of Financial Liabilities

Financial liabilities at amortized cost

Financial liabilities at fair value through profit or loss (FVTPL)

Guidance on specific financial liabilities

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Classification of Financial Liabilities

- **IND AS 109 requires all financial liabilities to be measured at amortized cost unless:**
  - The financial liability is required to be measured at FVTPL because it is held for trading or designated as such at Initial recognition to reduce accounting mismatch or group of FL or FA or both are managed and evaluated on FV basis as per documented risk policy.

    The financial liability arise when a transfer of financial asset does not qualify for derecognition or when the continuing involvement approach applies , such FL shall be Classified as per the Classification criteria of Asset transferred.

Classification of Financial Liabilities

- FL contains one or more embedded derivative to be Classified as FVTPL.
- The financial liability commits to provide a loan at a below-market interest rate, should be Classified at FVTPL.
- The financial liability is a contingent consideration recognized by an acquirer in a business combination to which IND AS 103 applies, should be Classified at FVTPL.
- The financial liability is a financial guarantee contract, should be Classified at FVTPL.

Classification of Financial Liabilities

- **Examples** of financial liabilities measured at amortized cost :
  - Trade payables, Advances Received
  - Loan payable with standard interest rates (such as benchmark rate plus a margin)
  - Bank borrowings, Debentures, Bonds
  - Preference Shares

  Initially recognised at fair value directly attributable transaction costs are added to FV

Measurement of FL

Classification	Amortized Cost	Held For Trading	Designated as at FVTPL
Balance Sheet Measurement	Amortized Cost	FV	FV
Transaction Costs- Initial Recognition	Added to Initial recognition amount	Charge to P&L	Charge to P&L
Transactions Costs – Subsequent Accounting	Amortized to P&L using EIR	Not Applicable	Not Applicable
FV Gain/ Loss attributable to changes in ***Own Credit Risk***	*Not Applicable*	*P&L*	*OCI. However, this can be recognized in P&L to avoid accounting mismatch*
Other FV Gain /Loss	Not Applicable	P&L	P&L

Measurement of FL

Classification	Amortized Cost	Held For Trading	Designated as at FVTPL
Interest	P&L using EIR	P&L	P&L
Foreign Exchange Gain/Loss	P&L	P&L	P&L

FL@FVTPL& Credit Risk

Interest Free Loan to Subsidiary

Financial arantee to Subsidi

Measurement of FL

Credit risk is the risk that one party to financial Instrument will cause a financial loss for the other party by failing to discharge an obligation. It is not necessary that it relates to credit worthiness of the issuer.

Suppose, if one entity has issued two identical liability and one is collateralized, then credit risk of collateralized liability is less.

Credit risk is different from performance risk.

Measurement of FL

Guidance on specific financial liabilities

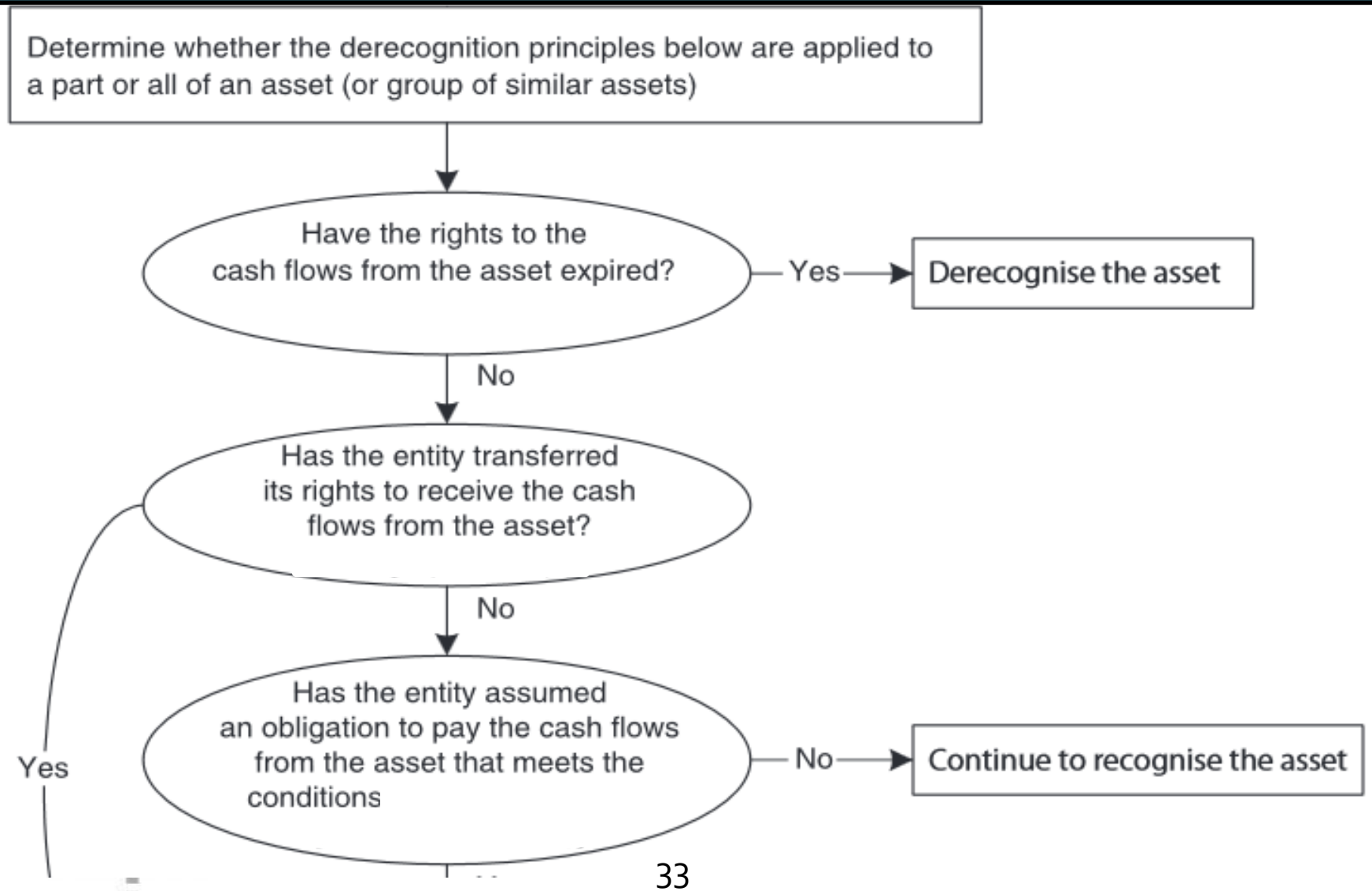
- Financial guarantee contracts- Initially recognised at fair value subsequently recognised at higher of amortized carrying amount or valuation as per IND AS 37, subsequent changes are recognised in P&L.
- Commitments to provide a loan at a below market interest rate- Initial and subsequent measurement at **FV.** At initial recognition difference between upfront fee and fair value and on subsequent measurement change in FV accounted in **PL**.
- Financial liabilities resulting from the transfer of a financial asset that does not qualify for derecognition or when the continuing involvement (CI) approach applies-Subsequently measured at amortized cost or FV depending upon CI is measured, Changes accounted for in PL.

Trade Date & Settlement Date Accounting

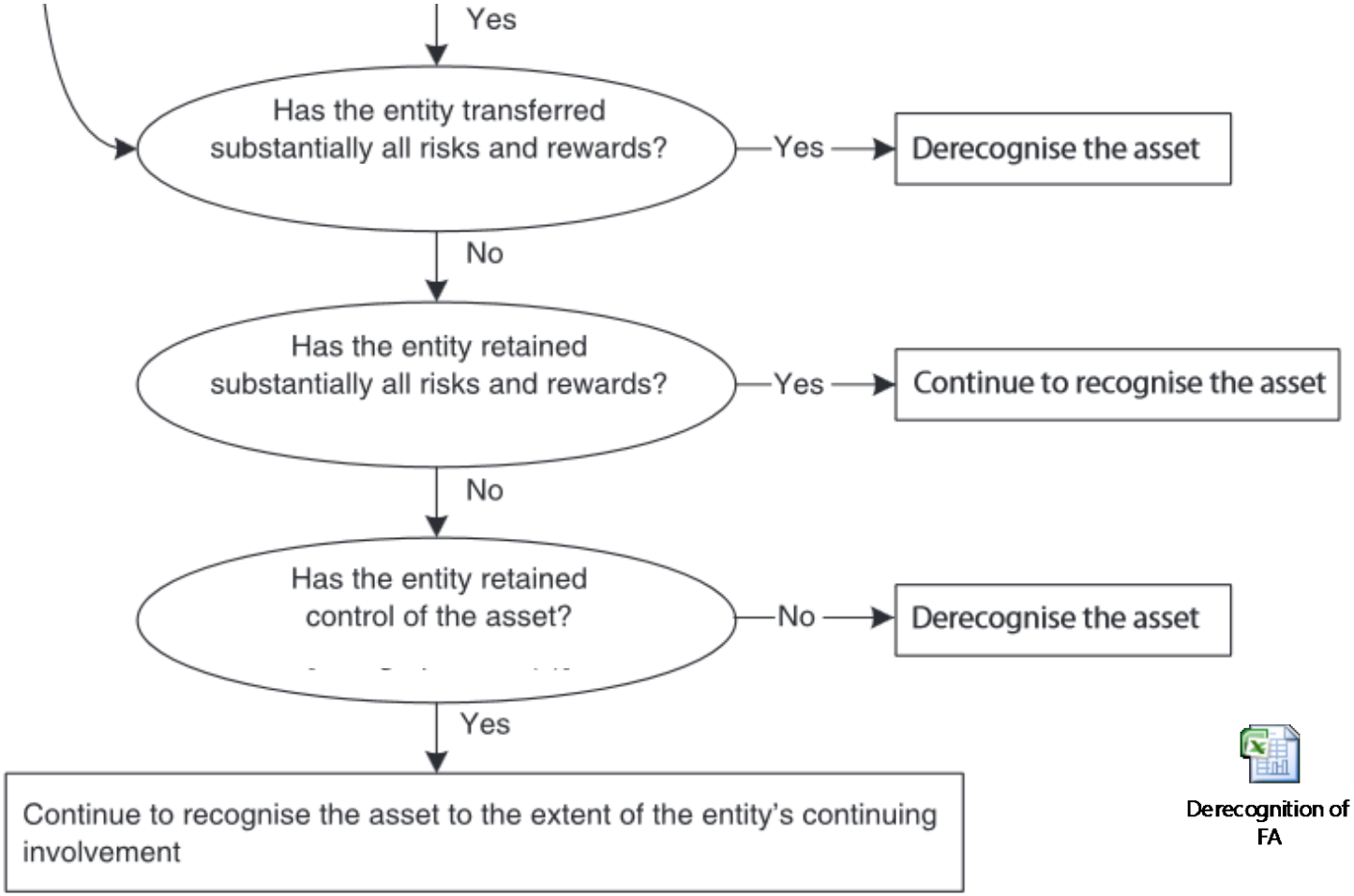
- No fair value change between trade date and settlement date is recognized for FA at amortized cost.
- If entity applies trade date accounting and carries FA at FV, fair value changes between trade date and settlement date is recognized in PL and corresponding effect is given to Investment.
- If entity applies settlement date accounting and carries FA at FV, no entry is passed on trade date, fair value changes between trade date and settlement date is recognized in PL with corresponding effect to receivable. Investment is recognized at the value on settlement date.

Trade T
Settlement Date

Derecognition of Financial Asset



Derecognition of Financial Asset



Derecognition of FA

Derecognition of Financial Asset

- An entity shall derecognize the financial asset when and only when –
- The contractual rights to the cash flows from the financial asset expire, or transferred.
- Retains the contractual right to receive the cash flows, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement, subject to following conditions-
- The entity has no obligation to pay the amount unless it collects equivalent amount from the original asset.
- The entity is prohibited from selling or pledging the original asset
- The entity has an obligation to remit any cash flows it collects without material delay and not entitled to reinvest such cash flows.

Derecognition of Financial Asset

- On transfer of the FA the entity shall evaluate the extent to which it retains the risks and rewards of ownership of the FA-
- If entity transfers substantially all the risks and rewards of ownership, the entity will derecognize the FA and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.
- If the entity retains substantially all the risks and rewards of ownership FA shall continue to be recognized.
- If the entity neither transfers nor retains substantially all the risks and rewards, then derecognition decision is based on whether the entity retains control over the financial assets, in case the entity has retained control, it would continue to recognize the FA to the extent of it's continuing involvement. It may take the form of guarantee, put and call option, cash settled option or similar provisions.

Derecognition of Financial Asset

Examples of substantially transferred all the risks and rewards-

- An unconditional sale of FA
- Sale of FA with option to repurchase at FV
- Sale of FA with a put or call option which is deeply out of money.

Examples of substantially retained all the risks and rewards-

- Sale and repurchase transaction where repurchase price is fixed
- Securities lending agreement
- Sale of FA with a put or call option which is deeply in the money
- Sale of short term receivables, in which entity guarantees to compensate the transferee for credit losses that are likely to occur.

Derecognition of Financial Asset

- If the FA is transferred in part, part of the FA can be derecognized if following conditions are satisfied-

- The part comprises of identified cash flows.
- The part comprises only a fully proportionate share of the cash flows from a FA. Example- In a loan arrangement comprising of multiple lenders the entity has 50% share of cash flows.
- The part comprises of only proportionate share of specifically identified cash flows from a FA. Example- Entity has the right to receive 50% of interest cash flows of a loan pool.

A FL is derecognized when the liability is extinguished i.e. obligation is discharged, cancelled or expired .

Reclassification

- IND AS 109 requires the reclassification of financial assets if an entity changes its business model.
  - Must be determined by senior management as a result of an external or internal change
  - Must be a significant change to the entity's operation
  - These are expected to be rare and infrequent events
- An entity shall not reclassify any financial liability.

Reclassification

- The following changes in circumstances are NOT considered changes in the overall business model of the entity:
  - An entity changes its intention in relation to a specific financial asset
  - The temporary disappearance of a particular market for financial assets
  - The transfer of financial assets between different parts of an entity that have different business models

Reclassification

- Reclassification mechanics:
  - Accounted for prospectively from the reclassification date
  - Entities are not permitted to restate previously recognized gains, losses or interest
  - Additional disclosures apply when an entity reclassifies its debt instruments

Reclassification

Type of Reclassification	Accounting Treatment
FA at amortized cost to FVTPL	Fair valued at reclassification date, difference between Fair Value and amortized cost charged to PL. Recognition of Interest will not change, Measurement of expected loss doesn't change.
FA at amortized cost to FVTOCI	Fair valued at reclassification date, difference between Fair Value and amortized cost charged to OCI. The effective interest rate and the measurement of expected credit losses are not adjusted. The loss allowance is derecognized , instead it would be recognized as an accumulated impairment in OCI, disclosed from reclassification date.
FA at FVTPL to amortized cost	Difference between amortized cost measured and Carried FV is charged to PL, The FV on reclassification date becomes new carrying amount for applying amortized cost method.

Reclassification

Type of Reclassification	Accounting Treatment
FA at FVTPL to FVTOCI	The FA continues to be recognized at FV, Prospective change in FV shall be recognized in OCI
FA at FVTOCI to amortized cost	Cumulative loss or gain previously recognized in OCI is removed from equity and adjusted against FV of FA on reclassification date. Amortized cost is measured retrospectively. This adjustment effects OCI but doesn't effect PL, so it is not a classification adjustment. The effective interest rate and the measurement of expected credit losses are not adjusted.
FA at FVTOCI to FVTPL	The FA continues to be recognized at FV, cumulative loss or gain previously recognized in OCI is reclassified to PL.

Embedded Derivatives

- An Embedded derivative (ED)- is a component of hybrid instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a standalone derivative . Examples are-

- Company A holds a bond which is convertible into the ordinary shares of Company B .
  The hybrid contract is the convertible bond; the host contract is the bond asset; the embedded derivative is the conversion option.

Embedded Derivatives

- Company C enters into a lease with an inflation factor , such that each year rentals are adjusted for changes in Retail Price Index (RPI).
  The hybrid contract is the entire lease; the host is the lease contract, the embedded derivative is the adjustment to the RPI.

- Company D sells furniture to Company E in USD. Both companies are located in India .
  The hybrid contract is the entire sale contract which will be settled in USD; the host contract is the Rupee sale contract ; the embedded derivative is the foreign exchange INR/USD forward.

- Equity or commodity price linked debenture

- Debenture with embedded call and/or put option

Embedded Derivatives

Embedded Derivatives

Separation of ED from host contract

- If a hybrid contract contains a host that is not an asset within the scope of IND AS 109, an ED shall be separated from the host and accounted for as a derivative if following conditions are fulfilled-
  - The economic characteristics and risks of the ED are not closely related to the economic characteristics and risks of the host contract.
  - A separate instrument having the same term as the ED would be characterized as an independent derivative.
  - The hybrid instrument is not accounted for as FVTPL.

  The separated ED is accounted for as standalone derivative at FVTPL. If the host contract is financial instrument, it is accounted as per IND AS 109, if non financial item as per applicable IND AS. The FV of ED is difference between FV of hybrid instrument and FV of host contract. If entity is unable to determine FV using this method , then the entire hybrid instrument is classified as FVTPL.

Impairment of Financial Instruments

- An entity shall recognize a loss allowance for expected credit losses on a financial asset that is measured at Amortized Cost or at FVTOCI, a lease receivable, a contract asset or a loan commitment and a financial guarantee.

- The impairment model establishes a three-stage approach, based on changes in expected credit losses of a financial instrument. This determines the recognition of impairment (as well as the recognition of interest revenue).

Impairment of Financial Instruments

Credit loss is difference between all contractual cash flows due to the entity as per the contract and the cash flow that the entity expects to receive

FA that are measured at FVTOCI, loss allowances are recognised in OCI and carrying amount of investment on Balance Sheet doesn't change.

Impairment of Financial Instruments

- Expected credit loss should be recognised as under:
  - Stage 1: credit risk has not increased significantly since initial recognition – entities recognizes 12 months expected losses, updated at each reporting date. Interest Revenue is calculated based on EIR on gross carrying amount.
  - Stage 2: credit risk has increased significantly since initial recognition – entities recognize lifetime expected losses.

    Interest Revenue is calculated based on EIR on gross carrying amount.
  - Stage 3: credit risk has increased significantly since initial recognition and Credit Impaired, loss allowances is made.

    Interest Revenue is calculated based on EIR on gross carrying amount less loss allowances.

    Impairment loss shall be reversed when there is favourable changes in lifetime expected losses.

Impairment of Financial Instruments

Issue	Loan Commitments	Financial Guarantee Contracts	FA at amortized Cost or at FVTOCI
What is the date of Initial Recognition to apply Impairment Requirements	Date on which the entity becomes party to the irrevocable commitment	Date on which the entity becomes party to the irrevocable commitment	Trade Date
How Does an entity assess significant increase in credit risk	Considers changes in the risk of a default occurring on the loan to which the commitment relates	Considers changes in the risk that the specified debtor will default	Considers changes in the risk of a default occurring on the FA

Impairment

Impairment of Financial Instruments

Issue	Loan Commitments	Financial Guarantee Contracts	FA at amortized Cost or at FVTOCI
What is the period over which to estimate expected credit losses	The maximum period over which entity has a present contractual obligation to extend credit.	The maximum period over which entity has a present contractual obligation to extend credit.	The maximum period over which entity is exposed to credit risk.
How cash shortfall are determined to measure ECL	Shortfall between Contractual Cash flow due to entity and expected cash flow if loan is draw down	Shortfall between expected payment to reimburse the holder for a credit loss that it incurs less any amount expects to receive from the holder, debtor or any other party.	Shortfall between Cash flows due to the entity as per contract and cash flow entity expects to receive
EIR to be used in discounting ECL	EIR of resulting asset or current rate representing the risk of cash flow	current rate representing the risk of cash flow	Determined at initial recognition

Impairment of Financial Instruments

Presentation of ECL impairment in Financial Statements-

Profit or Loss Presentation

- ECL impairment loss allowance (or reversal) recognized as income/expense in P&L, reflected in a separate line as impairment gain or loss.

Balance Sheet Presentation

- FA at amortized Cost, Contract Assets and Lease Receivables- ECL is presented as an allowances, the allowance reduces the net carrying amount. Until the asset meets write off criteria impairment allowances can't be reduced from Gross Carrying Amount.
- Loan Commitments and Financial Guarantee Contract- Presented as a Provision i.e. as a Liability.
- Debt Instruments measured at FVTOCI- presented as Accumulated Impairment amount in OCI

Hedge Accounting

An entity is exposed to number of risks affecting the fair value or cash flows associated with a FA or FL. When entity uses another instrument to offset such change through equal and opposite effect it is said to have hedged it's position.

The objective of hedge accounting is to represent the effect of an entity's risk management activities in financial statement.

Hedged Items can be-

- ✓ A recognized asset or liability, exp-Foreign currency borrowings or receivable
- ✓ An unrecognized firm commitment, exp- commitment to purchase raw material

Hedge Accounting

- ✓ A highly probable forecast transaction, exp- proposed issue of foreign currency bond
- ✓ A net investment in foreign operation, exp- foreign subsidiaries

Hedging Instruments can be-

- ✓ A designated derivative measured at FVTPL , or
- ✓ A designated non derivative FA/ FL measured at FVTPL with the following two exceptions-

- A FL designated as at FVTPL, for which amount of change in FV attributable to change in credit risk is presented in OCI

- For hedge of foreign currency risk, the foreign currency risk component of a non-derivative FA/FL may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in FVTOCI.

  Only contracts with a party external to the reporting entity can be designated as hedging instrument.

Hedge Accounting

Types of Hedges- There are following three kinds of hedges-

- **Fair Value Hedge-** A hedge of the exposure to change in the FV of a recognized asset or liability or an unrecognized firm commitment or component thereof, that is attributable to particular risk and could affect profit or loss.

  Changes in FV may arise through changes in interest rates (for fixed rates loans), foreign exchanges rates, equity prices or commodity prices.
- **Cash Flow Hedge-** A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all or component of a recognized asset or liability or a highly probable forecast transaction and could affect profit or loss.

  Variability in future cash flows might result from changes in interest rates, exchange rates, equity prices or commodity prices.

Hedge Accounting

- **Hedge of Net Investment in foreign operation-** The hedge of foreign currency risk of the net investment in foreign operation i.e. entity's interest in the net assets of that operation including any recognized goodwill.

Steps Involved in Hedge Accounting-

- Indentifying and Designating Hedged Items
- Designating Hedging Instruments
- Verify whether hedging satisfies qualifying criteria
- Accounting for Qualifying hedging relationship

Hedge Accounting

- **Designating Hedging Instruments**- A qualifying instrument must be designated in **entirety,** subject to following three **exceptions**-
- Separating **Intrinsic Value and Time value** of option contract and designating only intrinsic value
- Separating **forward element and spot element** of a forward contract and designating only change in value of spot element.
- A **proportion** of the entire hedging instrument, exp- 50% of the nominal amount, can't be designated for a part of it's change in FV that results only a portion of the time period during which the hedging instrument remains outstanding.

Intrinsic value (Call Option) = Underlying price – Strike price
Intrinsic value (Put Option) = Strike price - Underlying price

Time Value = Option premium – Intrinsic Value

Hedge Accounting

- **Qualifying Hedging Criteria-** A **hedging relationship** qualifies for hedge accounting only if all of the following three criteria are met-
- Consists only **eligible** hedging instruments and hedged items
- At Inception formal **designation and documentation** of hedging **relationship** and entity's risk management **objective and strategy** for undertaking the hedge, **hedged item and hedging instrument** and **process of evaluation of hedge effectiveness**.
- Hedging relationship meets following hedge effectiveness requirement-
  - ✓ An **economic relationship** exists between the hedged item and hedging instrument, i.e. change in FV or cash flows of hedged item and hedging instrument generally move in the opposite direction.

Hedge Accounting

- ✓ While determining hedging relationship **impact of credit risk** is also taken into account, credit risk shouldn't dominate change in value. (even if there exists inverse economic relationship between bond price and value of purchased put option, the credit risk of the bond may dominate the relationship.)
- ✓ The hedge ratio is same for quantity of hedged item and hedging instrument.

Hedge effectiveness is the extent to which change in FV or the cash flows of the hedging instrument **offset** changes in FV or cash flow of hedged item.

Hedge Accounting

- **Accounting for Qualifying Hedge relationship-**

- **Fair Value Hedge-**

Fair value hedge

- ✓ Gain or loss on hedging Instrument and hedged item both is recognized in profit or loss, except where hedging instrument or hedged item is an equity instrument and it is measured at FVTOCI , then recognized in OCI.
- ✓ The corresponding effect of gain or loss shall be given to carrying amount of hedged item, except in case of Investment in equity instrument recognized in OCI .
- ✓ In case of FA/FL measured at amortized cost or FVTOCI (not an equity investment), such gain or loss shall be amortized to Profit or loss over the remaining term of such FA/FL at EIR.
- ✓ Any ineffective portion of FV hedge is automatically recognized in P&L or OCI

Hedge Accounting

- **Cash Flow Hedge-**

Cash flow hedge

- ✓ Cash flow hedge reserve (CFHR) (a separate component of equity) is recognized for **lower of cumulative** gain or loss on hedging instrument since inception or cumulative change in FV of the expected cash flow of hedged item since inception. Amount recognized in CFHR will be treated as follows-
  - ✓ For forecast transaction resulting in a non-financial asset or liability , the CFHR is removed and included in non-financial asset/ liability. This is not accounted for reclassification.
  - ✓ For other forecast transactions, CFHR is reclassified to profit or loss in the periods when the cash flows are expected to affect profit or loss. However if CFHR is loss and entity expects that all or part of that loss will not be recovered in future periods ,that should be immediately reclassified to profit or loss.

Hedge Accounting

- ✓ Effective portion of gain or loss on the **hedging instrument** i.e. the portion that is offset by the change in CFHR shall be recognized in OCI ,balance gain or loss on the hedging instrument shall be recognized in profit or loss.

Example 1- Cumulative change in hedging item is $100 and cumulative change in FV of hedged item is $80, so lower of two i.e. $80 will be recognized as CFHR and balance of $ 20 i.e. over hedge will be recognized in profit or loss .

Example 2- Cumulative change in hedging item is $70 and cumulative change in FV of hedged item is $100, so lower of two i.e. $70 will be recognized as CFHR, since in this case change in hedging instrument is less than change in hedged item, this is called under hedged and no ineffectiveness will be recognized.

Hedge Accounting

- **Hedges of a net investment in foreign operation-**

  - ✓ Gain or loss on effective portion of hedge instrument is recognized in OCI, upon disposal of foreign operation accumulated amount in equity as foreign currency translation reserve is reclassified to profit or loss .
  - ✓ Gain or loss on ineffective portion of hedging instrument is recognized in profit or loss.

Hedge Accounting

- **Discontinuance of Hedge Accounting-** Discontinued prospectively if hedging relationship ceases to meet qualifying criteria, or hedging instrument expires, sold, terminated or exercised. However rollover of a hedging instrument to another hedging instrument is not an expiration or termination. Accounting treatment is as below-

Fair value hedge-

- When hedged item is FA or FL measured at amortized cost- Any adjustment to it's carrying amount due to FV Hedge previously accounted, shall be amortized over the remaining term of such FA or FL, based on recalculated effective interest rate.
- When hedged item is FA in debt instrument measured at FVTOCI amortization applies in the same manner , to the cumulative amount which was previously recognized in PL due to FV hedge.

Cash Flow Hedge-

- The Cash flow Hedge Reserve (CFHR) continued to be carried as separate component of equity till future cash flows occur or entity expects that all or part of the loss will not be recovered . When cash flow occurs and entity recognizes non-financial asset or liability, CFHR is adjust to carrying amount of such asset or liability. In case entity recognizes FA or FL CFHR will be reclassified to P&L by way of reclassification adjustment.

Extinguish of Financial Liability with Equity Instrument (Appdx- D)

- When entity extinguishes it's liability fully or partially by issuing equity instruments to the creditor, Appendix D of this standard apply for **accounting by issuer of equity only**, subject to following **criteria-**
  - Creditor shouldn't be direct or indirect shareholder of the entity and creditor is not acting in this capacity.
  - Creditor and entity shouldn't be controlled by the same party before **and** after the transaction and substance of the transaction doesn't include an equity distribution by or contribution to the entity.
  - Such extinguishment of financial liability by issuing equity shares is **not in accordance the original terms** of financial liability. Exp- when convertible debenture is converted into equity as per the terms of debenture, this appendix will not apply.

Extinguish of Financial Liability with Equity Instrument (Appdx- D)

Accounting Treatment-

- Entity will remove the Financial liability from balance sheet
- Will measure equity instrument at FV (if FV can't be measured at FV of liability extinguished)
- In case part of the FL extinguished, entity shall assess whether consideration paid relates to modification of the terms of the liability that remains outstanding. If there is modification consideration will be allocated between the two portions based on facts and circumstances.
- The difference between consideration paid and carrying amount of FL is recognized in P&L. and will be disclosed separately.

Exceptions to retrospective application As per IND AS 101

A first time a adopter shall apply the following exceptions to retrospective application of:

- **Derecognition of financial assets and financial liabilities**: Not required to recognise any item of FA or FL which is already derecognized under local GAAP.
- **Hedge accounting**: On transition date FV of all derivative instruments will be measured ,tested for hedge accounting principles ,deferred losses or gains on such derivative will be eliminated.
- **Classification and measurement of financial assets**: Based on conditions existing on transition date classification and measurement will be done
- **Impairment of financial assets**: on transition date risk of default shall be compared with risk of default on initial recognition and accordingly impairment provision needs to be made.
- **Embedded derivatives**: on transition date assessment needs to be made that whether host contract and derivative needs to be separated , based on condition existing at the later of the date it becomes party to the contract.

Optional Exemptions Available as per IND As 101

- **Compound financial instruments**: Need not separate liability and equity , if liability is no longer outstanding.
- **Designation of previously recognized financial instruments**: Based on condition existing on transition date, amortized cost shall be determined based on benchmark interest rate existing on transaction date.
- **Fair value measurement of financial assets or financial liabilities at initial recognition**: Can be done prospectively from the date of transition.
- **Extinguishing financial liabilities with equity instruments**: May apply Appendix – D from transition date.
- **Designation of contracts to buy or sell a non financial item**: Can be done on transition date.

THANKS