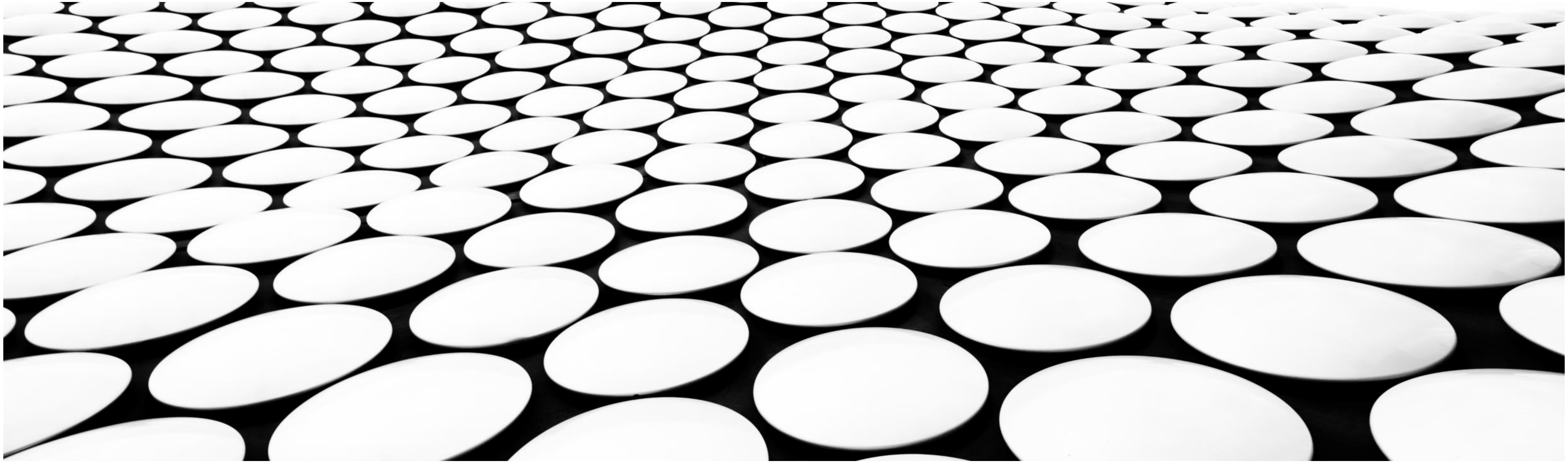
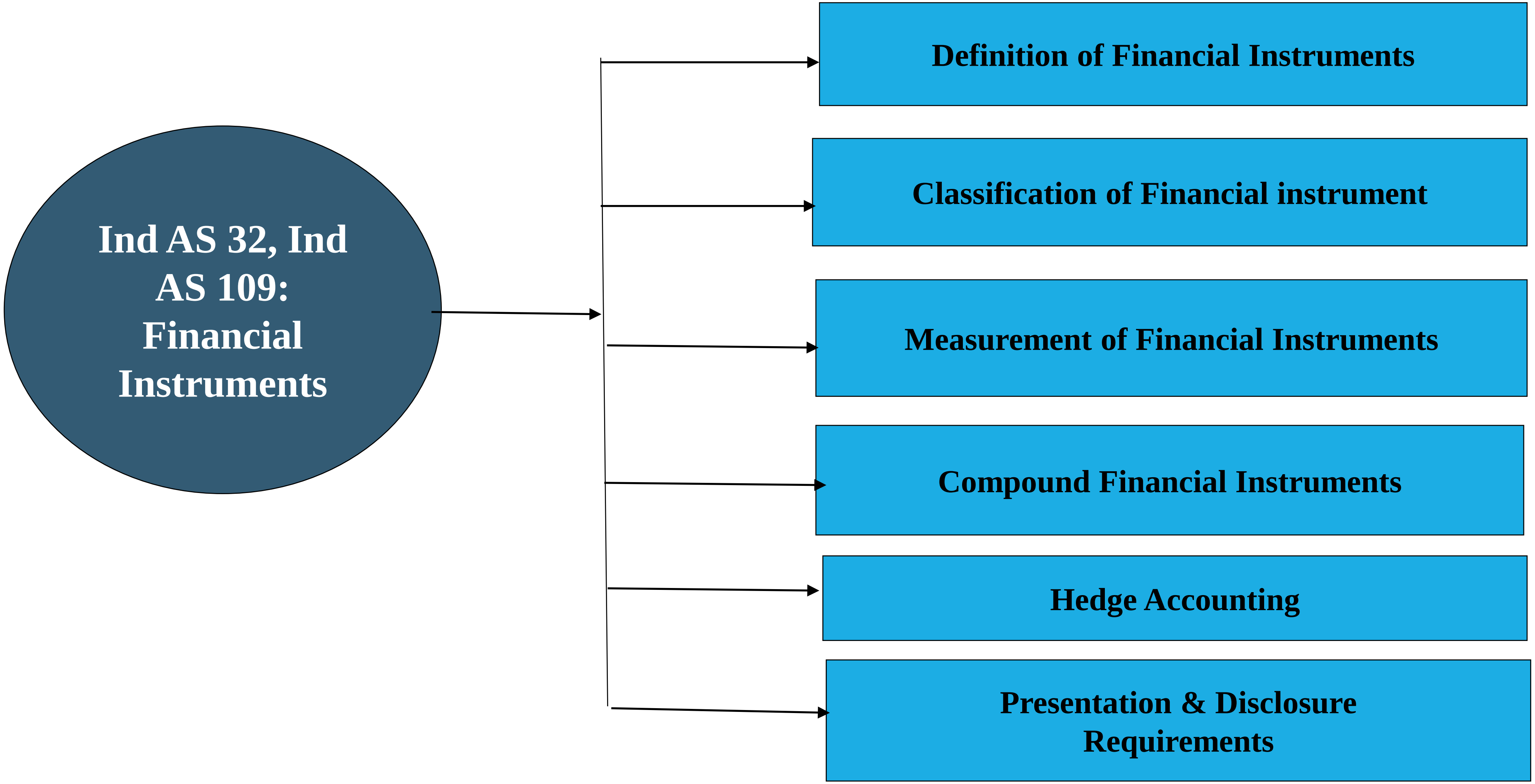
INDIAN ACCOUNTING STANDARDS
FINANCIAL INSTRUMENTS – IND AS 32, IND AS 109, IND AS 107

B D CHATTERJEE FCA, ACMA, ACS, DIP IFR (ACCA) – UNITED KINGDOM



INDIAN ACCOUNTING STANDARDS
FINANCIAL INSTRUMENTS – IND AS 32, IND AS 109 AND IND AS 107

FINANCIAL INSTRUMENTS SCOPE



FINANCIAL INSTRUMENTS

What is a Financial Instrument?

A Financial Instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

FINANCIAL INSTRUMENTS

Financial Assets

Financial Asset comprises of the following:

a) cash

b) equity instrument of another entity

c) contractual right to receive cash or another financial assets from an entity

d) contractual right to exchange financial assets or financial liabilities with another entity under the conditions that are potentially favourable to the entity

e) A contract which will be settled with the entity's own equity instruments and is

   i) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instrument

   ii) That is a non – derivative for which the entity is or may be obliged to receive variable number of its own equity instruments

FINANCIAL INSTRUMENTS

Financial Liabilities

Financial liability constitutes the following:

a) Contractual obligation to deliver cash or another financial asset to an entity

b) Exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity

c) A contract which will be settled with the entity's own equity instruments and is:

i) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instrument

ii) That is a non-derivative for which the entity is or may be obliged to receive a variable number of its own equity instruments

FINANCIAL INSTRUMENTS
EXAMPLES OF FINANCIAL ASSETS AND LIABILITIES

Financial Instruments	Category	Remarks
Cash & cash equivalents	Financial Assets	Per definition
Bank balance	Financial Assets	Per definition
Investment in equity shares	Financial Assets	Per definition
Loans & Receivables	Financial Assets	Per definition
Loans payable	Financial liabilities	Per definition
Bank overdraft	Financial liabilities	Per definition
Advances & deposits given and received	Financial liabilities	Per definition
Inventories	Not a financial asset	Physical asset held for manufacture or sale
Prepaid expense	Not a financial asset	Right to receive service, but no right to receive cash or any other financial assets
Debentures and bonds	Financial liabilities	Per definition
Trade & other receivables	Financial assets	Per definition
Trade & other payables	Financial liabilities	Per definition
Non-convertible redeemable preference shares	Financial liabilities	Per definition
Property, Plant & Equipment	Not a financial asset	Physical Resource, controlled based on a past event , which would generate probable economic benefits to the organization
Intangible asset	Not a financial asset	Resource, identifiable, controlled by organization, reliably measured and generate probable economic benefits to the organization
Deferred revenue expenditure	Not a financial asset	No contractual obligation to pay cash or another financial asset
Income taxes	Not a financial asset	It is a statutory right or obligation to pay///receive taxes and not a contractual right or obligation

FINANCIAL INSTRUMENTS
DERIVATIVES

What is a Derivative	A derivative is a financial instrument which has all the characteristics as highlighted below a) its value changes in response to a change in specified interest rate, financial instrument price or other variable b) no initial net investment or lower initial net investment c) settled at a future date An example of a derivative is a Forward contract to purchase Rs.10,000 of Euros at an agreed rate in 3 months' time.
Characteristics of derivatives are	• it creates a contractual right • to exchange financial assets or financial liabilities with another party • under conditions that are potentially favourable or unfavourable • because the instrument's fair value changes in accordance with changes in financial markets. • The basis on which the value of a derivative changes is often referred to as the instruments 'underlying'.
Examples of derivatives	• Forwards – contracts to purchase or sell a specific quantity of a financial instrument with delivery or settlement on pre-agreed future date. These are over-the-counter contracts • Futures – similar to forward contracts. These are exchange-traded contracts. • Options – contracts that give the purchaser the right, but not the obligation to buy or sell a specified quantity of a particular financial instrument. • Interest rate swaps – are contracts to exchange cash flows as of specified dates based on a notional amount.

FINANCIAL INSTRUMENTS
EXAMPLES OF DERIVATIVES

Types of Contract	Main Pricing-Settlement variable (Underlying Variable)
Interest Rate Swap	Interest rates
Currency Swap (Foreign exchange Swap)	Currency rates
Commodity Swap	Commodity prices
Equity Swap	Equity prices (equity of another entity)
Credit Swap	Credit rating (Credit index or Credit price)
Currency futures	Currency rates
Commodity futures	Commodity prices
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity of another entity)

FINANCIAL INSTRUMENTS CLASSIFICATION

Financial assets	a) At fair value through profit and loss (FVTPL)(which is further divided in two classes depending on whether the changes in the values are recognised in profit or loss or other comprehensive income) and b) At amortized cost As per guideline from Ind AS 109
Financial liabilities	a) At fair value through profit and loss b) At amortized cost As per latest from Ind AS 109

Initial Recognition

a) An entity shall recognize a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument.
b) A regular way purchase or sale of financial assets shall be recognised and derecognized, as applicable, using trade date accounting or settlement date accounting.

Initial Measurement

All financial instruments are initially measured 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.

[Ind AS 109]

Subsequent Measurement – Financial Assets

Amortized cost	if both of the following conditions are met: *(a)* *Business model test*: the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and (b) *Cash flow test*: the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
Fair value through other comprehensive income	if both of the following conditions are met: (a) the financial asset is held within a ***business model*** whose objective is achieved by both collecting contractual cash flows and selling financial assets and (b) the contractual terms of the financial asset give rise on specified dates to ***cash flows*** that are solely payments of principal and interest on the principal amount outstanding.
Option to designate a financial asset at fair value through profit or loss	An entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an '***accounting mismatch***') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

Measurement of Amortized cost

- Effective Interest method
- Modification of contractual cash flows
- Write-off

Transaction cost

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

Examples:
- Registration and other regulatory fees
- Amounts paid to legal, accounting and other professional advise
- Printing costs and stamp duties

Transaction costs attributed to an equity transaction that otherwise would have been avoided, are deducted from equity.

Impairment

- Recognition of expected credit losses
- Measurement of expected credit losses
- Determining significant increases in credit risk
- Modified financial assets
- Purchased or originated credit-impaired financial assets
- Trade receivables and contract assets
- Lease receivables

Subsequent Measurement – Financial Liabilities

Financial liabilities measured at amortized cost	An entity shall classify all financial liabilities as subsequently measured at amortized cost using the effective interest method, except for (a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value. (b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. (c) financial guarantee contracts. After initial recognition, an issuer of such a contract shall subsequently measure it at the higher of: (i) the amount of the loss allowance and (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115. (d) commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall subsequently measure it at the higher of: (i) the amount of the loss allowance and (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115. (e) contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.
Financial liabilities at fair value through profit or loss	Ind AS 109 provides for an option to measure financial liability at fair value through profit or loss. This option is exercisable if: a) using this option recognition inconsistency that would arise on measuring or recognizing gain or loss on financial liability on some different basis is either eliminated or significantly reduced, or b) the liability is part or a group of financial liabilities or financial assets and financial liabilities that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 Related Party Disclosures), for example, the entity's board of directors and chief executive officer.

FINANCIAL INSTRUMENTS RECOGNITION AND MEASUREMENT

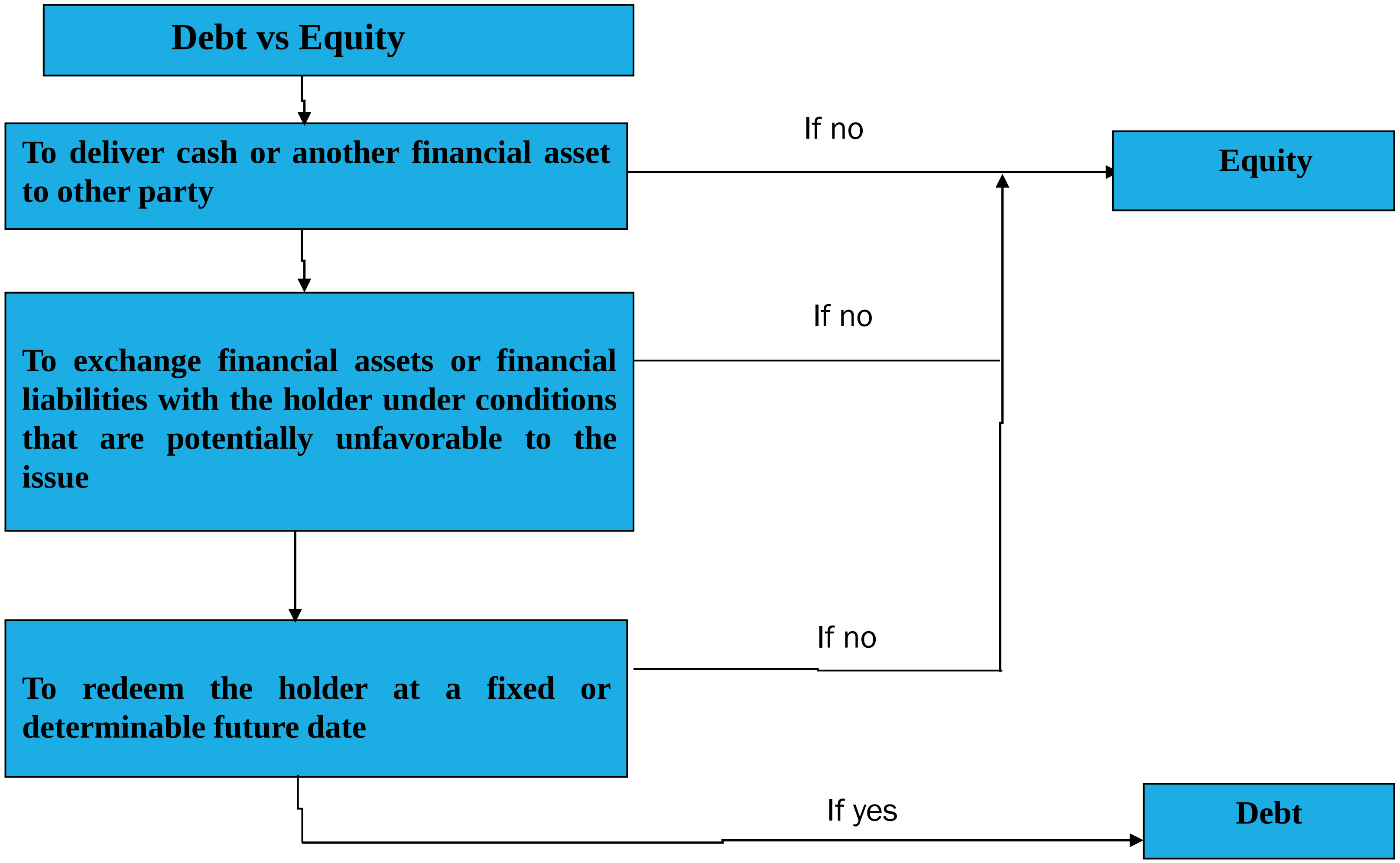
Instrument	IFRS 9 classification	Subsequent Measured	Value Changes	Impairment Testing
Debt instruments	Amortized cost	Amortized Cost	Not relevant – unless impaired	Yes
	Fair Value Through Profit & Loss	Fair value	Through profit or loss	No
Equity instruments	Fair Value Through Other Comprehensive Income – if irrevocable election made on initial recognition	Fair value	Through OCI	No
	Fair Value Through Profit & Loss	Fair value	Through profit or loss	No
Financial liabilities	Fair Value Through Profit & Loss	Fair value	Through profit or loss for changes not attributable to changes in credit risk. For changes attributable to credit risk, the change is presented in other comprehensive Income (OCI)	No
	Amortized cost	Amortized cost	Not relevant – unless impaired	No

Measurement – Derivatives

All derivatives including those linked to unquoted equity investments, are measured at fair value. Value changes are recognized in profit or loss unless the entity has elected to treat the derivative as a hedging instrument in accordance with Ind AS 109, in which case the requirements of Ind AS 109 apply.

Measurement of embedded derivatives	An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined instrument vary in a way similar to stand-alone derivative. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument or has a different counter party is not an embedded derivative but separate financial instrument

FINANCIAL INSTRUMENTS
WHETHER DEBT OR EQUITY – DECISION TREE



FINANCIAL INSTRUMENTS

Compound financial instruments	are hybrid instruments which are combination of both debt and equity. The debt element would be the coupon rate e.g. 5% five year debentures and equity element would be the option to convert to equity shares after five yea$. Accordingly, the proceeds of the issue minus the carrying amount of the liability component would determine the equity element.

FINANCIAL INSTRUMENTS

RECLASSIFICATION OF FINANCIAL ASSETS

i) When an entity changes its business model for managing financial assets it shall reclassify all affected financial assets.

ii) If an entity reclassifies financial assets, it shall apply the reclassification prospectively from the reclassification date. The entity shall not restate any previously recognised gains, losses (including impairment gains or losses) or interest.

iii) If an entity reclassifies a financial asset out of the amortized cost measurement category and into the fair value through profit or loss measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortized cost of the financial asset and fair value is recognised in profit or loss.

iv) If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the amortized cost measurement category, its fair value at the reclassification date becomes its new gross carrying amount.

v) If an entity reclassifies a financial asset out of the amortized cost measurement category and into the fair value through other comprehensive income measurement category, its fair value is measured at the reclassification date. Any gain or loss arising from a difference between the previous amortized cost of the financial asset and fair value is recognised in other comprehensive income.

FINANCIAL INSTRUMENTS

RECLASSIFICATION OF FINANCIAL ASSETS

ivi) If an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the amortized cost measurement category, the financial asset is reclassified at its fair value 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. As a result, the financial asset is measured at the reclassification date as if it had always been measured at amortized cost. This adjustment affects other comprehensive income but does not affect profit or loss and therefore is not a reclassification adjustment (see Ind AS 1 Presentation of Financial Statements). The effective interest rate and the measurement of expected credit losses are not adjusted as a result of their classification.

vii) If an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the fair value through other comprehensive income measurement category, the financial asset continues to be measured at fair value.

viii) If an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the fair value through profit or loss measurement category, the financial asset continues to be measured at fair value. The cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see Ind AS 1) at the reclassification date.

FINANCIAL INSTRUMENTS

RECLASSIFICATION OF FINANCIAL LIABILITIES

An entity shall not reclassify any financial liability.

FINANCIAL INSTRUMENTS

GAINS AND LOSSES OF FINANCIAL ASSETS AND LIABILITIES

A gain or loss on a financial asset or financial liability **that is measured at fair value shall be recognised in profit or loss unless**

(a) it is part of a hedging relationship

(b) it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income

(c) it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's *credit risk* in other comprehensive income or

(d) it is a financial asset measured at fair value through other comprehensive income and the entity is required to recognize some changes in fair value in other comprehensive income

FINANCIAL INSTRUMENTS

DE-RECOGNITION OF FINANCIAL ASSETS

i) An entity shall derecognize a financial asset when, and only when

(a) the contractual rights to the cash flows from the financial asset expire, or

(b) it transfers the financial asset and the transfer qualifies for derecognition.

ii) An entity transfers a financial asset if, and only if, it either:

(a) transfers the contractual rights to receive the cash flows of the financial asset, or

(b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the following conditions:

(i) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.

(ii) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.

(iii) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in IAS 7 Statement of Cash Flows) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.

FINANCIAL INSTRUMENTS

DE-RECOGNITION OF FINANCIAL ASSETS

iv) When an entity transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

(a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.

(b) if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognize the financial asset.

(c) if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:

(i) if the entity has not retained control, it shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.

(ii) if the entity has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset.

iv) The basic premise for the de-recognition model in IFRS 9 is to determine whether the asset under consideration for de recognition is:

- an asset in its entirety. On derecognition of a financial asset in its entirety, the difference between:

  (a) the carrying amount (measured at the date of derecognition) and

  (b) the consideration received (including any new asset obtained less any new liability assumed) shall be recognised in profit or loss.
- specifically identified cash flows from an asset (or a group of similar financial assets) or
- a fully proportionate (pro rata) share of the cash flows from an asset (or a group of similar financial assets) or
- a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets)

FINANCIAL INSTRUMENTS

DE-RECOGNITION OF FINANCIAL LIABILITIES

i) A financial liability should be removed from the balance sheet when and only when, it is extinguished that is when the obligation specified in the contract is either discharged or cancelled or expires.

ii) Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

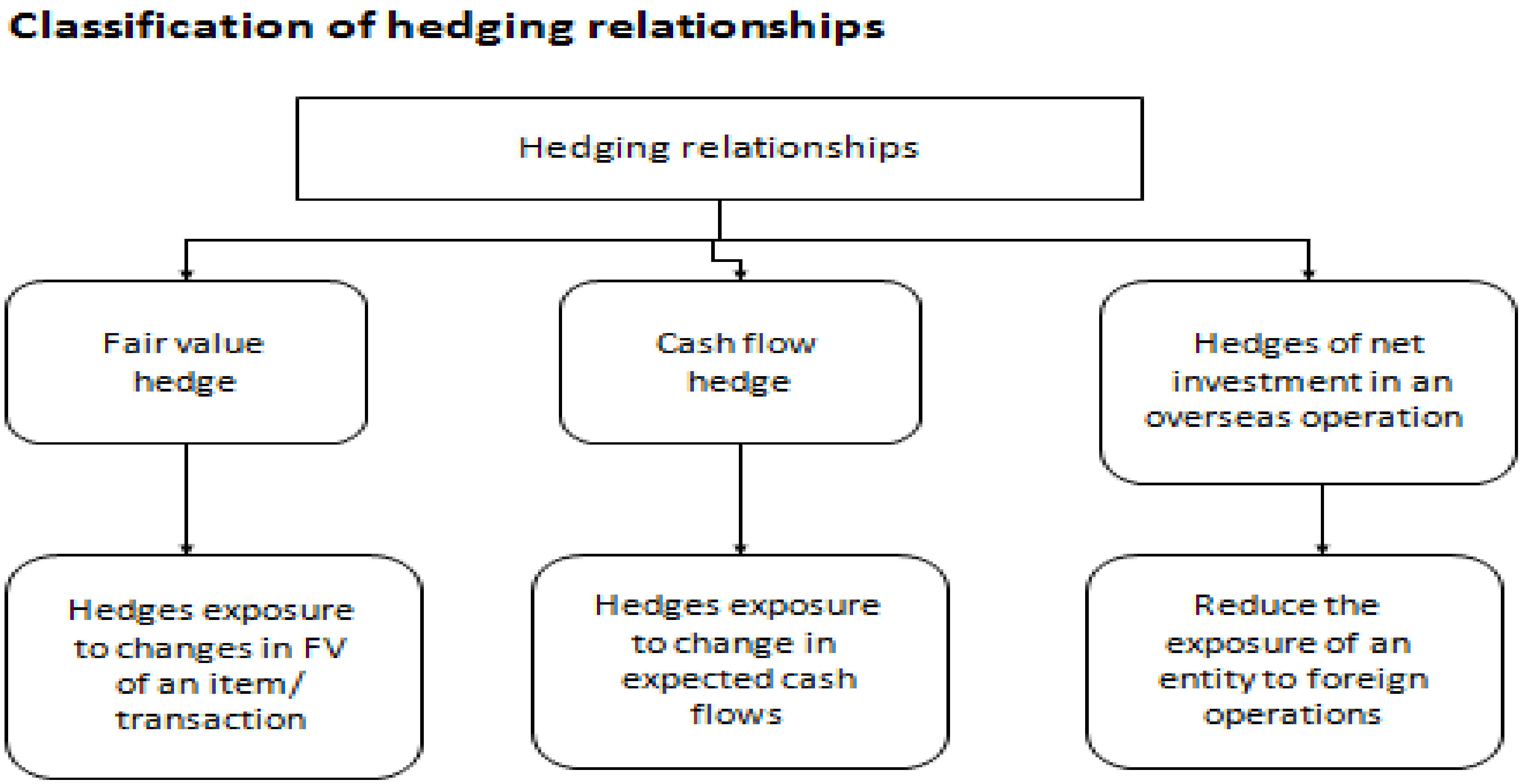
iii) The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

HEDGE ACCOUNTING

Hedged item	A 'hedged item' is a) an asset, b) liability or c) forecast transaction or d) net investment in foreign operation that exposes the entity to risks regarding changes in fair value or future cash flows. In order to be classified as a hedged item for accounting purposes, the item should be specifically designated as a hedged item for accounting purposes. The hedged item can be a single asset, a group of assets or a portion of asset. The hedged item must be reliably measured. If a hedged item is a forecast transaction or a component thereof, that transaction must be highly probable.
Hedging instrument	The hedging instrument is a financial instrument, whose fair value or cash flows is expected to offset changes in the fair value or cash flows of a designated hedged item.
Hedge accounting	Hedge accounting is a technique that changes the normal basis for recognizing gains and losses on associated hedging instruments and hedged items so that both are recognized in earnings in the same accounting period.

FINANCIAL INSTRUMENTS

HEDGE ACCOUNTING



HEDGE ACCOUNTING

Fair value hedge	a) Hedging instrument should be re-measured at fair value, with the gain or loss reported in the statement of profit and loss (or other comprehensive income if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income). b) the hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss.
Cash flow hedge	a) the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts): (i) the cumulative gain or loss on the hedging instrument from inception of the hedge; and (ii) the cumulative change in fair value (present value) of the hedged item (i.e. the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge Hedging instrument should be split between the proportion which is effective and the proportion which is ineffective (i) The effective proportion should be recognised in equity (OCI). (ii) The ineffective element should be recognised directly in the statement of profit and loss.
Hedges of a net investment in a foreign operation	Hedges of a net investment in a foreign operation shall be accounted for as the cash flow hedge • The effective proportion should be recognized in equity • The ineffective element should be recognized directly in the income statement.

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Statement of Financial Position disclosures	• financial assets measured at fair value through profit and loss showing separately those held for trading and those designated at initial recognition • held-to-maturity investments • loans and receivables • available –for –sale assets • financial liabilities at fair value through profit and loss , showing separately those held for trading and those designated at initial recognition • financial liabilities measured at amortized cost Special disclosures about financial assets and financial liabilities designated to be measured at fair value through profit and loss, including disclosures about credit risk and market risk and changed in fair value • Reclassification of financial instruments from fair value to amortized cost or vice versa • Disclosures about de-recognitions, including transfers of financial assets for which de-recognition accounting is not permitted by Ind AS 109 • information about financial assets pledged as collateral and about financial or non-financial assets held as collateral • Reconciliation of the allowance account for credit losses bad debts) • Information about compound financial instruments with multiple embedded derivatives and breaches of terms of loan agreement

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Income statement and equity (with separate disclosures of gains and losses)	• Financial assets measured at fair value through profit or loss, showing separately those held for trading and those designated at initial recognition • held-to-maturity investments • loans and receivables • Available-for-sale assets • Financial liabilities measured at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition • Financial liabilities at amortized cost - interest income and interest expense for those financial instruments that are not measured at fair value through profit or loss - fee income and expense - amount of impairment losses on financial assets - interest income on impaired financial assets - other disclosures - accounting policies for financial instruments

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Information about hedge accounting including:	- description of each hedge, hedging instrument, and fair values of those instruments and nature of risks being hedged - for cash flow hedges, the periods in which the cash flows are expected to occur when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur - if a gain or loss on a hedging instrument in a cash flow hedge has been recognized directly in equity, an entity should disclose the following: - the amount that was so recognized in equity during the period - the amount that was removed from equity and included in profit or loss for the period - the amount that was removed from equity during the period and included in the initial measurement of the acquisition cost or other carrying amount of a non-financial asset or non-financial liability in a hedged highly probable forecast transaction - for fair value hedges information about fair value changes of the hedging instrument and the hedged item - hedge effectiveness recognized in profit and loss (separately for cash flow hedges and hedges of a net investment in foreign operation)

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Income statement and equity (with separate disclosures of gains and losses)	• Financial assets measured at fair value through profit or loss, showing separately those held for trading and those designated at initial recognition • held-to-maturity investments • loans and receivables • Available-for-sale assets • Financial liabilities measured at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition • Financial liabilities at amortized cost - interest income and interest expense for those financial instruments that are not measured at fair value through profit or loss - fee income and expense - amount of impairment losses on financial assets - interest income on impaired financial assets - other disclosures - accounting policies for financial instruments

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Information about fair values	• of each class of financial asset and financial liability along with : - comparable carrying amounts - description of how fair value was determined - detailed information if fair value cannot be reliably measured Note: Disclosure of fair values is not required when the carrying amount is a reasonable approximation of fair value, such as short-term trade receivables and payables or for instruments whose fair value cannot be measured reliably

FINANCIAL INSTRUMENTS
DISCLOSURE REQUIREMENTS

Nature and extent of exposure to risks arising from financial instruments	• Qualitative disclosures • risk exposures of each type of financial asset • management objectives, policies, and processes for managing these risks • change from prior period • Quantitative disclosures • summary quantitative data about exposure to each risk at the reporting date • disclosures about credit risk, liquid risk and market risk • concentration of risk • Credit risk • maximum amount of exposure (before deducting the value of collateral), • Description of collateral, • information about credit quality of financial assets that are neither past due nor impaired • Information about credit quality of financial assets whose terms have been renegotiated • for financial assets which are past due or impaired, analytical disclosures are required • Information about collateral or other credit enhancements obtained or called • Liquidity risk • A maturity analysis of financial liabilities • Description of approach to risk management • Market risk • risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. • reflects interest rate risk, currency risk and other price risks

THANK YOU!