

Practical Aspects of Accounting for Financial Instruments under Ind AS

- ▶ *Ind AS 32 Financial Instruments: Presentation*
- ▶ *Ind AS 109 Financial Instruments*
- ▶ *Ind AS 107 Financial Instruments: Disclosures*

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16 August 2020

**ICAI WIRC Ind AS
Refresher Course**

Scope exclusions

Scope Exception	Applicable Standard
Interests in subsidiaries	Ind AS 27, Consolidated and Separate Financial Statements
Interests in associates	Ind AS 28, Investments in Associates
Interests in joint ventures	Ind AS 111, Interests in Joint Ventures
Employee benefit plans	Ind AS 19, Employee Benefits
Share-based payment transactions	Ind AS 102, Share-Based Payment
Contracts for contingent consideration in business Combinations	Ind AS 103, Business Combinations
Insurance contracts	Ind AS 104, Insurance Contracts

What is a Financial instrument?

- ▶ Any **contract** that gives rise to both
 - ▶ A **financial asset** of one entity, and
 - ▶ A **financial liability** or **equity instrument** of another entity

Examples of financial instruments

1. Cash
2. Investment in shares
3. Receivables
4. Loans to other entities
5. Investments in bonds
6. Refundable deposits
7. Derivative financial assets
8. Trade receivables/ payables

Examples of NOT financial instruments

1. Prepaid expense
2. Advance for goods/ services
3. GST Input Tax Credits
4. Advance tax/ IT refund
5. Export entitlements
6. Constructive obligations

Financial asset

- ▶ An asset that is:
 - ▶ Cash
 - ▶ An equity instrument of another entity
 - ▶ A contractual right:
 - ▶ To receive cash or another financial asset, or
 - ▶ To exchange financial assets or financial liabilities under potentially favourable conditions, or
 - ▶ A contract that will or may be settled in the entity's own equity instruments and is:
 - ▶ A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or
 - ▶ A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

Financial liability

- ▶ Any liability that is
 - ▶ A contractual obligation:
 - ▶ To deliver cash or another financial asset to another entity
 - ▶ To exchange financial assets/ liabilities under potentially unfavourable conditions, or
 - ▶ A contract that will or may be settled in the entity's own equity instruments and is:
 - ▶ Non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or
 - ▶ Derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

Equity instruments

- ▶ Any contract that evidences a residual interest in the net assets of an entity
 - ▶ Examples
 - ▶ Equity shares
 - ▶ Preference shares (if certain criteria are met)
 - ▶ Warrants
 - ▶ Written call options to issue fixed number of equity shares for a fixed price

Liabilities vs. equity – general rules

- ▶ An issuer of a financial instrument must classify the instrument or its component parts:
 - ▶ On initial recognition as financial liability/financial asset/equity
 - ▶ In accordance with the substance of the contractual arrangement
 - ▶ Based on definitions of financial liabilities/financial assets/equity

Does the entity have an unavoidable contractual obligation?

Yes



Liability

No



Equity

Liabilities vs. equity

An instrument is an equity if, and only if, both conditions are met:

1. The instrument includes **no contractual obligation**:
 - ▶ **To deliver cash** or another **financial asset** to another entity
 - ▶ To exchange financial assets/ liabilities with another entity under conditions that are potentially unfavorable to the issuer
2. If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - ▶ A non-derivative that includes no contractual obligation for the issuer to deliver a **variable number of own equity instruments**
 - ▶ A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments

Liabilities vs. equity

- ▶ Classification of an instrument as equity or a financial liability is not impacted by, for example:
 - ▶ A history of making distributions
 - ▶ An intention to make distribution in the future
 - ▶ A possible negative impact on price of the issuer's ordinary shares if distributions are not made
 - ▶ The amount of the issuer's reserves
 - ▶ An issuer's expectations of a profit or loss for a period
 - ▶ An ability or inability of the issuer to influence the amount of its profit or loss for the period.

Dividend blocker and dividend pusher

Dividend blocker:

- ▶ Issue of non-redeemable instruments with following terms:
 - ▶ Discretionary annual dividend upto a capped maximum amount
 - ▶ Unless a full discretionary dividend is paid to holders of the instrument, no dividend can be paid to ordinary shareholders.
- ▶ This restriction on dividend payments to ordinary shareholders is often referred to as a 'dividend blocker' clause.

Dividend pusher:

- ▶ Non redeemable preference shares on which dividends are payable only if the entity also pays a dividend on its ordinary shares.

Both are equity instruments since dividend is discretionary and principal amount is non-redeemable.

Compound instruments

Compound Instruments are non-derivative financial instruments contain both liability and equity elements

Example

A bond that is convertible into a fixed number of ordinary shares of the issuer is a compound instrument. From the perspective of the issuer, a convertible bond has two components:

An obligation to pay interest and principal payments on the bond as long as it is not converted. This component meets the definition of a financial liability, because the issuer has an obligation to pay cash.

A sold (written) call option that grants the holder the right to convert the bond into a fixed number of ordinary shares of the entity. This component meets the definition of an equity instrument.

Method of splitting the value

Fair value of compound instrument – Fair value of liability component = Initial carrying amount of equity component.

Equity is not remeasured subsequent to initial recognition.

Contingent Settlement Provisions

A Financial Instrument may require delivery of cash depending on the

- a) Occurrence, or
- b) Non Occurrence of the uncertain future events

The Contractual Obligation to redeem is not certain of occurring but may be contingent on the occurrence or non occurrence of uncertain future events that are beyond the control of both

- The issuer and
- The holder of the Instrument

ie at the time of issue, the issuer does not have unconditional Right to avoid delivering cash and hence it is Financial Liability unless it is - -
“Not Genuine”, OR

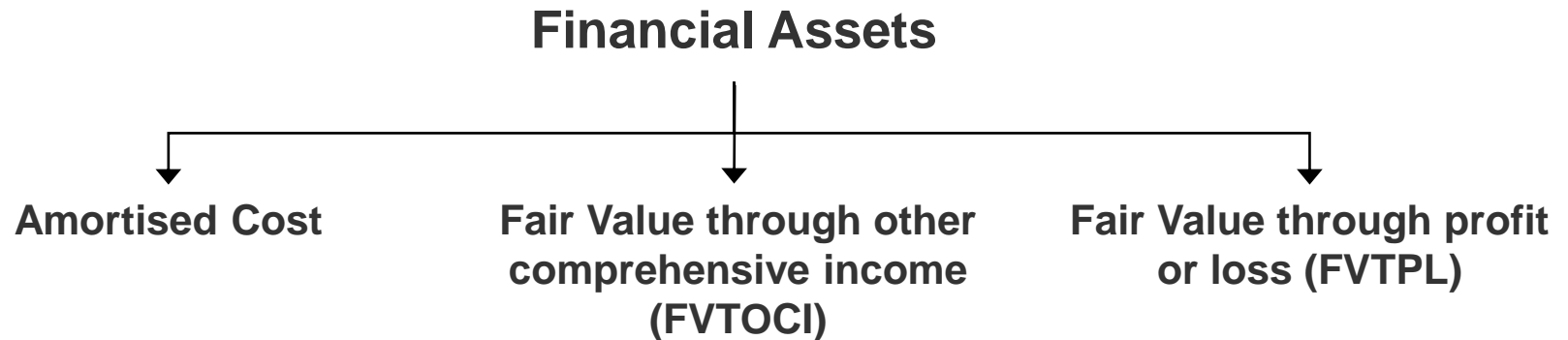
Can be settled only on Liquidation and Liquidation is not certain.

Contingent Settlement Provisions

Contingent Provision	Whether within Control of the parties
Commencement of War	NO
Issue of Security	YES
Issue of IPO prospectus Prior to Conversion Date	YES
Execution of an effective IPO	NO
Change in Credit Rating	NO
Event of Default on Debt Facility	NO
Change in Accounting, Taxation or Regulatory regime adversely affecting the entity	NO

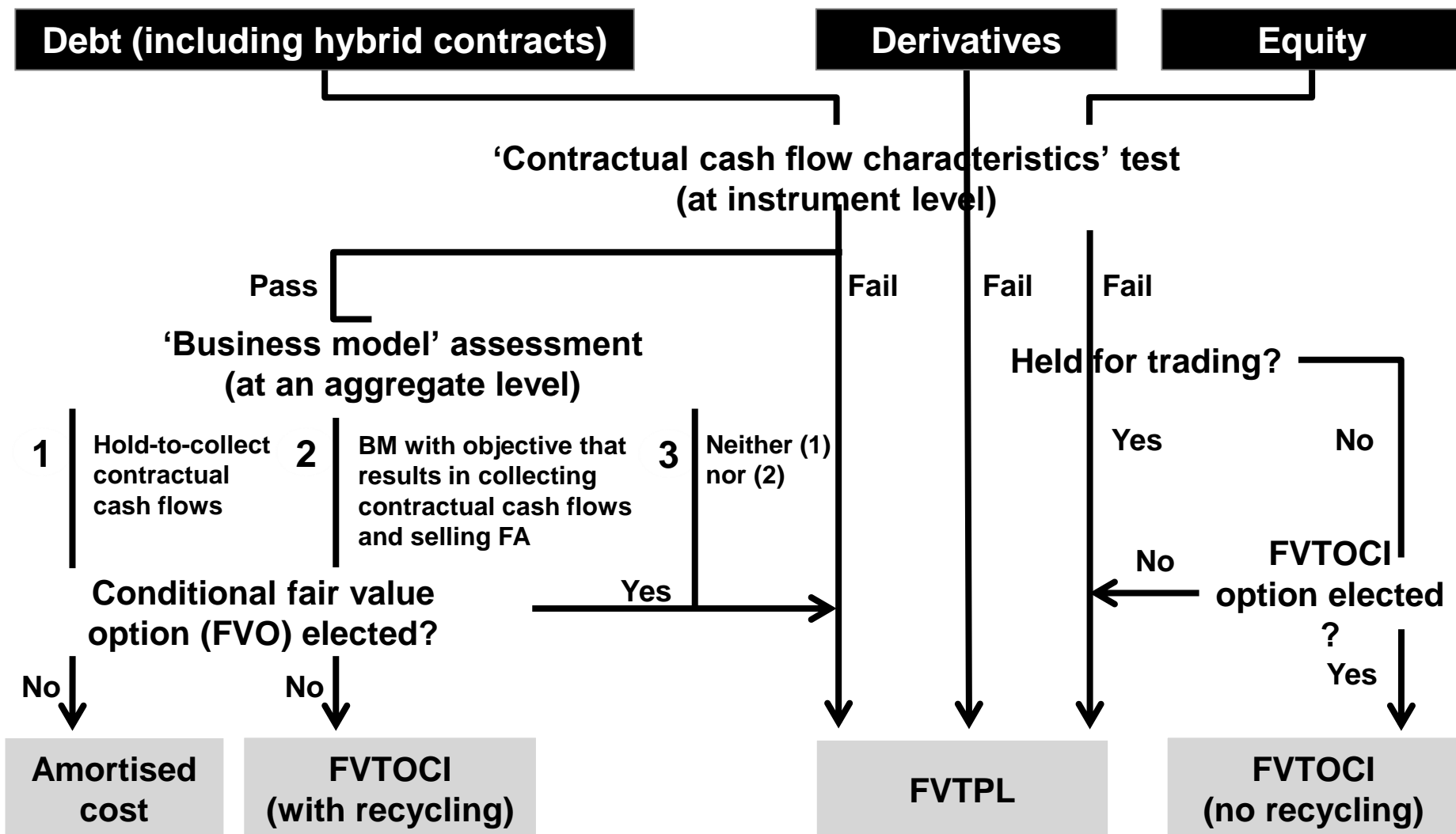
Classification of financial assets – an overview

Three categories as per Ind AS 109:



- ▶ Key criteria to decide classification:
 - ▶ Entity's **business model** for managing the financial assets and
 - ▶ **Contractual cash flow** characteristics (SPPI test)
- ▶ Classification requirements are applied to a financial asset in its entirety – No separation of embedded derivatives

Synopsis of the model for financial assets



Classification of debt instruments (including loans) – outcomes

Contractual cash flow characteristics:

Contractual cash flows are solely payments of principal and interest on the principal amount outstanding

		yes	no
Business model	Held within a business model whose objective is to hold financial assets in order to collect contractual cash flows	Amortised cost	FVTPL
	Held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets	FVTOCI	FVTPL
	Financial assets which are neither held at amortised cost nor at fair value through other comprehensive income (FVTOCI)	FVTPL	FVTPL

Elections and designations for financial assets

- ▶ Irrevocable option to designate a financial asset as measured at FVTPL at initial recognition if it eliminates or significantly reduces an accounting mismatch

Classification of financial liabilities

Financial liabilities has been classified into two categories:

Fair value through profit or loss	<ul style="list-style-type: none">▶ Financial liabilities that are held for trading (including derivatives)▶ Financial liabilities that are designated as FVTPL on initial recognition▶ Contingent consideration recognised by an acquirer in a business combination
Amortised Cost	<ul style="list-style-type: none">▶ All liabilities not in the above category

Case Studies



Case Study 1– Equity shares

I Ltd. Issues equity shares to H ltd.

Scenario 1: H is holding company with control over I

Scenario 2: I is not subsidiary/ associate/ JV of H

Solution to Case Study 1– Equity shares

- ▶ Accounting by H:
 - ▶ Scenario 1: H has option to measure investment in equity shares of I (subsidiary) at cost or FV under Ind AS 109 (FVOCI or FVPL)
 - ▶ Scenario 2: H has to measure the investments at FV under Ind AS 109 (FVOCI or FVPL)
- ▶ Accounting by I: Equity

Case Study 1: Some Examples

Tata Power (Extracts from Consolidated financial statements 2017-18)

Certain unquoted investments are not held for trading, instead they are held for medium or long term strategic purpose. Upon the application of Ind AS 109, the Group has chosen to designate these investments in equity instruments as at FVTOCI as the directors believe this provides a more meaningful presentation for medium and long-term strategic investments, then reflecting changes in fair value immediately in profit or loss.

The cost of certain unquoted investments approximate their fair value because there is a wide range of possible fair value measurements and the cost represents the best estimate of fair value within that range.

Tata Steel (Extracts from Consolidated financial statements 2017-18)

Cost of unquoted equity instruments has been considered as an appropriate estimate of fair value because of a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

Case Study 2– Preference shares

- ▶ I Ltd. Issues redeemable preference shares to H Ltd. Annual preference share dividends are only payable to H Ltd. if I declares dividend on equity shares.
- ▶ *How will I classify and measure the instrument?*

Response to Case Study 2– Redeemable preference shares with discretionary dividend

- ▶ Accounting by I (issuer):
 - ▶ I treats the preference share as compound instrument – redemption obligation – debt and discretionary dividend - equity

Response to Case Study 2–Few examples – extracts from financial results

▶ Chennai Petroleum

The reconciliation of equity as previously reported (referred to as “Previous GAAP”) and the equity as per Ind-AS is as per the table below:

₹ crore

Particulars	As on 31.03.2016
Share Capital plus Reserves and Surplus as per previous GAAP (Indian GAAP)	3296.67
Preference Share Capital classified as Financial Liability [*]	(1000.00)
Proposed dividend and Dividend Distribution Tax (DDT) for FY 2015-16 reversed	113.24
Preference dividend (including DDT) considered as Finance cost	(41.55)
Others	8.50
Equity as per Ind AS	2376.86

* Preference Share is accounted and reflected as financial liability as per Ind AS 32, as these are redeemable on maturity for a fixed determinable amount and carry fixed rate of dividend. Correspondingly, in line with the requirements of Ind AS 32, proportionate preference dividend (including Dividend Distribution Tax) has been provisionally accrued as finance cost. However, as per the Companies Act 2013, the preference shares continues to be part of share capital and the provisions of the Act relating to declaration of Preference Dividend would be applicable.

▶ Zee

6% cumulative redeemable preference shares have been classified as debt and have been recorded at fair value as at 1 April 2015 with the resultant gain has been recognised in the opening reserves.

For subsequent measurement, preference shares have been valued based on fair value through profit and loss (FVTPL). Dividend distribution tax thereon has been charged to the finance cost.

Case Study 3– Redeemable preference shares with premium

- ▶ I Ltd. Issues redeemable preference shares to H Ltd. Annual preference share dividends are only payable to H Ltd. if I declares dividend on equity shares. I Ltd has to redeem the preference shares at a premium at the end of 20 years. Under Indian GAAP, the redemption premium has been charged directly to securities premium account.
- ▶ *How will I classify and measure the instrument?*

Solution to Case Study 3 – Redeemable preference shares with premium

- ▶ Accounting by I (issuer):
 - ▶ I treats the preference share as compound instrument – redemption obligation – debt and discretionary dividend – equity. Redemption premium can not be directly charged to securities premium and should be charged to P&L based on Effective Interest Rate



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Case Study 4– Optionally convertible Preference Shares

- ▶ I Ltd. Issues optionally convertible preference shares to H Ltd. Annual preference share dividends are only payable to H Ltd. if I declares dividend on equity shares. The shares are convertible at the option of H at 1:1 ratio. If H does not convert, I Ltd. has to redeem the preference shares at the end of 20 years.
- ▶ *How will I classify and measure the instrument?*

Response to Case Study 4 – Optionally convertible preference shares

- ▶ Accounting by I (issuer):
 - ▶ I treats the preference share as compound instrument – redemption obligation – debt and optional conversion at fixed ratio and discretionary dividend – equity.

Case Study 5 – Compulsorily convertible debentures

- ▶ I Ltd. Issues compulsory convertible debentures to H Ltd. Annual interest payments are mandatory. The shares are convertible at the option of H at 1:1 ratio.
- ▶ *How will I classify and measure the instrument?*

Response to Case Study 5 – compulsory convertible debenture

- ▶ Accounting by I (issuer):
 - ▶ I treats the CCD as compound instrument – mandatory interest payment – debt and compulsory conversion feature– equity.

Case Study 6 – Investment in Perpetual bonds

- ▶ I Ltd. issues perpetual non-redeemable callable bond with a fixed 8% coupon to H Ltd. The bonds are redeemable only at the issuer's option. Coupon interest can be deferred in perpetuity at the I's option. I Ltd has a history of paying the coupon each year and based on this trend current bond price is predictable on the holders expectation that the coupon will continue to be paid each year. Stated policy of A says that the coupon will be paid each year, which is available in public domain.
- ▶ *How will I and H classify and measure the instrument?*

Response to Case Study 6 – Perpetual bonds

- ▶ Accounting by I (issuer):
 - ▶ I treats the perpetual bonds as equity. Economic compulsions and market reputation issues are ignored for classification of financial liabilities.
- ▶ Accounting by H(holder):
 - ▶ Since I treats as equity, H would treat this as investment in equity shares- FV (FVOCI or FVPL)



Tata Steel

Case Study 7 – Interest free loan

- ▶ H Ltd. provides an interest free loan to subsidiary S, an infrastructure company for 25 years.
- ▶ *How will S and H account of the same?*

Response to Case Study 7 – interest free loan

- ▶ Accounting by H (lender/ holding):
 - ▶ H treats the interest free loan as financial asset-measuring at FV on initial recognition. The difference between the FV and the loan amount is treated as investment in subsidiary.
- ▶ Accounting by S (borrower/subsidiary):
 - ▶ S treats loan as financial liability, measured at FV on initial recognition. Difference between FV and loan is treated as equity by parent.



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Case Study 8 –Corporate Guarantee

- ▶ Holdco Ltd. issues corporate guarantee in favor of banks for a loan taken by subsidiary Subco. For 5 years.
- ▶ *How will Holdco and Subco classify and measure the instrument?*
- ▶ Scenario 1: Holdco charges 2% pa commission from Subco
- ▶ Scenario 2: Holdco charges no commission from Subco

Response to Case Study 8 – Guarantee

- ▶ Accounting by Holdco:
 - ▶ Scenario 1: It is financial liability recognised at fair value, based on the fair value of the future commission income
 - ▶ Scenario 2: It is financial liability recognised at fair value, based on the fair value of the future notional commission income. The day 1 debit is to investment in equity of subsidiary
- ▶ Accounting by Subco:
 - ▶ No accounting if guarantee integral part of the loan



C Greaves

Alternative Accounting for Financial Guarantee

Relevant extracts of Vedanta Limited Annual Report 2016-17 (Stand Alone financial statements)

(j) Financial guarantees

Financial guarantees issued by the Company on behalf of group companies are designated as 'Insurance Contracts'. The Company assess at the end of each reporting period whether its recognised insurance liabilities (if any) are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities is inadequate in the light of the estimated future cash flows, the entire deficiency is recognised in profit or loss.

48 Financial guarantees

The Company has issued financial guarantees to banks on behalf of and in respect of loan facilities availed by its group companies. In accordance with the policy of the Company (refer note 3(j) the Company has designated such guarantees as 'Insurance Contracts'. The Company has classified financial guarantees as contingent liabilities.

Accordingly, there are no assets and liabilities recognized in the balance sheet under these contracts other than those related to commission income recognized and/or receivable from such group companies as disclosed in note 53.

Refer below for details of the financial guarantees issued:

				(₹ in Crore)
Company Name	As at March 31, 2017	As at March 31, 2016	As at April 01, 2015	Purpose
Talwandi Sabo Power Limited	10,693.00	9,590.00	6,975.74	Borrowing for long term power agreement
Vizag General Cargo Berth Private Limited	458.24	258.24	522.24	Buyers credit for capital expenditure, custom bonds and term loan facility
Bharat Aluminium Company Limited	2,500.00	2,500.00	-	Short term commercial paper
Copper Mines of Tasmania Pty Limited	30.23	3.91	29.14	Environmental and closure obligations relating to Mining leases granted
Thalanga Copper Mines Pty Limited	23.22	50.25	22.39	Environmental and closure obligations relating to Mining leases granted
Western Cluster Limited	32.42	33.17	31.30	Extending banking facilities
Rampia Coal Mines & Energy Private Limited	-	-	22.17	

Case Study 9 –Performance Guarantee

- ▶ Holdco Ltd. issues performance guarantee in favor of a customer for construction contract of subsidiary Subco.
- ▶ *How will Holdco and Subco classify and measure the instrument?*

Solution to Case Study 9 –Performance Guarantee

- ▶ Financial guarantee is defined under Ind AS 109 as:
- ▶ *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.*
- ▶ In the current case, a performance guarantee is not a financial guarantee under Ind AS 109, since there is no debt instrument.

Case Study 10 –Advance against share subscription

- ▶ I Ltd. accepts advance for share subscription from H Ltd. to be adjusted over next 6 months.
- ▶ *How will I and H account of the same?*

Response to Case Study 10 – Advance against share subscription

- ▶ Accounting by I (issuer):
 - ▶ Financial liability if the conversion ratio is not fixed.
 - ▶ If conversion ratio is fixed and advance is non refundable, equity
- ▶ Accounting by H (holder):
 - ▶ Financial asset. If conversion ratio is not fixed – SPPI test not met. FVPL
 - ▶ Financial asset if conversion ratio fixed, investment in equity – FVPL/ FVOCI



Spice Jet

Case Study 11 –Buy back obligation

- ▶ I Ltd. issues equity shares to PE investor. As per the terms of the issue, if I Ltd does not come out with an IPO within next 3-4 years, H, the parent of I has to buyback the share from PE at 16% IRR. I Ltd does not have any buyback obligation.
- ▶ *How will I and H account of the same?*

Response to Case Study 11 – Buyback obligation

- ▶ Accounting by I (issuer):
 - ▶ If I does not have any buyback obligation, the shares are treated as equity
- ▶ Accounting by H (Holding):
 - ▶ Financial Liability since H is obliged to provide 16% IRR to PE investor on behalf of the subsidiary.

Case Study 12– Classification of Preference shares from Investor’s perspective

X Ltd. holds preference shares issued by its group companies. The objective of the business model within which these preference shares are held is to hold them until maturity in order to collect their contractual cash flows.

A. Cumulative Redeemable preference shares:

X Ltd. holds non-convertible cumulative redeemable preference shares that are redeemable at the end of the term of 5 years. The preference shares bear mandatory dividend of 10% p.a. that are cumulative in nature.

How will X classify this investment ?

B. Non-cumulative Redeemable preference shares:

X Ltd. holds non-convertible non-cumulative redeemable preference shares that are redeemable at the end of the term of 5 years. The preference shares bear discretionary dividend of 10% p.a. that are non-cumulative in nature which are payable only if the issuer pays dividend on equity shares.

How will X classify this investment ?

Case Study 12– Classification of Preference shares from Investor’s perspective(contd.)

C. Optionally Convertible preference shares:

X Ltd. holds cumulative optionally convertible preference shares that are redeemable at the end of the term of 5 years. The preference shares bear mandatory dividend of 10% p.a. that are cumulative in nature. Each preference share is convertible at the option of the holder into 3 ordinary equity shares of the issuer at any time prior to the maturity.

How will X classify this investment ?

D. Compulsorily Convertible preference shares:

X Ltd. holds compulsorily convertible non-cumulative preference shares that are convertible at the end of the term of 5 years. The preference shares bear discretionary dividend of 10% p.a. that are non-cumulative in nature which are payable only if the issuer pays dividend on equity shares. Each preference share is convertible into such number of ordinary equity shares of the issuer with a fair value so as to give the holder a return of 16% per annum on the amount of investment after considering the dividend paid , if any, on the preference shares.

How will X classify this investment ?

Response to Case Study 12– Classification of Preference shares from Investor’s perspective

Analysis under Ind AS 109:

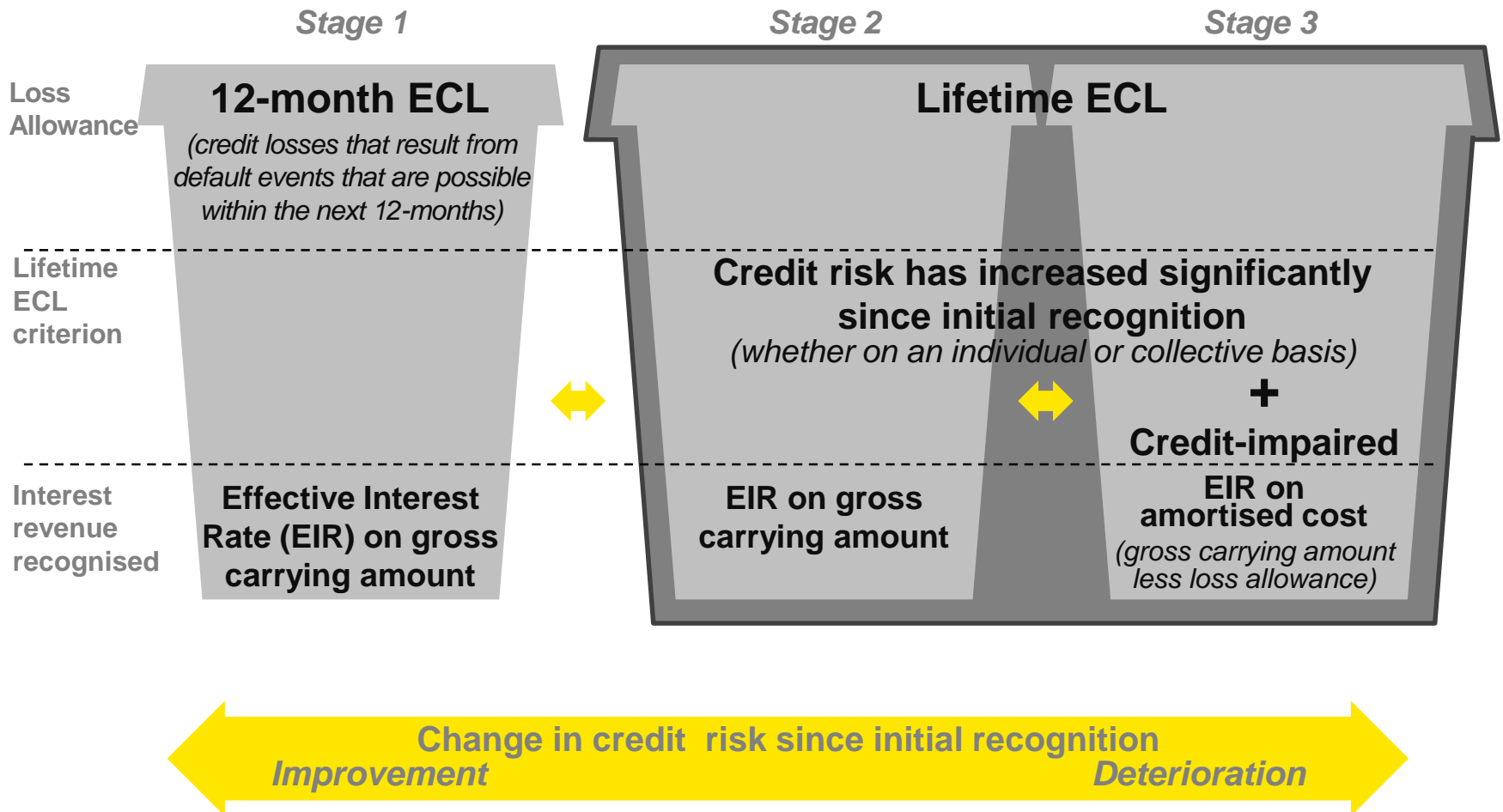
Criteria	CRPS	NRPS	OCPS	CCPS
Does the instrument meet the definition of equity under Ind AS 32?	No (since redeemable at maturity and mandatory dividend obligations)	No (since redeemable at maturity)	No (since redeemable at maturity if conversion option not exercised by the holder and mandatory dividend obligations)	No (since conversion is not at fixed-for-fixed ratio of equity shares)
Is the SPPI test of the contractual cash flows met?	Yes (Principal repayment and cumulative dividend representative of interest cash flows)	No (non-cumulative discretionary nature of dividend distribution being inconsistent with the SPPI test)	No (option to convert at fixed -for fixed conversion ratio being inconsistent with the SPPI test)	Yes (since the IRR of 16% p.a. represents the principal repayment and the interest cash flows) (Refer Note 1 below)
Can the investment be classified as ‘at amortised cost’?	Yes	No (since the SPPI test is not met)	No (since the SPPI test is not met)	Yes (Refer Note 1 below)
Classification	Amortised cost	FVTPL	FVTPL	Amortised cost(Refer Note 1 below)

Note 1: In case of an investment in a convertible instrument, the contractual cash flows are not payments of principal and interest on the principal amount outstanding because they reflect a return that is inconsistent with a basic lending arrangement.

Impairment of financial assets



Expected credit loss model – general approach



Case Study 13 – Impairment

M Ltd., a manufacturer, has a portfolio of trade receivables of Rs. 30 crores. The customer base consists of a large number of small clients and the trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component in accordance with Ind AS 115. In accordance with paragraph 5.5.15 of Ind AS 109, the loss allowance for such trade receivables is always measured at an amount equal to lifetime ECLs.

To determine the ECLs for the portfolio, M uses a provision matrix. The provision matrix is based on its historical observed loss rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date, the historical observed loss rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.

On that basis, M estimates the following provision matrix:

	Current	1-30 days past due	31-60 days past due	61-90 days past due	More than 90 days past due
Loss rate	0.3%	1.6%	3.6%	6.6%	10.6%

Solution to Case Study 13– Impairment

The trade receivables from the large number of small customers amount to €30 million and are measured using the provision matrix.

	Gross carrying amount	Lifetime ECL allowance (Gross carrying amount × lifetime loss rate)
Current	Rs. 15 crores	Rs.4,50,000
1-30 days past due	Rs.7.5 crores	Rs.12,00,000
31-60 days past due	Rs.4 crores	Rs.14,40,000
61-90 days past due	Rs.2.5 crores	Rs.16,50,000
More than 90 days past due	Rs.1crore	Rs.10,60,000
	Rs. 30 crores	Rs. 58 Lakhs

Case Study 14 – Impairment

A manufacturing company has a major part of its financial assets in the form of Trade Receivables that result from transactions within the scope of Ind AS 115. For the purpose of recognition and measurement of impairment loss for these financial assets, the entity has been following a simplified approach and recognising life time expected credit losses using a provision matrix based on its last five years robust data of loss rates.

In the present economic environment of COVID-19 outbreak, can the entity continue with its old provision matrix based on historical loss rates?

Response to Case Study 14 – Impairment

Under simplified approach the impairment loss allowance is measured at an amount equal to the life time ECL instead of applying ‘three-stage’ model (general model) for impairment. Entities often calculate ECL by using a provision matrix. In respect of measurement of ECL, it is important to consider the requirements of paragraph 5.5.17 of Ind AS 109:

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

(a)

(b).....; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.”

Response to Case Study 14 – Impairment (contd.)

This paragraph that Ind AS 109 also requires consideration of current conditions and the forecasts of future economic conditions at the reporting date. Further, historical information or historical loss data is an important anchor or base to measure expected credit losses. However, the entity shall adjust the historical information for current observable data and also for the forecasts of future conditions that did not affect the historical data or remove those that are not relevant for the future cash flows.

Accordingly, the onset of COVID-19 outbreak would have an effect on the current and future economic environment of the entity and hence the past data and assumptions may not be fully relevant in the future. Therefore, it is imperative to reassess and re-evaluate the original provision matrix employed by the entity for any changes and considerations required to be made in regard to the changes in the current economic environment and forward looking information (including macro-economic information) for the entity in light of COVID-19 outbreak.

Ind AS 107 - *Financial Instruments Disclosures*



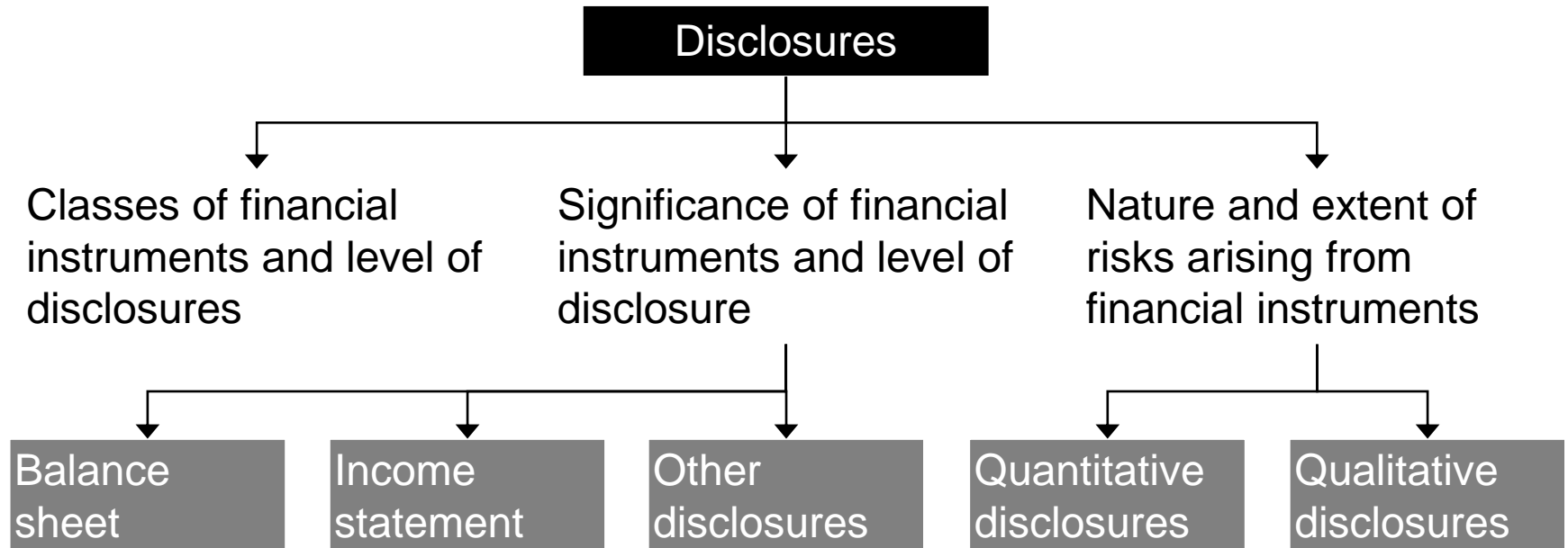
Objectives

- ▶ Requires entities to provide disclosures that would enable users to evaluate:
 - ▶ The **significance of financial instruments** for an entity's
 - ▶ Financial position
 - ▶ Financial performance; and
 - ▶ Cash flows
 - ▶ The **nature and extent of risks arising from financial instruments** to which the entity is exposed
 - ▶ During the period and
 - ▶ At the reporting date, and
 - ▶ **How the entity manages those risks**

Scope

- ▶ Similar to Ind AS 109/ Ind AS 32
- ▶ Applies to all entities
- ▶ Applies to all financial instruments, except:
 - ▶ those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 27 and IndAS 28
 - ▶ employers' rights and obligations arising from employee benefit plans
 - ▶ insurance contracts as defined in Ind AS 104
 - ▶ financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 applies

Ind AS 107 – Disclosure summary



Classes of financial instruments

- ▶ Group financial instruments into classes that:
 - ▶ Are appropriate to the nature of the information disclosed; and
 - ▶ Take into account the characteristics of those financial instruments
- ▶ Classes are determined by the entity
- ▶ May be distinct from the categories specified in Ind AS 109

Classes of financial instruments (cont'd.)

- ▶ In determining classes, at a minimum:
 - ▶ distinguish instruments measured at amortised cost from those measured at fair value
 - ▶ treat financial instruments outside the scope of Ind AS 107 as a separate class or classes
- ▶ Strike a balance between:
 - ▶ overburdening financial statements with excessive details; and
 - ▶ obscuring important information as a result of too much aggregation

Significance of financial instruments for financial position and performance

- ▶ Disclose information that enables users to evaluate the significance of financial instruments for an entity's:
 - ▶ Financial position; and
 - ▶ Performance

Balance sheet disclosures

- ▶ Disclosure permitted on the face of the balance sheet or in the notes to the financial statements
- ▶ Focus on disclosure by class of financial instrument
- ▶ Additional detail in disclosures for each category of financial instruments

Categories of financial assets and financial liabilities

- ▶ Disclose carrying amounts of the following categories either on face of balance sheet or in notes:
 - ▶ Financial assets at fair value through profit or loss (FVTPL), showing separately:
 - ▶ Designated as such upon initial recognition; and
 - ▶ Classified as held-for-trading
 - ▶ FVOCI equity investments
 - ▶ FVOCI debt investments
 - ▶ Financial assets at amortised cost
 - ▶ Financial liabilities at fair value through profit or loss (FVTPL), showing separately:
 - ▶ Designated as such upon initial recognition; and
 - ▶ Classified as held-for-trading
 - ▶ Financial Liabilities carried at amortised cost

Categories of financial assets and financial liabilities

- ▶ Sufficient information should be provided to permit the disclosures by class of asset to be reconciled to the line items presented in the balance sheet
- ▶ Carrying amounts of financial instruments classified as held for trading and those designated at fair value through profit or loss are shown separately because designation is at the discretion of the entity

▶ Example:

▶ Infosys



Infy- FI FV note.xps

Nature and extent of risks

- ▶ Disclose information that enables users to evaluate
 - ▶ Nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date.
- ▶ Combination of qualitative and quantitative risk disclosures required to meet the objective
- ▶ To bring financial reporting more closely into line with the way the management views/ runs their businesses
- ▶ May bridge gap between the internal management information and the general purpose financial statements

Nature of risks

- ▶ Credit risk
- ▶ Liquidity risk
- ▶ Market risk
 - ▶ Currency risk
 - ▶ Interest rate risk
 - ▶ Other price risk

Qualitative disclosures

- ▶ Disclose for each type of risk
 - ▶ exposures to risk and how they arise;
 - ▶ objectives, policies and processes for managing the risk;
 - ▶ methods used to measure the risk; and
 - ▶ any changes in the above from the previous period

Quantitative disclosures

- ▶ For each type of risk arising from financial instruments, an entity shall disclose:
 - ▶ summary quantitative data about its exposure to that risk at the reporting date
 - ▶ This disclosure shall be based on the information provided internally to key management personnel of the entity
 - ▶ disclosures required by specific paragraphs of the standard, to the extent not provided in above, unless the risk is not material
 - ▶ concentrations of risk if not apparent from the above

Quantitative disclosures – liquidity risk

- ▶ An entity shall disclose:
 - ▶ A maturity analysis for financial liabilities that shows the remaining contractual maturities; and
 - ▶ A description of how it manages the liquidity risk inherent in the above requirement
- ▶ Disclosure of contractual maturities i.e. undiscounted future cash flows arising from the financial instruments

Liquidity Risk – How should financial guarantees be disclosed?

- ▶ Financial Guarantees to be recorded in the contractual maturity analysis based on the maximum amount guaranteed
- ▶ Financial guarantees disclosures based on the earliest date they can be drawn down, irrespective of whether it is likely that those guarantees will be drawn or the amount that is expected to be paid.

Quantitative disclosures

- ▶ Market risks

Market risk is “the risk that the fair value or future cash flows of a financial instruments will fluctuate because of changes in market prices and includes interest rate risk, foreign currency risk and other price risk.”

- ▶ Disclosure

- ▶ Sensitivity analysis for each type of market risk
 - ▶ Market risk sensitivity analysis includes the effect of ‘a reasonably possible change’ in risk variables in existence at balance sheet date if applied to all risks in existence at that date.
 - ▶ Reasonable possible change is not remote or ‘worst-case’ scenarios or ‘stress tests
- ▶ Affect on profit or loss and equity
- ▶ Methods and assumption used in analysis
- ▶ Changes for previous period
- ▶ Reason for change

Ind AS 107 Case Studies

- ▶ Tata Steel
- ▶ Infosys



Thank you