



# Ind AS



20 June 2015

*Ram Iyer*





# Agenda

## *Ind AS*

Financial Instruments

Fair Value Concepts of Ind AS 113





# Financial Instruments



# Financial Instruments

## *Ind AS*

Map of Financial Instruments Standards

Key Topics in Financial Instruments

Rapid Quiz – Financial Instruments

Accounting Map for Financial Instruments

Loans by Financial Institutions

Trade Receivables

Investments

Trade Payables

Derivatives

Embedded Derivatives

Hedge Accounting

Presentation of Financial Instruments

Disclosures

Transition Requirements

GAAP Differences – Common Examples



# Map of Financial Instruments Standards

**Ind AS  
32**

**Presentation**

**Ind AS  
109**

**Classification  
and  
Measurement**

**Ind AS  
113**

**Fair Value  
Measurement**

**Ind AS  
107**

**Disclosures**





# Key Topics in Financial Instruments





# Rapid Quiz

What is a  
financial  
instrument?





# Rapid Quiz

What is a financial instrument?



A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity







# Rapid Quiz

What are  
common  
financial  
assets?





# Rapid Quiz

What are  
common  
financial  
assets?



Cash, equity  
instrument,  
contractual right to  
receive cash or  
exchange financial  
instruments under  
conditions that are  
potentially favourable





# Rapid Quiz

What are  
common  
financial  
liabilities?





# Rapid Quiz

What are common financial liabilities?



Contractual obligation to deliver cash or exchange financial instruments under conditions that are potentially unfavourable





# Rapid Quiz

How do you initially record a financial instrument?





# Rapid Quiz

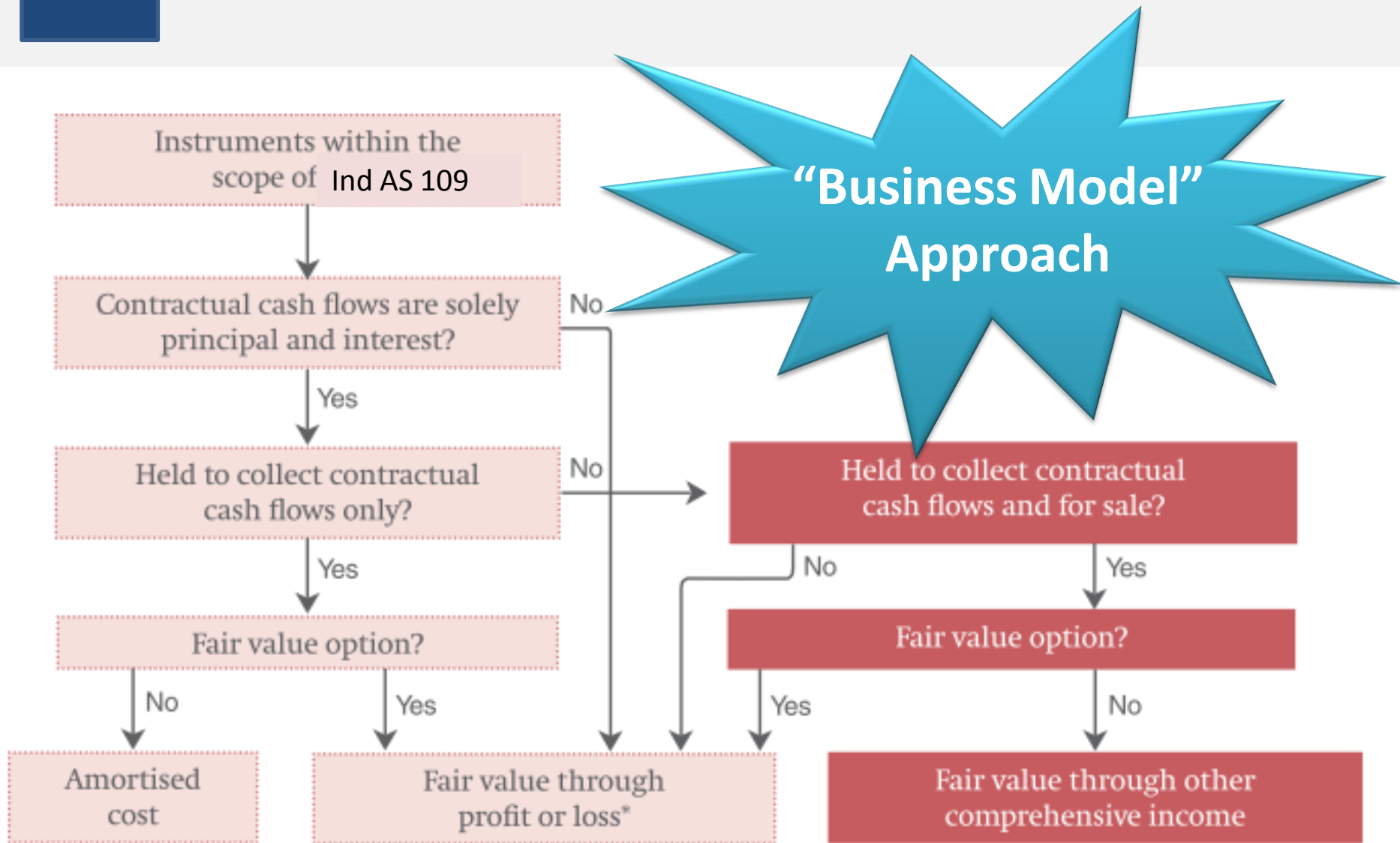
How do you initially record a financial instrument?



At fair value less transaction costs. However, transaction costs are expensed for financial instruments recorded at FVPL



# Accounting Map for Financial Assets



\* Presentation option for equity investments to present fair value changes in OCI



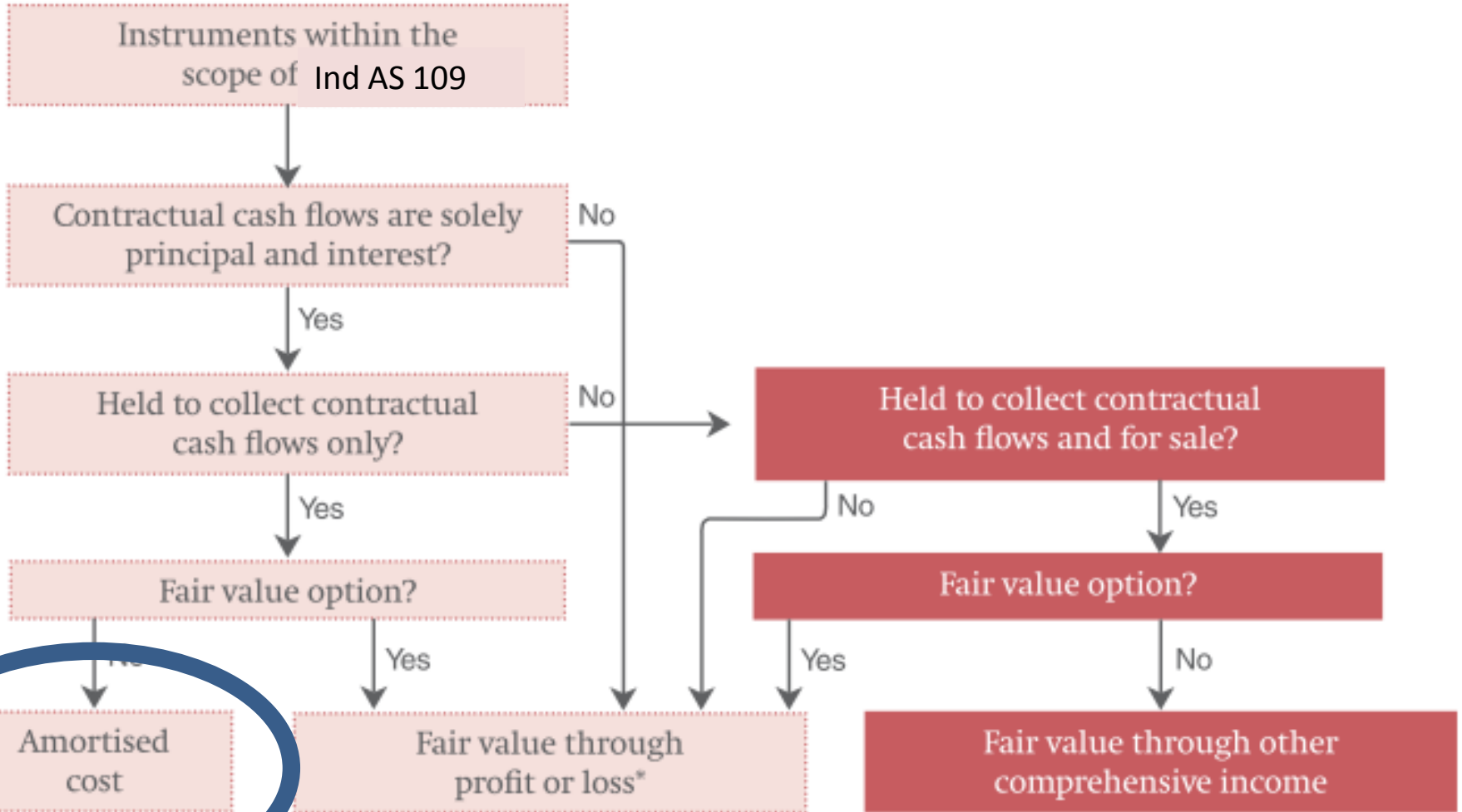
What is the most common measurement basis of Loans originated by a bank or Financial Institution





# Loans by Financial Institutions

## - *Common Classification*



Presentation option for equity investments to present fair value changes in OCI

# Amortized Cost

## - *Example*

### Amortized Cost - Customer Repayment Schedule

Loan	100,000			
Up-front Fees	(10,000)			
	<b>Cash Flows</b>	<b>Principal</b>	<b>Interest</b>	<b>Balance</b>
Loan	100,000			100,000
Year 1	(39,000)	30,719	8,281	69,281
Year 2	(39,000)	33,263	5,737	36,018
Year 3	(39,000)	36,018	2,982	(0)
			17,000	
IRR			8%	





What is  
the  
lender's  
rate (IRR)



# Amortized Cost

## - Example

Amortized Cost - Customer Repayment Schedule

	Cash Flows	Principal	Interest	Balance
Loan	100,000			
Up-front Fees	(10,000)			
Net Loan	100,000			100,000
Year 1	(39,000)	30,719	8,281	69,281
Year 2	(39,000)	33,263	5,737	36,018
Year 3	(39,000)	36,018	2,982	(0)
			17,000	
IRR			8%	

Amortized Cost - Accounting

	Cash Flows	Principal	Interest	Balance
Loan	100,000			
Up-front Fees	(10,000)			
	90,000			
			Ind AS	
Net Loan	90,000			90,000
Year 1	(39,000)	26,076	12,924	63,924
Year 2	(39,000)	29,821	9,179	34,103
Year 3	(39,000)	34,103	4,897	(0)
			27,000	
IRR			14%	

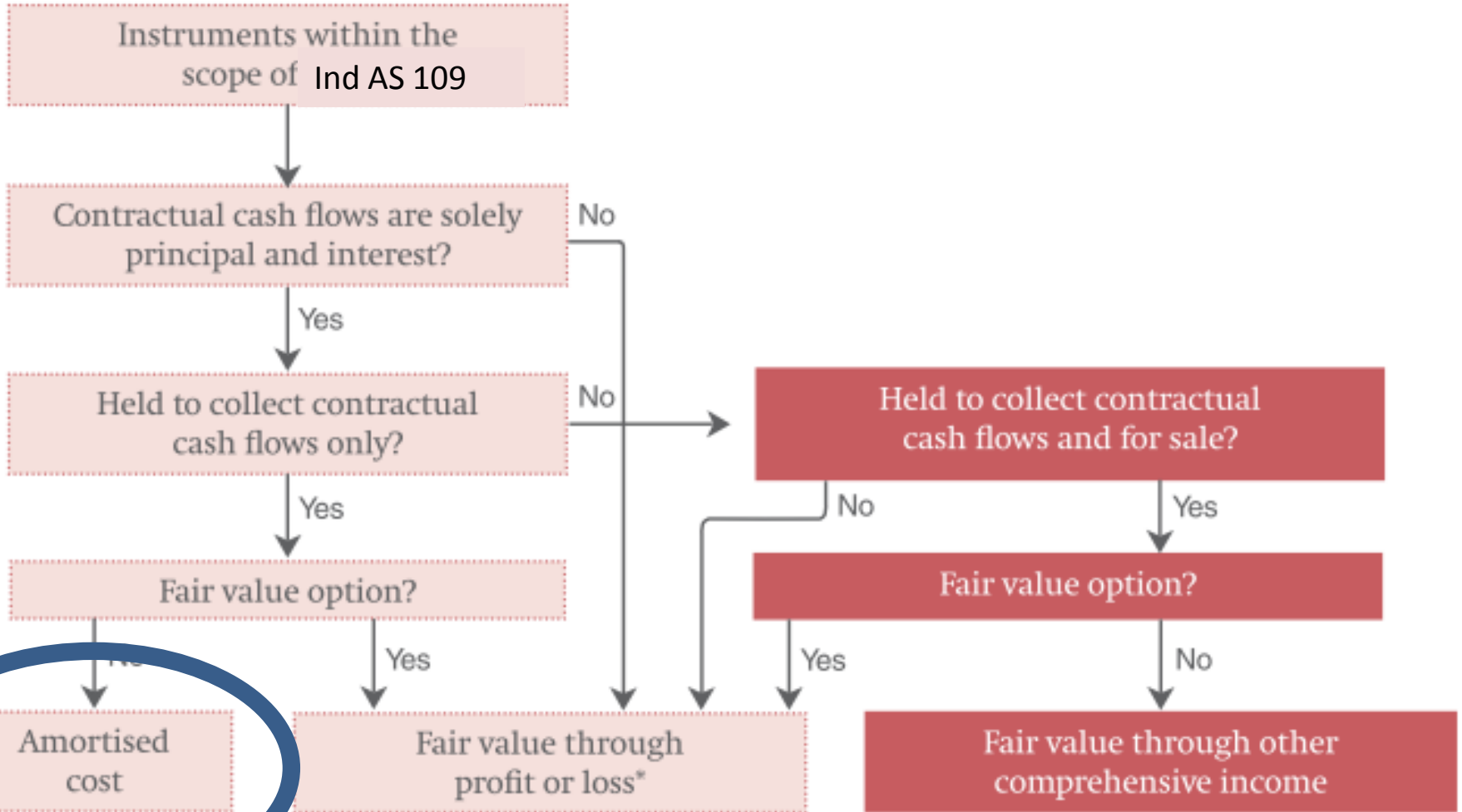


What is the most common measurement basis of Trade Receivables



# Trade Receivables

## - *Common Classification*



Presentation option for equity investments to present fair value changes in OCI

# Recognition of Expected Credit Losses

## *Example – Financial Institution*

Change in credit quality since initial recognition



### Recognition of expected credit losses

12-month expected credit losses

Lifetime expected credit losses

Lifetime expected credit losses

### Interest revenue

Effective interest on gross carrying amount

Effective interest on gross carrying amount

Effective interest on amortised cost carrying amount (that is, net of credit allowance)

#### Stage 1

*Performing*  
(Initial recognition\*)

#### Stage 2

*Underperforming*  
(Assets with significant increase in credit risk since initial recognition\*)

#### Stage 3

*Non-performing*  
(Credit-impaired assets)

# Recognition of Expected Credit Losses

## *Example – Financial Institution*

Stages	1	2	3
Evidence of credit risk	No evidence of increase in credit risk	Macro evidence of significant increase in credit risk (a)	Micro evidence of credit impairment (b)
Indicators	Past history	Past history	Past history
	+	+	+
	Current information	Current information	Current information
	+	+	+
	Forecast	Forecast	Forecast
Mechanics			
Collective evaluation	PD x LGD*	PD x LGD	PD x LGD
Individual evaluation	NA	NA	PV of CF
Technique	12 month ECL**	Lifetime ECL	Lifetime ECL
Loan Book			
6-year Term Loans 1000 x 10 crores each	0.4% x 10000 = 40	0.8% x 10000 = 80	0.8% x 9900 = 79
			+
			30% x 100 = 30
<b>Total Loss Provision</b>	<b>40</b>	<b>80</b>	<b>109</b>

(a) 30-day past due = presumption of significant increase in credit risk

(b) Credit Impairment = can't reasonably expect to recover all cash flows

\* PD = Probability of Default; LGD = Loss Given Default

\*\* ECL = Expected Credit Losses



# Trade Receivables



# Recognition of Expected Credit Losses

## *Example – Trade Receivable*

<i>Rupees Cr</i>	Stage 1	Stage 2	Stage 3
<b>Evidence of credit risk</b>	No evidence of increase in credit risk	Macro evidence of significant increase in credit risk (a)	Micro evidence of credit impairment (b)
<b>Indicators</b>	Past history	Past history	Past history
	+	+	+
	Current information	Current information	Current information
	+	+	+
	Forecast	Forecast	Forecast
<b>Mechanics</b>			
<b>Collective evaluation</b>	PD x LGD*	PD x LGD	PD x LGD
<b>Individual evaluation</b>	NA	NA	PV of CF
<b>Technique</b>	Lifetime ECL**	Lifetime ECL	Lifetime ECL
<b>Lifetime ECL</b>	1% x 500	1% x 400	1% x 400
		+	+
		5% x 100	5% x 90
			+
			20% x 10
	=	=	=
<b>Total</b>	<b>5</b>	<b>9</b>	<b>10.5</b>

Trade Receivables 500 customers x 1 crore each = 500 crore

(a) 30-day past due = presumption of significant increase in credit risk

(b) Credit Impairment = can't reasonably expect to recover all cash flows

\* PD = Probability of Default; LGD = Loss Given Default

\*\* ECL = Expected Credit Losses



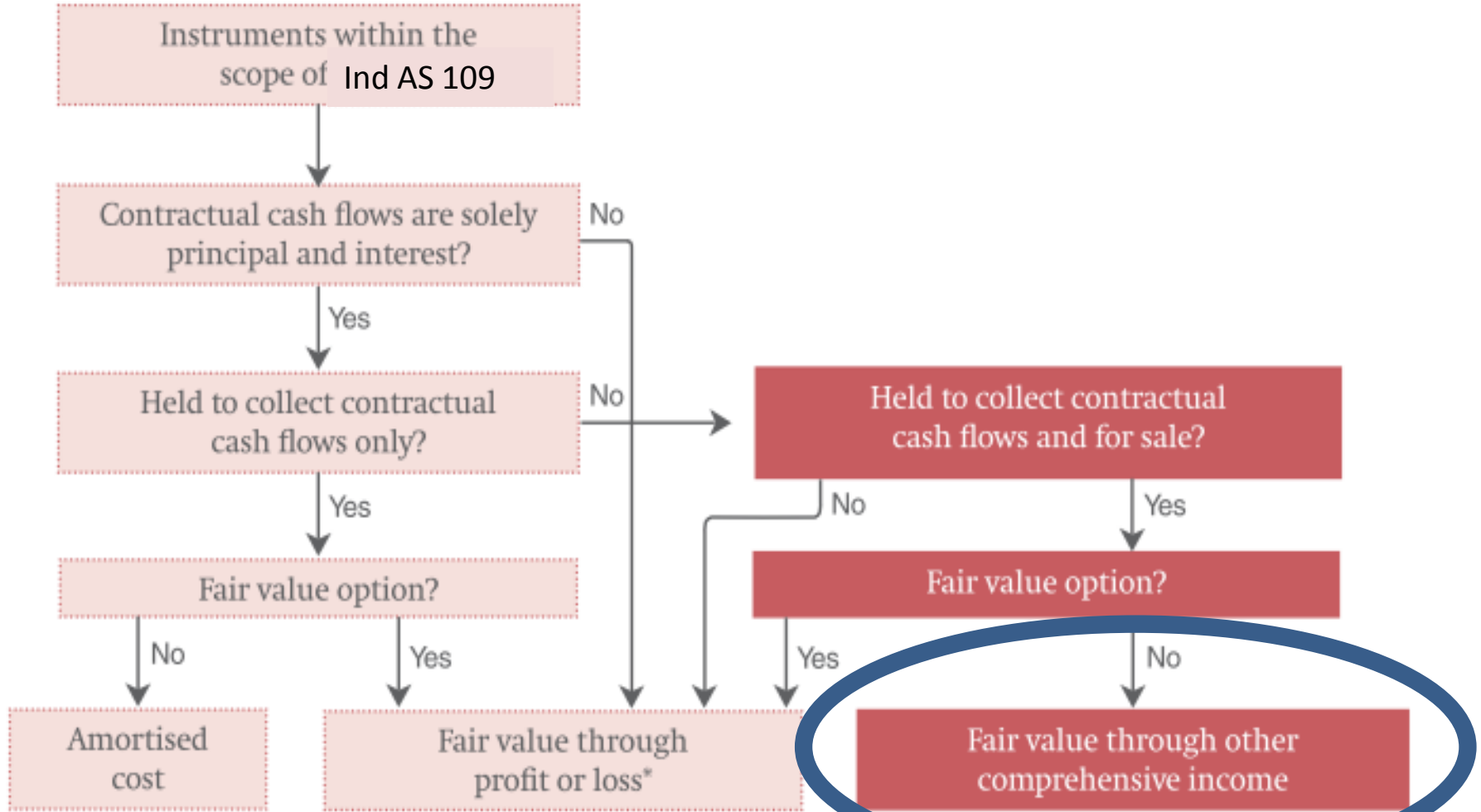
What is the  
most common  
measurement  
basis of  
Investments





# Investments

## – *Common Classification*



\* Presentation option for equity investments to present fair value changes in OCI

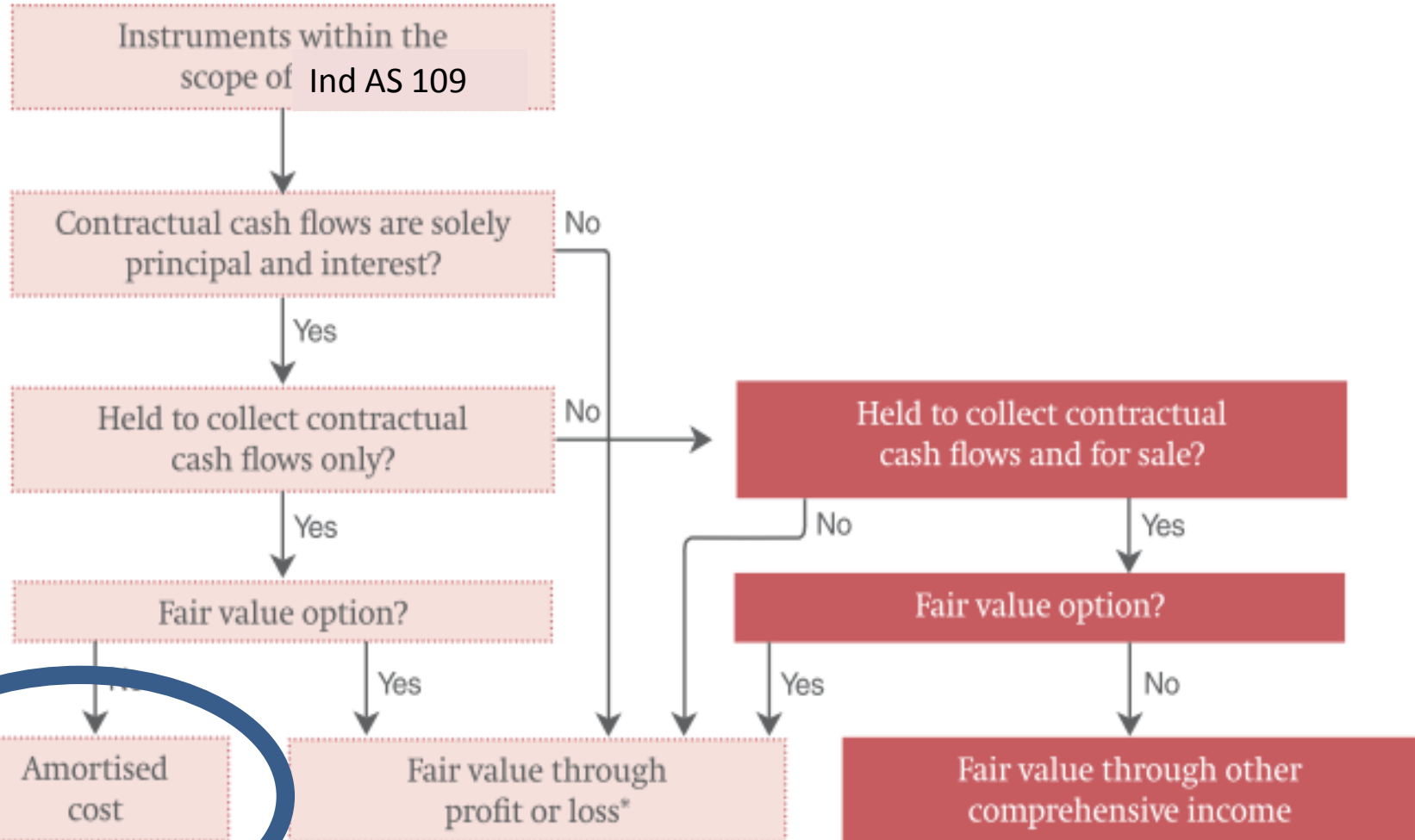
Investments - Examples		Debt	Trading Shares	Strategic Investment in Shares
<b>Invest</b>		10 cr (assume no premium / discount)	10 cr	10 cr
<b>Terms</b>		10% Interest; Bullet repayment after 3 years	Ordinary shares with no special rights	Ordinary shares with no special rights
<b>Accounting</b>		<b>Amortized Cost</b> (since contractual interest and principal payments, in line with entity's business model and no fair value option taken)	<b>FVPL</b> (since no contractual interest and principal payments and FVOCI option not taken)	<b>FVOCI</b> (option)
<b><u>End of Year 1</u></b>	<b>Fair Value</b>	9	9	9
	<b>Fair Value Change</b>	1	1	1
	<b>Accounting for Fair Value Change</b>	NA	P&L	OCI
<b><u>During Year 2</u></b>	<b>Selling Price</b>	11	11	11
	<b>Profit</b>	1	2	2
	<b>Accounting for Profit</b>	P&L	P&L	OCI

# Accounting Summary

Classification	Amortized Cost	FVOCI (Debt)	FVPL	FVOCI (Equity)
<b>Instrument Type</b>	Debt (e.g. loan)	Debt (e.g. debentures)	All (Debt, equity and derivatives) (e.g. trading securities)	Equity (e.g. strategic investments)
<b>Balance Sheet Measurement</b>	Amortized cost	Fair value	Fair value	Fair value
<b>Transaction Costs – Initial Recognition</b>	Added to initial recognition amount	Added to initial recognition amount	Charged to P&L	Added to initial recognition amount
<b>Transaction Costs – Subsequent Accounting</b>	Amortized to P&L using EIR	Amortized to P&L using EIR	Not applicable	Amortized to P&L using EIR
<b>Recognition of Fair Value Gain / Loss</b>	Not applicable	OCI	P&L	OCI
<b>Interest and Dividend</b>	P&L using EIR	P&L using EIR	P&L	Dividend in P&L
<b>Impairment Losses</b>	P&L	P&L	Not relevant	OCI
<b>Foreign Exchange Gain / Loss</b>	P&L	P&L	Not relevant	OCI
<b>Gain / Loss on Sale / Derecognition of Asset</b>	P&L	Gain / loss plus amount parked in OCI transferred to P&L	P&L	OCI. Recycling to P&L not allowed

# Financial Liabilities

## – *Common Accounting*



\* Presentation option for equity investments to present fair value changes in OCI



# Reclassification

Only allowed (for financial assets\*) if business model changes

Examples:  
acquisition, disposal, or termination of business line

*\*Not allowed for financial liabilities*







# Derecognition

## Assets

Expiry of contractual rights, transfer of rights, obligation to pay cash flows, transfer of substantially all risks, transfer of control

Examples: Sale, assignment, securitization

## Liabilities

Extinguishment, i.e. obligation discharged, cancelled or expires

Example: Discharge in normal course of business



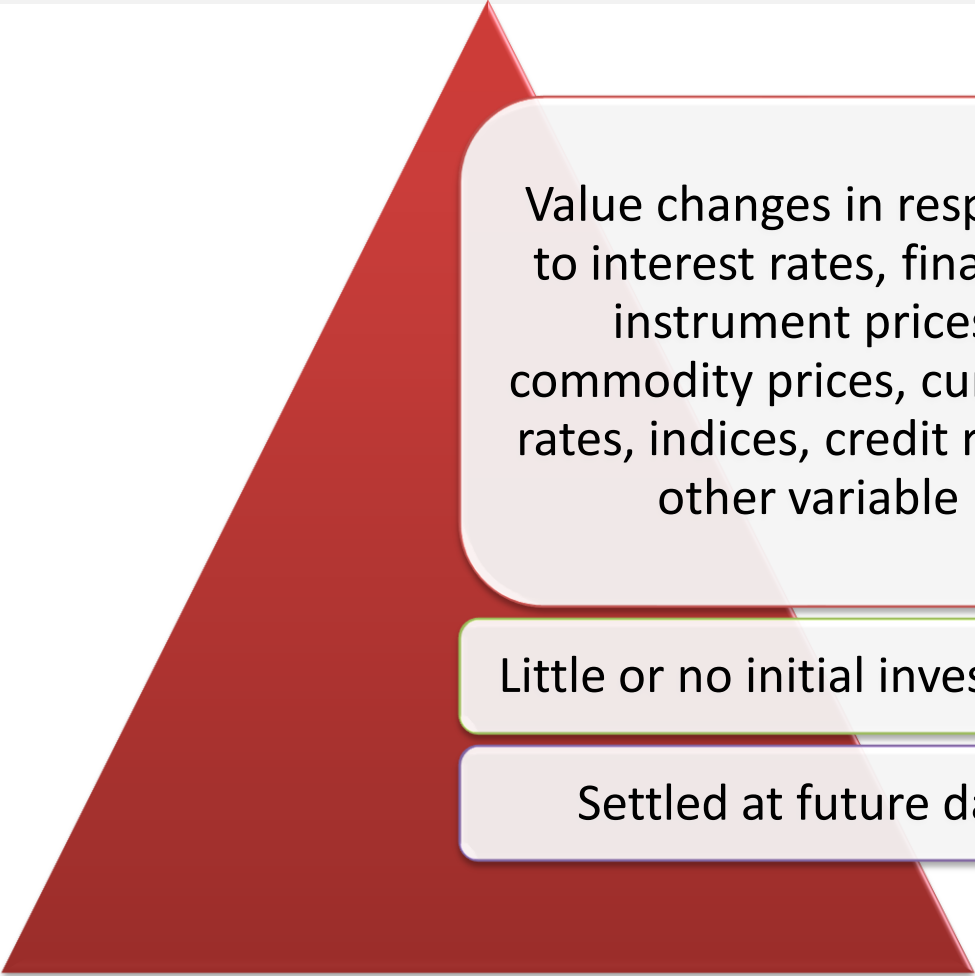


# Derivative





# Derivative



Value changes in response to interest rates, financial instrument prices, commodity prices, currency rates, indices, credit rating, other variable

Little or no initial investment

Settled at future date





# Derivatives

## – *Examples*



- Forward contracts



- Interest rate swaps



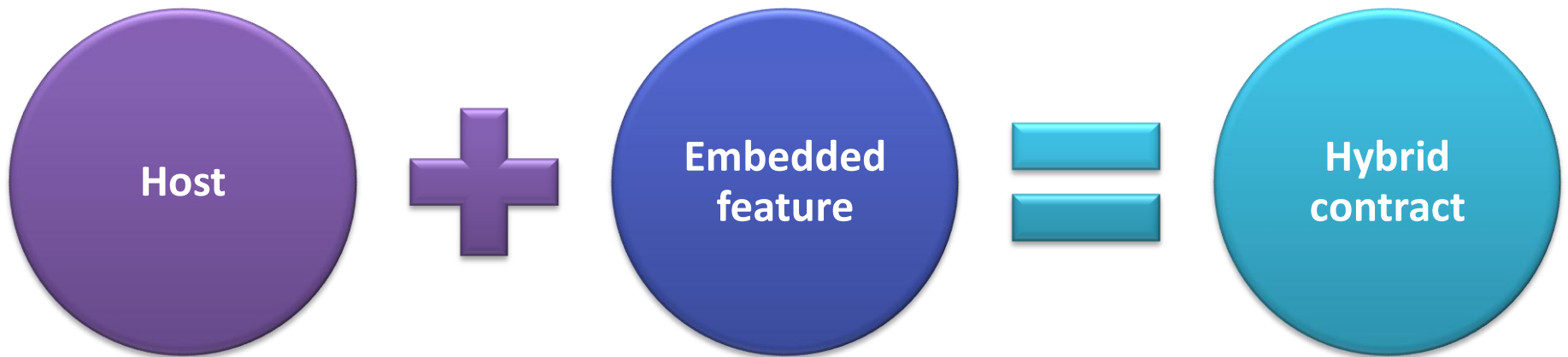
- Cross-currency swaps



- Commodity futures



# Embedded Derivative



If economic characteristics are closely related then no separation. Otherwise, embedded feature is separated and accounted for as derivative.





# Embedded Derivatives

## – *Examples*

### Not Closely Related

- Put option in debt instrument, linked to ordinary share prices

### Closely Related

- Lease rental linked to inflation
  - *No separation of base rental and inflation piece*





# Accounting for Derivatives and Embedded Derivatives

**At fair value**





# Fair Value of a Derivative

	Derivative Contract Rate	Balance Sheet Rate of Equivalent Contract	Derivative Gain / Loss	Accounting for Derivative Gain / Loss ( <i>without hedge accounting</i> )
<b>Exporter:</b> Forward Contract to pay USD and receive Rupee	60	62	2 Notional Loss	P&L
<b>Borrower:</b> IRS (Interest Rate Swap) – Floating to Fixed	10%	11%	1% Notional Gain	P&L
<b>Borrower:</b> IRS (Interest Rate Swap) – Fixed (10%) to Floating	Floating	11%	1% Notional Loss	P&L
<b>Manufacturer:</b> Copper Future (hedging raw material cost of forecast transaction)	100 per tonne	90 per tonne	10 loss per tonne	P&L





# What is Hedge Accounting?

Accounting that protects the P&L from volatility by  
mirroring the entity's risk management activities





# Hedge Accounting

	Derivative Contract Rate	Balance Sheet Rate of Equivalent Contract	Derivative Gain / Loss	Accounting for Derivative Gain / Loss ( <i>without hedge accounting</i> )	Hedge Accounting
<b>Exporter:</b> Forward Contract to pay USD and receive Rupee	60	62	2 Notional Loss	P&L	OCI
<b>Borrower:</b> IRS (Interest Rate Swap) – Floating to Fixed	10%	11%	1% Notional Gain	P&L	OCI
<b>Borrower:</b> IRS (Interest Rate Swap) – Fixed (10%) to Floating	Floating	11%	1% Notional Loss	P&L	P&L, along with Fair Value of hedged item, i.e. borrowing
<b>Manufacturer:</b> Copper Future (hedging raw material cost of forecast transaction)	100 per tonne	90 per tonne	10 loss per tonne	P&L	OCI

# Hedge Accounting

## Hedging Criteria

Economic correlation, common hedge ratio

Formal designation and documentation

Eligible Instruments

## What can be hedged

Assets

Liabilities

Firm Commitments

Highly Probable Forecast Transactions



# Hedges

## – *Examples*

### Types of Hedge

Fair Value Hedge

Cash Flow Hedge

Hedge of Net Investment  
in Foreign Operation

### Hedge Examples

• Forward contracts

• Interest rate swaps

• Cross-currency swaps

• Commodity futures



# Hedge Accounting

	Derivative Contract Rate	Balance Sheet Rate of Equivalent Contract	Derivative Gain / Loss	Accounting for Derivative Gain / Loss ( <i>without hedge accounting</i> )	Hedge Accounting
<b>Exporter:</b> Forward Contract to pay USD and receive Rupee	60	62	2 Notional Loss	P&L	OCI ( <u><i>Cash Flow Hedge</i></u> )
<b>Borrower:</b> IRS (Interest Rate Swap) – Floating to Fixed	10%	11%	1% Notional Gain	P&L	OCI ( <u><i>Cash Flow Hedge</i></u> )
<b>Borrower:</b> IRS (Interest Rate Swap) – Fixed (10%) to Floating	Floating	11%	1% Notional Loss	P&L	P&L, along with Fair Value of hedged item, i.e. borrowing ( <u><i>Fair Value Hedge</i></u> )
<b>Manufacturer:</b> Copper Future (hedging raw material cost of forecast transaction)	100 per tonne	90 per tonne	10 loss per tonne	P&L	OCI ( <u><i>Cash Flow Hedge</i></u> )



# Cash Flow Hedge

## – Example

Y Ltd exports IT services
Exports services on Day One worth USD 10 million; spot rate is 62
Credit period = 90 days
Company expects Rupee to appreciate so wishes to protect its cash flows
Forward rate for three months is 63

Hedge Accounting	Cum P&L	No Hedge Accounting	Cum P&L
	DR / (CR)		DR / (CR)

Record receivable on Day One									
DR	Trade Receivable	62			DR	Trade Receivable	62		
CR	Sales		62	0	CR	Sales		62	0

No entry is recorded for forward contract on Day One	No entry is recorded for forward contract on Day One
--	--



# Cash Flow Hedge

## – Example

Hedge Accounting				Cum P&L	No Hedge Accounting				Cum P&L
				DR / (CR)					DR / (CR)
Receivable at end of M1 is USD 10 million due in 60 days									
Spot rate moved up from 62 to 63 (Rupee depreciation)									
Forward rate constant at 63									
Remeasure receivable									
DR	Trade Receivable	1			DR	Trade Receivable	1		
CR	OCI		1		CR	P&L		1	(1)
(New spot rate 63 minus transaction rate 62 = remeasurement gain of 1)					(New spot rate 63 minus transaction rate 62 = remeasurement gain of 1)				
Fair value forward contract									
DR / CR	OCI	0			DR / CR	P&L	0		
DR / CR	Derivative Liability		0	0	DR / CR	Derivative Liability		0	
(No gain or loss on forward contract)					(No gain or loss on forward contract)				

# Cash Flow Hedge

## – Example

Hedge Accounting				Cum P&L	No Hedge Accounting				Cum P&L
				DR / (CR)					DR / (CR)
Receivable at end of M2 is USD 10 million due in 30 days									
Spot rate moved down from 63 to 61 (Rupee appreciation)									
Forward rate moved down from 63 to 62									
Remeasure receivable					Remeasure receivable				
DR	OCI	2		DR	P&L	2			
CR	Trade Receivable		2	CR	Trade Receivable		2		
(New spot rate 61 minus previous receivable 63 = remeasurement loss of 2)					(New spot rate 61 minus previous receivable 63 = remeasurement loss of 2)				
Fair value forward contract					Fair value forward contract				
DR	Derivative Asset	1		DR	Derivative Asset	1			
CR	OCI		1	CR	P&L		1		0
(Equivalent forward rate 62 minus previous rate of 63 = derivative gain of 1)					(Equivalent forward rate 62 minus previous rate of 63 = derivative gain of 1)				



# Cash Flow Hedge

## – Example

Hedge Accounting				Cum P&L	No Hedge Accounting				Cum P&L
				DR / (CR)					DR / (CR)
Receivable settled at end of M3; spot rate moved from 61 to 60 (Rupee appreciation)									
DR	Cash	63			DR	Cash	63		
CR	Trade Receivable		61		CR	Trade Receivable		61	
CR	P&L		2		CR	P&L		2	
Release derivative balance					Release derivative balance				
DR	P&L	1		(1)	DR	P&L	1		(1)
CR	Derivative Asset		1		CR	Derivative Asset		1	



# Hedge Accounting

Hedge accounting is a privilege,  
you *CAN* use it *IF YOU QUALIFY  
FOR HEDGE ACCOUNTING*, you  
can't use it if you don't qualify  
for hedge accounting, you need  
not use it if you do qualify





# Equity versus Liability

	<b>AS</b> <i>(Legal form takes precedence)</i>	<b>Ind AS</b> <i>(Contractual substance takes precedence)</i>
<b>Ordinary Equity Shares</b>		
<b>Redeemable Preference Shares</b>		
<b>Optionally Convertible Bonds</b>		
<b>Equity Shares with Put Options requiring cash settlement</b>		
<b>Compulsorily Convertible Debentures</b>		
<b>Obligation to issue Variable Number of Shares</b>		



# Equity versus Liability

	AS <i>(Legal form takes precedence)</i>	Ind AS <i>(Contractual substance takes precedence)</i>
Ordinary Equity Shares	Equity	
Redeemable Preference Shares	Equity	
Optionally Convertible Bonds	Liability	
Equity Shares with Put Options requiring cash settlement	Equity	
Compulsorily Convertible Debentures	Liability	
Obligation to issue Variable Number of Shares	???	



# Equity versus Liability

	AS <i>(Legal form takes precedence)</i>	Ind AS <i>(Contractual substance takes precedence)</i>
Ordinary Equity Shares	Equity	Equity
Redeemable Preference Shares	Equity	Liability
Optionally Convertible Bonds	Liability	Split**
Equity Shares with Put Options requiring cash settlement	Equity	Liability
Compulsorily Convertible Debentures	Liability	Equity
Obligation to issue Variable Number of Shares	???	Liability

*General concept: Residual Interest = Equity*

*\*\*Under carve-out, FCCB will be entirely equity*



# Disclosures

## Qualitative Disclosures

- Accounting policies
- Risk management strategy
- Hedging activities
- Hedge effectiveness evaluation processes
- Credit risk management practices

## Quantitative Disclosures

- Categories of financial instruments
- Carrying values and fair values of financial instruments
- Exposures to credit risk and amount mitigated through derivatives
- Income, expense, gain, loss
- OCI movements
- Credit risk movements
- Hedge movements





# Transition Requirements

## Classification and Measurement

- Use conditions at transition date



## Impairment

- Apply retrospectively



## Hedge Accounting

- No hindsight accounting!



## GAAP Differences – Common Examples

	AS	Ind AS
<b>Forward Contract</b>		
- Existing receivable	Amortize premium	Recognize MTM Gain / Loss
- Forecast transaction	Recognize MTM losses	Recognize MTM Gain / Loss
<b>Interest Rate Swap</b>	Recognize MTM losses	Recognize MTM Gain / Loss
<b>Commodity Contract</b>	Recognize MTM losses	Recognize MTM Gain / Loss







# Fair Value Concepts of Ind AS 113



# What is Fair Value?



Price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date





What is an  
'orderly  
transaction'?



A transaction that  
assumes market  
exposure for reasonable  
period before  
measurement date,  
usual, customary, and is  
not forced, liquidation  
or distressed





Who are  
market  
participants?



Buyers and sellers in  
the principal or most  
advantageous market  
who are independent,  
knowledgeable, able  
and willing to transact





P Ltd shares are traded on the exchange. M Ltd holds a large block of shares. The market cannot absorb the block in one tranche. What is the fair value of P Ltd shares?



In quoted markets, fair value =  $P \times Q$ , i.e. Ignore blockage factors.





## Three Levels of Valuation Inputs

	Meaning	Examples
<b>Level 1</b>	Quoted prices in active markets for identical assets or liabilities that entity can access	Quoted prices in exchanges, brokered markets
<b>Level 2</b>	Inputs other than quoted prices included in Level 1 that are observable	Quoted prices of similar assets, yield curves
<b>Level 3</b>	Unobservable inputs	Replacement cost, present value calculation





# Fair Valuation of Financial Instruments

Common Instruments	Common Valuation Sources / Techniques
Quoted Shares	Quoted prices
Unquoted Shares	Pricing Models
Debt Instruments	Prices of comparative instruments, yield curve data, discounting using market rates
Forward Contracts	Quoted forward rates
Commodity Derivatives	Quoted futures rates
Long Term Receivable	Discounting using market rates



# DOGBERT EXPLAINS STOCK INVESTING

PAY ATTENTION.

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FIRST, EMPLOYEES PROVIDE VALUABLE DATA.

IS YOUR PROJECT ON SCHEDULE?

I DIDN'T KNOW I HAD A PROJECT.

A MANAGER REFINES THE DATA.

WE'RE ON SCHEDULE.

THE CEO GIVES 'VISIBILITY' TO ANALYSTS.

NO PROBLEMS WHATSOEVER.

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**Further Reading**



# Further Reading

## Some Useful Sources

*icai.org*

*ifrs.org [standards, interpretations, work plan]*

*fasb.org*

*sec.gov*

*Accounting firms' guidance*





# Questions





# Thank You

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