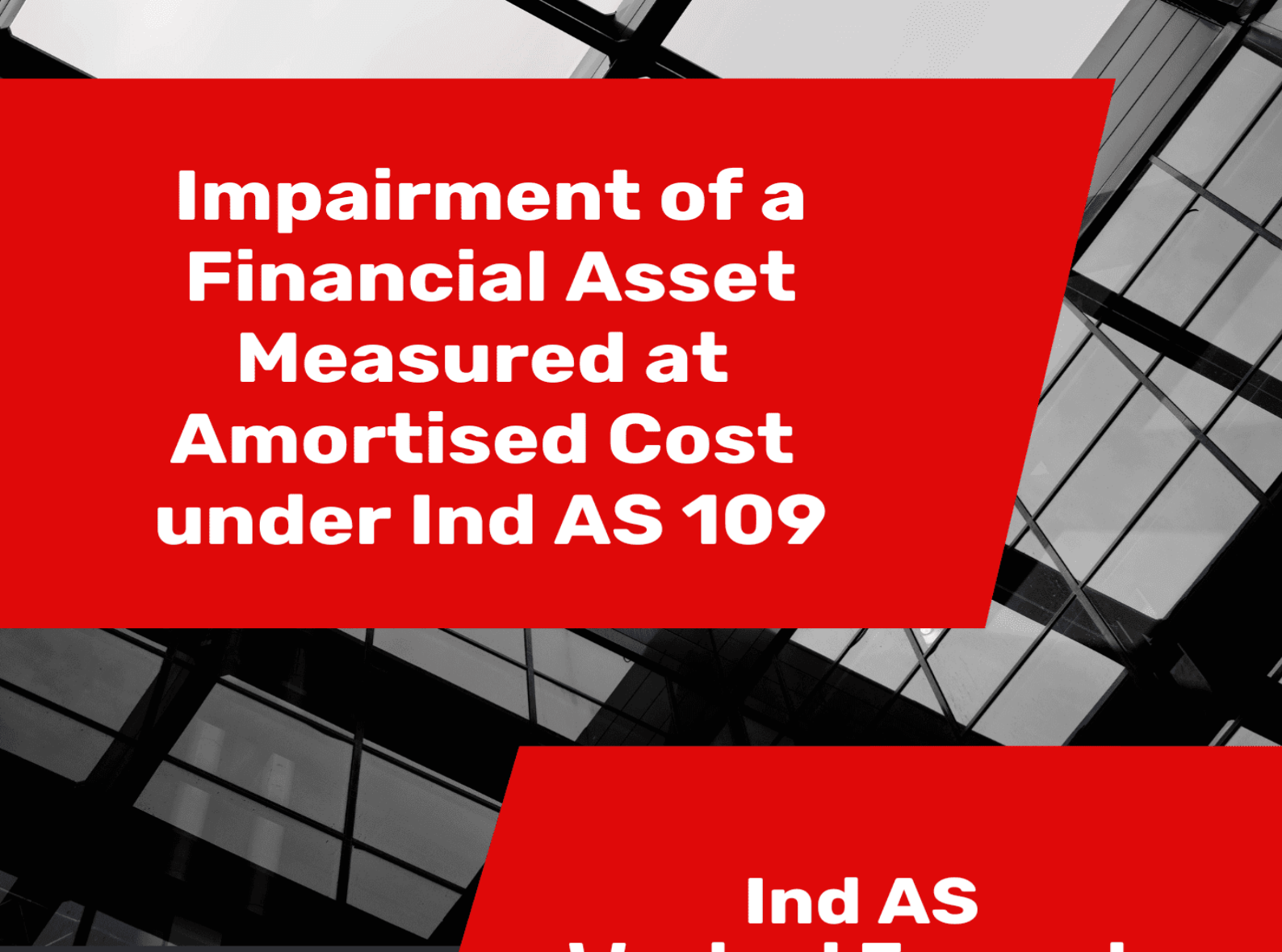

Impairment of a Financial Asset Measured at Amortised Cost under Ind AS 109

Ind AS Worked Example

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Ind AS Worked Example

Impairment of a Financial Asset Measured at Amortised Cost under Ind AS 109

INTRODUCTION

A financial asset is measured at amortised cost only if its contractual terms give rise on specified dates to cash flows that was solely payments of principal and interest on the principal amount outstanding. This measurement allocates interest over time using the **effective interest rate** which is based on contractual cash flows. There is an indication of impairment of a financial asset when the investor anticipates a **credit risk** (ie, the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation) of the issuer. In effect, there is a credit loss for the financial asset, which is the present value of the difference between the –

- contractual cash flows that are due to an entity under the contract; and
- cash flows that the entity expects to receive.

RECOGNITION

An entity shall recognise in profit and loss, as an impairment loss (or gain), the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard.

EXAMPLE

On 1 April 20x1, Entity A (year-end 31 March) purchases a financial asset for CU 1,000. The date of maturity is 31 March 20x6. Entity A measures the financial asset at amortised cost.

Additional information:

For the Financial Asset			
Coupon and Effective Interest rate	@ 7% p.a.	Income Tax rate	30%

Since the financial asset is recognised initially at an amount equal to the principal receivable on maturity, the principal amount and the gross carrying amount is the same i.e., CU 1,000. The reason for this, in each period, for a financial asset, the gross carrying amount at the beginning of the period is multiplied by the effective interest rate and added to the carrying amount (CA). This is the interest, calculated using the Effective Interest Method, which is recognised in Profit and Loss. Any cash receipts as interest in the period are deducted from the resulting number.

Since the two amounts are equal, there is no effect on the gross carrying amount of the financial asset.

SOLUTION

CU

Year	Gross CA – Beginning	Interest @ 7% p.a. *	Cash Flows	Gross CA – End
20x1 – x2	1,000	70	(70)	1,000
20x2 – x3	1,000	70	(70)	1,000

* Coupon and Effective Interest Rate

CU

Reconciliation	
Total interest to be taken to profit and loss	140
Total interest to be received	(140)
	NIL

} No effect on the gross carrying amount.

On 1 April 20x3, there is an indication of impairment of the financial asset, when Entity A anticipates a credit risk of the issuer. Entity A estimates that, in future, it will be able to realise interest @ 5% p.a. instead of the contractual rate @ 7% p.a. There is no indication of impairment of the principal amount repayable at maturity (ie, CU 1,000). In effect, there is a credit loss for the financial asset, which is the present value of the difference between the –

- contractual cash flows that are due to Entity A under the contract; and
- cash flows that Entity A expects to receive.

Entity A recalculates the gross carrying amount of the financial asset as the present value of the estimated future contractual cash flows that are discounted at the financial asset's original effective interest rate. The loss allowance is calculated at an amount equal to **lifetime expected credit losses** (ie, the expected credit losses that result from all possible default events over the expected life of the financial asset) at the current reporting date.

The difference between the existing gross carrying amount and the amortised cost is the impairment loss (ie, the expected credit losses).

RECOGNITION

Entity A shall recognise in profit and loss, the impairment loss that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised.

SOLUTION

Present Value of Future Cash Flows

Year	Receipts (CU)	Factor @ 7% p.a.	Present Value (CU)
20x3 – x4	50	0.935	47
20x4 – x5	50	0.873	45
20x5 – x6	1,050 *	0.816	858
* [CU 1,000 + CU 50]	Amortised Cost of the Financial Asset		950

Gross carrying amount adjusted for the loss allowance

Amortisation of the Financial Asset **CU**

Year	Amortised Cost – Beginning	Interest @ 7% p.a. **	Receipts	Amortised Cost – End
20x3 – x4	950	66	(50)	966
20x4 – x5	966	67	(50)	983
20x5 – x6	983	67 [1]	(1,050)	–

** Original Effective Interest Rate

[1] Ignore rounding-off calculations. The differences are too small to be of any consequence.

Reconciliation	CU
Total interest to be taken to profit and loss [CU 66 + CU 67 + CU 67]	200
Total interest to be received [CU 50 x 3]	(150)
	50 [2]

[2] Difference between the existing gross carrying amount and the amortised cost recognised as loss allowance [CU 1,000 – CU 950]

As estimated, from the year 20x3 – x4, Entity A receives CU 50 per year as interest and CU 1,000 as repayment of principal at maturity.

JOURNAL

Reporting Period	Date	Journal No.	Heads of Account	Debit (CU)	Credit (CU)
20x1 – 20x2	1 April 20x1	1	Financial asset	1,000	
			Cash		1,000
	31 March 20x2	2	Financial asset	70	
			Interest revenue		70
		3	Interest revenue	70	
			Profit and loss		70
		4	Cash	70	
			Financial asset		70
20x2 – 20x3	31 March 20x3	5	Financial asset	70	
			Interest revenue		70
		6	Interest revenue	70	
			Profit and loss		70
		7	Cash	70	
			Financial asset		70
		8	Loss allowance *	50	
			Financial asset		50
			* [CU 1,000 – CU 950]		
		9	Profit and loss	50	
			Loss allowance		50
		10	Deferred tax asset **	15	
			Deferred tax income		15
			** [30% of CU 50]		
		11	Deferred tax income	15	
			Profit and loss		15
20x3 – 20x4	31 March 20x4	12	Financial asset	66	
			Interest revenue		66
		13	Interest revenue	66	
			Profit and loss		66
		14	Cash	50 [3]	
			Financial asset		50
20x4 – 20x5	31 March 20x5	15	Financial asset	67	
			Interest revenue		67
		16	Interest revenue	67	
			Profit and loss		67
		17	Cash	50 [3]	
			Financial asset		50
20x5 – 20x6	31 March 20x6	18	Financial asset	67	
			Interest revenue		67
		19	Interest revenue	67	
			Profit and loss		67
		20	Cash	1,050 [3]	
			Financial asset		1,050
		21	Profit and loss	15	
			Deferred tax asset		15

[3] As anticipated

CU

Year	Gross CA – Beginning	Interest @ 7% p.a.	Cash Flows	Loss Allowance	Gross CA – End
20x1 – x2	1,000	70	(70)	–	1,000
20x2 – x3	1,000	70	(70)	(50)	950
20x3 – x4	950	66	(50)	–	966
20x4 – x5	966	67	(50)	–	983
20x5 – x6	983	67	(1,050)	–	–

CU

Reconciliation		
Interest recognised in profit and loss	[CU 70 + CU 70 + CU 66 + CU 67 + CU 67]	340
Interest received	[CU 70 + CU 70 + CU 50 + CU 50 + CU 50]	(290)
	Impairment loss recognised	50

Statement of Profit and Loss for the year ended 31 March (Extract) CU

Date	Particulars	20x2	20x3	20x4	20x5	20x6
31 March	Interest revenue	70	70	66	67	67
	Loss allowance	–	(50)	–	–	–
	Deferred tax income	–	15	–	–	–
	Deferred tax asset	–	–	–	–	(15)

Balance Sheet as at 31 March (Extract) CU

Date	Particulars	20x2	20x3	20x4	20x5	20x6
31 March	Financial asset	1,000	950	966	983	–
	Deferred tax asset	–	15	–	–	–

Statement of Cash Flows for the year ended 31 March (Extract) CU

Date	Particulars	20x2	20x3	20x4	20x5	20x6
31 March	Investing Activities					
	Interest received	70	70	50	50	50
	Repayment of principal	–	–	–	–	1,000