

## Impairment of Financial Assets

An Entity shall recognize a LOSS ALLOWANCE for expected credit loss on the following ÷

- FA measured at Amortised cost or FVTOCI (Except Inv in Equity Instt.)
- Trade Receivables or lease Receivables.
- Loan Commitment or a Financial Guarantee Contract.

Recognition of Impairment loss not required if ÷

- It is a Financial liability or Equity Instruments.
- FA measured at FVTPL. (Eq. Inv in Debt Instrument measured at FVTPL)
- Investment in Equity instrument measured either at FVTPL or FVTOCI.

Q What is Credit loss Allowance ?

Present value of contractual cash flows, **less**, Present value of cash flows Entity expects due to the entity to receive discounted using original EIR.

Loss allowance to be provided are of two types ÷

(i) Lifetime Expected Credit loss

↓

- Trade Receivables / lease Receivables
- Other short term FA
- Credit risk increased significantly.

(ii) 12 months Expected Credit loss

↓

Other FA whose credit risk not increased significantly.

**Note** when contractual payments are more than 30 days due, there is rebuttable presumption that CREDIT RISK INCREASED SIGNIFICANTLY

Credit risk Impaired (Very high risk) Lifetime ECL ↓ Interest on NET FA	Significant increase in Credit risk (moderate to high risk) Lifetime ECL  Interest on GROSS FA	No significant increase in Credit risk (low risk) 12 months ECL  Interest on GROSS FA
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An Entity may use Practical Expedient when measuring Expected Credit loss on Trade Receivables.

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- Calculation of ECL on Trade Receivables using a Provision matrix.
- Entity would use its historical credit experience to measure 12 months ECL on lifetime ECL.

Example Specify Fixed Provision rates depending on number of days that a Trade Receivable is PAST DUE.

1% Provision → If not Past due.

2% Provision → If less than 30 days Past due.

3% Provision → Between 30 days to 90 days Past due.

20% Provision → Between 90 days to 180 days Past due.

E.g.

	<u>0<sup>m</sup></u>	<u>1<sup>st</sup></u>	<u>2<sup>nd</sup></u>	<u>3<sup>rd</sup></u>	<u>4<sup>th</sup></u>	<u>5<sup>th</sup></u>
Amount Due →		50000	50000	50000	50000	50000
						500000
Amount Expected to be received →		40000	40000	40000	40000	350000
		10000	10000	10000	10000	200000

∴ Expected Credit loss  
 ₹ 1692378

Original EIR = 8%

(i) Lifetime Expected Credit loss (100%) = 1692378 { Assume credit risk increased significantly }

(ii) 12 months Expected Credit loss = 92592 { Assume credit risk not increased significantly }

$\langle 10000 \div 1.08 \rangle$

∴

On 10 probability of default is 5% over next 12 months.

∴ 12 months Expected Credit loss = 5% of 1692378  
 = 84618

E.g. Investment in 10% debentures = 50000 { 5 years }  
 Transaction cost = 3000 { FV to CF method }

<u>0<sup>m</sup></u>	<u>1<sup>st</sup></u>	<u>2<sup>nd</sup></u>	<u>3<sup>rd</sup></u>
50000	50000	50000	50000
+ 3000			50000
<u>53000</u>			

10% EIR = 7.685%

<u>Opening Value</u>	<u>Interest @ 7.685%</u>	<u>Receipts</u>	<u>Closing Value</u>
530000	40730	(50000)	520730
520730	40018	(50000)	510748
510748	39252	(550000)	—

Year 1 : Impairment loss = 20000, Fair Value = 450000

Journal

(i) FA	40730	(ii) Loss Allowance (PL)	20000
To Interest Income	40730	OCF	50730
		To FA	70730
(ii) Bank	50000		
To FA	50000		

Year 2 : Loss Allowance = 15000, Fair Value loss = 35000 (total)

Journal

(i) FA	40018	(ii) Loss Allowance (PL)	15000
To Interest Income	40018	OCF	20000
		To FA	35000
(ii) Bank	50000		
To FA	50000		

Year 3 No loss, All recovered

(i) FA	39252	(ii) PL	70730
To Interest Income	39252	To OCF	70730
		↑ Recycling OCF to PL on Disposal / Derecognition	
(ii) Bank	550000		
To FA	444270		
To PL	105730		

1st year

PL Interest  $\rightarrow 40730$  (1st yr)

Loss Allowance  $\rightarrow -20000$  (1st yr)

OCF F.V. Loss  $\rightarrow -50730$  (1st yr)

2nd yr

PL Interest  $\rightarrow 44018$  (2nd yr)

Loss Allowance  $\rightarrow -15000$  (2nd yr)

OCF

FV loss  $\rightarrow -20000$  (2nd yr)

3rd yr

PL Interest  $\rightarrow 39252$  (3rd yr)

De-recognition  $\rightarrow 105730$  (3rd yr)

Reclassification from OCF  $\rightarrow -70730$

OCF  $\rightarrow 70730$

B/Sheet (1st yr End)

Bank  $\rightarrow (530000) + 50000 + 50000$

FA  $530000$

(+) Int @ 7.685%  $40730$

(-) Receipt  $(50000)$

520730

Fair Value Change  $70730$

R.e.A. (1st yr) 450000

(+) Int @ 7.685% on 520730  $40018$

(-) Receipt  $(50000)$

440018

(-) F.V. Change  $(35000)$

R.e.A. (2nd yr) 405018

(+) Int @ 7.685% on 40748  $39252$

(-) Receipt 550000

-105730

+105730

De-recognition

NIL

When Financial Asset credit risk has increased significantly  $\rightarrow$  Calculate interest on Gross FA  
on Gross FA

When Financial Asset credit risk is Credit Impaired  $\rightarrow$  Calculate interest on Net FA  
(after deducting impairment loss)

## Determining whether credit risk has increased significantly.

1. Significant increase in credit risk on other Financial Instruments of same Borrower.
2. Significant change in operating results of the borrower. (eg. Declining Revenue, margins etc)
3. Significant change in Expected Performance and behaviour of the borrower.
4. Reduction in Financial support from Parent Entity.
5. Adverse change in Business, Financial or Economic condition expected to cause significant change in Borrower's ability to meet its debt obligation.
6. Significant change in value of Collaterals or Quality of third party guarantees or Credit Enhancements.
7. Significant adverse change in Regulatory, economic or technological environment of the borrower.

### Illustration 42(OLD SM ILL 43): 12 month expected credit loss - Probability of default approach

Entity A originates a single 10-year amortising loan for CU1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PoD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PoD are a reasonable approximation of the changes in the lifetime PoD for determining whether there has been a significant increase in credit risk since initial recognition. Loss given default (LGD) is estimated as 25% of the balance outstanding. Calculate loss allowance.

#### Solution

At reporting date, no change in 12-month POD and entity assesses that there is no significant increase in credit risk since initial recognition - therefore lifetime ECL is not required to be recognised.

Particulars	Details
Loan	₹ 1,000,000 (A)
LGD	25% (B)
PoD - 12 months	0.5% (C)
Loss allowance (for 12-months ECL)	₹ 1,250 (A*B*C)

Loss Given Default is the amount of money a lender loses when a borrower defaults on a loan, after taking consideration any recovery, represented as a percentage of total exposure at the time of loss.

### Question 3 (RTP Nov'19/MTP Mar'21)

An entity purchases a debt instrument with a fair value of ₹ 1,000 on 15th March, 20X1 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5% over the contractual term of 10 years, and has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset.

On 31st March 20X1 (the reporting date), the fair value of the debt instrument has decreased to ₹ 950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that ECL should be measured at an amount equal to 12 month ECL, which amounts to ₹ 30.

On 1st April 20X1, the entity decides to sell the debt instrument for ₹ 950, which is its fair value at that date.

Pass journal entries for recognition, impairment and sale of debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided.

Solution:

On Initial recognition			
Financial asset-FVOCI	Dr.	₹ 1,000	
To Cash			₹ 1,000
On Impairment of debt instrument			
Impairment expense (P&L)	Dr.	₹ 30	
Other comprehensive income	Dr.	₹ 20	
To Financial asset-FVOCI			₹ 50

The cumulative loss in other comprehensive income at the reporting date was ₹ 20. That amount consists of the total fair value change of ₹ 50 (that is, ₹ 1,000-₹ 950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (₹ 30).

On Sale of debt instrument

On Initial recognition			
Cash A/c	Dr.	₹ 950	
To Financial Asset-FVTOCI			₹ 950
Loss on Sale(P&L)			
To Other Comprehensive Income			₹ 20

B/Sheet (for understanding)

<u>P/L</u>	Loss Allowance →	(30)	Bank (1000) + 950	= (50)
<u>P/L</u>	O/E Recycled to P/L →	(20)	FA	1000
		(50)	(-) Reduction	(50)
<u>O/E</u>	Fair Value Loss →	(20)		950
	Recycling	20	(-) Sale of FA	(950)
		NIL		NIL

On Derecognition, 04 balance of ₹ 30 (Dr.) recycled to P/L.