THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF SRI LANKA

Insights on SLFRS 9 Financial Instruments

Insights into SLFRS 9 *Financial Instruments*

- SLFRS 9 includes requirements for recognition, measurement, impairment, de-recognition and general hedge accounting.
- Effective from for annual periods beginning on or after 1 January 2018.
- SLFRS 9 largely replaces LKAS 39 Financial Instruments: Recognition and Measurement, except Hedge Accounting.

1. Overview of SLFRS 9

Financial Instruments

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

Financial Asset (FA)

Any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

(i) non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

(ii) 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 (FL)

Any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) 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.

Equity Instrument

Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Certain financial instruments that meet the definition of a financial liability are classified as equity instruments.

These are:

- Puttable financial instruments that meet certain specified conditions
- Financial instruments which contain a contractual obligation for the issuing entity to deliver to the holder a pro rata share of its net assets only on liquidation.

2. Comparison of LKAS 39 and SLFRS 9

Criteria	LKAS 39	SLFRS 9
Classification and measurement of financial assets	Had four categories of Financial Assets, i.e. ▪ Fair value through profit or loss (FVTPL) ▪ Loans & receivables (L&R) ▪ Held to maturity (HTM) ▪ Available for sale (residual)	Introduces three categories of Financial Assets, based on the measurement basis, i.e. ▪ Amortised cost ▪ Fair value through Other Comprehensive Income (FVTOCI) ▪ Fair value through profit or loss (unless measured at amortised cost or FVTOCI)
	Classification was dependent on the type of the debt instrument	Classification depends on: ▪ The contractual cash flow characteristics of financial assets. ▪ The entity's business model objective for managing financial assets
	For Financial Assets classified as Available for Sale, the option to present subsequent changes in the FV in OCI was not irrevocable.	Option for equity instruments to present subsequent changes in the FV in OCI is irrevocable.
	Exception was available to measure investments in equity instruments (without having a quoted price in an active market) at the cost, if fair value cannot be assessed at cost.	This exception is no longer available.
	Initially, trade receivables were also need to be measured at fair value.	Allows trade receivables that don't have a significant financing component to be measured at undiscounted invoice price rather than fair value.
Reclassification of Financial Assets	Permitted, provided that there was a change in the intention or ability, but subject to restrictions.	Permits, only if there is a change in the entity's business model objective for its financial assets.
	Tainting rule was applicable for the HTM category.	Not applicable
Classification and measurement of financial liabilities	Entire change in the fair value of financial liabilities designated as FVTPL was always recognised in profit and loss.	The portion of the change attributable to changes in the entity's own credit risk is recognised in OCI, with no recycling*, unless: ▪ OCI presentation would create or enlarge an accounting mismatch in profit and loss; or ▪ the liability is a loan commitment or financial guarantee contract.

*Recycling (the reclassification from equity to P&L) means gains or losses are first recognised in the OCI and then in a later accounting period moved to the P&L.

Criteria	LKAS 39	SLFRS 9
De-recognition	Recycling was permitted, upon de-recognition.	Recycling is permitted only for the debt instruments classified as FVTOCI, when it is de-recognised.
Impairment	Loan losses were accounted using "Incurred loan loss model"	Loan losses need to be accounted using "Expected Credit Loss Model"
	Impairment assessment requirements were applicable for investments in equity instruments as well.	Eliminates impairment assessment requirements for investments in equity instruments, because they can only be measured at FVPL or FVTOCI (an irrevocable option) without recycling of fair value changes to profit and loss.
Embedded derivatives	Embedded derivatives not closely related to a non-trading host contract were measured at FVTPL, but the host contract could be measured at amortised cost. Therefore, separation of the host contract from the derivative was required.	The entire contract has to be measured at FVTPL. As a result, effectively the changes in fair value of both the host contract and the embedded derivative will immediately affect profit and loss. Therefore, in the event the SPPI test is not passed, separation of the host contract (if it is a non-financial asset) from the derivative is not required.

3. Exclusions from SLFRS 9

Excluded Category	Relevant SLFRS
Interests in subsidiaries, associates and joint ventures	SLFRS 10, SLFRS 11, SLFRS 12, LKAS 27 & LKAS 28
Rights and obligations under leases	LKAS 17/ SLFRS 16
Employers' rights and obligations under employee benefit plans	LKAS 19
Rights and obligations arising under Insurance Contracts (other than derivatives and financial guarantee contracts)	SLFRS 4
Financial instruments, contracts and obligations under share-based payment transactions	SLFRS 2
Contracts with discretionary participation feature	SLFRS 4
Forward contract between an acquirer and a selling shareholder to buy or sell an acquiree	SLFRS 3
Loan commitments, other than for the SLFRS 9 requirements for impairment and de-recogniton (except those which are designated at FVTP) can be settled net in cash or by delivering or issuing another financial instrument, commitments to provide a loan at a below-market interest rate - scoped into SLFRS 9)	SLFRS 15
Rights to payments to reimburse the expenditure recognised as a provision to settle a liability	LKAS 37
Equity instruments issued by the entity in accordance with 16A – 16D of LKAS 32	LKAS 32
Financial liabilities issued by an entity that are classified as equity in accordance with 16A to 16D of LKAS 32.	LKAS 32
Rights and obligations within the scope of SLFRS 15 that can be treated as financial instruments, unless specified to be accounted under SLFRS 9.	SLFRS 15

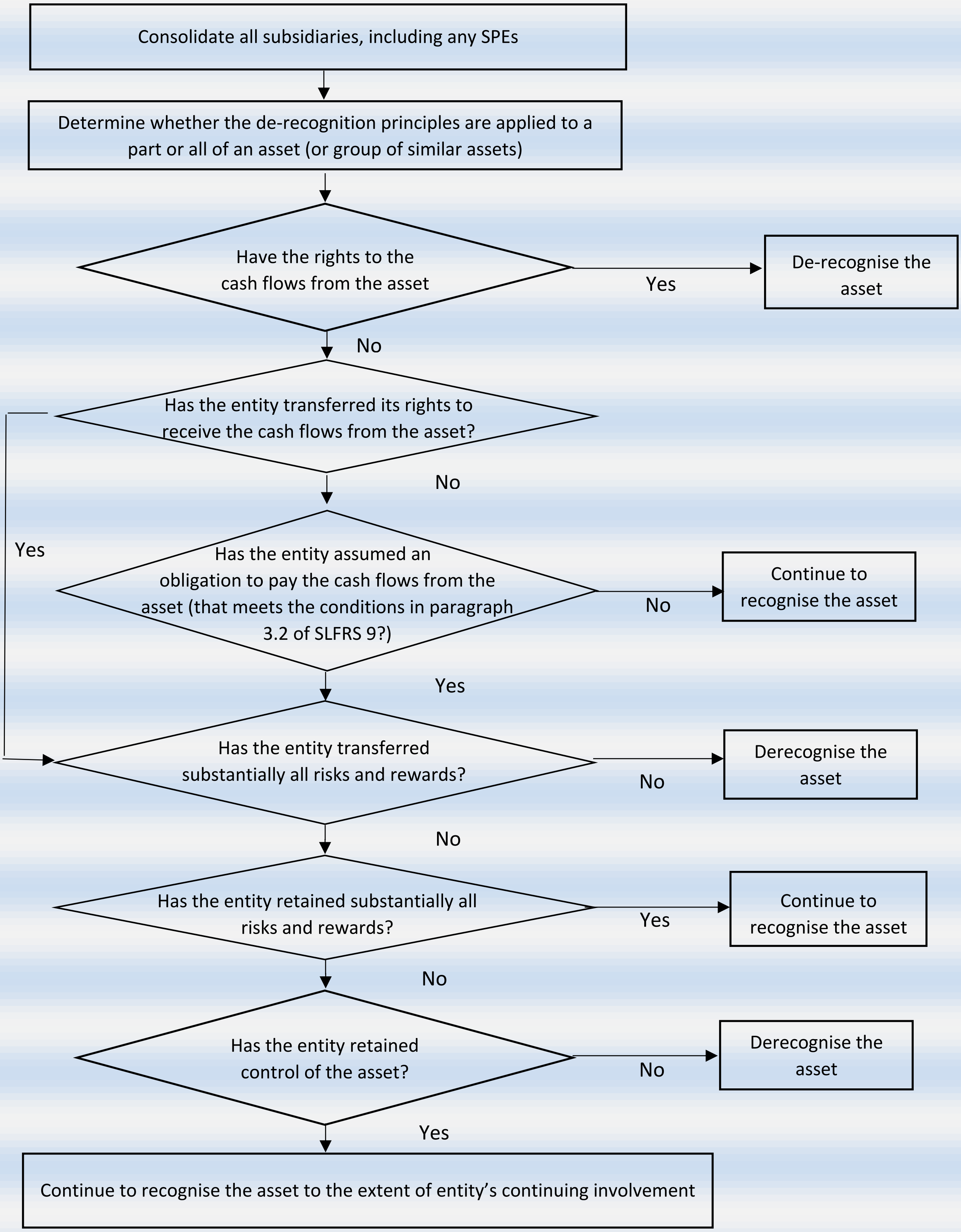
4. Financial Assets

4.1 Recognition and Derecognition of Financial Assets

4.1.1 Initial recognition of Financial Assets

Financial Assets are initially recognised only when the entity becomes a party to the contractual provisions of the instrument.

4.1.2 Derecognition of Financial Assets



On de-recognition of a financial asset in its entirety, the difference between:
(a) the carrying amount (measured at the date of de-recognition) and
(b) the consideration received (including any new asset obtained less any new liability assumed) shall be recognised in profit or loss.

4.2 Classification and Measurement of Financial Assets

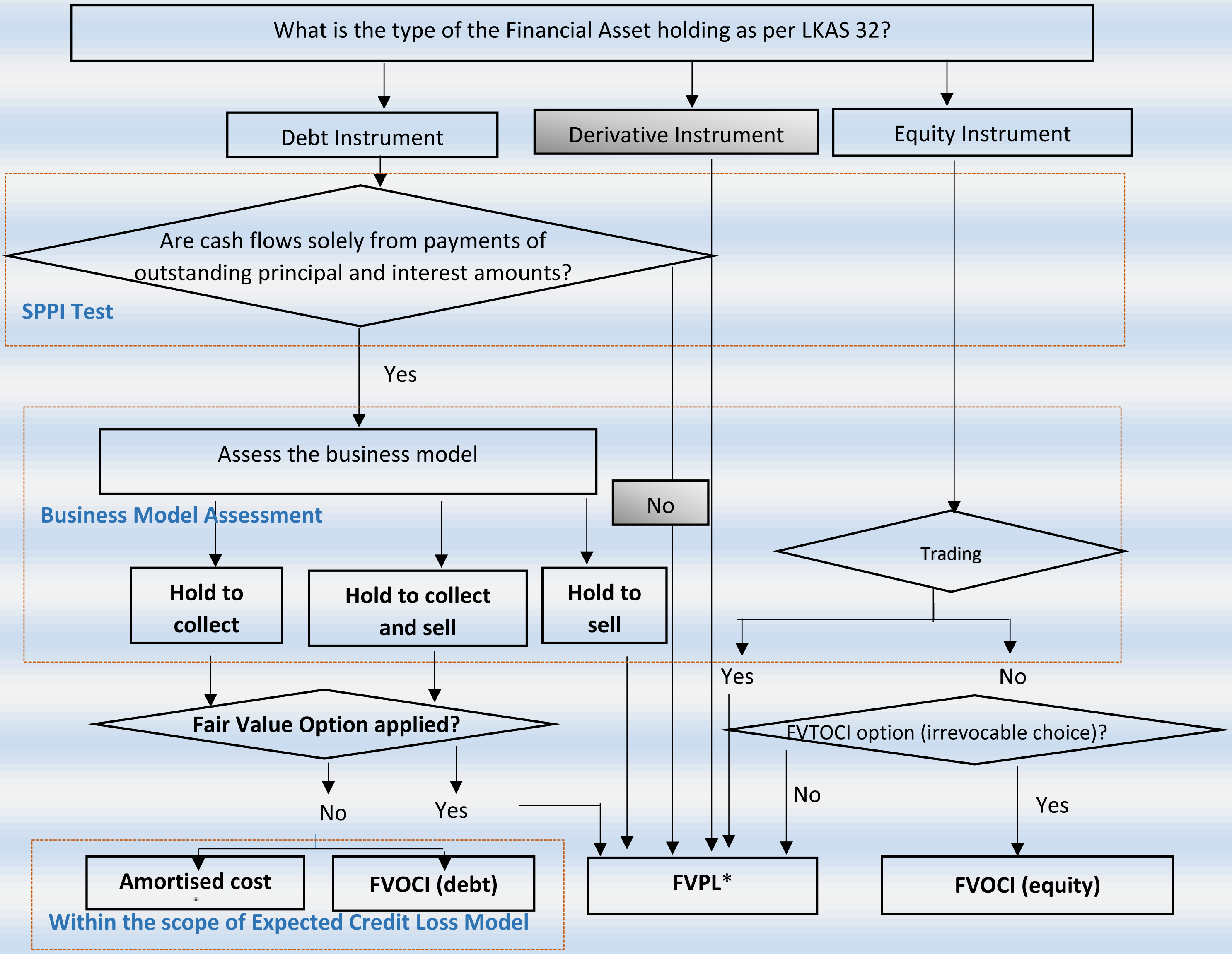
4.2.1 Classification of Financial Assets

Financial assets are classified as:
- Amortised cost;
- Fair value through profit or loss;
- Fair Value through other comprehensive income.

Classification depends on:
- the contractual cash flow characteristics of the financial asset (SPPI test); and
- the entity's business model for managing the financial assets.

Figure 4.2.1 depicts the classification of financial assets and Table 4.2.1 further summarises the same.

Figure 4.2.1- Classification of financial assets



* A derivative measured at FVPTL may be designated as a hedging instrument, except for some written options.

Table 4.2.1- Classification of financial assets

<table>
<tr><th colspan="2" rowspan="3"></th><th colspan="4">Characteristics of Contractual Cash Flows</th></tr>
<tr><th colspan="2">Solely from the principal and interest</th><th colspan="2">Receive additional cash flows as well</th></tr>
<tr><th>FV Option not taken</th><th>FV Option taken</th><th>FV Option not taken</th><th>FV Option taken</th></tr>
<tr><th rowspan="3">Business Model</th><th>Hold assets to collect contractual CFs</th><td>Amortised Cost</td><td>FVPTL</td><td>FVTOCI (without recycling) for equity instruments</td><td>FVTPL</td></tr>
<tr><th>Hold assets to collect contractual CFs & to sell</th><td>FVTOCI (with recycling) for debt instruments</td><td>FVTPL</td><td>FVTPL</td><td>FVTPL</td></tr>
<tr><th>Other (e.g.: held for trading)</th><td>N/A</td><td>FVTPL</td><td>N/A</td><td>FVTPL</td></tr>
</table>

Contractual cash flow characteristics of the financial asset

- In performing this assessment, a detailed instrument-by-instrument analysis of the pool may not be necessary and an entity must use judgement and perform the required analysis to determine whether the instruments in the pool meet the conditions in paragraphs B4.1.23–B4.1.24 of SLFRS 9.
- Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement and with consideration for the time value of and credit risk being typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk), costs (for example, administrative costs) associated with holding the financial asset for a particular period of time and a profit margin that is consistent with a basic lending arrangement.

Business Model for managing the financial assets

- This refers to how an entity manages its financial assets in order to generate cash flows as determined by the entity's key management personnel. That is, the entity's business model determines whether cash flows will result from collecting contractual cash flows through holding the assets, selling financial assets or both.
- This condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation.

4.2.2 Measurement of Financial Assets

4.2.2.1 Initial Measurement of Financial Assets

- Trade receivables at their transaction price, if the trade receivables do not contain a significant financing component in accordance with SLFRS 15.
- Any other financial asset at its fair value (including directly attributable transaction costs for financial instruments not measured at FVTPL).

4.2.2.2 Subsequent Measurement of Financial Assets

Description	Classification of the Financial Asset			
	Amortised Cost	Fair Value Through OCI		Fair Value Through P&L
		Equity Instruments	Debt Instruments	
Initial measurement	FV	FV		FV
Transaction cost	Capitalised	Capitalised		Expensed
Subsequent measurement	Amortised cost	FV		FV
Income recognition	Accrued interest income by applying EIR	Dividends are recognised in P&L	Accrued interest income by applying EIR	Accrued interest income by applying EIR
FV gains & losses	P&L	OCI	OCI	P&L
Impairment losses	P&L	N/A	P&L	P&L
Recycling of FV changes to P&L on de-recognition	N/A	Not permitted	Permitted	N/A

4.2.3 Re-classification of Financial Assets

- Re-classification of financial assets is required if the entity changes its business model for managing those financial assets.
- Re-classification is applied prospectively from the date of the re-classification.

		To the **Financial Assets**		
		Amortised Cost	**FVTPL**	**FVTPL**
From the **Financial Assets**	Amortised Cost	N/A	FV is measured at the reclassification date and difference (between amortised cost & FV) is recognized in OCI	FV is measured at the reclassification date and difference (between amortised cost & FV) is recognized in P&L
	Fair Value Through OCI	Cumulative gain or loss previously recognised in OCI is adjusted against the FV	N/A	Cumulative gain or loss previously recognised in OCI is re-classified to P&L
	Fair Value Through P&L	FV at the re-classification date becomes its new gross carrying amount	Continues to be measured at fair value	N/A

5. Financial Liabilities

5.1 Recognition and Derecognition of Financial Liabilities

5.1.1 Initial recognition of Financial Liabilities

Financial Liabilities are initially recognised only when the entity becomes a party to the contractual provisions of the financial instrument.

5.1.2 Derecognition of Financial Liabilities

- A financial liability is derecognised only when it is extinguished—i.e., when the obligation specified in the contract is discharged or cancelled or expires.

- For this purpose, an exchange between an existing borrower and lender of debt instruments with substantially different terms or substantial modification of the terms of an existing financial liability of part thereof is accounted for as an extinguishment.

The difference between the carrying amount 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.

5.2. Classification and Measurement of Financial Liabilities

5.2.1 Classification of Financial Liabilities

Type of the Financial Liability	Classified Category
Held for trading liabilities	FVTPL
Derivative liabilities	
FV recognition of that liability eliminates or reduces an accounting mismatch	
Liabilities that belong to a group that is managed and its performance evaluated on a FV basis	
Liabilities arise as a result of consideration received when a transfer of a financial asset does not qualify for derecognition and when the continuing involvement approach applies:	
- if the transferred asset is measured at FV	
- if the transferred asset is measured at amortised cost	Amortised Cost
Other financial liabilities	

Financial guarantee contracts and commitments to provide a loan at a below-market interest rate shall be measured after initial recognition, 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 SLFRS 15.

5.2.2 Measurement of Financial Liabilities

Description		Classification	
		Amortised Cost	**Fair Value Through P&L**
Initial measurement		FV	FV
Subsequent measurement		At Amortised cost	At FV
FV gains	attributable to changes in the credit risk	Recognise in P&L	Recognise in OCI*
	remaining amount		Recognise in P&L

* If the recognition creates or enlarges an accounting mismatch in profit or loss, all gains or losses on that liability (including the effects of changes in the credit risk of that liability) shall be presented in profit or loss.

5.2.3 Reclassification of Financial Liabilities

Reclassification of financial liabilities is not permitted under SLFRS 9.

6. Impairment

6.1 Highlights

- The Impairment model under SLFRS 9 is forward-looking and changes the way loan loss provisions are recognised and measured.
- At the initial recognition, at a minimum of 12 months Expected Credit Losses (ECL) is rcognised in profit or loss for financial assets measured at amortised cost or FVTOCI.
- After initial recognition, Lifetime Expected Credit Losses (LECL) will be recognised on assets for which there is a significant increase in credit risk (except for the purchased or originated credit-impaired financial assets).
- The impairment model follows a three-stage approach based on changes in expected credit losses of a financial instrument that determine the recognition of impairment and the recognition of interest revenue.

6.2 Scope of SLFRS 9

The following would be subject to impairment testing:

- Financial assets measured at amortised cost;
- Financial assets mandatorily measured at FVTOCI;
- Loan commitments when there is a present obligation to extend credit (except where these are measured at FVTPL);
- Financial guarantee contracts to which SLFRS 9 is applied (except those measured at FVTPL);
- Lease receivables within the scope of LKAS 17 Leases; and
- Contract assets within the scope of SLFRS 15 Revenue from Contracts with Customers (i.e., rights to consideration following transfer of goods or services).

6.3 Impairment Model under SLFRS 9 at a glance

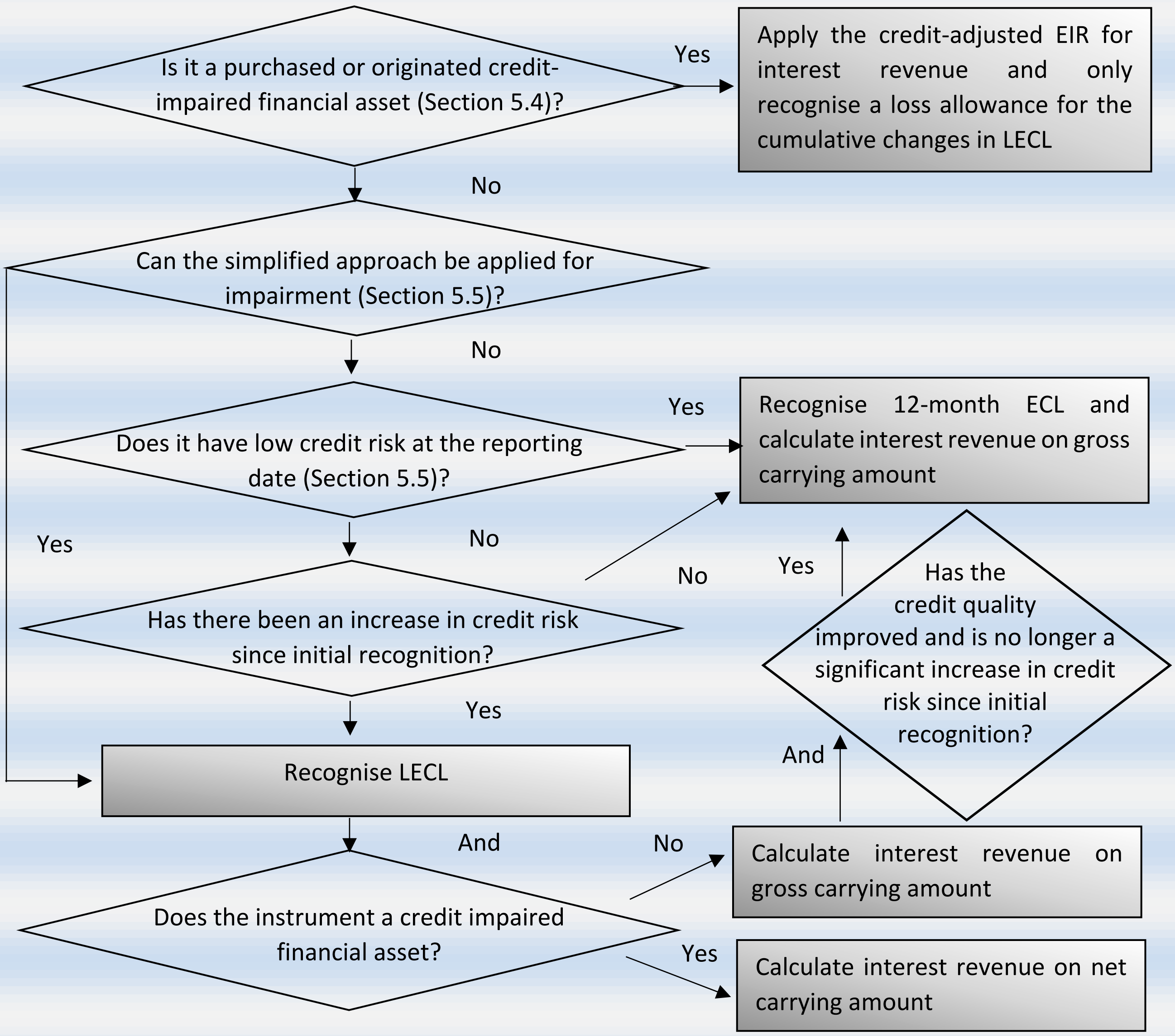
<table>
<tr><th colspan="2">Criteria</th><th>Stage 1</th><th>Stage 2</th><th>Stage 3</th></tr>
<tr><td colspan="2">Category</td><td>Performing</td><td>Under - performing</td><td>Non - Performing</td></tr>
<tr><td colspan="2">Status of Credit risk</td><td>Credit risk has not increased significantly since the initial recognition</td><td>Credit risk has increased significantly since the initial recognition</td><td>Credit impaired</td></tr>
<tr><td rowspan="2">Recognition of impairment as per SLFRS 9</td><td>Initial Recognition</td><td>12 month ECL</td><td colspan="2">LECL for purchased or originated credit-impaired financial assets</td></tr>
<tr><td>Subsequent Recognition</td><td>12 month ECL</td><td colspan="2">LECL</td></tr>
<tr><td colspan="2">Recognition of Interest</td><td colspan="2">Effective interest on the gross carrying amount</td><td>Effective interest on the net (carrying) amount</td></tr>
</table>

<table>
<tr><td colspan="2">Expected Credit Loss
An entity shall measure expected credit losses of a financial instrument in a way that reflects:
(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
(b) time value of money; 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.</td></tr>
<tr><td>12-month expected credit losses
The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that is possible within the 12 months after the reporting date.</td><td>Lifetime expected credit losses
The expected credit losses that result from all possible default events over the expected life of a financial instrument.</td></tr>
</table>

6.4 Impairment approaches

<table>
<tr><th>Criteria</th><th>Simplified approach</th><th>General approach</th></tr>
<tr><td>Applicability</td><td>▪ For trade receivable or contract assets that:
- do not contain a significant financing component as per SLFRS 15; or
- if the entity chooses as an accounting policy.
▪ All lease receivables that result from transactions that are within the scope of LKAS 17. The policy choice may be applied separately to finance & operating leases</td><td>▪ Financial assets that are debt instruments measured at amortised cost
▪ Financial assets that are debt instruments measured at FVTOCI
▪ Lease receivables under LKAS 17 (accounting policy choice)
▪ Contract assets under SLFRS 15
▪ Loan commitments and financial guarantee contracts that are designated as at FVTPL.</td></tr>
<tr><td rowspan="2">Recognition of Impairment Provision</td><td>Simplified approach does not require an entity to track the changes in credit risk. Instead, it requires the entity to recognize a loss allowance based on the lifetime expected credit loss as of the reporting date.</td><td>Three-stage ECL impairment model is applicable considering the credit risk on that financial instrument.</td></tr>
<tr><td>The changes in the loss allowance balance are recognised in profit or loss as an impairment gain or loss.</td><td>The changes in the loss allowance balance are recognised in P&L (OCI for FVTOCI assets) as an impairment gain or loss.</td></tr>
</table>

6.5 Process of recognising impairment under SLFRS 9



6.6 Related concepts under Impairment

6.6.1 Collective and individual assessment basis to recognise LECL for significant increases in credit risk since initial recognition

It may be necessary to perform the assessment of significant increases in credit risk on a collective basis by considering information that is indicative of significant increases in credit risk (e.g., on a group or sub-group of financial instruments).

The objective is to ensure that an entity meets the objective of recognizing lifetime expected credit losses when there are significant increases in credit risk, even if evidence of such significant increases in credit risk at the individual instrument level is not yet available.

6.6.2 Rebuttable presumption over more than 30 days past due

- Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are due after more than 30 days. Then, the financial asset is considered to be in Stage 2 and lifetime expected credit losses would be recognised.
- Subject to reasonable and supportable information to demonstrate that the credit risk has not increased significantly since initial recognition, even though the contractual payments are more than 30 days past due this presumption can be rebutted.
- 30 days past due simplification to measure the significant increase in credit risk permits the use of delinquency together with other more forward looking information, to identify a significant increase in credit risk. The 30 days past due rebuttable presumption serves as a backstop even when forward looking information is used.

6.6.3 Default

The standard does not define default; instead, it requires entities to be consistent with their internal credit risk management policies consistently from one period to another.

The notion of default is fundamental to the application of the model, particularly because it affects the subset of the population that is subject to lifetime expected credit losses. The standard restricts diversity resulting from this effect by establishing a rebuttable presumption that default does not occur later than 90 days past due.

6.6.4 Financial instruments that have low credit risk at the reporting date

If the financial instrument is determined to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument, (i.e., low risk of default and the borrower has a strong capacity to meet its contractual cash flow obligations at the reporting date), an entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition.

The credit risk on a financial instrument is considered low and if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

Lifetime expected credit losses are not recognised as it was considered to have low credit risk in the previous reporting period and is not considered at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognized at each subsequent reporting periods.

6.7 Calculation of Expected Credit Loss (ECL)

Recognition of a loss allowances	Components of ECL Calculation	Basis of Impairment
▪ Delinquency Based Approach (DPD) ▪ Internal Rating Based Approach ▪ Qualitative factors taking into consideration the credit risk characteristics at initial recognition (subject to continuous review)	▪ Probability of Default (PD) ▪ Exposure at Default (EAD) ▪ Loss Given Default (LGD) ▪ Probability weighted multiple economic factor adjustment ▪ Discount Factor (DF)/time value of money	▪ Individual Impairment ▪ Collective Impairment

7. Hedge Accounting

7.1 Overview

- SLFRS 9 better aligns hedge accounting with risk management activities of an entity.
- When an entity first applies SLFRS 9, it may choose as its accounting policy choice to continue to apply the hedge accounting requirements of LKAS 39 (along with IFRIC 16) instead of the requirements of Chapter 6 of SLFRS 9 (SLFRS 9 para 7.2.21)
- Hedge Accounting requirements can be applied prospectively (subject to exceptions in para 7.2.26).
- Entities may apply LKAS 39 requirements for fair value hedges of the interest rate exposure of a portfolio of financial assets or financial liabilities (commonly referred as ‘fair value macro hedges’), as it is not addressed in SLFRS 9 yet.

7.2 Objective

The objective is to represent, in the financial statements, the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss or other comprehensive income.

7.3 Qualifying criteria for hedge accounting

A hedging relationship qualifies for hedge accounting only if all of the following criteria are to be met):
- Consists only of eligible hedging instruments and eligible hedged items.
- At the inception, there is formal designation and documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge.
- Meets all of the hedge effectiveness requirements:
  - an economic relationship exists between the hedged item and the hedging instrument;
  - credit risk does not dominate the value changes; and
  - the designated hedge ratio is consistent with risk management strategy.

7.4 Hedging instruments

Only contracts with a party external to the reporting entity may be designated as hedging instruments and they may be:
- derivatives (except for some written options) measured at FVTPL; or
- non-derivative financial instruments measured at FVTPL (unless FVTPL financial liabilities where changes due to credit risk are presented in OCI). For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument, except equity investments designated as FVTOCI, may be designated as the hedging instrument.

Designation of hedging instruments

A qualifying instrument must be designated in its entirety as a hedging instrument, subject to exceptions in para 6.2.4.

SLFRS 9 allows combinations of derivatives and non-derivatives to be designated as the hedging instrument. Combinations of purchased and written options do not qualify as a hedging instrument if it is, in effect, a net written option at the date of designation (unless it qualifies in accordance with paragraph B6.2.4).

7.5 Hedged items

A hedged item is a ready measurable asset or liability, an unrecognised firm commitment, a highly probable forecast transaction or a net investment in a foreign operation. It may be a single item, or a group of items (subject to the following:

- it consists of items individually, eligible hedged items;
- the items are managed on a group basis for risk management purposes; and
- for group cash flow hedges: where cash flow variability is not expected to be approximately proportional to the overall group cash flows variability, both:
  - Foreign currency is being hedged
  - The reporting period, nature, and volume, in which the forecast transactions are expected to affect profit or loss are specified.

7.6 Hedge Accounting Models

7.6.1 Fair Value Hedges

A hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss.

Recognition:

- Gain or loss on the hedging instrument is recognised in profit or loss (if an equity instrument at FVTOCI, then recognised in OCI).
- Gain or loss on the hedged item is recognised in profit or loss and the carrying amount is adjusted.
- When a hedged item is an unrecognised firm commitment the cumulative hedging gain or loss is recognised as an asset or a liability with a corresponding gain or loss recognised in profit or loss.
- If the hedged item is a debt instrument measured at amortized cost or FVTOCI any hedge adjustment is amortised to profit or loss based on a re-calculated effective interest rate. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses.

7.6.2 Cash Flow Hedges

A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect profit or loss. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.

Recognition:

- Hedge effectiveness is recognised in OCI ·
- Hedge ineffectiveness is recognised in profit or loss
- The lower of the cumulative gain or loss on the hedging instrument or fair value in the hedged item is recognised separately within equity (cash flow hedge reserve (CFHR)).
- For forecast transactions resulting in a non-financial asset/liability, the amount recognised in CFHR is removed and included in the initial cost of the non-financial asset/liability. This is not accounted for as a re-classification.
- For all other forecast transactions, the amount recognized in CFHR is re-classified to profit or loss in the periods when the cash flows are expected to affect profit or loss.

7.6.3 Net Investment Hedges

Hedge of a net investment in a foreign operation as defined in LKAS 21, including a hedge of a monetary item that is accounted for as part of the net investment, is accounted for similarly to cash flow hedges, i.e., the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized in OCI; and the ineffective portion is recognised in profit or loss.

Recognition:

- Hedge effectiveness is recognised in OCI
- Hedge ineffectiveness is recognised in profit or loss
- Upon disposal of the foreign operation, accumulated amounts in equity are reclassified to profit or loss.

7.7 Re-balancing

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio, but the risk management objective for that designated hedging relationship remains the same, an entity shall adjust the hedge ratio of the hedging relationship so that it meets the qualifying criteria again.

7.8 Discontinuation

Hedge accounting is discontinued only if the qualifying criteria are no longer met (after applying 'rebalancing'). This includes hedging instrument sale /termination / expiration, but excludes:

- Replacement/rollovers documented in the risk management objective;
- Novation of hedging instruments (subject to specific criteria).

Abbreviations

AFS	Available For Sale
CA	Carrying Amount
CFHR	Cash Flow Hedge Reserve
EIR	Effective Interest Rate
ECL	Expected Credit Losses
FVPL	Fair Value through Profit or Loss
FV	Fair Value
FVTOCI	Fair Value through OCI
HTM	Held to Maturity
L&R	Loans & receivables
LECL	Lifetime Expected Credit Losses
OCI	Other Comprehensive Income
P&L	Profit and Loss
SPEs	Special Purpose Entities