INDAS – 109 & 32
FINANCIAL INSTRUMENTS

(TOTAL NO. OF QUESTIONS – 44)

INDEX

RTPs QUESTIONS

Q.1 (RTP May 18, MTP Oct.20, MTP April 19, MTP Nov.19, MTP Aug. 18)

On 1st April, 20X4, Shelter Ltd. issued 5,000, 8% convertible debentures with a face value of Rs 100 each maturing on 31st March, 20X9. The debentures are convertible into equity shares of Shelter Ltd. at a conversion price of Rs 105 per share. Interest is payable annually in cash. At the date of issue, Shelter Ltd. could have issued non-convertible debt with a 5-year term bearing a coupon interest rate of 12%. On 1st April, 20X7, the convertible debentures have a fair value of Rs 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for Rs 5,25,000, which the holders accepted. At the date of repurchase, Shelter Ltd. could have issued non-convertible debt with a 2-year term bearing a coupon interest rate of 9%.

Show accounting entries in the books of Shelter Ltd. for recording of equity and liability component:

1. At the time of initial recognition and
2. At the time of repurchase of the convertible debentures.

The following present values of Rs 1 at 8%, 9% & 12% are supplied to you:

Interest Rate	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.926	0.857	0.794	0.735	0.681
9%	0.917	0.842	0.772	0.708	0.650
12%	0.893	0.797	0.712	0.636	0.567

SOLUTION

1. The reversal of impairment loss took place in the 6th year. However, goodwill is amortised in 5 years. Therefore, there would be no balance in the goodwill account in the 6th year even without impairment loss. Hence in W.N. 2 above there is no column for recalculation of goodwill.

(i) At the time of initial recognition

	Rs
Liability component	
Present value of 5 yearly interest payments of Rs 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component	
(Rs 5,00,000 – Rs 4,27,700)	72,300
Total proceeds	**5,00,000**

Note: Since Rs 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs 100 each only.

Journal Entry

	Rs	Rs
Bank Dr.	5,00,000	
To 8% Debentures (Liability component)		4,27,700
To 8% Debentures (Equity component)		72,300
(Being Debentures are initially recorded a fair value)		

(for understanding only)

Financial Liability Account

Year	Debit	Amount	Credit	Amount
1	To bank To bal c/f	40,000 4,39,024	By Bank By interest	4,27,700 51,324
2	To bank To bal c/f	40,000 4,51,707	By bal b/f By interest	4,39,024 52,683
3	To bank To bal c/f	40,000 4,66,100	By bal b/f By interest*	4,51,707 54,393

(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference	Effect
	Rs	Rs	Rs	
Liability component				
Present value of 2 remaining yearly interest payments of Rs 40,000, discounted at 12% and 9%, respectively	67,600	70,360		
Present value of Rs 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	3,98,500	4,21,000		
Liability component	4,66,100	4,91,360	(25,260)	increase in liab
Equity component	72,300	33,640* (5,25,000 – 4,91,360)	38,660	decrease in equity
Total	**5,38,400**	**5,25,000**	**13,40**	

Note - FV on date of modification = 5,25,000 (given). Do not take 5,00,000

Journal Entries

	Rs.	Rs.
8% Debentures (Liability component) Dr. Profit and loss A/c (Debt settlement expense) Dr. To Bank A/c (Being the repurchase of the liability component recognised)	4,66,100 25,260	 4,91,360
8% Debentures (Equity component) Dr. To Bank A/c To Reserves and Surplus A/c (Being the cash paid for the equity component recognised)	72,300	 33,640 38,660

Entries for Year 3 (after modification)

1. P/L Dr. 25,260
   To Financial Liability 25,260
2. 8% Debentures Dr 38,660
   To General Reserve 38,660

Q2 (Nov 18)

On 1st April 2017, A Ltd. lent Rs. 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company Rs10 lakhs. The company has agreed not to charge interest on this loan to help the supplier's short-term cash flow but expected the supplier to repay Rs2.40 crores on 31st March 2019. As calculated by the finance team of the company, the effective annual rate of interest on this loan is 6.9% On 28th February 2018, the company received the information that poor economic climate has caused the supplier significant problems and in order to help them, the company agreed to reduce the amount repayable by them on 31st March 2019 to Rs2.20 crores. Suggest the accounting entries as per applicable Ind AS.

SOLUTION

The loan to the supplier would be regarded as a financial asset. The relevant accounting standard Ind AS 109 provides that financial assets are normally measured at fair value.

If the financial asset in which the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these inflows rather than dispose of the asset to a third party, then Ind AS 109 allows the asset to be measured at amortised cost using the effective interest method.

If this method is adopted, the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value Rs. 2,10,00,000.

Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due. The income recognised in the current period is Rs. 14,49,000 (Rs. 2,10,00,000 x 6.9%)

In the absence of information regarding the financial difficulties of the supplier the financial asset at 31st March, 2018 would have been measured at Rs. 2,24,49,000 (Rs. 2,10,00,000 + 14,49,000). The information regarding financial difficulty of the supplier is objective evidence that the financial asset suffered impairment at 31st March 2018.

The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be Rs. 2,05,79,981 (Rs. 2,20,00,000 / 1.069). The reduction in carrying value of Rs. 18,69,019 (Rs. 2,24,49,000 – 2,05,79,981) would be charged to profit or loss in the current period as an impairment of a financial asset.

Therefore, the net charge to profit or loss in respect of the current period would be Rs. 4,20,019 (18,69,019 – 14,49,000).

Q3 (May 19)

KK Ltd. has granted an interest free loan of Rs 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:

1. *The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.*
2. *The said Loan is interest free and will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loans is 10%. Considering the same, the fair value of the loan at initial recognition is Rs 8,10,150.*

3. The said loan is interest free and will be repaid as and when the YK Ltd. has funds to repay the Loan amount.
4. Further the Company is also planning to grant interest free loan from YK Ltd. to KK Ltd. in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS?

Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year for the above loan.

SOLUTION

Scenario (i)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. KK Ltd. and YK Ltd. should recognize financial assets and liability, respectively, at the amount of loan given (assuming that loan is repayable within a year). Upon repayment, both the entities should reverse the entries that were made at the origination.

Journal entries in the books of KK Ltd.

At origination	
Loan to YK Ltd. A/c Dr	Rs 10,00,000
To Bank A/c	Rs 10,00,000
On repayment	
Bank A/c Dr. To Loan to YK Ltd. A/c	Rs 10,00,000 Rs 10,00,000

Journal entries in the books of YK Ltd.

At origination	
Bank A/c Dr. To Loan from KK Ltd. A/c	Rs 10,00,000 Rs 10,00,000
On repayment	
Loan from KK Ltd. A/c Dr. To Bank A/c	Rs 10,00,000 Rs 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan receivable and loan payable will get set off.

Scenario (ii)

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain types of instruments may be exchanged at off market terms (i.e., different from market terms for a similar instrument if exchanged between market participants).

If a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then the fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will be treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of Rs10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as Rs8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (holding Company) (for one year)

At origination Loan to YK Ltd. A/c Dr. Investment in YK Ltd. A/c Dr. To Bank A/c During periods to repayment- to recognise interest	 Rs 8,10,150 Rs 1,89,850	 Rs 10,00,000
Year I – Charging of Interest		
Loan to YK Ltd. A/c Dr. To Interest income A/c	Rs 81,015	 Rs 81,015
Transferring of interest to Profit and Loss		
Interest income A/c Dr.	Rs 81,015	
To Profit and Loss A/c On repayment Bank A/c Dr. To Loan to YK Ltd. A/c	 Rs 10,00,000	Rs 81,015 Rs 10,00,000
Note- Interest needs to be recognised in statement of profit and loss. The same cannot be adjusted against capital contribution recognised at origination.		

Journal entries in the books of YK Ltd. (Subsidiary Company) (for one year)

At origination	
Bank A/c Dr.	Rs 10,00,000
To Loan from KK Ltd. A/c	Rs 8,10,150
To Equity Contribution in KK Ltd. A/c	Rs 1,89,850
During periods to repayment- to recognise interest	
Year I	
Interest expense A/c Dr.	Rs 81,015
To Loan from KK Ltd. A/c	Rs 81,015
On repayment	
Loan from KK Ltd. A/c Dr.	Rs 10,00,000
To Bank A/c	Rs 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

Scenario (iii)

Generally, a loan which is repayable when funds are available, cannot be stated as loan repayable on demand. Rather the entity needs to estimate the repayment date and determine its measurement accordingly by applying the concept prescribed in Scenario

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

Scenario (iv)

In case the subsidiary YK Ltd. is planning to grant interest free loan to KK Ltd., then the difference between the fair value of the loan on initial recognition and its nominal value should be treated as dividend distribution by YK Ltd. and dividend income by the parent KK Ltd.

Journal entries

In books of parent	In books of subsidiary
Bank a/c Dr. To Financial Liability a/c (at Present Value) To Dividend Income (P/L)	Financial Asset (Loan) a/c Dr. Dividend (P&L) a/c Dr. To Bank a/c

Q4 (RTP - November 19 & MTP March 21 – 5 Marks)

An entity purchases a debt instrument with a fair value of Rs. 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 decreased to Rs. 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 Rs. 30.

On 1st April 20X1, the entity decided to sell the debt instrument for Rs. 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

	Debit (Rs)	Credit (Rs)
Financial asset-FVOCI Dr.	1,000	
To Cash		1,000

On Impairment of debt instrument

	Debit (Rs.)	Credit (Rs.)
Impairment Exp. (P&L) Dr.	30	
Other Comprehensive Income Dr.	20	
To Financial Asset FVTOCI		50

The cumulative loss in other comprehensive income at the reporting date was Rs 20. That amount consists of the total fair value change of Rs 50 (that is, Rs 1,000-Rs 950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (Rs30).

	Debit (Rs)	Credit (Rs)
Cash	950	
To Financial asset –FVOCI		950
Loss on sale (P&L)	20	
To Other comprehensive income		20

Q5 (Nov. 19)

An Indian entity, whose functional currency is rupees, purchases USD denominated bonds at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = Rs 40 and USD 1 = Rs 45, respectively. The weighted average exchange rate for the year is 1 USD = Rs 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in an effective interest rate (EIR) of 10% p.a. Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees)

SOLUTION

Computation of amounts to be recognized in the P&L & OCI:

Particulars	USD	Exchange rate	Rs
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	45	47,700
Interest income to be recognized in P & L			4,200
Exchange gain on the principal amount [1,000 x (45-40)]			5,000
Exchange gain on interest accrual [100 x (45 - 42)]			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI [45 x (1,060 - 1,041)]			855

Journal entry to recognize gain/loss

Bond (Rs 47,700 – Rs 40,000) Dr.	7,700	
Bank (Interest received) Dr.	2,655	
To Interest Income (P & L)		4,200
To Exchange gain (P & L)		5,300
To OCI (fair value gain)		855

Q6 (RTP - May 20 & MTP March 21 – 5 Marks)

XYZ issued Rs 4,80,000 4% redeemable preference shares on 1st April 20X5 at par. Interest is paid annually in arrears, the first payment of interest amounting Rs 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by the accountant. The preference shares are redeemable for a cash amount of Rs 7,20,000 on 31st March 20X8. The effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity by the accountant as this reflects the legal nature of the shares. Board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

Mukesh, Accounts manager of XYZ has been told to review the accounting of aforesaid issues. CFO has asked from Mukesh the closing balance of preference shares at the year end. If you were Mukesh, then how much balance you would have shown to CFO on analysis of the stated issue. Prepare necessary adjusting journal entry in the books of account, if required.

SOLUTION

The preference shares provide the holder with the right to receive a predetermined amount of annual dividend out of profits of the company, together with a fixed amount on redemption.

Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is equivalent to the repayment of a loan.

Under Ind AS 32 'Financial Instruments: Presentation' these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18%.

Year	1 April, 20X5 Rs	Interest @18% Rs	Paid at 4% Rs	31 March, 20X6 Rs
20X5-20X6	480,000	86,400	(19,200)	547,200

Accordingly, the closing balance of Preference shares at year end i.e. 31st March, 20X6 would be Rs 5,47,200.

Accountant has inadvertently debited interest of Rs 19,200 in the profit and loss. However, the interest of Rs 86,400 should have been debited to profit and loss as finance charge.

Similarly, amount of Rs 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by Rs 480,000 proceeds of issue and Rs 67,200 (86,400 – 19,200) i.e. total by 5,47,200.

Necessary adjusting journal entry to rectify the books of accounts will be:

	Rs	Rs	Remarks
Preference share capital (equity) (Balance sheet) Dr.	4,80,000		
Finance costs (Profit and loss) Dr.	86,400		actual cost

To Equity – Retained earnings (Balance sheet)		19,200	reversal
To Preference shares (Long-term Borrowings) (Balance sheet)		5,47,200	

Q7 (May 21 & Newly Added in Latest ICAI Module for May22 Onwards)

On 1 April 20X1, Sun Limited guaranteed a Rs. 10,00,000 loan of Subsidiary – Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%. Sun Limited does not charge Moon Limited for providing the guarantee.

On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

Provide the accounting treatment of financial guarantee as per Ind AS 109 in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3.

SOLUTION

1. 1 April 20X1

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee

Particulars	Year 1 (Rs.)	Year 2 (Rs.)	Year 3 (Rs.)	Total (Rs.)
Cash flows based on interest rate of 11% (A)	1,10,000	1,10,000	1,10,000	3,30,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	2,40,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000
Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guarantee contract (at inception)				73,320

Journal Entry

Particulars	Debit (Rs.)	Credit (Rs.)
Investment in subsidiary Dr. To Financial guarantee(liability)	73,320	 73,320
(Being financial guarantee initially recorded)		

31 March 20X2

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

- *the amount of loss allowance; and*
- *the amount initially recognised less cumulative amortization, where appropriate.*

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore Rs.10,000 (Rs.10,00,000 x 1%).

The initial amount recognised less amortisation is Rs.51,385 (Rs.73,320 + Rs.8,065 (interest accrued based on EIR)) – Rs. 30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.

Year	Opening balance Rs.	EIR @11%	Benefits provided Rs.	Closing balance Rs.
1	73,320	8,065	(30,000)	51,385
2	51,385	5,652	(30,000)	27,037
3	27,037	2,963*	(30,000)	

** Difference is due to approximation*

The carrying amount of the financial guarantee liability after amortisation is therefore Rs. 51,385, which is higher than the 12-month expected credit losses of Rs. 10,000. The liability is therefore adjusted to Rs.51,385 (the higher of the two amounts) as follows:

Particulars	Debit (Rs.)	Credit (Rs.)
Financial guarantee (liability) Dr.	21,935	
To Profit or Loss		21,935
(Being financial guarantee subsequently adjusted)		

31 March 20X3

On 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore Rs.30,000 (Rs.10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is Rs. 27,037, which is lower than the 12-month expected credit losses (Rs.30,000). The liability is therefore adjusted to Rs.30,000 (the higher of the two amounts) as follows:

Particulars	Debit (Rs.)	Credit (Rs.)
Financial guarantee (liability) Dr.	21,385*	
To Profit or loss (Note)		21,385
(Being financial guarantee subsequently adjusted)		

** The carrying amount at the end of 31 March 20X2 = Rs. 51,385 less 12-month expected credit losses of Rs.30,000.*

Q8 (November 21) – (Similar to Q1.)

On 1st April, 20X1, PS Limited issued 6,000, 9% convertible debentures with a face value of Rs. 100 each maturing on 31st March, 20X6. The debentures are convertible into equity shares of PS Limited at a conversion price of Rs. 105 per share. Interest is payable annually in cash. At the date of issue, non-convertible debt could have been issued by the company at a coupon rate of 13%. On 1st April, 20X4, the convertible debentures have a fair value of Rs. 6,30,000. PS Limited makes a tender offer to debenture-holders to repurchase the debentures for Rs. 6,30,000 which the debenture holders accepted. At the date of repurchase, PS Limited could have issued non-convertible debt with a 2 years term bearing coupon interest @ 10%.

Show accounting entries in the books of PS Limited for recording of equity and liability component:

(i) At the time of initial recognition

(ii) At the time of repurchase of the convertible debentures

SOLUTION

At the time of initial recognition

	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs. 54,000, discounted at 13% annuity (54,000 x 3.517)	1,89,918
Present value of Rs. 6,00,000 due at the end of 5 years, discounted at 13%, compounded yearly (6,00,000 x 0.543)	3,25,800
Equity component	5,15,718
(Rs. 6,00,000 – Rs. 5,15,718)	84,282
Total proceeds	**6,00,000**

Note: Since Rs 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs 100 each only.

Journal Entry

	Rs.	Rs.
Bank Dr.	6,00,000	
To 9% Debentures (Liability component)		5,15,718
To 9% Debentures (Equity component)		84,282
(Being debentures initially recorded at fair value)		

At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 13%	Fair Value @ 10%	Difference
	Rs.	Rs.	Rs.
Liability component			
Present value of 2 remaining yearly interest payments of Rs. 54,000,			

discounted at 13% and 10%, respectively	90,072	93,690	
Present value of Rs. 6,00,000 due in 2 years, discounted at 13% and 10%, compounded yearly, respectively	4,69,800	4,95,600	
Liability component	5,59,872	5,89,290	(29,418)
Equity component	84,282*	40,710**	43,572
Total	**6,44,154**	**6,30,000**	**14,154**

***See Note**

**6,30,000 – 5,89,290 = 40,710

Journal Entries

	Rs.	Rs.
9% Debentures (Liability component) Dr.	5,59,872	
Profit and loss A/c (Debt settlement expense) Dr.	29,418	
To Bank A/c		5,89,290
(Being the repurchase of the liability component recognised)		
9% Debentures (Equity component) Dr.	84,282	
To Bank A/c		40,710
To Retained Earnings A/c		43,572
(Being the cash paid for the equity component recognised)		

Q9 (Nov. 21)

i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of Rs. 10. Entity XYZ's after-tax maintainable profits are estimated at Rs. 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

ii) Based on the facts given in the aforementioned part (i), assume that Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is Rs. 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

SOLUTION

i) An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

Particulars	Unit
Entity XYZ's after-tax maintainable profits (A)	Rs. 70,000
Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of Company XYZ (A) x (B) x (C)	Rs. 8,40,000

Value of a share of XYZ = Rs. 8,40,000 ÷ 5,000 shares = Rs. 168

The fair value of Entity A's investment in XYZ's shares is estimated at Rs. 42,000 (that is, 250 shares × Rs. 168 per share).

ii) Share price = Rs. 8,50,000 ÷ 5,000 shares = Rs. 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be Rs. 42,500 (250 shares × Rs. 170 per share).

Q10 (Nov. 22)

On 1st April, 20X1 an entity granted an interest-free loan of Rs. 5,00,000 to an employee for a period of three years. The market rate of interest for similar loans is 5% per year.

On 31st March, 20X3, because of financial difficulties, the employee asked to extend the interest-free loan for further three years. The entity agreed. Under the restructured terms, repayment will take place on 31st March, 20X7. However, the entity only expects to receive a payment of Rs. 2,50,000, given the financial difficulty of the employee.

Explain the accounting treatment on initial recognition of loan and after giving effect of the changes in the terms of the loan as per Ind AS 109. Support your answer with Journal entries and amortised cost calculation, as on the date of initial recognition and on the date of change in terms of loan.

SOLUTION

As the loan is not at a market interest rate, hence it is not recorded at the transaction price of Rs. 5,00,000. Instead, the entity measures the loan receivable at the present value of the future cash inflows discounted at a market rate of interest available for a similar loan.

The present value of the loan receivable (financial asset) discounted at 5% per year is Rs. 5,00,000 ÷ (1.05)3 = Rs. 4,32,000. Therefore, Rs. 4,32,000 is recorded on initial measurement of the loan receivable. This amount will accrete to Rs. 5,00,000 over the three-year term using the effective interest method.

The difference between Rs. 5,00,000 and Rs. 4,32,000 i.e., Rs. 68,000 is accounted for as prepaid employee cost in accordance with Ind AS 19 'Employee Benefits', which will be deferred and amortised over the period of loan on straight line basis.

The journal entries on initial recognition are:

		Rs.	Rs.
Loan receivable (financial asset)	Dr.	4,32,000	
Prepaid employee cost (asset)	Dr.	68,000	
To Cash / Bank (financial asset)			
(Being loan granted to the employee recognised)			5,00,000

The amortised cost calculation at 1st April, 20X1 is as follows:

Period	Carrying amount at 1st April	Interest at 5%	Cash inflow	Carrying amount at 31st March
20X1-20X2	4,32,000	21,600	–	4,53,600
20X2-20X3	4,53,600	22,680	–	4,76,280
20X3-20X4	4,76,280	23,720*	(5,00,000)	–

*Difference of Rs. 94 (Rs. 23,814 – Rs. 23,720) is due to approximation.

On 31st March, 20X3, the carrying amount of the loan receivable is Rs. 4,76,280.

As a result of that modification, on 31st March, 20X3, the present value of estimated cash flows is recalculated to be Rs. 2,05,750 using the asset's original effective interest rate of 5% (Rs. 2,50,000 ÷ $(1.05)^4$).

An impairment loss of Rs. 2,70,530 (Rs. 4,76,280 – Rs. 2,05,750) is recognised in profit or loss in the year 20X2-20X3.

The carrying amount of the loan receivable may be reduced directly, as follows:

	Rs.	Rs.
Profit or loss - impairment loss Dr.	2,70,530	
To Loan receivable		2,70,530
(Being impairment loss recognised)		

In this case, the loan receivable will be measured at Rs. 2,05,750 at 31st March, 20X3. The revised amortised cost calculation at 1st April, 20X3 is as follows:

Period	Carrying amount at 1st April	Interest at 5% (the original effective interest rate)	Cash inflow	Carrying amount at 31st March
20X3-20X4	2,05,750	10,288	–	2,16,038
20X4-20X5	2,16,038	10,802	–	2,26,840
20X5-20X6	2,26,840	11,342	–	2,38,182
20X6-20X7	2,38,182	11,818	(2,50,000)	–

MTPs QUESTIONS

Q11 (August 18 – 10 Marks)

i) On 1 January 2018, Entity X writes a put option for 1,00,000 of its own equity shares for which it received a premium of Rs. 5,00,000.

Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of Rs. 22,000,000. The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted assuming that the present value of option exercise price is Rs. 20,00,000?

ii) On 1st April, 2014, S Ltd. issued 5,000, 8% convertible debentures with a face value of Rs. 100 each maturing on 31st March, 2019. The debentures are convertible into equity shares of S Ltd. at a conversion price of Rs. 105 per share. Interest is payable annually in cash. At the date of issue, S Ltd. could have issued non-convertible debentures with a 5 year term bearing a coupon interest rate of 12%. On 1st April, 2017, the convertible debentures have a fair value of Rs. 5,25,000. S Ltd. makes a tender offer to debenture holders to repurchase the debentures for Rs. 5,25,000, which the holders accepted. At the date of repurchase, S Ltd. could have issued non-convertible debt with a 2 years term bearing a coupon interest rate of 9%.

Examine the accounting treatment in the books of S Ltd., by passing appropriate journal entries, for recording of equity and liability component:

(1) At the time of initial recognition and

(2) At the time of repurchase of the convertible debentures.

The following present values of Re. 1 at 8%, 9% & 12% are supplied to you:

Interest Rate	Year 1	Year 2	Year 3	Year 4	Year 5
8%	0.926	0.857	0.794	0.735	0.681
9%	0.917	0.842	0.772	0.708	0.650
12%	0.893	0.797	0.712	0.636	0.567

SOLUTION

i) This derivative involves Entity X taking delivery of a fixed number of equity shares for a fixed amount of cash. Even though the obligation for Entity X to purchase its own equity shares for Rs. 22,000,000 is conditional on the holder of the option exercising the option, Entity X has an obligation to deliver cash which it cannot avoid.

As per para 23 of Ind AS 32 'Financial Instruments: Presentation', the accounting for financial instrument will be as below:

- The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity. This would imply that a financial liability for an amount of present value of Rs. 22,000,000, say Rs. 20,000,000 will be recognised through a debit to equity. The initial premium received (Rs. 5,00,000) is credited to equity.

- *Subsequently, the financial liability is measured in accordance with Ind AS 109. While a subsequent paragraph will deal with measurement of financial liabilities. The financial liability of Rs. 20,000,000 will be measured at amortised cost as per Ind AS 109 and finance cost of Rs. 2,000,000 will be recognised over the exercise period.*
- *If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity i.e. an amount of Rs. 22,000,000 will be reclassified from financial liability to equity.*

(ii)

(1) At the time of initial recognition

	Rs.
Liability component	
Present value of 5 yearly interest payments of Rs. 40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs. 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component	
(Rs. 5,00,000 – Rs. 4,27,700)	72,300
Total proceeds	**5,00,000**

Note: Since Rs. 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs. 100 each only.

Journal Entry

	Rs.
Bank Dr.	5,00,000
To 8% Debentures (Liability component)	4,27,700
To 8% Debentures (Equity component) (Being Debentures are initially recorded a fair value)	72,300

(2)At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	**Fair Value @ 9%**	**Difference**
	Rs.	**Rs.**	**Rs.**
Liability component			
Present value of 2 remaining yearly interest payments of Rs. 40,000, discounted at 12% and 9%, respectively		67,600	70,360
Present value of Rs. 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively		3,98,500	4,21,000
Liability component	4,66,100	4,91,360	(25,260)

Equity component (5,25,000 -4,91,360)	72,300	33,640*	38,660
Total	**5,38,400**	**5,25,000**	**13,400**

*(5,25,000 – 4,91,360) = 33,640

Journal Entries

	Rs.	Rs.
8% Debentures (Liability component) Dr.	4,66,100	
Profit and loss A/c (Debt settlement expense) Dr.	25,260	
To Bank A/c		4,91,360
(Being the repurchase of the liability component recognised)		
8% Debentures (Equity component) Dr.	72,300	
To Bank A/c		33,640
To Reserves and Surplus A/c		38,660
(Being the cash paid for the equity component recognised)		

Q12 (Oct. 18 & March 22)

Hello limited borrowed Rs. 500,000,000 from a bank on 1 January 2016 The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal installments
- Payment of interest annually on accrual basis
- Upfront processing fee: Rs. 5,870,096
- Effective interest rate on loan: 11.50%

On 31 December 2017, Hello Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal installments starting 31st December 2018.
- Payment of interest on an annual basis

Record journal entries in the books of Hello Limited till 31st December 2018, after giving effect of the changes in the terms of the loan on 31st December 2017.

SOLUTION

(a) On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50%)
1-Jan-2016	(500,000,000)	5,870,096	494,129,904	
31-Dec-2016	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-2017	100,000,000	44,000,000	297,489,650	45,534,807

31-Dec-2018	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-2019	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-2020	100,000,000	11,000,000	(0)	11,448,430

a. 1 January 2016

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	494,129,904	 494,129,904

b. 31 December 2016

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Cash A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	98,175,061 56,824,939	 155,000,000

(for understanding only)

Financial Liability Account

Year	Debit	Amount	Credit	Amount
1	To bank To bal c/f	15,50,00,000 39,59,54,843	By Bank By interest	49,41,29,904 5,68,24,939
2	To bank To bal c/f	4,40,00,000 3,97,48,965	By bal b/f By interest	39,59,54,843 4,55,34,807

c. 31 December 2017 – Before Hello Limited approached the bank –

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Interest expense (profit & loss) Dr. To Loan from bank A/c To cash A/c (Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)	45,534,807	 1,534,807 44,000,000

Upon receiving the new terms of the loan, Hello Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	**Cash flows (principal)**	**Interest outflow @15%**	**Discount factor**	**PV of cash flows**
31-Dec-2017	(400,000,000)			
31-Dec-2018	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-2019	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-2020	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-2021	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-2022	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-2023	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-2024	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-2025	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-2026	40,000,000	12,000,000	0.3754	19,522,235
31-Dec-2027	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan (A)				**397,489,650**
Difference (B)				**54,033,141**
Percentage of carrying amount (B/A x 100)				**13.59%**

Note: Above calculations have been done on full decimals, though in the table the discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31 December 2017 – accounting for extinguishment

Particulars	**Dr. Amount (Rs.)**	**Cr. Amount (Rs.)**	**Remarks**
Loan from bank (old) A/c Dr	397,489,650		extinguished
Finance cost (profit and loss) Dr	2,510,350		bal fig.
To Loan from bank (new) A/c		400,000,000	new loan
(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)			

e. 31 December 2018

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank A/c Dr. Interest expense (P&L) Dr. To cash A/c (Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	40,000,000 60,000,000	 100,000,000

Q13 (October 18 – 4 Marks)

Discuss the need of hedge accounting and types of various hedges?

SOLUTION

Hedge accounting may be required due to accounting mismatches in:

- **Measurement** – some financial instruments (non-derivative) are not measured at fair value with changes being recognised in the statement of profit and loss whereas all derivatives, which commonly are used as hedging instruments, are measured at fair value
- **Recognition** – unsettled or forecast transactions that may be hedged are not recognised on the balance sheet or are included in the statement of profit and loss only in a future accounting period, whereas all derivatives are recognised at inception.
- Recognition mismatches include the hedge of a contracted or expected but not yet recognised sale, purchase or financing transaction in a foreign currency and future committed variable interest payments.

Types of hedge accounting

1. **Fair value hedge accounting model**
   - A fair value hedge seeks to offset the risk of changes in the fair value of an existing asset or liability or an unrecognised firm commitment that may give rise to a gain or loss being recognised in the statement of profit and loss.
   - A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect the statement of profit and loss.
2. **Cash flow hedge accounting model**
   - A cash flow hedge seeks to offset certain risks of the variability of cash flows in respect of an existing asset or liability or a highly probable forecast transaction that may be reflected in the statement of profit and loss in a future period.
   - A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction or a firm commitment in respect of foreign currency and (ii) could affect the statement of profit and loss.

3. Net investment hedging

- An investor in a non-integral operation is exposed to changes in the carrying amount of the net assets of the foreign operation (the net investment) arising from the translation of those assets into the reporting currency of the investor.

Q14 (March 19 – 8 Marks)

1. QA Ltd. issued 10,00,000 of 8% Long Term bond-A Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. The investors expect an effective interest rate on the loan at 10%. QA Ltd. wants you to suggest the suitable accounting entries for the issue of these bonds as per applicable Ind AS. Consider the discounting factor 3 years, 10% discounting factor is 0.751315 and 3 years cumulative discounting factor is 2.48685.

(i) What is the principal value of the bond at the initial recognition at the time of issue of bond as per applicable Ind AS?

(ii) What is the present value of the interest payment to be recognised as part of the sale price of the bond as per applicable Ind AS?

(iii) What are the proceeds of the sale of the bond to be recognized at the time of initial recognition as per applicable Ind AS?

(iv) What is the accounting entry to be passed at the time of accounting for payment of interest for the first year?

2. QA Ltd. has also issued 10,00,000 of 8% Long Term Bond-B Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. However, the bond holders of this series are entitled to convert the bonds to shares of Rs. 1 each on the date of maturity, instead of receiving the principal repayment. Interest rate on the similar bond without the conversion option is 10%. QA Ltd. has requested you to suggest the following for this type of instrument:

a) What is the entry to be passed at the date of issuance of the bond as per applicable Ind AS?

b) What is the entry to be passed at the date of conversion of the bond as per applicable Ind AS?

SOLUTION

1.

i. Option (C): Rs. 7,51,315

ii. Option (C): Rs. 1,98,948

iii. Option (B): Rs. 9,50,263

iv.	Bond Interest Expenses A/c	Dr.	Rs. 95,026
	To Discount on Bond A/s		Rs. 15,026
	To Cash/Bank A/c		Rs. 80,000

Workings for the above

Since the Effective interest rate on the loan is 10% while the Bond has been issued at 8%, the financial liability will be recognized at fair value determined as follows:

Calculation of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	1,98,948
Total Present Value of Long-term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method

= Rs.9,50,263 x 10% = Rs. 95,026

However, interest paid is @ 8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

2.

a. Option (B): Cash/Bank A/c Rs. 10,00,000

To 8% LT Bond Series B A/c Rs. 9,50,263

To Share Option A/c Rs. 49,737

Workings for the above

It is a compound instrument.

Calculation of initial recognition amount of 8% Long term Loan Bond B Series liability and equity component

Particulars	Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	51,98,948
Total Present Value of Long-term Loan Bond B I	9,50,263
Issue proceeds from convertible bond II	10,00,000
Value of equity component (II – I)	**49,737**

b. 8% LT Bond Series B A/c Rs. 10,00,000

Share Option A/c Rs. 49,737

To Share Capital A/c Rs. 10,00,000

To Share Premium A/c Rs. 49,737

Reasoning:

As per Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one-line item within equity to another). There is no gain or loss on conversion at maturity

Q15 (March 19 – 8 Marks)

On 1 April 2018, an 8% convertible loan with a nominal value of Rs. 6,00,000 was issued at par. It is redeemable on 31March 2022 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 48,000 has already been paid and included as a finance cost.

Present value rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

How will the Company present the above loan notes in the financial statements for the year ended 31 March 2019?

SOLUTION

Step 1 - There is an 'option' to convert the loans into equity i.e. the loan note holders do not have to accept equity shares; they could demand repayment in the form of cash.

Ind AS 32 states that where there is an obligation to transfer economic benefits there should be a liability recognised. On the other hand, where there is not an obligation to transfer economic benefits, a financial instrument should be recognised as equity.

In the above illustration we have both – 'equity' and 'debt' features in the instrument. There is an obligation to pay cash – i.e. interest at 8% per annum and a redemption amount – this is 'financial liability' or 'debt component'. The 'equity' part of the transaction is the option to convert. So, it is a compound financial instrument.

Step 2 - Debt element of the financial instrument so as to recognise the liability is the present value of interest and principal

The rate at which the same is to be discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting

Step 3 - Calculation of the debt element of the loan note as follows: 8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

S. No	Year	Interest amount	PVF	Amount
Year 1	**2019**	**48,000**	**0.91**	**43,680**
Year 2	**2020**	**48,000**	**0.83**	**39,840**
Year 3	**2021**	**48,000**	**0.75**	**36,063**
Year 4	**2022**	**648,000**	**0.68**	**4,40,640**
Amount to be recognised as a liability				**5,60,223**

Initial proceeds (6,00,000)

Amount to be recognised as equity 39,777

In year 4, the loan note is redeemed therefore Rs. 6,00,000 + Rs. 48,000 = Rs. 6,48,000.

Step 4 - The next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. Therefore, the interest should be recognised at 10%. As on date Rs. 48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.

The additional charge to be recognised in the income statement is calculated as:
Debt component of the financial instrument Rs. 5,60,000

Interest charge (5,60,000 x 10%)	Rs. 56,000
Already charged to the income statement	(Rs. 48,000)
Additional charge required	Rs. 8,000

Journal Entries for recording additional finance cost for year ended 31 March 2019

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Finance cost A/c Dr.	8,000	
To Debt component A/c		8,000
(Being interest recorded for difference between amount recorded earlier and that to be recorded per Ind AS 32)		

Q16 (March 19 – 8 Marks)

On April 1, 20X1, Pluto Ltd. has advanced a loan for Rs. 10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employees are not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. Rs. 10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 40,000 (Rs. 10 lakhs x 4%).

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment along with working for the same.

SOLUTION

The above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on Financial Instruments' and Ind AS 19 'Employee Benefits'.

Ind AS 32 'Financial Instruments: Presentation' states that:

"A financial asset is any asset that is:
(c) a contractual right:
(i) to receive cash or….."

Further, Ind AS 109 states that:

"At initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, Appendix B to Ind AS 109 states that:

"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or reduction of income unless it qualifies for recognition as some other type of asset".

Further, Ind AS 109 states that:

"After initial recognition, an entity shall measure a financial asset at:

a. amortised cost;

b. fair value through other comprehensive income; or

c. fair value through profit or loss.

Further, Ind AS 109 states that:

"Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset Ind AS 19 states that:

"Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment".

The Accountant of Pluto Ltd. has recognised the staff loan in the balance sheet at Rs. 10 lakhs being the amount disbursed and Rs. 40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

a) Calculation of Fair Value of the Loan

Year	Cash Inflow	Discounting Factor (10%)	Present Value
1	2,40,000	0.909	2,18,160
2	2,32,000	0.826	1,91,632
3	2,24,000	0.751	1,68,224
4	2,16,000	0.683	1,47,528
5	2,08,000	0.621	1,29,168
Total			**8,54,712**

Staff loan should be initially recorded at Rs. 8,54,712.

Q17 (October 19 – 8 Marks)

Croton Limited is engaged in the business of trading commodities. The company's main assets are investments in equity shares, preference shares, bonds, non-convertible debenture (NCD) and mutual funds.

The Company collects the periodical income (i.e. interest, dividend, etc.) from the investments and regularly sells the investment in case of favorable market conditions. Such investments have been classified as non-current investments in the financial statements.

Also, the company buys and sells equity shares of companies for earning short term profits from the stock market.

The CFO of the company classified all the non-current investments as Fair Value Through Other Comprehensive Income (FVTOCI) and all the current investment as Fair value Through Profit and Loss (FVTPL).

Croton Limited raised the following queries:

(a) Can the Company classify the equity shares previously held under current investment as FVTOCI if the company decides to hold them for more than one-year (i.e. classify it as non-current)?

(b) The Company had classified NCDs with a maturity period of less than twelve months from the reporting period as current. This has been classified as FVTPL by the CFO of the company. The Company wants to know whether these NCDs can be recognized as FVTOCI?

SOLUTION

(a) It seems that the equity shares are acquired for the purpose of selling it in the near term and therefore are held for trading. Such investments have been appropriately classified as subsequently measured at fair value through profit or loss. Such investments in equity shares cannot be classified as subsequently measured at fair value through other comprehensive income. The option to measure investment in equity shares at fair value through other comprehensive income has to be made at initial recognition. Therefore, equity shares that were held for trading previously cannot be reclassified to fair value through other comprehensive income due to change in business model to not held for trading.

(b) In absence of contractual terms of NCDs, it is assumed that the contractual terms give rise on specified dates to cash flows that are solely payment of principal and interest on the principal outstanding. The business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVTOCI. Therefore, such NCD investments shall be classified as subsequently measured at Fair Value through Other Comprehensive Income. The classification does not change based on whether the investment is current or non-current as the end of the reporting period. It seems the company has previously classified these investments at fair value through profit or loss. The company must rectify this by reclassifying as FVTOCI.

Q18 (MTP October 19 & MTP October 21 – 12 Marks)

ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ Rs 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	01-Apr-20X1
Date of Conversion	01-Apr-20X6
Number of Preference Shares	10,000
Face Value of Preference Shares	150
Total Proceeds	15,00,000
Rate of dividend	10%

Market Rate for Similar Instrument	15%
Transaction Cost	30,000
Face value of equity share after conversion	10
Number of Equity shares to be issued	5,000
Effective interest rate	15.86%

You are required to compute the liability and equity component and pass journal entries for entire term of arrangement i.e. from the issue of preference shares till their conversion into equity shares keeping in view the provisions of relevant Ind AS

SOLUTION

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0.00
31-Mar-20X2	Dividend	150,000	0.869565	130,434.75
31-Mar-20X3	Dividend	150,000	0.756144	113,421.6
31-Mar-20X4	Dividend	150,000	0.657516	98,627.4
31-Mar-20X5	Dividend	150,000	0.571753	85,762.95
31-Mar-20X6	Dividend	150,000	0.497177	74,576.55
Total Liability Component				502,823.25
Total Proceeds				1,500,000.00
Total Equity Component (Bal fig)				997,176.75

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	997,177	19,944	977,233
Total Proceeds	1,500,000	30,000	1,470,000

c. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs

- Subsequent accounting = At amortised cost, i.e., initial fair value adjusted for interest and repayments of the liability.

Assume the effective interest rate is 15.86%

	Opening Financial Liability A	Interest B	Cash Flow C	Closing Financial Liability A+B-C
01-Apr-20X1	492,767	-	-	4,92,767
31-Mar-20X2	492,767	78,153	150,000	4,20,920

31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	-

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars	Debit	Credit
01-Apr-20X1	Bank A/c Dr.	1,470,000	
	To Preference Shares A/c		492,767
	To Equity Component of Preference Shares A/c		977,233
	(Being compulsorily convertible preference shares issued. The same are divided into equity component & liability component as per the calculation)		
31-Mar-20X2	Preference shares A/c Dr.	150,000	
	To Bank A/c		150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X2	Finance cost A/c Dr.	78,153	
	To Preference Shares A/c		78,153
	(Being interest as per EIR method recorded)		
31-Mar-20X3	Preference shares A/c Dr.	150,000	
	To Bank A/c		150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X3	Finance cost A/c Dr.	66,758	
	To Preference Shares A/c		66,758
	(Being interest as per EIR method recorded)		
31-Mar-20X4	Preference shares A/c Dr.	150,000	
	To Bank A/c		150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X4	Finance cost A/c Dr.	53,556	
	To Preference Shares A/c		53,556
	(Being interest as per EIR method recorded)		
31-Mar-20X5	Preference shares A/c Dr.	150,000	
	To Bank A/c		150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X5	Finance cost A/c Dr.	38,260	

Date	Particulars	Debit	Credit
	To Preference Shares A/c		38,260
	(Being interest as per EIR method recorded)		
31-Mar-20X6	Preference shares A/c Dr.	150,000	
	To Bank A/c		150,000
	(Being Dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-20X6	Finance cost A/c Dr.	20,506	
	To Preference Shares A/c		20,506
	(Being interest as per EIR method recorded)		
31-Mar-20X6	Equity Component of Preference shares A/c Dr.	977,233	
	To Equity Share Capital A/c		50,000
	To Securities Premium A/c		927,233
	(Being Preference shares converted in equity shares & remaining equity component is recognised as securities premium)		

Q19 (May 20 – 10 Marks)

Blueberry Ltd entered into the following transactions during the year ended 31st March, 20X2:

(a) Entered into a speculative interest rate option costing Rs. 10,000 on 1st April, 20X0 to borrow Rs. 6,000,000 from Exon Bank commencing 30th June, 20X2 for 6 months at 4%.
The value of the option at 31st March.20X2 was Rs. 15,250.

(b) Purchased 6% debentures in Fox Ltd on 1st April, 20X1 (their issue date) for Rs. 150,000 as an investment. Blueberry Ltd. intends to hold the debentures, until their redemption at a premium, in 5 years' time. The effective rate of interest of the bond is 8%.

(c) Purchased 50,000 shares in Cox Ltd on 1st October, 20X2 for Rs. 3.50 each as an investment. The share price on 31st March, 20X2 was Rs. 3.75.

Show the accounting treatment and relevant extracts from the financial statements for the year ended 31st March, 20X2 of transactions related to financial instruments. Blueberry Ltd designates financial assets at fair value through Profit or loss only when this is unavoidable.

SOLUTION

Balance Sheet as at 31stMarch, 20X2(Extracts)

Financial Assets:	**Rs.**
Interest rate option (W.N.1)	15,250
6% Debentures in Fox Ltd. (W.N.2)	1,53,000
Shares in Cox Ltd. (W.N.3)	1,87,500
Statement of Profit and Loss (Extracts) **Finance Income:**	
Gain on interest rate option (W.N.1)	5,250
Effective interest on 6% Debentures (W.N.2)	12,000

Working Notes:

1. Interest rate option

This is a derivative and so it must be treated as at fair value through profit or loss

Particulars	Rs.	Rs.
Initial measurement (at cost) Financial Asset Dr.	10,000	
To Cash A/c		10,000

At 31st March, 20X2

Particulars	Rs.	Rs.
(Re-measured to fair value) Financial Asset (Rs. 15,250 - Rs.10,000) Dr.	5,250	
To Profit and loss A/c		5,250

Financial Assets (Rs.10,000 + Rs.5,250) = Rs. 15,250 (Balance Sheet)

Gain on interest option = Rs. 5,250 (Statement of Profit and Loss)

2. Debentures

On the basis of information provided, this can be treated as a held-to-maturity investment

Particulars	Rs.	Rs.
Initial measurement (at cost) Financial Asset Dr.	1,50,000	
To Cash A/c		1,50,000

At 31st March, 20X2 (Amortized cost)

Particulars	Rs.	Rs.
Financial Asset (Rs.1,50,000 x 8%) Dr.	12,000	
To Finance Income		12,000
Cash (Rs. 1,50,000 x 6%) Dr.	9,000	
To Financial asset		9,000

Amortized cost at 31st March, 20X2

(Rs. 150,000 + Rs. 12,000 – Rs. 9,000) = Rs. 153,000 (Balance Sheet)

Effective interest on 6% debenture = Rs. 12,000 (Statement of Profit and Loss)

3. Shares in Cox Ltd.

These are treated as an available for sale financial asset (shares cannot normally be held to maturity and they are clearly not loans or receivables)

Particulars	Rs.	Rs.
Initial measurement (at cost) Financial Asset (Rs. 50,000 x Rs.3.50) Dr.	1,75,000	
To Cash A/c		1,75,000

At 31st March, 20X2 (Re-measured at fair value)

Particulars	Rs.	Rs.
Financial Asset [(Rs. 50,000 x 3.75) – 1,75,000] Dr.	12,500	
To Equity A/c		12,500

Shares in Cox Ltd (Rs. 1,75,000 + Rs. 12,500) = Rs. 1,87,500 (Balance Sheet)

Q20 (May 20 – 4 Marks)

D Ltd. issues preference shares to G Ltd. for a consideration of Rs. 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a.

The prevailing market rate for similar preference shares, without the conversion feature or issuer's redemption option, is RBI base rate plus 4% p.a. On the date of contract, RBI base rate is 9% p.a.

Calculate the value of the liability and equity components.

SOLUTION

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (Rs. 10 lakhs discounted at 13% for 3 years) = Rs. 6,93,050

Present value of interest payable in arrears for 3 years (Rs. 100,000 discounted at 13% for each of 3 years) = Rs. 2,36,115

Paragraph AG31 of Ind AS 32 states that a common form of compound financial instruments is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivatives features.

The liability component = Present value of principal + Present value of Interest

= Rs. 6,93,050 + Rs.2,36,115 = Rs. 9,29,165

Equity Component = Rs. 10,00,000 –Rs. 9,29,165 = Rs. 70,835

Q21 (March 21 – 6 Marks)

Mercury Ltd. has sold goods to Mars Ltd. at a consideration of Rs. 10 lakhs, the receipt of which receivable in three equal installments of Rs. 3,33,333 over a two years period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5 % (i.e. Rs. 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at Rs. 10 Lakhs and hence, the management has recognised the revenue from sale of goods for Rs. 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same. Also show its presentation in the company's profit & loss and balance sheet.

SOLUTION

The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue.

The fair value of consideration (cash price equivalent) of the sale of goods is calculated as follows:

Rs.

Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		**9,50,000**

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		**Rs.**	**Rs.**
Cash	Dr.	3,33,333	
Trade Receivable	Dr.	6,16,667	
To Sale			9,50,000
Recognition of interest expense and receipt of second installment			
Cash	Dr.	3,33,333	
To Interest Income			33,053
To Trade Receivable			3,00,280
Recognition of interest expense and payment of final installment			
Cash	Dr.	3,33,334	
To Interest Income (Balancing figure)			16,947
To Trade Receivable			3,16,387

Statement of Profit and Loss (extracts)

for the year ended 31st March, 20X2 and 31st March, 20X3

Rs.

	As at 31st March, 20X2	**As at 31st March, 20X3**
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3

Rs.

	As at 31st March, 20X2	**As at 31st March, 20X3**
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	-

Q22 (April 21 – 4 Marks)

ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fees @1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

- *10 lacs for a term of 5 years*
- *8 lacs for a term of 3 years.*

Compute the fair value upon initial recognition of the loan in books of Target Ltd. and how will the loan processing fee be accounted for?

SOLUTION

The loans from ABC Bank carry interest @ 10% and 12% for 5 year term and 3 year term respectively. Additionally, there is a processing fee payable @ 1% on the principal amount on the date of transaction. It is assumed that ABC Bank charges all customers in a similar manner and hence this is representative of the market rate of interest.

Amortised cost is computed by discounting all future cash flows at market rate of interest. Further, any transaction fees that are an integral part of the transaction are adjusted in the effective interest rate and recognised over the term of the instrument.

Hence loan processing fees shall be reduced from the principal amount to arrive at the value on day 1 upon initial recognition.

Fair value (5 year term loan) = 10,00,000 – 10,000 (1% x 10,00,000) = 9,90,000

Fair value (3 year term loan) = 8,00,000 – 8,000 (1% x 8,00,000) = 7,92,000.

Now, effective interest rate shall be higher than the interest rate of 10% and 12% on 5 year loan and 3 year loan respectively, so that the processing fees gets recognised as interest over the respective term of loans.

Q23 (April 21 – 4 Marks)

A Ltd. (the 'Company') makes a borrowing for Rs. 10 lacs from RBC Bank, with bullet repayment of Rs. 10 lacs and an annual interest rate of 12% per annum. Now, the Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay Rs. 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

Does the above instrument meet the definition of financial liability? Please explain.

Analyse the differential amount to be exchanged for one-time settlement

SOLUTION

a) *A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make a stream of payments (including interest and principal). This meets the definition of financial liability.*

b) *Let's compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –*

- *Loan principal amount = Rs. 10,00,000*
- *Amount payable at the end of 6th year = Rs. 12,54,400 [10,00,000 x 1.12 x 1.12 (Interest for 5th & 6th year in default plus principal amount)]*
- *One-time settlement = INR 13,00,000*

- Additional amount payable = Rs. 45,600

The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavorable to A Ltd. (owing to additional amount payable in comparison to amount that would have been paid without one-time settlement). Hence the rescheduled arrangement meets the definition of 'financial liability'.

Q24 (October 21 – 4 Marks)

Which of the following would meet and not meet the definition of financial instruments and fall outside the scope of Ind AS 32?

(1) Cash deposited in banks
(2) Gold deposited in banks
(3) Trade receivables
(4) Investments in debt instruments
(5) Investments in equity instruments
(6) Prepaid expenses
(7) Inter-corporate loans and deposits
(8) Deferred revenue
(9) Tax liability
(10) Provision for estimated litigation losses.

SOLUTION

Table showing classification of various items:

S. No.	Item	Classification
(1)	Cash deposited in banks	Financial Instrument
(2)	Gold deposited in banks	Not a financial instrument
(3)	Trade receivables	Financial Instrument
(4)	Investments in debt instruments	Financial Instrument
(5)	Investments in equity instruments	Financial Instrument
(6)	Prepaid expenses	Not a financial instrument
(7)	Inter-corporate loans and deposits	Financial Instrument
(8)	Deferred revenue	Not a financial instrument
(9)	Tax liability	Not a financial instrument
(10)	Provision for estimated litigation losses	Not a financial instrument

Q25 (April 22)

On 1st April, 20X1, Star Limited has advanced a housing loan of Rs. 15 lakh to one of its employees at an interest rate of 6% per annum which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit. The market rate of similar loan for housing finance by banks is 10% per annum.

The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. Rs. 15 lakh. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 90,000 (6% of Rs. 15 lakh).

Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant

Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 20X1 -20X2 along with workings and applicable Ind AS.
You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance Sheet of Star Limited on 31st March, 20X2. Ignore defer tax impact.

SOLUTION

The accounting treatment made by the accountant is not in compliance with Ind AS 109 'Financial Instruments'. As per Ind AS 109, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value. The fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received.

After initial recognition, an entity shall measure a financial asset either at amortised cost or at fair value through profit and loss or fair value through other comprehensive income.
Here, the loan given to employee is not at market rate. Hence, the fair value of the loan will not be equal to its initial loan proceeds. As per Ind AS 109, a financial instrument is initially measured and recorded in the books at its fair value. Further, interest income to be recognised in the Statement of Profit and Loss will be the finance income recognised at effective rate of interest i.e. @ 10% and not the rate of interest charged by the company i.e. @ 6%.

The correct accounting treatment as per Ind AS 109 will be as under:
For measuring the fair value or present value of the loan at initial recognition, market rate of interest of similar loan is considered (level 1 observable input) ie @ 10%, to discount the cash outflows.
The fair value of the loan shall be as follows:

Date	Outstanding loan	Principal	Interest income @ 6%	Total inflow	Discount factor @ 10%	PV
31st March 20X2	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31st March 20X3	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31st March 20X4	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31st March 20X5	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31st March 20X6	3,00,000	3,00,000	18,000	3,18,000	0.621	1,97,478
Fair value of the loan						**13,54,602**

As per Ind AS 19, employee benefits are all forms of consideration given by an entity in exchange for services rendered by employees or for termination of employment. Difference of loan proceeds and present value of the loan (fair value) will be treated as prepaid employee cost irrespective of the fact that employee is not required to give any specific performanc e against this benefit. This is because employee is required to be in service of the company to continue availing the benefits of concessional rate of interest on housing loan. Practically, once the employee leaves the organisation, they have to repay the outstanding loan because the company provides the loan at concessional rate of interest only to its employees.

Hence, it is an employee benefit given by the company to its employees. This deemed employee cost of ₹ 1,45,398 (15,00,000 – 13,54,602) will be deferred and amortised over the period of loan on straight line basis.

Calculation of amortised cost of loan to employees

Financial year Ending on 31st March	Amortised cost (opening balance)	Interest to be recognize @ 10%	Repayment (including interest)	Amortised cost (closing balance)
20X2	13,54,602	1,35,460	3,90,000	11,00,062
20X3	11,00,062	1,10,006	3,72,000	8,38,068
20X4	8,38,068	83,807	3,54,000	5,67,875
20X5	5,67,875	56,788	3,36,000	2,88,663
20X6	2,88,663	29,337*	3,18,000	-

* 2,88,663 x 10% = ₹ 28,866. Difference of ₹ 471 (29,337 – 28,866) is due to approximation in computation.

Journal Entries to be recorded at every period end

1. On 1st April, 20X1

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Loan to employee A/c Dr.	13,54,602	
Prepaid employee cost A/c Dr.	1,45,398	
To Bank A/c		15,00,000
(Being loan asset recorded at initial fair value)		

2. On 31st March, 20X2

Particulars	Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c Dr.	3,90,000	
To Finance income A/c (profit and loss) @10%		1,35,460
To Loan to employee A/c		2,54,540
(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate @ 10%)		
Employee benefit cost (profit and loss) A/c Dr.	29,080	
To Prepaid employee cost A/c (1,45,398/5)		29,080
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

The following housing loan balances should appear in the financial statements:

Extracts of Balance Sheet of Star Ltd. as at 31st March, 20X2

Non-current asset	
Financial asset	
Loan to employee (11,00,062 – 3,72,000 + 1,10,006)	8,38,068
Other non-current asset	
Prepaid employee cost	87,238
Current asset	
Financial asset	

Loan to employee (3,72,000-1,10,006)	*2,61,994*
Other current asset	
Prepaid employee cost	*29,080*

QUESTIONS FROM PAST EXAM PAPERS

Q26 (May 18 - 8 Marks)

S Limited issued redeemable preference shares to its Holding Company -H Limited. The terms of the instrument have been summarized below. Analyse the given situation, applying the guidance in Ind AS 109 'Financial Instruments', and account for this in the books of H Limited

Nature	Non-cumulative redeemable preference shares
Repayment	Redeemable after 3 years
Date of Allotment	1st April 2015
Date of Repayment	31st March 2018
Total Period	3 Years
Value of Preference Shares issued	5,00,00,000
Dividend Rate	0.0001% Per Annum
Market rate of interest	12% Per Annum
Present value factor	0.7118

SOLUTION

1. **Analysis of the financial instrument issued by S Ltd. to its holding company H Ltd.**

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain types of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since S Ltd has issued preference shares to its Holding Company– H Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by H Ltd. in its subsidiary. This can further be substantiated by the nominal rate of dividend i.e. 0.0001% mentioned in the terms of the instrument issued.

Computations on initial recognition: **Rs**

Transaction value of the Redeemable preference shares	5,00,00,000
Less: Present value of loan component @ 12% (5,00,00,000 x .7118)	(3,55,90,000)
Investment in subsidiary	1,44,10,000

Subsequently, such preference shares shall be carried at amortised cost at each reporting date as follows:

Year	Date	Opening Balance	Interest @ 12%	Closing balance
	1st April, 2015	3,55,90,000	-	3,55,90,000
1	31st March, 2016	3,55,90,000	42,70,800	3,98,60,800
2	31st March, 2017	3,98,60,800	47,83,296	4,46,44,096
3	31st March, 2018	4,46,44,096	53,55,904	5,00,00,000

** Rs 4,46,44,096 x 12% = Rs 53,57,292. The difference of Rs 1,388 (Rs 53,57,292 – Rs 53,55,904) is due to approximation in present value factor.*

0. In the books of H Ltd. Journal Entries to be done at every reporting date

Date	Particulars	Amount	Amount
1st April, 2015	Investment (Equity portion) Dr.	1,44,10,000	
	Redeemable Preference Shares Dr.	3,55,90,000	
	To Bank (Being initial recognition of transaction recorded)		5,00,00,000
31st March, 2016	Redeemable Preference Share Dr.	42,70,800	
	To Interest income		42,70,800
	(Being interest income on loan component recognized)		
31st March, 2017	Redeemable Preference Shares Dr.	47,83,296	
	To Interest income		47,83,296
	(Being interest income on loan component recognized)		
31st March, 2018	Redeemable Preference Shares Dr.	53,55,904	
	To Interest income (Being interest income on loan component recognized)		53,55,904
31st March, 2018	Bank Dr.	5,00,00,000	
	To Redeemable Preference Shares (Being settlement of transaction done at the end of the third year)		5,00,00,000

Q27 (May 18 - 8 Marks)

On 1st January 2017, Expo Limited agreed to purchase USD ($) 40,000 from E&I Bank in future on 31st December 2017 for a rate equal to Rs 65 per USD. Expo Limited did not pay any amount upon entering into the contract. Expo Limited is a listed company in India and prepares its financial statements on a quarterly basis.

Using the definition of derivative included in Ind AS 109 and following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchases of USD.

For the purpose of accounting, use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March, 2017	Rs (50,000)
As at 30th June, 2017	Rs (30,000)
As at 30th September, 2017	Rs 24,000
Spot rate of USD on 31st December, 2017	Rs 62 per USD

SOLUTION

Assessment of the arrangement using the definition of derivative included under Ind AS 109.

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following **characteristics:**

. its value changes in response to the change in foreign exchange rate (emphasis laid)

a. It requires no initial net investment or an initial net investment is smaller than would be required for other types of contracts with similar response to changes in market factors.

b. It is settled at a future date.

Upon evaluation of contract in question, on the basis of the definition of derivative, it is noted that the contract meets the definition of a derivative as follows:

. The value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

b. The initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 40,000 on inception.

c. the contract is settled in future

The derivative is a forward exchange contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

Accounting in each Quarter

i. Accounting on 1st January 2017

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

ii. Accounting on 31st March 2017

Particulars	Dr. (Rs)	Cr. (Rs)
Profit and loss A/c Dr.	50,000	
To Derivative financial liability (Being mark to market loss on forward contract recorded)		50,000

iii. Accounting on 30th June 2017

Particulars	Dr. (Rs)	Cr. (Rs)
Derivative financial liability A/c Dr.	20,000	
To Profit and Loss A/c (Being partial reversal of mark to market loss on forward contract recorded)		20,000

Loss has decreased to 30,000. In substance it is a gain of 20,000

iv. Accounting on 30th September 2017

Particulars	Dr. (Rs)	Cr. (Rs)
Derivative financial liability A/c Dr.	30,000	
Derivative financial asset A/c Dr.	24,000	
To Profit and Loss A/c (Being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)		54,000

v. Accounting on 31st December 2017

The settlement of the derivative forward contract by actual purchase of USD 40,000

Particulars	Dr. (Rs)	Cr. (Rs)
Cash (USD Account) (USD 40,000 x Rs 62) Dr.	24,80,000	
Profit and loss A/c Dr.	1,44,000	
To Cash (USD 40,000 x Rs 65)		26,00,000
To Derivative financial asset A/c (Being loss on settlement of forward contract booked on actual purchase of USD)		24,000

Q28 (Nov 18 – 4 Marks)

NAV Limited granted a loan of Rs120 lakh to OLD Limited for 5 years @ 10% p.a. which is Treasury bond yield of equivalent maturity. But the incremental borrowing rate of OLD Limited is 12%. In this case, the loan is granted to OLD Limited at below market rate of interest. Ind AS 109 requires that a financial asset or financial liability is to be measured at fair value at the initial recognition. Should the transaction price be treated as fair value? If not, find out the fair value. What is the accounting treatment of the difference between the transaction price and the fair value on initial recognition in the book of NAV Ltd.? Present value factors at 12%:

Year	1	2	3	4	5
PVF	0.892	0.797	0.712	0.636	0.567

SOLUTION

Since the loan is granted to OLD Ltd at 10% i.e. below market rate of 12%. It will be considered as loan given at off market terms. Hence the Fair value of the transaction will be lower from its transaction price & not the transaction price.

Calculation of fair value

Year	Future cash flow (in lakh)	Discounting factor @ 12%	Present value (in lakh)
1	12	0.892	10.704
2	12	0.797	9.564
3	12	0.712	8.544

Year	Future cash flow (in lakh)	Discounting factor @ 12%	Present value (in lakh)
4	12	0.636	7.632
5	120+12=132	0.567	74.844
			111.288

The fair value of the transaction is Rs111.288 lakh.

Since fair value is based on level 1 input or valuation technique that uses only data from observable markets, difference between fair value and transaction price will be recognized in Profit and Loss as fair value loss i.e. Rs120 lakh- Rs111.288 lakh= Rs 8.712 lakh.

Note: One may also calculate the above fair value by the way of annuity on interest amount rather than separate calculation

Q29 (Nov 18 - 8 Marks)

Veer Limited issues convertible bonds of Rs75,00,000 on 1st April, 2018. The bonds have a life of five years and a face value of Rs20 each, and they offer interest payable at the end of each financial year at a rate of 4.5 percent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in Veer Ltd at any time in the next five years. Companies of a similar risk profile have recently issued debt at 6 percent per annum with similar terms but without the option for conversion.

You are required to:

(i) Provide the appropriate accounting entries for initial recognition as per the relevant Ind AS in the books of the company.

(ii) Calculate the stream of interest expenses across the five years of the life of the bonds.

(iii) Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year.

SOLUTION

Present value of bonds at the market rate of debt

Present value of principal to be received in 5 years discounted at 6% (75,00,000 x 0.747) = 56,02,500

Present value of interest stream discounted at 6% for 5 years (3,37,500 x4.212) = 14,21,550

Total present value = 70,24,050

Equity component = 4,75,950

Total face value of convertible bonds = 75,00,000

(i) **Journal Entries**

	Dr. Amount (Rs)	Cr. Amount (Rs)
1st April, 2018		
Cash Dr.	75,00,000	
To Convertible bonds (liability)		70,24,050
To Convertible bonds (equity component)		4,75,950
(Being entry to record the convertible bonds and the		

recognition of the liability and equity components)		
31st March, 2019 Interest expense Dr. To Cash To Convertible bonds (liability) (Being entry to record the interest expense)	 4,21,443	 3,37,500 83,943

(ii) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 6 per cent.

Date	Payment	Interest expense at 6% (e of previous year x 6%)	Increase in bond liability (c-b)	Total bond liability (e of previous year +d)
(a)	(b)	(c)	(d)	(e)
1st April, 2018				70,24,050
31st March, 2019	3,37,500	4,21,443	83,943	71,07,993
31st March, 2020	3,37,500	4,26,480	88,980	71,96,973
31st March, 2021	3,37,500	4,31,818	94,318	72,91,291
31st March, 2022	3,37,500	4,37,477	99,977	73,91,268
31st March, 2023	3,37,500	4,46,232*	1,08,732	75,00,000

❖ Difference is due to rounding off.

(iii) If the holders of the bond elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving their interest payments), the entries in the fourth year would be:

	Dr. (Rs)	Cr. (Rs)
31st March, 2022 Interest expense A/c Dr. To Cash A/c To Convertible bonds (liability) A/c (Being entry to record interest expense for the period)	 4,37,477	 3,37,500 99,977
31st March, 2022 Convertible bonds (liability) A/c Dr. Convertible bonds (equity component) A/c Dr. To Ordinary share capital A/c (Being an entry to record the conversion of bonds into ordinary shares of Veer Limited).	 73,91,268 4,75,950	 78,67,218

Q30 (Nov 18 - 8 Marks)

Growth Limited on 1st April, 2015 issued 50,000, 7% convertible debentures of face value of Rs100 per debenture at par. The debentures are redeemable at a premium of 10% on 31st March, 2020 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is 1st April, 2017.

Suggest how Growth Limited should account for this compound financial instrument on the date of transition. Also discuss Ind AS on 'Financial Instrument' presentation in the above context.

The present value of Rs1 receivable at the end of each year based on discount rates of 7% and 10% can be taken as:

End of Year	1	2	3	4	5
7%	0.94	0.87	0.82	0.76	0.71
10%	0.91	0.83	0.75	0.68	0.62

SOLUTION

Since the liability is outstanding on the date of Ind AS transition, Growth Ltd. is required to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, first the liability component will be measured discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option)

Calculation of Equity & Liability component on initial recognition

	(Rs)
Present Interest payments for 5 years on debentures by applying annuity factor [(50,000 x 7% x 100) x 3.79]	13,26,500
PV of principal repayment (including premium) (50,000x110x0.62)	34,10,000
Total liability component	**47,36,500**
Total equity component (Balancing figure)	2,63,500
Total proceeds from issue of Debentures	**50,00,000**

Thus, on the date of transition, the amount of Rs 50,00,000 being the amount of debentures will split as under:

Debt	Rs 47,36,500
Equity	Rs 2,63,500

Q31 (May 19 – 12 Marks)

Perfect Ltd. issued 50,000 Compulsory Cumulative Convertible preference Shares (CCCPS) as on 1st April, 2017 @ Rs 180 each. The rate of dividend is 10% payable at the end of every year. The preference shares are convertible into 12,500 equity shares (Face value Rs 10 each) of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion option is 15% per annum.

Transaction cost on the date of issuance is 2% of the value of the proceeds. Effective Interest Rate is 15.86%. (Round off the figures to the nearest multiple of Rupee)

Discounting Factor @ 15%

Year	1	2	3	4	5
Discount Factor	0.8696	0.7561	0.6575	0.5718	0.4971

You are required to compute Liability and Equity Component and Pass Journal Entries for entire term of arrangement i.e. from the issue of Preference Shares till their conversion into Equity Shares. Keeping in view the provisions of relevant Ind AS.

SOLUTION

This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

Total proceeds = 50,000 Shares x 180each = 90,00,000

Dividend @ 10% = 9,00,000

1. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-2017		0	1	0.00
31-Mar-2018	Dividend	9,00,000	0.8696	7,82,640
31-Mar-2019	Dividend	9,00,000	0.7561	6,80,490
31-Mar-2020	Dividend	9,00,000	0.6575	5,91,750
31-Mar-2021	Dividend	9,00,000	0.5718	5,14,620
31-Mar-2022	Dividend	9,00,000	0.4971	4,47,390
Total Liability Component				30,16,890
Total Proceeds				**90,00,000**
Total Equity Component (Bal fig)				59,83,110

2. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
	a	b	a-b
Liability Component	30,16,890	60,338	29,56,552
Equity Component	59,83,110	1,19,662	58,63,448
Total Proceeds	**90,00,000**	**1,80,000**	**88,20,000**

3. Accounting for liability at amortised cost

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, i.e. initial fair value adjusted for interest and repayments of the liability.

	Opening Financial Liability A	Interest @ 15.86% B	Cash Flow (Dividend payment) C	Closing Financial Liability A+B-C
01-Apr-2017	29,56,552			29,56,552
31-Mar-2018	29,56,552	4,68,909	9,00,000	25,25,461
31-Mar-2019	25,25,461	4,00,538	9,00,000	20,25,999
31-Mar-2020	20,25,999	3,21,323	9,00,000	14,47,322
31-Mar-2021	14,47,322	2,29,545	9,00,000	7,76,867
31-Mar-2022	7,76,867	1,23,133*	9,00,000	-

*Difference of Rs 78 (adjusted in the interest value of 31stMarch, 2022) is due to approximation of figures in the earlier years.

4. Journal Entries to be recorded for entire term of arrangement are as follows:

Date	Particulars	Debit	Credit
01-Apr-2017	Bank A/c Dr.	88,20,000	
	To Preference Shares A/c		29,56,552
	Equity Component of Preference shares A/c		58,63,448

Date	Particulars	Debit	Credit
	(Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation)		
31-Mar-2018	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2018	Finance cost A/c Dr.	4,68,909	
	To Preference Shares A/c		4,68,909
	(Being interest as per EIR method recorded)		
31-Mar-2019	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2019	Finance cost A/c Dr.	4,00,538	
	To Preference Shares A/c		4,00,538
	(Being interest as per EIR method recorded)		
31-Mar-2020	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2020	Finance cost A/c Dr.	3,21,323	
	To Preference Shares A/c		3,21,323
	(Being interest as per EIR method recorded)		
31-Mar-2021	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2021	Finance cost A/c Dr.	2,29,545	
	To Preference Shares A/c		2,29,545
	(Being interest as per EIR method recorded)		
31-Mar-2022	Preference shares A/c Dr.	9,00,000	
	To Bank A/c		9,00,000
	(Being dividend at the coupon rate of 10% paid to the shareholders)		
31-Mar-2022	Finance cost A/c Dr.	1,23,133	
	To Preference Shares A/c		1,23,133
	(Being interest as per EIR method recorded)		
31-Mar-2022	Equity Component of Preference shares A/c Dr.	58,63,448	
	To Equity Share Capital A/c		1,25,000
	To Securities Premium A/c		57,38,448

Date	Particulars	Debit	Credit
	(Being preference shares converted in equity shares and remaining equity component is recognised as securities premium)		

Q32 (Nov 19 - 10 Marks)

Vedika Ltd. issued 80,000 8% convertible debentures of Rs 100 each on 1st April, 2015. The debentures are due for redemption on 31st March, 2019 at a premium of 20%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion right was12%. The conversion to equity qualifies as fixed for fixed.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Vedika Ltd.'s books at initial recognition only. The following present values of Rupee 1 at 8% and 12% are provided for a period of 5 years.

Interest rate	Year 1	Year 2	Year 3	Year 4	Years 5
8%	0.923	0.853	0.789	0.731	0.677
12%	0.887	0.788	0.701	0.625	0.557

SOLUTION

Computation of debt component of convertible debentures on 1st April, 2015

Particulars	Amount (Rs)
Present value of principal amount repayable after 4 years	
(A) 80,00,000 x 50% x 120% x 0.625 (12% discount factor)	30,00,000
(B) Present value of interest [8,00,000 x 80% x 3.001] (4 years cumulative 10% discount factor)	19,20,640
Total present value of debt component (A) + (B)	49,20,640
Issue proceeds from convertible debentures	80,00,000
Value of equity component	**30,79,360**

Journal entry at initial recognition

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Bank A/c Dr.	80,00,000	
To 8% Debentures A/c (liability component)		49,20,640
To 8% Debentures A/c (equity component)		30,79,360
(Being disbursement recorded at fair value)		

Note: The question has been solved on the basis of the discounting factors given in the question.

Q33 (Nov 19 – 4 Marks)

Make necessary journal entries for accounting of the security deposit made by Admire Ltd., whose details are described below. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1st April, 2014
Date of Security Deposit (Finishing Date)	31st March, 2019
Description	Lease
Total Lease Period	5 years
Discount rate	12%
Security deposit (A)	20,00,000
Present value factor at the 5th year	0.567427

SOLUTION

The above security deposit is an interest free deposit redeemable at the end of lease term for Rs 20,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement

Particulars	Details
Security deposit (A)	20,00,000
Total lease period (Years)	5
Discount rate	12.00%
Present value annuity factor	0.567427
Present value of deposit at beginning (B)	**11,34,854**
Prepaid lease payment at beginning (A-B)	**8,65,146**

Journal entry at initial recognition

Particulars		Amount	Amount
Security deposit A/c	Dr.	11,34,854	
Prepaid lease expenses A/c	Dr.	8,65,146	
To Bank A/c			20,00,000

Subsequently, every annual reporting year, interest income shall be accrued @ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Following table shows the amortisation of security deposit based on discount rate:

Year	Opening balance (A)	Interest @12% (B)	losing balance (A) = (A) + (B)
1	11,34,854	1,36,183	12,71,037
2	12,71,037	1,52,524	14,23,561
3	14,23,561	1,70,827	15,94,388
4	15,94,388	1,91,327	17,85,715
5	17,85,315	2,14,685*	20,00,000

*Difference is due to approximation.

Journal entries for Year 1-5 For – Year 1

Particulars	Amount	Amount
Security deposit A/c Dr.	1,36,183	
To Interest income		1,36,183
Lease expense (8,65,146 /5 years) Dr.	1,73,029	
To Prepaid lease expenses		1,73,029

For – Year 2

Particulars	Amount	Amount
Security deposit A/c Dr.	1,52,524	
To Interest income		1,52,524
Lease expense (8,65,146 /5 years) Dr.	1,73,029	
To Prepaid lease expenses		1,73,029

For – Year 3

Particulars	Amount	Amount
Security deposit A/c Dr.	1,70,827	
To Interest income		1,70,827
Lease expense (8,65,146 /5years) Dr.	1,73,029	
To Prepaid lease expenses		1,73,029

For – Year 4

Particulars	Amount	Amount
Security deposit A/c Dr.	1,91,327	
To Interest income		1,91,327
Lease expense (8,65,146 /5years) Dr.	1,73,029	
To Prepaid lease expenses		1,73,029

For-Year 5

Particulars	Amount	Amount
Security deposit A/c Dr.	2,14,685	
To Interest income		2,14,685
Lease expense (8,65,146 /5years) Dr.	1,73,030	
To Prepaid lease expenses		1,73,030

Journal entry for realisation of security deposit at the end of 5th year

Particulars	Amount	Amount
Bank A/c Dr.	20,00,000	
To Security deposit Ac		20,00,000

Q34 (Nov. 20)

On April 1st, 2020, Star Limited has advanced a housing loan of ₹ 15 lakhs to one of its employees at an interest rate of 6% per annum which is repayable in 5 equal annual installments along with interest at each year end. Employees are not required to give any specific performance against this benefit. The market rate of similar loans for housing finance by banks is 10% per annum.

The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. 15 lakhs. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e.₹ 90,000 (6% of 15 lakhs).

Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 2020-21 along with workings and applicable Ind AS.

You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance sheet of Star Limited on March 31s', 2021.

SOLUTION

The accounting treatment made by the accountant is not in compliance with Ind AS 109 'Financial Instruments'. As per Ind AS 109, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value. The fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received.

After initial recognition, an entity shall measure a financial asset either at amortised cost or at fair value through profit and loss or fair value through other comprehensive income.

Here, the loan given to employees is not at market rate. Hence, the fair value of the loan will not be equal to its initial loan proceeds. As per Ind AS 109, a financial instrument is initially measured and recorded in the books at its fair value. Further, interest income to be recognised in the Statement of Profit and Loss will be the finance income recognised at effective rate of interest i.e. @ 10% and not the rate of interest charged by the company i.e. @ 6%.

The correct accounting treatment as per Ind AS 109 will be as under:

For measuring the fair value or present value of the loan at initial recognition, market rate of interest of similar loan is considered (level 1 observable input) i.e. @ 10%, to discount the cash outflows.

The fair value of the loan shall be as follows:

Date	Outstanding loan	Principal	Interest Income @ 6%	Total inflow	Discount factor@ 10%	PV
31 March 2021	15,00,000	3,00,000	90,000	3,90,000	0.909	3,54,510
31 March 2022	12,00,000	3,00,000	72,000	3,72,000	0.826	3,07,272
31 March 2023	9,00,000	3,00,000	54,000	3,54,000	0.751	2,65,854
31 March 2024	6,00,000	3,00,000	36,000	3,36,000	0.683	2,29,488
31 March 2025	3,00,000	3,00,000	18,000	3,18,000	0.621	1,97,478
Fair value of the loan						**13,54,602**

As per Ind AS 19, employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for termination of employment. Difference of loan proceeds and present value of

the loan (fair value) will be treated as prepaid employee cost irrespective of the fact that the employee is not required to give any specific performance against this benefit. This is because an employee is required to be in service of the company to continue availing the benefits of concessional rate of interest on housing loan. Practically, once the employee leaves the organisation, they have to repay the outstanding loan because the company provides the loan at concessional rate of interest only to its employees.
Hence, it is an employee benefit given by the company to its employees. This deemed employee cost of Rs. 1,45,398 (15,00,000 – 13,54,602) will be deferred and amortised over the period of loan on a straight line basis.

Calculation of amortised cost of loan to employees

Financial year ending on 31 March	Amortised cost (opening balance)	Interest to be recognised @ 10%	Repayment (including interest)	Amortised cost (closing balance)
2021	13,54,602	1,35,460	3,90,000	11,00,062
2022	11,00,062	1,10,006	3,72,000	8,38,068
2023	8,38,068	83,807	3,54,000	5,67,875
2024	5,67,875	56,788	3,36,000	2,88,663
2025	2,88,663	29,337*	3,18,000	-

* 2,88,663 x 10% = Rs. 28,866. Difference of Rs. 471 (29,337 – 28,866) is due to approximation in computation.

Journal Entries to be recorded at every period end:

1. **On 1 April 2020**

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan to employee A/c	Dr.	13,54,602	
Prepaid employee cost A/c	Dr.	1,45,398	
To Bank A/c			15,00,000
(Being loan asset recorded at initial fair value)			

2. **On 31 March 2021**

Particulars		Dr. Amount (Rs.)	Cr. Amount (Rs.)
Bank A/c	Dr.	3,90,000	
To Finance income A/c (profit and loss) @10%			1,35,460
To Loan to employee A/c			2,54,540
(Being first instalment of repayment of loan accounted for using the amortised cost and			

effective interest rate @ 10%)	29,080	
Employee benefit cost A/c Dr.		29,080
To Prepaid employee cost A/c (1,45,398/5) (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

The Following housing loan balances should appear in the financial statements:

Extracts of Balance sheet of Star Ltd. as at 31 March 2021

Non-current asset	
Financial asset	
Loan to employee (11,00,062 – 3,72,000 + 1,10,006)	8,38,068
Other non-current asset	
Prepaid employee cost	87,238
Current asset	
Financial asset	
Loan to employee (3,72,000-1,10,006)	2,61,994
Other current asset	
Prepaid employee cost	29,080

Deferred tax on temporary differences arising on the above-mentioned account balances (appearing in the balance sheet) should be recognised. However, in the absence of any tax rate in the question no deferred tax has been recognised.

Q35 (Nov. 20)

On April 1st, 2019, a 8% convertible loan with a nominal value of ₹ 12,00,000 was issued at par by Cargo Ltd. It is redeemable on March 31st, 2023 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each ₹ 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of ₹ 96,000 has already been paid and included as a finance cost.

Present Value (PV) rates as follows:

Year-end	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

How will the Company present the above loan notes in the financial statements for the year ended March 31", 2020?

SOLUTION

There are both 'equity' and 'debt' features in the instrument. An obligation to pay cash i.e. interest at 8% per annum and a redemption amount will be treated as 'financial liability' while the option to convert the loan into equity shares is the equity element in the instrument. Therefore, a convertible loan is a compound financial instrument.

Calculation of debt and equity component and amount to be recognised in the books:

S. No	Year	Interest amount@ 8%	Discounting factor@ 10%	Amount
Year 1	2020	96,000	0.91	87,360
Year 2	2021	96,000	0.83	79,680
Year 3	2022	96,000	0.75	72,000
Year 4	2023	12,96,000*	0.68	8,81,280
Amount to be recognised as a liability				11,20,320
Initial proceeds				(12,00,000)
Amount to be recognised as equity				**79,680**

* In year 4, the loan note will be redeemed; therefore, the cash outflow would be Rs. 12,96,000 (Rs. 12,00,000 + Rs. 96,000).

Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 2020

Finance cost to be recognised in the Statement of Profit and Loss (11,20,320 x 10%)	Rs. 1,12,032
Less: Already charged to the income statement	(Rs. 96,000)
Additional finance charge required to be recognised in the Statement of Profit and Loss	Rs. 16,032

In Balance Sheet as at 31 March 2020

Equity and Liabilities	
Equity	
Other Equity (8% convertible loan)	79,680
Non-current liability	
Financial liability [8% convertible loan – [(11,20,320 + 1,12,032 – 96,000)]	11,36,352

Q36 (Nov. 20)

Parent Limited, prepares consolidated financial statements of the group on 31 March every year. During the year ended 31 March 2020, the following events affected the tax position of the group:

(i) S Limited, a wholly owned subsidiary of Parent Limited, incurred a loss of Rs. 20,00,000 which is adjustable from future taxable profits of the company for tax purposes. S Limited is unable to utilize this loss against previous tax liabilities. The Income Tax Act does not allow S Limited to transfer the tax loss to other group companies. However, it allows S Limited to carry forward the loss and utilize it against the company's future taxable profits. The directors of Parent Limited estimate that S Limited will not make any taxable profits in the foreseeable future.

(ii) On 1 April 2019, Parent Limited borrowed Rs. 50,00,000. The cost incurred by Parent Limited for arranging the borrowing was Rs. 1,00,000 on the said date and this expenditure is qualified for deduction under the Income Tax Act for the accounting year 2019-2020. The loan was given for a three-year period. As per agreement, no principal or interest was payable on the loan during the tenure of loan but the amount repayable on 31 March 2022 will be by way of a bullet payment of Rs. 65,21,900. As per

Parent Limited, this equates to an effective annual interest rate of 10% on loan. As per the Income-tax Act, a further expense of Rs. 15,21,900 will be claimable from taxable income till the loan is repaid on 31 March 2022.

The rate of corporate income tax to be assumed @ 20%.

Explain and show how each of these events would affect the deferred tax assets/liabilities in the consolidated balance sheet of Parent Limited as at 31 March 2020 as per applicable Ind AS.

You are also required to examine whether the effective rate of interest arrived at by Parent Limited for the loan of Rs. 50,00,000 is in accordance with applicable Ind AS or not?

* PS: Read 'vested' as 'exercised'.

SOLUTION

i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs. 20,00,000.

However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

ii) The carrying value of the loan at 31 March 2020 is Rs. 53,90,000 (Rs. 50,00,000 – Rs. 1,00,000 + (Rs. 49,00,000 x 10%)).

The tax base of the loan is Rs. 50,00,000.

This creates a deductible temporary difference of Rs. 3,90,000 (Rs. 53,90,000 – Rs. 50,00,000) and a potential deferred tax asset of Rs. 78,000 (Rs. 3,90,000 x 20%).

If there are prospects of availability of taxable profits in future, deferred tax asset can be recognised.

Amortisation Table for verification of effective rate of interest

Year	Opening balance (Rs.) (A)	Interest @ 10% (Rs.) (B)	Closing balance (Rs.) (A) + (B)
1	(50,00,000 – 1,00,000) 49,00,000	4,90,000	53,90,000
2	53,90,000	5,39,000	59,29,000
3	59,29,000	5,92,900	65,21,900

Since the closing balance calculated as per the above table on the basis of 10% matches with the bullet payment of Rs. 65,21,900, it assures that 10% rate of interest taken as effective rate of interest is correct and is in accordance with Ind AS 109. It considers the impact of cost of borrowing adjusted from the loan amount at initial recognition.

(only for understanding)

Year	Carrying Amount	Tax Base	Temporary difference	DTA / DTL
1	53,90,000	50,00,000	3,90,000	DTA
2	59,29,000	50,00,000	9,29,000	DTA
3	65,21,900	50,00,000	9,29,000	reversal of DTA

Q.37 (January 21 – 14 Marks)

Lovely Limited has a policy of providing subsidized loans to its employees for the purpose of buying 2 Wheelers and 4 Wheelers vehicles. Simran, who is a Sales Executive, took a loan for a Four-wheeler vehicle from the Company. The following were the terms of the loan:

- Principal Amount : Rs. 9,00,000
- Interest: 5% p.a. for the First Rs. 3,00,000 and 8% p.a. for the remaining amount.
- Loan disbursed date: 1st April 2017
- Loan Tenure: 3 Years
- Prepayment : Full or Partial payment at the option of the employee.
- Simran shall remain in service till the term of the loan ends.
- The Principal amount should be recovered in 3 equal installments at the end of each year and will be first applied to 8% interest bearing principal.
- The accrued interest shall be paid on an annual basis.

The market rate of a comparable loan available to Simran is 12 % per annum.

Following table shows the expected contractual cash flows from the loan given to Simran.

(In Rs.)

Date	Outflows	Inflows:			Principal Outstanding
		Principal	Interest Income 8%	Interest Income 5%	
01.04.2017	(9,00,000)				9,00,000
31.03.2018		3,00,000	48,000	15,000	6,00,000
31.03.2019		3,00,000	24,000	15,000	3,00,000
31.03.2020		3,00,000	-	15,000	-

Simran pre-pays Rs. 1,00,000 on 31st March, 2019.

Following table shows the actual cash flows from the loan, considering the prepayment on 31st March 2019.

(In Rs.)

Date	Outflows	Inflows:			Principal Outstanding
		Principal	Interest Income 8%	Interest Income 5%	
01.04.2017	(9,00,000)				9,00,000
31.03.2018		3,00,000	48,000	15,000	6,00,000
31.03.2019		4,00,000	24,000	15,000	2,00,000
31.03.2020		2,00,000	-	10,000	-

You are required to pass journal entries in the books of Lovely Limited considering the requirements of Ind AS 109.

SOLUTION

As per requirement of Ind AS 109, a financial instrument is initially measured and recorded at its fair value. Therefore, considering the market rate of interest of similar loan available to Simran is 12%, the fair value of the contractual cash flows shall be as follows:

Date	Inflows			Total inflow	Discount Factor @ 12%	PV
	Principal	Interest income 8%	Interest income 5%			
31.03.2018	3,00,000	48,000	15,000	3,63,000	0.893	3,24,159
31.03.2019	3,00,000	24,000	15,000	3,39,000	0.797	2,70,183
31.03.2020	3,00,000	-	15,000	3,15,000	0.712	2,24,280
Total (fair value)						**8,18,622**

Benefit to Simran, to be considered as part of employee cost for Lovely Ltd. Rs 81,378 (9,00,000 – 8,18,622). The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Simran must remain in service.

The amortization schedule of the Rs. 8,18,622 loan is shown in the following table:

Amount in Rs.

Date	Opening outstanding Loan	Total cash inflows (principal repayment + interest	Interest @ 12%	Closing outstanding Loan
01.04.2017	8,18,622			8,18,622
31.03.2018	8,18,622	3,63,000	98,235	5,53,857
31.03.2019	5,53,857	3,39,000	66,463	2,81,320
31.03.2020	2,81,320	3,15,000	33,680*	Nil

* Difference is due to an approximation of the discounting factor and interest amount.

Journal Entries to be recorded at every period end:

a. 1 April 2017 –

Particulars	Dr. (Rs.)	Cr. (Rs.)	Remarks
Loan to employee A/c Dr. Pre-paid employees cost A/c Dr. To Bank A/c (Being loan asset recorded at initial fair value)	8,18,622 81,378	 9,00,000	financial asset deferred payment

b. 31 March 2018 –

Particulars	Dr. (Rs.)	Cr. (Rs.)
Bank A/c Dr. To Interest income A/c To Loan to employee A/c (Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	3,63,000	 98,235 2,64,765
Employee benefit A/c Dr. To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost on straight line basis)	27,126	 27,126

c. On 31 March 2019, due to prepayment of a part of loan by Simran, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31 March 2019, first the realisation of the contractual cash flow as shown below and then the accounting for the pre-payment of Rs. 1,00,000 included in (d) below:

31 March 2019 –

Particulars	Dr. (Rs.)	Cr. (Rs.)
Bank A/c To Interest income A/c To Loan to employee A/c (Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	3,39,000	 66,463 2,72,537
Employee benefit (profit and loss) A/c To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	27,126	 27,126

Computation of new carrying value of loan to employee:

Date	**Principal**	**Interest income 8%**	**Interest income 5%**	**Discount factor @12%**	**PV**
31.03.2020	200,000	-	10,000	0.893	1,87,530
Total (revised carrying value)					1,87,530
Less: Current carrying value					(2,81,320)
Adjustment required					93,790

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to prepaid employee cost, which shall be amortised over the remaining tenure of the loan.

d. 31st March 2019 prepayment-

	Dr. Rs.	Cr. Rs.
Bank A/c Dr. To Pre-paid employee cost A/c To Loan to employee (Being gain to lovely Limited recorded as an adjustment to pre-paid employee cost)	1,00,000	 6,210 93,790

Amortisation of employee benefit cost shall be as follows:

Date	Opening Balance	Amortised to P & L	Adjustment	Closing balance
01.04.2017	81,378			81378
	81,378	27,126		54,252
	54,252	27,126	6,210	20,916
	20,916	20,916		Nil

e. **31^{st} March 2020-**

Particulars	Dr. Rs.	Cr. Rs.
Bank A/c Dr. To Interest income (profit and loss) @12% A/c To Loan to employee A/c (Being last instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	2,10,000	 22,470 1,87,530
Employee benefit (profit and loss) A/c Dr. To Pre- paid employee cost A/c (Being amortization of pre- paid employee cost charged to profit and loss as employee benefit cost)	20,916	 20,916

Q.38 (January 21 – 5 Marks)

Jewels Ltd. entered into a transaction to purchase 1,000 gms of platinum on 15th January, 2020. The transaction provides for a price payable which is equal to market value of 1,000 gms of platinum on 15th April 2020 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction, at a price of Rs. 100 per share on 15th April 2020. Whether this is to be classified as liability or equity as on 31st March 2020 as per Ind AS 109?

You are required to explain with reasons.

SOLUTION

There is a contract for purchase of 1,000 gms of platinum whose consideration varies in response to changing value of platinum. Analysing this contract as a derivative with all three of the following characteristics:

(a) Value of contract changes in response to change in market value of platinum;

(b) There is no initial net investment

(c) It will be settled at a future date, i.e. 15th April 2020.

Since the above criteria are met, this is a derivative contract.

Now, a derivative contract that is settled in own equity other than exchange of fixed amount of cash for fixed number of shares is classified as 'liability'. In this case, since the contract results in the issue of variable number of shares based on transaction on price to be determined in future, hence, this shall be classified as 'derivative financial liability' as per Ind AS 109.

Q.39 (July 21 – 14 Marks)

Softech Limited has a policy of providing subsidized loans to its employees for the purpose of buying or construction of residential houses. Mrs. B is a Senior Manager in the Company. The Company granted a loan to her on the following terms:

- Principal amount : Rs 25 lakh
- Interest rate: 4% for the first Rs 10 lakh and 7% for the next Rs 15 lakh
- Loan disbursed on: 1st January, 2019
- Tenure: 5 years
- Prepayment: Full or partial pre-payment at the option of the employee.
- The principal amount of loan shall be recovered in 5 equal installments and will be first applied to 7%

interest bearing principal.

- *The accrued interest shall be paid on an annual basis.*
- *Mrs. B must remain in service till the term of the loan ends.*
- *The market rate of a comparable loan available to Mrs. B, is 12% per annum.*
- *Give your calculations by adopting the present value factor as:*

31.12.2019	31.12.2020	31.12.2021	31.12.2022	31.12.2023
0.8929	0.7972	0.7118	0.6355	0.5674

Following table shows the contractually expected cash flows from the loan given to Mrs. B.

(Amount in Rs)

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income (7%)	Interest income (4%)	
1st January 2019	(25,00,000)				25,00,000
		5,00,000	1,05,000	40,000	
31st December 2020		5,00,000	70,000	40,000	15,00,000
31st December 2021		5,00,000	35,000	40,000	10,00,000
31st December 2022		5,00,000	-	40,000	5,00,000
31st December 2023		5,00,000	-	20,000	-

Mrs. B pre-pays Rs 5,00,000 on 31st December 2020, reducing the outstanding principal as on date to Rs 10,00,000.

Following table shows the actual cash flows from the loan given to Mrs. B, considering the prepayment event on 31st December, 2020: (Amount in Rs)

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income (7%)	Interest income (4%)	
1st January 2019	(25,00,000)				25,00,000
31st December 2019		5,00,000	1,05,000	40,000	20,00,000
31st December 2020		10,00,000	70,000	40,000	10,00,000
31st December 2021		5,00,000	-	40,000	5,00,000
31st December 2022		5,00,000	-	20,000	-
31st December 2023		-	-	-	-

Record the journal entries (up to 31st December, 2020) in the books of Softech Limited considering the requirements of Ind AS 109.

SOLUTION

As per Ind AS 109, a financial instrument is initially measured and recorded at its fair value. Therefore, considering the market rate of interest of similar loan available to Mrs. B is 12%, the fair value of the contractual cash flows shall be as follows:

Date	Inflows			Discount factor @12%	PV
	Principal	Interest income @ 7%	Interest income @ 4%		
31st December 2019	5,00,000	1,05,000	40,000	0.8929	5,75,921

31st December 2020	5,00,000	70,000	40,000	0.7972	4,86,292
31st December 2021	5,00,000	35,000	40,000	0.7118	4,09,285
31st December 2022	5,00,000	-	40,000	0.6355	3,43,170
31st December 2023	5,00,000	-	20,000	0.5674	2,95,048
Total (fair value)					**21,09,716**

Benefit to Mrs. B, to be considered a part of employee cost for Softech Limited Rs 3,90,284 (Rs 25,00,000 – Rs 21,09,716).

The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Mrs. B must remain in service.

The amortization schedule of Rs 21,09,716 loan is shown in the following table:

Date	**Opening outstanding loan**	**Total cash inflows (principal repayment + interest**	**Interest @ 12%**	**Closing outstanding loan**
1st January 2019	21,09,716	-	-	21,09,716
31st December 2019	21,09,716	6,45,000	2,53,166	17,17,882
31st December 2020	17,17,882	6,10,000	2,06,146	13,14,028
31st December 2021	13,14,028	5,75,000	1,57,683	8,96,711
31st December 2022	8,96,711	5,40,000	1,07,605	4,64,316
31st December 2023	4,64,316	5,20,000	55,684*	-

* Difference of Rs 34 (55,718 – 55,684) is due to approximation.

Journal Entries in the books of Softech Limited

a. 1st January 2019

Particulars	**Dr. (Rs)**	**Cr. (Rs)**
Loan to Mrs. B A/c Dr.	21,09,716	
Pre-paid employee cost A/c Dr.	3,90,284	
To Bank A/c		25,00,000
(Being loan asset recorded at initial fair value)		

b. 31st December 2019

Particulars	**Dr. (Rs)**	**Cr. (Rs)**
Bank A/c Dr.	6,45,000	
To Interest income (profit and loss) @ 12% A/c		2,53,166
To Loan to Mrs. B A/c		3,91,834
(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)		
Employee benefit (profit and loss) A/c Dr.	78,057	
To Pre-paid employee cost A/c		78,057
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

On 31st December 2020, due to pre-payment of a part of loan by Mrs. B, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31st December 2020, first the realisation of the contractual cash flow as shown in (c) below and then the accounting for the pre-payment of Rs 5,00,000 included in (d) below:

c. 31st December 2020

Particulars	Dr. (Rs)	Cr. (Rs)
Bank A/c Dr.	6,10,000	
To Interest income (profit and loss) @ 12% A/c		2,06,146
To Loan to Mrs. B A/c		4,03,854
(Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)		
Employee benefit (profit and loss) A/c Dr.	78,057	
To Pre-paid employee cost A/c		78,057
(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)		

Computation of new carrying value of loan to Mrs. B:

	Inflows				
Date	Principal	Interest income 7%	Interest income 4%	Discount factor @ 12%	PV
31st December 2021	5,00,000	-	40,000	0.8929	4,82,166
31st December 2022	5,00,000	-	20,000	0.7972	4,14,544
Total (revised carrying value)					8,96,710
Less: Current carrying value					(13,14,028)
Adjustment required					4,17,318

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to pre-paid employee cost, which shall be amortised over the remaining tenure of the loan.

d. 31st December 2020 prepayment

Particulars	Dr. (Rs)	Cr. (Rs)
Bank A/c Dr.	5,00,000	
To Pre-paid employee cost A/c To Loan to Mrs. B A/c		82,682
(Being gain to Softech Limited recorded as an adjustment to pre-paid employee cost)		4,17,318

Amortisation of employee benefit cost shall be as follows:

Date	Opening Balance	Amortised to P&L	Adjustment	Closing Balance
1st January 2019	3,90,284			3,90,284
31st December 2019	3,90,284	78,057		3,12,227
31st December 2020	3,12,227	78,057	82,682	1,51,488

Q40. (July 21 – 6 Marks)

Government of India provides loans to MSMEs at a below-market rate of interest to fund the set-up of a new manufacturing facility. Sukshma Limited's date of transition to Ind AS is 1st April 2020.

In the financial year 2014-2015, the Company had received a loan of Rs 2.0 crore at a below - market rate of interest from the government. Under Indian GAAP, the Company had accounted for the loan as equity and the carrying amount was Rs 2.0 crore at the date of transition. The amount repayable on 31st March 2024 will be Rs 2.50 crore.

The Company has been advised to recognize the difference of Rs 0.50 crores in equity by correspondingly increasing the value of various assets under property, plant & equipment by an equivalent amount on proportionate basis. Further, on 31st March 2024 when the loan has to be repaid, Rs 2.50 crore should be presented as a deduction from property, plant & equipment.

Discuss the above treatment and share your views as per applicable Ind AS.

SOLUTION

Requirement as per Ind AS:

A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32. A first-time adopter shall apply the requirements in Ind AS 109 and Ind AS 20, prospectively to government loans existing at the date of transition to Ind AS and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

Treatment to be done:

Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind AS.

In the instant case, the loan meets the definition of a financial liability in accordance with Ind AS 32. Company therefore reclassifies it from equity to liability. It also uses the previous GAAP carrying amount of the loan at the date of transition as the carrying amount of the loan in the opening Ind AS balance sheet.

It calculates the annual effective interest rate (EIR) starting 1st April 2020 as below: EIR = Amount / Principal(1/t) i.e. 2.50/2(1/4) i.e. 5.74%. approx.

At this rate, Rs 2 crore will accrete to Rs 2.50 crore as at 31st March 2024.

During the next 4 years, the interest expense charged to statement of profit and loss shall be:

Year ended	Opening amortised cost (Rs)	Interest expense for the year (Rs) @ 5.74% p.a. approx.	Closing amortised cost (Rs)
31st March 2021	2,00,00,000	11,48,000	2,11,48,000
31st March 2022	2,11,48,000	12,13,895	2,23,61,895
31st March 2023	2,23,61,895	12,83,573	2,36,45,468
31st March 2024	2,36,45,468	13,54,532	2,50,00,000

An entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government loan originated before the date of transition to Ind AS, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

The accounting treatment is to be done as per above guidance and the advice which the company has been provided is not in line with the requirements of Ind AS 101.

Q41. (July 21 – 5 Marks)

On 1st October, 2017 Axe Limited issued preference shares to B Limited for a consideration of Rs 18 lakh. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer any time up to a period of 4 years. If the holder does not exercise the option, the preference shares are redeemable at the end of 4 years. The preference shares carry a fixed coupon of 5.5% per annum and are payable every year. The prevailing market rate for similar preference shares without the conversion feature is 8% per annum.

Axe Limited has an early redemption option to prepay the instrument at Rs 20 lakh and on 30th September, 2020, it exercised that option. The interest rate has changed on that date.

At that time, Axe Limited could have issued a 1 year (that is maturity 30th September, 2021) non-convertible instrument at 6%.

Calculate the value of liability and equity components at the date of initial recognition. Also give an amortization schedule.

(Limit discounting factor to 3 decimal places for calculation purpose).

SOLUTION

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 4 years (Rs 18,00,000 discounted at 8% for 4 years i.e. Rs 18,00,000 x 0.735)	Rs 13,23,000
Present value of interest payable in arrears for 4 years (Rs 99,000 (Rs 18,00,000 x 5.5%) discounted at 8% for each of 4 years (i.e. Rs 99,000 x 3.312))	Rs 3,27,888
Total financial liability	Rs 16,50,888
Consideration amount	(Rs 18,00,000)
Residual – equity component	Rs 1,49,112

Therefore, equity component = fair value of compound instrument, say, Rs 18,00,000 less financial liability component i.e. Rs 16,50,888 = Rs 1,49,112.

The amortisation schedule of the instrument is set out below:

Dates	Cash flows	Finance cost at effective interest rate	Liability
1st October 2017	18,00,000	-	16,50,888
30th September 2018	(99,000)	1,32,071	16,83,959
30th September 2019	(99,000)	1,34,717	17,19,676
30th September 2020	(99,000)	1,37,574	17,58,250
30th September 2021	(18,99,000)	1,40,750*	-

***Note:** The difference in the amount of finance cost is due to the approximation of discounting factor to 3 decimal places.

Q42 (December 21 – 12 Marks)

KUPA LTD BORROWED Rs. 95 lakhs as loan from XYZ Bank as of April 1st 2018 at an interest rate of 10% p.a. KUPA ltd spent Rs. 1,80,912 as loan processing charges. The principal amount of the loan is to be repaid in 5 equal installments and interest to be paid annually on an accrual basis. The effective interest rate on a loan is 10.80%.

On 31st March 2020, KUPA Ltd faced challenges in business because of sudden changes in technology. It approached XYZ Bank and renegotiated the terms of the loan. Interest rate changed to 15% p.a. Principal amount of loan is to be repaid in 8 equal installments annually starting 31st March 2021 and interest is to be paid annually on an accrual basis. Before approaching the bank KUPA ltd made the interest payment on 31st March 2020.

You are required to record Journal entries in the books of KUPA Ltd till 31st March, 2021, also giving effect of the changes in the terms of the loan on 31st March, 2020. Workings should form part of the answer.

PV of Rel	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
10%	0.909	0.826	0.751	0.683	0.621	0.564	0.513	0.467
10.8%	0.903	0.815	0.735	0.664	0.599	0.540	0.488	0.440
15%	0.870	0.756	0.658	0.572	0.497	0.432	0.376	0.327

SOLUTION

1. *On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:*

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (10.80%)
1/4/18	(95,00,000)	1,80,912	93,19,088	
31/3/19	19,00,000	9,50,000	74,75,550	10,06,462
31/3/20	19,00,000	7,60,000	56,22,909	8,07,359
31/3/21	19,00,000	5,70,000	37,60,183	6,07,274
31/3/22	19,00,000	3,80,000	18,86,283	4,06,100
31/3/23	19,00,000	1,90,000	(0)	2,03,719

a. Beginning 1/4/18-

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Cash A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	93,19,088	 93,19,088

b. 31/03/19-

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Cash A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	18,43,538 10,06,462	 28,50,000

c. 31 March 2020 – Before Kupa Limited approached the bank –

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Interest expense (profit and loss) Dr.	8,07,359	
To Loan from bank A/c		47,359
To cash A/c		7,60,000
(Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)		

Upon receiving the new terms of the loan, Kupa Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31st March 20	(76,00,000)			
31st March 21	9,50,000	11,40,000	0.903	18,87,270
31st March 22	9,50,000	9,97,500	0.815	15,87,213
31st March 23	9,50,000	8,55,000	0.735	13,26,675
31st March 24	9,50,000	7,12,500	0.664	11,03,900
31st March 25	9,50,000	5,72,700	0.599	9,12,097
31st March 26	9,50,000	4,30,200	0.540	7,45,308
31st March 27	9,50,000	2,87,700	0.488	6,03,998
31st March 28	9,50,000	1,45,200	0.440	4,81,888
PV of new contractual cash flows discounted at 10.80%				**86,48,349**
Carrying amount of loan as on 31 Dec 20X2				75,22,909
Difference				**11,25,440**
Percentage of carrying amount				**14.96%**

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31st March 2020 – Accounting for Extinguishment

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Loan from bank (old) A/c Dr	75,22,909	
Finance cost (profit and loss) Dr	77,091	
To Loan from bank (new) A/c		76,00,000
(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)		

e. 31st March 2021

Particulars	Dr. Amount (Rs)	Cr. Amount (Rs)
Loan from bank A/c Dr.	9,50,000	
Interest expense (profit and loss) Dr.	11,40,000	
To cash A/c		20,90,000
(Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)		

Q43. (December 21 – 12 Marks)

Ram Limited is a company incorporated in India. It provides Rs. 25,00,000 interest free loan to its wholly owned Indian subsidiary Balram Limited. There are no transaction costs.

How should the loan be accounted for, in the light of provisions of related Ind AS, in the books of Ram Limited, Balram Limited and Consolidated Financial Statements of the group, considering the following scenarios:

- **i.** *The loan is repayable on demand.*
- **ii.** *The loan is repayable after 3 years. The current market rate of interest for similar loans is 12% P.A. for both holding and subsidiary.*
- **iii.** *The loan is repayable when Balram Limited has funds to repay the loan.*

Briefly, analyse the above scenarios. Also pass Journal Entries in the books of Ram Limited and Balram Limited in case of Scenario (a) and (b).

Present Value of Rs. 1 payable in 3 years' time at an annual discount rate of 12% is 0.7118.

Suggested SOLUTION

Ind AS 109 requires that financial assets and liabilities are recognized on initial recognition at its fair value, as adjusted for the transaction cost. In accordance with Ind AS 113 Fair Value Measurement, the fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Using the guidance, the loan will be accounted for as below in various scenarios:

Scenario (a)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. The parent and subsidiary recognize financial assets and liability, respectively, at the amount of loan given. Going forward, no interest is accrued on the loan.

Upon repayment, both the parent and the subsidiary reverse the entries made at origination.

Scenario (b)

Both parent and subsidiary recognize financial assets and liability, respectively, at fair value on initial recognition. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Accounting in the books of RAM Ltd (Parent)

S.No.	Particulars	Amount	Amount
	On the date of loan		
1	Loan to Balram Ltd (Subsidiary) Dr.	17,79,500	
	Deemed Investment (Capital Contribution) in Balram Ltd Dr.	7,20,500	

	To Bank		25,00,000
	(Being the loan is given to Balram Ltd and recognised at fair value)		
	Accrual of Interest income		
2	Loan to Balram Ltd Dr.	2,13,540	
	To Interest income		2,13,540
	(Being interest income accrued) – Year I		
3	Loan to Balram Ltd Dr.	2,39,165	
	To Interest income		2,39,165
	(Being interest income accrued) – Year 2		
4	Loan to Balram Ltd Dr.	2,67,795	
	To Interest income		2,67,795
	(Being interest income accrued) – Year 3		
	On repayment of loan		
5	Bank Dr.	25,00,000	
	To Loan to Balram Ltd (Subsidiary)		25,00,000

Accounting in the books of Balram Ltd (Subsidiary)

S. No.	Particulars	Amount	Amount
	On the date of loan		
1	Bank Dr.	25,00,000	
	To Loan from Ram Ltd (Payable)		17,79,500
	To Equity (Deemed Capital Contribution from Ram Ltd)		7,20,500
	Accrual of Interest		
2	Interest expense Dr.	2,13,540	
	To Loan from Ram Ltd (Payable)		2,13,540
	(Being interest expense recognised) – Year I		
3	Interest expense Dr.	2,39,165	
	To Loan from Ram Ltd (Payable)		2,39,165
	(Being interest expense recognised) – Year II		
4	Interest expense Dr.	2,67,795	
	To Loan from Ram Ltd (Payable)		2,67,795
	(Being interest expense recognised) – Year III		
	On repayment of loan		
5	Loan from Ram Ltd (Payable) Dr.	25,00,000	
	To Bank		25,00,000

Scenario (c)

Generally, a loan, which is repayable when funds are available, can't be stated to be repayable on demand. Rather, the entities need to estimate repayment date and determine its measurement accordingly. If the loan is expected to be repaid in three years, its measurement will be the same as in scenario (b).

In the Consolidated Financial Statements (CFS), the loan and interest income/expense will get knocked-off as intra-group transactions in all three scenarios. Hence the above accounting will not have any impact on the CFS. However, if the loan is in foreign currency, exchange differences will continue to impact the statement of profit and loss in accordance with the requirements of Ind AS 21.

Q44. (December 21 – 5 Marks)

M Limited has made a Security Deposit whose details are given below:

Particulars	Details
Date of Security Deposit (Starting Date)	April 01, 2016
Date of Security Deposit (Finishing Date)	March 31, 2021
Description	Lease
Total Lease Period	5 Years
Security Deposit	Rs. 20,00,000
Present Value Factor at the 5'' year	0.6499

Determine how the above Financial Asset should be measured and briefly explain the measurement determined as such. Make necessary Journal Entries for accounting of the Security Deposit in the First Year and Last Year. Assume the market rate for a deposit for a similar period to be 9% P.A.

SOLUTION

The above security deposit is an interest free deposit redeemable at the end of lease term for Rs. 20,00,000. Hence this involves collection of contractual cash flows at specified date and not able to sale in the market hence will be categorized under "Amortised Cost".

Journal Entry:

At beg.	Security Deposit a/c Dr.	12,99,800	
	Prepaid Lease Exp A/c Dr.	7,00,200	
	To Bank A/c		20,00,000

At the end of 1st Year:

Security deposit a/c Dr.	1,16,982	
To Interest income a/c		1,16,982

Prepaid lease expense shall be amortised over the life of lease term on SLM basis unless any other approach is reasonable.

Rent Expense a/c Dr.	1,40,040	
To Prepaid Expense a/c		1,40,040