Definitions

1. Financial Instrument

If Both Equity & FL then it's compound Financial Instrument

one entity	another Entity
Financial Asset	Equity or Financial Liability

2. Financial Asset :

1. Cash.
2. Equity instrument of another entity
   [Investment in Equity shares]
3. Contractual Right to receive
   - 3a) Cash (*)
     - Debtors
     - Bills Receivable
     - Loan given
     - Investment in
       - Bonds
       - Debenture
       - Preference shares
   - 3b) Equity instruments
     - Investment in
       - convertible Bonds
       - convertible Debenture
       - convertible Preference shares
   - 3c) Another Financial Asset.
     - Debtors (who will give bonds of another company)
4. Potentially favourable Derivative contracts.

3. Equity (Residual Interest):

1. Equity shares issued
2. Contract to issue fixed number of Equity share

4. Financial Liability :

3. Contractual obligation to deliver
   - 3a) Cash (*)
     - Creditors
     - Bill Payable
     - Loan taken
     - Issued by Entity
       - Bonds
       - Debenture
       - Preference shares
   - 3b) Equity Instrument (variable)
     - Issued by Entity
       - convertible Bonds
       - convertible Debenture
       - convertible Preference shares
   - 3c) Another Financial Asset.
     - Creditors (To whom bond of another company will be given.
4. Potentially Unfavourable Derivative contracts.

* Statutory Right is not FA : ⟶ Income Tax Receivable.
Statutory Obligation is not FL : ⟶ Income Tax Payable.

Example 1

Evaluate the financial assets.

S. No.	Particulars	Whether FA or not	Remarks
1	Investment in bonds debentures	FA	• Contractual right to receive cash.
2	Loans and receivables	FA	• Contractual right to receive cash.
3	Deposits given	FA	• Contractual right to receive cash.
4	Trade & other receivables	FA	• Contractual right to receive cash.
5	Cash and cash equivalents	FA	• Specifically covered in the definition.
6	Bank balance	FA	• Contractual right to receive cash.
7	Investments in equity shares	FA	• Equity instrument of another entity.
8	Perpetual debt instruments Eg. perpetual bonds, debentures and capital notes.	FA	• Such instruments provide the contractual right to receive interest for indefinite future or a right to return of principal under terms that make it very unlikely or very far in the future.
9	Physical assets Eg. inventories, property, plant and equipment etc.	No	• Control of such assets does not create a present right to receive cash or another financial asset.
10	Right to use assets Eg. Lease vehicle etc.	No	• Control of such assets does not create a present right to receive cash or another financial asset.
11	Intangibles Eg. Patents, trademark etc.	No	• Control of such assets does not create a present right to receive cash or another financial asset.
12	Prepaid expenses Eg. Prepaid insurance, prepaid rent etc.	No	• These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash.
13	Advance given for goods and services	No	• These instruments provide future economic benefit in the form of goods or services, rather than the right to receive cash.

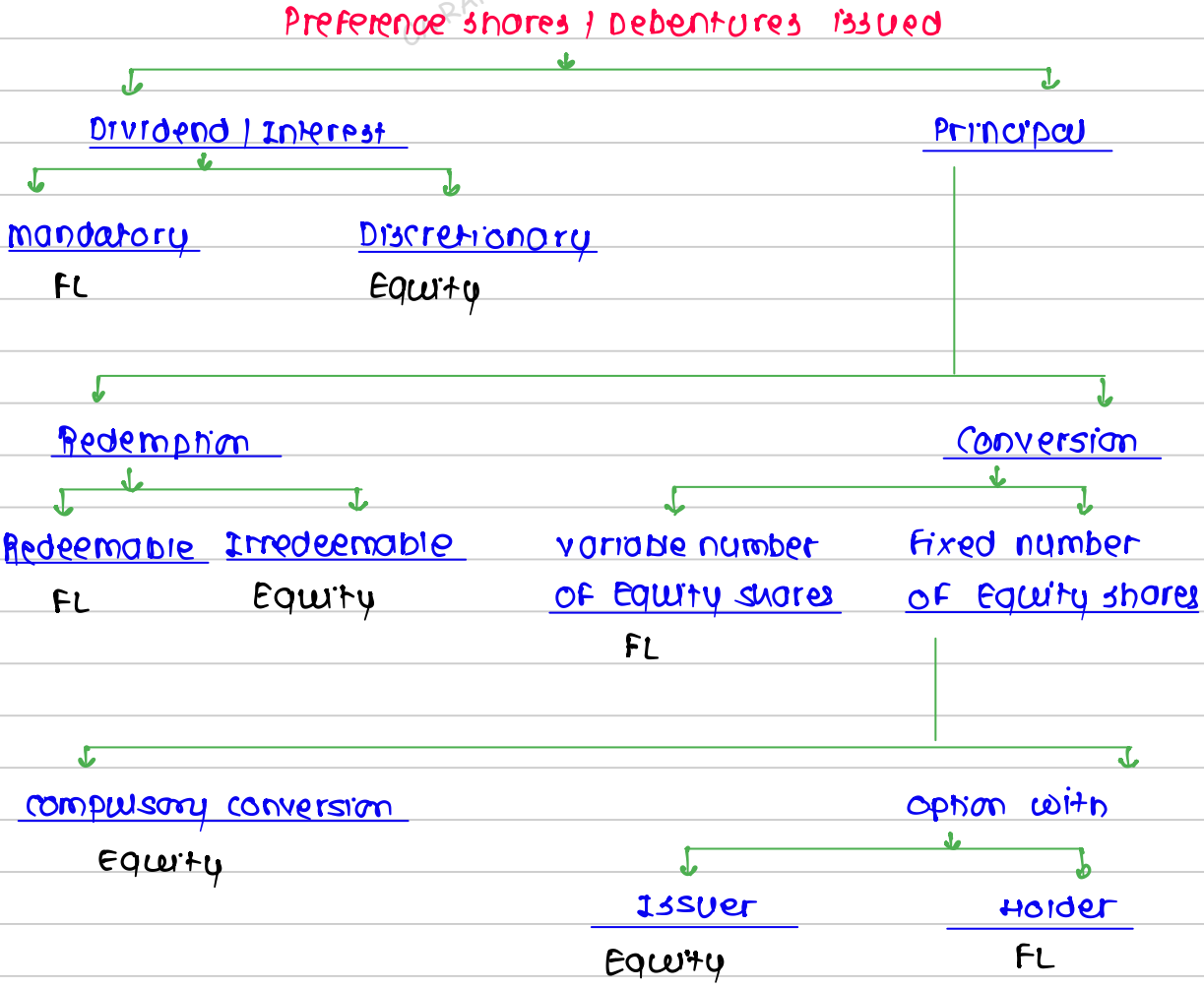
Example 2

Evaluate the financial Liability.

S.No.	Particulars	Whether FL or not	Remarks
1	Loans payable or bank loan	FL	• Contractual obligation to pay cash / bank.
2	Trade and other payables	FL	• Contractual obligation to pay cash / bank
3	Bills payable / acceptance	FL	• Contractual obligation to pay cash / bank
4	Deposits received	FL	• Contractual obligation to pay cash / bank
5	Mandatory redeemable preferences shares	FL	Contractual obligation to pay cash / bank
6	Financial guarantee given	FL	• Contractual obligation to pay cash, due to the occurrence of certain events.

5. Compound Financial Instruments: (only for issuer)

Instrument which contains features of Equity & Financial Liability both.



EXAM NOV 18

(c) *NAV Limited granted a loan of ₹120 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*

(4 Marks)

Solution

(c) 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
4	12	0.636	7.632
5	120+12=132	0.567	74.844
			111.288

The fair value of the transaction be ₹ 111.288 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 ₹ 120 lakh– ₹ 111.288 lakh= ₹ 8.712 lakh.

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

SM 12.193

Illustration 1

A Ltd. issued redeemable preference shares to a Holding Company – Z Ltd. The terms of the instrument have been summarized below. Account for this in the books of Z Ltd.

Nature	Non-cumulative redeemable preference shares
Repayment:	Redeemable after 5 years
Date of Allotment:	1-Apr-20X1
Date of repayment:	31-Mar-20X6
Total period:	5.00 years
Value of preference shares issued:	100,000,000
Dividend rate	0.0001%
Market rate of interest	12% per annum
Present value factor	0.56743

Solution

1. Initial measurement:

Year	Cash Flow	DF @ 12%	PV
5	10 Cr	0.567426 86	56742686

2. Amortisation schedule:

Year	Opening	Int @ 12%	Cash Flow	Closing
31-3-X2	56742686	6809122	-	63551808
31-3-X3	63551808	7626217	-	71178025
31-3-X4	71178025	8541363	-	79719388
31-3-X5	79719388	9566327	-	89285715
31-3-X6	89285715	10714285	10,00,00,000	-

3. Journal Entry:

Particulars		Amount	Amount
Date of transaction			
Investment - Equity portion	Dr.	43,257,314	
Loan receivable	Dr.	56,742,686	
To Bank			100,000,000
Interest income - March 31, 20X2			
Loan receivable	Dr.	6,809,122	
To Interest income			6,809,122
Interest income - March 31, 20X3			
Loan receivable	Dr.	76,26,217	
To Interest income			76,26,217

Interest income - March 31, 20X4			
Loan receivable	Dr.	85,41,363	
To Interest income			85,41,363
Interest income - March 31, 20X5			
Loan receivable	Dr.	95,66,327	
To Interest income			95,66,327
Interest income - March 31, 20X6			
Loan receivable	Dr.	10,714,285	
To Interest income			10,714,285
Settlement of transaction			
Bank	Dr.	100,000,000	
To Loan receivable			100,000,000

SM 12.57

Illustration 25 : Accounting for assets at amortised cost

A Ltd has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit in the first year and last year. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1-Apr-20X1
Date of Security Deposit (Finishing Date)	31-Mar-20X6
Description	Lease
Total Lease Period	5 years
Discount rate	12.00%
Security deposit (A)	10,00,000
Present value factor at the 5th year	0.567427

Solution

1. Calculation of Fair value

Year	CF	PVF @ 12%	PV
5	10L	0.567427	567427

2. Amortisation schedule: (FA → Int Income)

Year	Opening	EIR @ 12%	CF	Closing
1	567427	68091	-	-
2	635518	76262	-	-
3	711780	85414	-	-
4	797194	95663	-	-
5	892857	107143	10,00,000	-

3. Journal Entry:

Y0 : Security Deposit 567427
ROU Asset (Prepaid rent) 432573
To Bank 10 Cr

Y1 : Security Deposit 68091
To Interest 68091

Depn (432573 ÷ 5) 86515
To ROU Asset 86515

Last Year:

Security Deposit	107143	
To Interest		107143
Bank	10L	
To Security Deposite		10L
Depn (432573 ÷ 5)	86515	
To ROU Asset		86515

SM 12.208

1. As part of staff welfare measures, Y Co Ltd. has contracted to lend to its employees sums of money at 5% per annum rate of interest. The amounts lent are to be repaid in five equal instalments for principle along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent ₹ 1,600,000 to its employees on 1st January 20X1.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31 December 20X1, for the transaction and also compute the value of loan initially to be recognised and amortised cost for all subsequent years.

For the purpose of calculation, following discount factors at interest rate of 10% per annum may be adopted –

At the end of year –

Year	Present value factor
1	.909
2	.827
3	.751
4	.683
5	.620

1. Calculation of Cash Flows:

Year	Opening Balance	Int @ 5%	Principal Repaid	Total Cash Flow	PVF @ 10%	PV
1	1600,000	80,000	320,000	400,000	0.909	363600
2	1280,000	64000	320,000	384000	0.827	317568
3	960,000	48000	320,000	368000	0.751	276368
4	640,000	32000	320,000	352000	0.683	240416
5	320,000	16000	320,000	336000	0.620	208320
						1406272

2. Amortisation Table:

Year	Opening	Int@10%	Cash Flow	Closing
1	1406272	140627	400,000	1146899
2	1146899	114690	384000	877589
3	877589	87759	368000	597348
4	597348	59735	352000	305083
5	305083	30917	336000	-

3. Journal Entries

Date	Particulars	Debit	Credit
1-1-20X1	Loan to staff (FA)	1406272	
	Prepaid staff cost	193728	
	To Bank		1600,000
31-3-20X1	Loan to staff (FA)	140627	
	To Interest Exp		140627
	Bank	400,000	
	To Loan to staff		400,000
	staff cost (193728÷5)	38746	
	To Prepaid staff cost		38746

RTP MAY 19 MTP OCT 20

KK Ltd. has granted an interest free loan of ₹ 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:

(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand. [CA & CL]

(ii) 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 loan is 10%. Considering the same, the fair value of the loan at initial recognition is ₹ 8,10,150.

(iii) The said loan is interest free and will be repaid as and when the YK Ltd. has funds to repay the Loan amount.

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.

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?

Solution Case 1

Since the loan is repayable on demand, it has fair value equal to cash consideration given. KK Ltd. and YK Ltd. should recognize financial asset 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.	₹ 10,00,000	
To Bank A/c			₹ 10,00,000
On repayment			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to YK Ltd. A/c			₹ 10,00,000

Journal entries in the books of YK Ltd.

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

Case 2

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

At origination			
Loan to YK Ltd. A/c	Dr.	₹ 8,10,150	
Investment in YK Ltd. A/c	Dr.	₹ 1,89,850	
To Bank A/c			₹ 10,00,000
During periods to repayment- to recognise interest			
Year 1 – Charging of Interest			
Loan to YK Ltd. A/c	Dr.	₹ 81,015	
To Interest income A/c			₹ 81,015
Transferring of interest to Profit and Loss			
Interest income A/c	Dr.	₹ 81,015	
To Profit and Loss A/c			₹ 81,015
On repayment			
Bank A/c	Dr.	₹ 10,00,000	
To Loan to YK Ltd. A/c			₹ 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. (for one year)

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

Case 3

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 (ii).

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

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.

SM 12.60

Illustration 28: Accounting for assets at Amortised Cost

XYZ Ltd. is a company incorporated in India. It provides INR 10,00,000 interest free loan to its wholly owned Indian subsidiary (ABC). There are no transaction costs.

How should the loan be accounted for, in the Ind AS financial statements of XYZ, ABC and consolidated financial statements of the group?

Consider the following scenarios:

a) The loan is repayable on demand.

b) The loan is repayable after 3 years. The current market rate of interest for similar loan is 10% p.a. for both holding and subsidiary.

c) The loan is repayable when ABC has funds to repay the loan.

SM 12.67

Illustration 31: Issue of borrowings with fixed rate of interest

A Ltd has made a borrowing from RBC Bank for ₹ 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for ₹ 500 and loan is payable after 5 years in bullet repayment of principal. Details are as follows:

Particulars	Details
Loan amount	₹ 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of repayment of principal amount (Finishing Date)	31-March-20X6
Interest rate	10.00%
Interest charge	Interest to be charged and paid yearly
Upfront fees	₹ 500

How would loan be accounted in books of A Ltd?

Solution

Calculation of EIR (Effective Interest Rate)

Year	Cash flow	DF @10%	PV	DF @13%	PV	
1-5	1000	3.790787	3791	3.517231	3517	
5	10,000	0.620921	6209	0.542760	5428	
			10,000		8945	(1055)

3% ? 1.42%

500 (10,000-9500)

$$EIR = 10 + \frac{500}{1055} \times 3$$

$$10 + 1.42$$

$$= 11.42\%$$

Amortisation table:

Year end	Opening balance	Interest @ 11.42%	Repayment of interest & principal	Closing balance
1	9,500	1,085	1,000	9,585
2	9,585	1,095	1,000	9,679
3	9,679	1,105	1,000	9,785
4	9,785	1,117	1,000	9,902
5	9,902	1,098*	11,000	-

SM 12.68

Illustration 32: Issue of borrowings with fixed rate of interest

A Ltd has made a borrowing from RBC Bank for ₹ 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for ₹ 500 and loan is payable 4 half-yearly instalments of ₹ 2,500 each. Details are as follows:

Particulars	Details
Loan amount	₹ 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of loan (Finishing Date)	31-March-20X3
Description of repayment	Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)
Installment amount	₹ 2,500
Interest rate	12.00%
Interest charge	Interest to be charged quarterly
Upfront fees	₹ 500

How would loan be accounted in books of A Ltd?

Consider IRR is 16.60% p.a.

Solution

Calculation of Cash Flows: (Interest & Principal)

Date	Opening Balance	Interest @3 %	Cash Flow		
			Interest	Principal	Total
30-6-X1	10,000	300	300	-	300
30-9-X1	10,000	300	300	2500	2800
31-12 X1	7500	225	225	-	225
31-3-X2	7500	225	225	2500	2725
30-6-X2	5000	150	150	-	150
30-9-X2	5000	150	150	2500	2650
31-12 X2	2500	75	75	-	75
31-3-X3	2500	75	75	2500	2575

Initial Recognition:

Financial Liability: Loan Payable: 10,000 − 500 = 9500.

Amortisation Table :

	Date	Opening Balance	Interest @ 16.60%	Cash Flow.	Closing Balance
90	30-6-X1	9500	389	300	9589
92	30-9-X1	9589	401	2800	7190
92	31-12 X1	7190	301	225	7266
90	31-3-X2	7266	297	2725	4838
91	30-6-X2	4838	200	150	4888
92	30-9-X2	4888	204	2650	2442
92	31-12 X2	2442	102	75	2473
91	31-3-X3	2473	102	2575	-

RTP MAY 20 MTP MARCH 21

XYZ issued ₹ 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 ₹ 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by accountant. The preference shares are redeemable for a cash amount of ₹ 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 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 issue. 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

1. Initial Recognition: 480,000

2. Amortisation Table:

Year	Opening	EIR @ 18%	Cash Flow	Closing
X5-X6	480,000	86400	19200	547200

3. Rectification Entry:

		₹	₹
Preference share capital (equity) (Balance sheet)	Dr.	4,80,000	
Finance costs (Profit and loss)	Dr.	86,400	
To Equity – Retained earnings (Balance sheet)			19,200
To Preference shares (Long-term Borrowings) (Balance sheet)			5,47,200

SM 12.59

Illustration 27: Accounting for assets at FVOCI

Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for ₹ 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is ₹ 45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

Solution

The Company has made an irrecoverable option to carry its investment at fair value through other comprehensive income. Accordingly, the investment shall be initially recognised at fair value and all subsequent fair value gains/ losses shall be recognised in other comprehensive income (OCI).

Journal Entries

Particulars		Amount	Amount
Upon initial recognition –			
Investment in equity shares of C Ltd.	Dr.	5,00,000	
To Bank a/c			5,00,000
(Being investment recognized at fair value plus transaction costs upon initial recognition)			
Subsequently –			
Fair value loss on financial instruments	Dr.	50,000	
To Investment in equity shares of C Ltd.			50,000
(Being fair value loss recognised)			
Fair value reserve in OCI	Dr.	50,000	
To Fair value loss on financial instruments			50,000
(Being fair value loss recognized in other comprehensive income)			

Illustration 26 : Accounting for assets at FVTPL

A Ltd. invested in equity shares of C Ltd. on 15th March for ₹ 10,000. Transaction costs were ₹ 500 in addition to the basic cost of ₹ 10,000. On 31 March, the fair value of the equity shares was ₹ 11,200 and market rate of interest is 10% per annum for a 10 year loan. Pass necessary journal entries. Analyse the measurement principle and pass necessary journal entries.

The above investment is in equity shares of C Ltd and hence, does not involve any contractual cash flows that are solely payments of principal and interest. Hence, these equity shares shall be measured at fair value through profit or loss. Also, an irrecoverable option exists to designate such investment as fair value through other comprehensive income.

Journal Entries

Particulars		Amount	Amount
Upon initial recognition –			
Investment in equity shares of C Ltd.	Dr.	10,000	
Transaction cost	Dr.	500	
To Bank A/c			10,500
(Being investment recognized at fair value plus transaction costs upon initial recognition)			
Profit and Loss A/c	Dr.	500	
To Transaction cost			500
(Being transaction cost incurred on assets measured at FVTPL transferred to P&L A/c)			

Subsequently –			
Investment in equity shares of C Ltd.	Dr.	1,200	
To Fair value gain on financial instruments			1,200
(Being fair value gain recognized at year end in P&L)			
Fair value gain on financial instruments	Dr.	1,200	
To Profit and Loss A/c			1,200
(Being fair value gain transferred to P&L A/c)			

12.1.24 Q 13

Illustration 32: Optionally convertible preference shares with issuer's redemption option

D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 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. and is payable at the end of every year.

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. (5 decimals)

(WN1): Details:

Coupon Rate : 9 + 1 = 10% p.a

Market Rate : 9 + 4 = 13% p.a.

1. Calculation of Financial Liability & Equity

Year	Cash Flow	PVF @ 13%	PV
1-3	100,000	2.36115	236115
3	10,00,000	0.69305	693050
		Financial Liability	929165
		Equity Component	70835
			1000000

Illustration 32: Optionally convertible preference shares with issuer's redemption option

D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 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. and is payable at the end of every year.

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 (₹ 10 lakhs discounted at 13% for 3 years) = ₹ 6,93,050

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

Paragraph AG 31 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

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

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

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12.210

4. K ltd. issued 500,000, 6% convertible debentures @ ₹ 10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, 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 rights was 10%.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Company's books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

Interest rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

1. Calculation of Financial Liability & Equity

Year	Cash Flow	PVF @ 10%	PV
1-4	300,000	3.17	951000
4	2750,000	0.68	1870,000
[(500,000 x 50% x 10) + 10%]		Financial Liab	2821000
		Equity	2179,000
			5000,000

2. Entries:

Bank		5000,000	
To	6% Debentures (FL)		2821000
To	6% Debentures (equity)		2179 000

12.210

4. K ltd. issued 500,000, 6% convertible debentures @ ₹ 10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, 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 rights was 10%.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in Company's books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

Interest rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

4. Computation of debt component of convertible debentures on 01 April 20X1

Particulars	Amount
Present value of principal amount repayable after 4 years	
(A) 5,000,000 x 50% x 1.10 x 0.68 (10% discount factor)	1,870,000
(B) Present value of interest [300,000 x 3.17] (4 years cumulative 10% discount factor)	951,000
Total present value of debt component (A) + (B)	2,821,000
Issue proceeds from convertible debentures	5,000,000
Value of equity component	2,179,000

Journal entry at initial recognition

Particulars		Dr. Amount (₹)	Cr. Amount (₹)
Bank A/c	Dr.	5,000,000	
To 6% debenture A/c (liability component)			2,821,000
To 6% debenture A/c (equity component)			2,179,000
(Being disbursement recorded at fair value)			

Illustration 2 12.195

A Limited issues ₹ 1 crore convertible bonds on 1 July 20X1. The bonds have a life of eight years and a face value of ₹ 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited at any time in the next eight years. Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8 per cent per annum. (PV = 4 decimals)

Required:

(a) *Provide the appropriate accounting entries for initial recognition.*

(b) *Calculate the stream of interest expenses across the eight years of the life of the bonds.*

(c) *Provide the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the third year.*

(W.N 1): Initial measurement:

Year	CF	PVF @ 8%	PV
1-8	600,000	5.7466	3447960
8	100,00,000	0.5403	5403000
		FL	8850960
		Equity	1149040
			100,00,000

a) Accounting Entry (Initial Recognition)

1-07-X1	Bank		100,00,000	
	To Bonds (FL)			8850960
	To Bonds (Equity)			1149040
30-06-X1	Interest Exp		708077	(8850960 x 8%)
	To Bonds			708077
	Bonds		600,000	
	To Bank			600,000

1:36.

b) Amortisation Table

Year	opening	Interest @ 8%	cash Flow	Closing
1	8850960	708077	600,000	8959037
2	8959037	716723	600,000	9075760
3	9075760	726061	600,000	9201821
4	9201821	736146	600,000	9337967
5	9337967	747037	600,000	9485004
6	9485004	758800	600,000	9643804
7	9643804	77504	600,000	9815308
8	9815308	784692	600,00	100,00,000

c) Accounting Entries end of 3rd year:

30-6-X4	Interest Exp	726061	
	To Bond (FL)		726061
	Bond (FL)	600,000	
	To Bank		600,000
	Bond (FL)	9201821	
	Bond (Equity)	1149040	
	To ESC		10350861

Illustration 6 12.204

ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ ₹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. (PV = 6 decimals)

1. Initial measurement:

Year	CF	PVF@15%	PV
1-5	150,000	3.352155	502823

(10,000 × 150 × 10%)

Particulars	Gross	Allocation	Net
FL	502823	10056	492767
Equity	997177	19944	977233
	1500,000	30,000	1470,000

(10,000 × 150)

2. Amortisation Table:

NOT : 15%

Year	Opening	Interest @ 15.86%	Cash Flow	Closing
1	492767	78153	150,000	420920
2	420920	66758	150,000	337678
3	337678	53556	150,000	241234
4	241234	38260	150,000	129494
5	129494	20506	150,000	-

Journal Entries:

1-4-X1	Bank	1470,000	
	To Preference shares (FL)		492767
	To Preference shares (equity)		977233

	31-3-X2	31-3-X3	31-3-X4	31-3-X5	31-3-X6
Finance cost	78153	66758	53556	38260	20506
To PS (FL)	78153	66758	53556	38260	20506
PS(FL)	150,000	150,000	150,000	150,000	150,000
To Bank	150,000	150,000	150,000	150,000	150,000

31-3-X6 :	PS (Equity)	977233		
	To Equity share capital		50,000	(5000x10)
	To Security Premium		927233	(977233 - 50,000)

12.210

5. On 1 April 20X1, an 8% convertible loan with a nominal value of ₹ 6,00,000 was issued at par. It is redeemable on 31 March 20X5 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 ₹ 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

→ 3.17

Explain how will the Company account for the above loan notes in the financial statements for the year ended 31 March 20X2?

1. Initial measurement: * (600,000 × 8%)

Year	CF	PVF@10%	PV
1	48000	0.91	43680
2	48000	0.83	39840
3	48000	0.75	36000
4	648000	0.68	440640
			560160

ICAI solution → 360 63 ↓ 560223

2. Classification

FL	560160
Equity	39840
Total Proceeds	600,000

3. Amortisation Table:

Year	opening	Int@10%	CF	Closing
1.	560160	56016	48000	568172

4. Rectification Entry:

Finance cost (to be recorded)	56016	FC	8016
(-) FC already recorded	48000	To Loan (FL)	8016
	8016		

12.113

Illustration 31: Optionally convertible redeemable preference shares (continued from Illustration 29) (assumed year ending 30th June)

On 1 July 20X1, D Ltd. issues preference shares to G Ltd. for a consideration of ₹ 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 fixed coupon of 6% p.a. and is payable every year. The prevailing market rate for similar preference shares, without the conversion feature, is 9% p.a.

Calculate the value of the liability and equity components. (PVF = 6 decimals)

1. Initial measurement: * (10,00,000 × 6%)

Year	CF	PVF@9%	PV
1-3	60,000	2.531295	151878
3	10,00,000	0.772183	772183
			924061

2. Classification

FL	924061
Equity	75939
Total Proceeds	10,00,000

3. Amortisation Table:

Year		Opening	Int@9%	CF	Closing
(30-6-X2)	1	924061	83165	60,000	
(30-6-X3)	2	947226	85250	60,000	
(30-6-X4)	3	972476	87524	60,000	10,00,000

12.117

Illustration 34: Optionally convertible redeemable preference shares (continued from Illustration 31)

The amortisation schedule of the instrument is set out below:

Dates	Cash flows	Finance cost at effective interest rate	Liability	Equity
1July 20X1	1,000,000	-	9,24,061	75,939
30 June 20X2	(60,000)	83,165	9,47,226	75,939
30 June 20X3	(60,000)	85,250	9,72,476	75,939
30 June 20X4	(10,60,000)	87,524	-	75,939

Assume that D Ltd. has an early redemption option to prepay the instrument at ₹ 11 lakhs and on 30 June 20X3, it exercises that option. At 30 June 20X3, the interest rate has changed. At that time, D Ltd. could have issued a one-year (i.e. maturity 30 June 20X4) non-convertible instrument at 5%. Calculate the value of the liability and equity components.

1. C.A & Cash Flow.

Particulars	CA	Cash Flow	
FL	972476	1009524	
Equity	75939	90476	(1100000 - 1009524)
Total Proceeds	xx	1100,000	

2. Cash Flow related to FL.

Year	CF	PVF@5%	PV
30-6-X4	1060,000	0.952381	1009524

Journal Entry: (not asked : Extra)

PS (FL)	972476	PS (Equity)	75939
PL	37048	Retained Earning	14537
To Bank	1009524	To Bank	90476

2. On 1st April, 20X4, Shelter Ltd. issued 5,000, 8% convertible debentures with a face value of ₹ 100 each maturing on 31st March, 20X9. The debentures are convertible into equity shares of Shelter Ltd. at a conversion price of ₹ 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 ₹ 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for ₹ 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%.

{MAY 18 RTP}

(12 Marks)

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

(i) At the time of initial recognition and

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

The following present values of ₹ 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

1. Initial Recognition: (5000 X 100 X 8%)

Year	CF	PV @ 12%	PV
1-5	40,000	3.605	144200
5	500,000	0.567	283500
			427700

2. Classification:

Par	Amt
FL	427700
Equity	72300
Total	500,000

3. Journal Entry (Initial Recognition)

Bank		500,000	
To	8% convertible debenture (FL)		427700
To	8% convertible debenture (Equity)		72300

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

4. Carrying Amount of FL on Repurchase date (1-4-X7)

Year		Opening	Int@12%	CF	Closing
(31-3-X5)	1	427700	51324	40,000	
(31-3-X6)	2	439024	52683	40,000	
(31-3-X7)	3	451707	54205	40,000	465912

5. Fair value of FL on Repurchase date (1-4-X7)

Year		CF	PV@9%	PV
(31-3-X8)	1	40,000	0.917	36680
(31-3-X9)	2	540,000	0.842	454680
				491360

6. Carrying Amount & Fair value

Particulars	CA	FV
FL	465912	491360
Equity	72300	33640
		525000

7. Journal Entry:

8% convertible debenture (FL)		465912	
P&L		25448	
To Bank			491360

8% convertible debenture (Equity)		72300	
To Retained Earning			38660
To Bank			33640

FA

Transaction cost

18. On 1st April 2017, A Ltd. lent ₹ 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company ₹ 10 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 ₹ 2.40 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 ₹ 2.20 crores. Suggest the accounting entries as per applicable Ind AS. (NOV 18 RTP) (PVF = 7 decimals)

1. Carrying amount on modification date: (FA)

a) Initial Recognition: 200,00,000 + 10,00,000 = 210,00,000

b) CA on modification date

Year	opening	Int @ 6.9%	CF	Closing
31-3-18	2,10,00,000	1449000	-	22449000

2. Fair value on modification date:

Year	CF	PVF @ 6.9%	PV
(31-3-19) 1	220,00,000	0.9354537	20579981

3. Difference:

FV	20579981
CA	(22449000)
↓ in FA	1869019

PIL	1869019	FA	1449000
To FA	1869019	To PIL (Int)	1449000

Net Amt Charged to P&L (1869019 - 1449000) = 420019

FA

2. Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Principal amount: 1,000,000
- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 January 20X1
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Following table shows the contractually expected cash flows from the loan given to Mr. X:

(amount in ₹)

		Inflows			
Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1	258000	200,000	42,000	16,000	800,000
31-Dec-20X2		200,000	28,000	16,000	600,000
31-Dec-20X3		200,000	14,000	16,000	400,000
31-Dec-20X4		200,000	-	16,000	200,000
31-Dec-20X5		200,000	-	8,000	-

Mr. S, pre-pays ₹ 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to ₹ 400,000.

Following table shows the actual cash flows from the loan given to Mr. X, considering the pre-payment event on 31 December 20X2: (amount in ₹)

		Inflows			
Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		400,000	28,000	16,000	400,000
31-Dec-20X3		200,000	-	16,000	200,000
31-Dec-20X4		200,000	-	8,000	-
31-Dec-20X5		-	-	-	-

Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109. (PVF = 6 decmals) (asked 2 times)

1. Initial measurement: (1-1-X1)

	Year	CF	PVF@12%	PV
31-12-X1	1	258000	0.892857	230357
X2	2	244000	0.797194	194515
X3	3	230,000	0.711780	163709
X4	4	216000	0.635518	137272
X5	5	208000	0.567427	118025
				843878

2. Classification:

FL	843878
Prepaid staff cost	156122
	10,00,000

3. Journal Entry

1-1-X1	Loan to employee (FA)	843878	
	Prepaid staff cost	156122	
	To Bank		10,00,000

4. Prepaid staff cost w/off to P&L each year = 156122 / 5 = 31224

5. Amortisation Table:

Year	Opening	Int @12%	CF	Closing
1	843878	101265	258000	687143
2	687143	82457	244000	525600
3	525600	63072	230,000	358672
4	358672	43041	216000	185713
5	185713	22287	208000	-

6. Journal Entries:

	31-12-X1		31-12-X2	
Loan to EE	101265		82457	
To Interest		101265		82457
Bank	258000		244000	
To Loan to EE		258000		244000
Staff cost (P/L)	31224		31224	
To Prepaid staff cost		31224		31224

7. Fair value (Revised value) on modification date

	Year	CF	PVF@12%	PV
(31-12-X3)	1	216000	0.892857	192857
(X4)	2	208000	0.797194	165816
				358673

8. Difference

Fair value	358673
Carrying Amt	(525600)
↓ in FA	166927

9. Journal Entry:

31-12-02 :	Bank	200,000	
	To Prepaid staff cost		33073
	To FA		166927

10. New Amortisation Table: (31-12-02 onwards)

	Year	Opening	Int @12%	CF	Closing
(31-12-X3)	1	358673	43041	216000	185714
(X4)	2	185714	22286	208000	-

11. Prepaid staff cost (to be written off in 2003 & 2004:

Opening balance (on 1-1-X1)		156122
(-) W/O to PIL (20X1 & 20X2)	(31224 + 31224)	(62448)
(+) modification effect		(33073)
Balance on 31-12-X2		60601
W/O every year	60601 × 1/2	= 30300

11. Journal Entries:

	31-12-X1		31-12-X2	
Loan to EE	43041		22286	
To Interest		43041		22286
Bank	216000		208000	
To Loan to EE		216000		208000
Staff cost (PIL)	30300.		30301	
To Prepaid staff cost		30300		30301

(MTP mark18) 23

5. (a) On 1 January 20X0, Preet Ltd. issues 10 year bonds for ₹ 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for ₹ 10,00,000. No costs or fees are incurred. The effective interest rate is 10%. On 1 January 20X5 (i.e. after 5 years) Preet Ltd. and the bondholders agree to a modification in accordance with which:

X = 0
Y = 1

- the term is extended to 31 December 20Y1;
- interest payments are reduced to 5% p.a.;
- the bonds are redeemable on 31 December 20Y1 for ₹ 15,00,000; and
- legal and other fees of ₹ 1,00,000 are incurred.

Preet Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%.

Analyse whether the extinguishment accounting will apply or not as per Ind AS. If yes, determine the fair value of the modified liability and compute the gain or loss on modification.

(PVF = 6 decimals) **(14 Marks)**

1. Initial measurement:

Fair value on 1-1-X0 = 10,00,000

2. Amortisation table:

years	opening	Int @ 10%	CF	closing
31-12-X0	10,00,000	100,000	100,000	10,00,000
X1	10,00,000	100,000	100,000	10,00,000
X2	10,00,000	100,000	100,000	10,00,000
X3	10,00,000	100,000	100,000	10,00,000
X4	10,00,000	100,000	100,000	10,00,000

3. PV of revised remaining cash flows using original EIR on modification date

Year	cash flows	PVF @ 10%	PV
31-12-X5	50,000		
X6	50,000		
X7	50,000		
X8	50,000	4.355261	217763
X9	50,000		
X10	50,000		
X11	15,50,000	0.513158	795395
			1013158

modification %

$$\frac{(1013158 + 100,000) - 10,00,000}{10,00,000} \times 100 = 11.32\%$$

since modification % (i.e. 11.32%) more than 10%
Hence, extinguishment accounting will apply.

Fair value of modified liability on 1-1-X5

Years	CF	PVF @ 11%	PV
7 (31-12-X5 to 31-12-Y1)	50,000	4.712196	235610
31-12-Y1	1500,000	0.481658	722487
			958097

Journal Entry:

FL (Existing)	10,00,000	
P&L	58097	
To Bank		100,000
To FL (New)		958097

∴ Loss on modification = 58097

24 12.209 (50 Cr)

3. Wheel Co. Limited borrowed ₹ 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: ₹ 5,870,096

Effective interest rate on loan: 11.50%

After 2 years.

On 31 December 20X2, Wheel Co. 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 instalments starting 31 December 20X3
- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2 (PVF = 8 decimals)

1. Initial Measurement

On 1-1-X1 = 50,00,00,000 - 58,70,096 = 49,41,29,904

1-1-X1 : Bank 49,41,29,904

To Loan from Bank (FL) 49,41,29,904

2. Amount of Actual Instalment to be paid each year:

Year	opening	Int @ 11%	Principal	Total CF
31-12-X1	50,00,00,000	550,00,000	10,00,00,000	15,50,00,000
X2	40,00,00,000	440,00,000	10,00,00,000	14,40,00,000
X3	30,00,00,000	330,00,000	10,00,00,000	13,30,00,000
X4	20,00,00,000	220,00,000	10,00,00,000	12,20,00,000
X5	10,00,00,000	110,00,000	10,00,00,000	11,10,00,000

3. Amortisation Table

Year	Opening	Int @ 11.50%	CF	Closing
20X1	494129904	56824939	150000000	395954843
20X2	395954843	45534807	144000000	297489650
20X3			133000000	
20X4			122000000	
20X5			111000000	

4. Journal Entry:

31-12-X1

Interest	56824939	
To Loan		56824939
Loan	150000000	
To Bank		150000000

31-12-X2

Interest	45534807	
To Loan		45534807
Loan	44000000	
To Bank		44000000

(Only interest paid not instalment)

5. Carrying Amount of Loan on modification date 31-12-X2

2974809650 + 100000000 = 397489650

6. Revised Fair value on modification date

Amount of Actual Instalment to be paid each year:

Year	Opening	Int @ 15%	Principal	Total CF
31-12-X3	400000000	60000000	400000000	100000000
X4	360000000	54000000	400000000	94000000
X5	320000000	48000000	400000000	88000000
X6	280000000	42000000	400000000	82000000
X7	240000000	36000000	400000000	76000000
X8	200000000	30000000	400000000	70000000
X9	160000000	24000000	400000000	64000000
Y1	120000000	18000000	400000000	58000000
Y2	80000000	12000000	400000000	52000000
Y3	40000000	6000000	400000000	46000000

Year	CF	PVF@11.50%	PV
31-12-X3	10,00,00,000	0.89686099	89,686,099
X4	9,40,00,000	0.80435963	75,609,805
X5	8,80,00,000	0.72139877	63,483,092
X6	8,20,00,000	0.64699441	53,053,542
X7	7,60,00,000	0.58026405	44,100,068
X8	7,00,00,000	0.52041619	36,429,133
X9	6,40,00,000	0.46674097	29,871,422
Y1	5,80,00,000	0.41860177	24,278,903
Y2	5,20,00,000	0.37542760	19,522,235
Y3	4,60,00,000	0.33670636	15,488,493
			451,522,791

Modification %

$$\frac{451522791 - 397489650}{397489650} \times 100 = 13.59\%$$

Since modification % (i.e. 13.59%) more than 10%.
Hence, extinguishment accounting will apply.

Fair value of modified liability on

Since Interest rate for PV = 15%.
So, new FL = 40,00,00,000

Journal Entry:

FL (Existing)	397489650	
P&L	2510350	
To Bank		-
To FL (New)		40,00,00,000

∴ Loss on modification = 2510350

New Amortisation Table:

Year	opening	Int@15 %	CF	Closing
31-12-x3	40,00,00,000	600,00,000	10,00,00,000	36,00,00,000

31-12-x3

Interest	600,00,000	
To Loan		600,00,000
Loan	10,00,00,000	
To Bank		10,00,00,000

Example 4: Modification accounting

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for ₹ 1,000,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for ₹ 1,000,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

- no further interest payments are made
- the bonds are redeemed on the original due date (31 December 20X9) for ₹ 1,600,000;
- legal and other fees of ₹ 50,000 are incurred.

The repayment schedule for the original debt till the date of renegotiation is as below:

Q 33 12.211

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

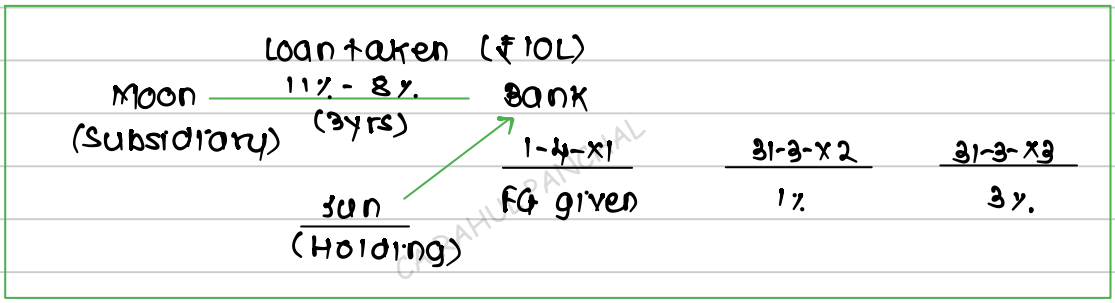
Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

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. Initial Recognition of Financial Guarantee:

Year	Int @ 11%	Int @ 8%	Saving	DF @ 11%	PV
1	110,000	80,000	30,000	0.901	27030
2	110,000	80,000	30,000	0.812	24360
3	110,000	80,000	30,000	0.732	21930
					73320

1-4-01: Invt in subsidiary 73320.
To Financial Guarantee 73320.

2. Subsequent recognition on 31-3-X2:

a) PV of remaining Interest saving:

Year	Int @ 11%	Int @ 8%	Saving	DF @ 11%	PV
1	110,000	80,000	30,000	0.901	27030
2	110,000	80,000	30,000	0.812	24360
					51390.

b) Expected loss : 10,00,000 x 1% = 10,000

c) Higher of above: 51390

d) Change in Financial Guarantee = 73320 - 51390 = 21930.

31-3-02: Financial Guarantee 21930
To P&L 21930

3. Subsequent recognition on 31-3-X3:

a) PV of remaining Interest saving:

Year	Int @ 11%	Int @ 8%	Saving	DF @ 11%	PV
1	110,000	80,000	30,000	0.901	27030

b) Expected loss : 10,00,000 x 3% = 30,000

c) Higher of above: 30,000

d) Change in Financial Guarantee = 30,000 - 51390 = 21390.

31-3-02: Financial Guarantee 21390
To P&L 21390.