

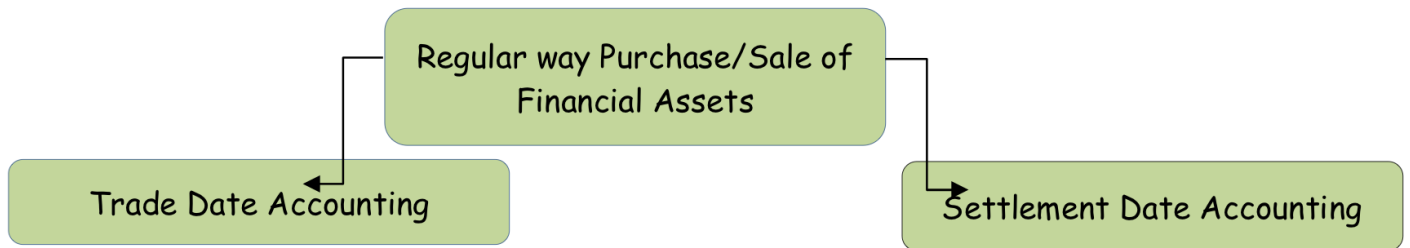
Recognition and Derecognition of Financial Instruments.

Recognition of FA

REGULAR WAY PURCHASE OR SALE OF FINANCIAL ASSETS

Ind AS 109 defines a regular way purchase or sale as:

- a purchase or sale of a financial asset
- under a contract
- whose terms require delivery of the asset
- within the time frame *by T+2, T+3, T+7 days*
- established generally by regulation or convention in the market place concerned



Trade Date: Date that an entity commits itself to purchase or sell an asset

Settlement Date: Date that an asset is delivered to or by an entity

For instance, on the Bombay Stock Exchange in India, all transactions in all groups of securities in the Equity segment, Fixed Income securities and Government securities are settled on "T+2" basis. In this case, "T" is the trade date and "T+2" is the settlement date i.e., exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade date.

It follows that if a contract is entered into with a broker for purchase or sale of securities which is normally traded on the Bombay Stock Exchange, with a settlement period that differs from the norms mentioned above, it would not be regarded as a regular way purchase or sale.

When trade date accounting is applied:

The buyer of a financial asset recognises the financial asset and its liability to pay on the trade date itself. Correspondingly, the seller derecognises the financial asset and recognises any gain or loss on sale on the trade date. The buyer subsequently measures the financial asset in accordance with its classification category.

When settlement date accounting is applied:

A buyer of financial asset accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset.

Example (Master Sum)

On 30th March 2002, Entity enters into an agreement to purchase a Financial Assets delivery on 2nd April 2002 for £ 1000 which is the fair value on that date. \downarrow Govt securities.

On B/S date i.e. 31/3/02 the fair value is £ 1020 and on settlement date i.e. 2/4/2002 fair value is £ 1030.

1. Pass necessary Journal Entries in case of Derivatives Accounting.
2. Pass necessary Journal Entries in case of **Regular way** purchase of FA on Trade date and settlement date when the Asset Acquired is measured at — i) ACM ii) FYTOLE iii) FYTFL.

1. Derivatives Accounting

30/3/2002 \Rightarrow No Entry.

31/3/2002 \Rightarrow Potentially Favourable $(1020 - 1000) = \text{£ } 20$ Profit

D.F.A.	20	
TO F.Y. Gain (P/L)		20

2/4/2002 \Rightarrow Favourable $(1030 - 1020) = \text{£ } 10$ Further Profit.

D.F.A.	10	
TO F.Y. Gain (P/L)		10

\longrightarrow DFA (or) = 30

CASE 1 | if settled net in cash

Bank	30	
TO DFA		30

CASE 2 | if settled through delivery

Inv in Govt Securities (FA) or	1030	
TO Bank		1000
TO DFA		30

2. Regular way purchase of FA

Trade Date Accounting (non Derivative Pricing - ACM, FVTOCF, FVTPL)

TRADE DATE ACCOUNTING

ACM

2/13
Inv in Govt Securities (FA) 1000
 To Payables (Li) 1000

31/3 B/S Date
No Entry (FV change ignored)

02/04 Settlement Date
Payables 1000
 To Bank 1000

B/Sheet

Payables 1000	FA 1000
Discount (1000)	
<u>NIL</u>	Bank (1000)

FVTOCF

2/13
Inv in Govt Securities (FA) 1000
 To Payables (Li) 1000

31/3 B/S Date
Inv in Govt Securities (FA) 20
 To OCI Reserve 20

02/04 Settlement Date
Inv in Govt Securities (FA) 10
 To OCI Reserve 10
Payables 1000
 To Bank 1000

OCI - 20 + 10	B/Sheet	FA 1000
Payables 1000		FV Gain + 20
(1000)		<u>1020</u>
<u>NIL</u>		+ 10
		<u>1030</u>
		Bank (1000)

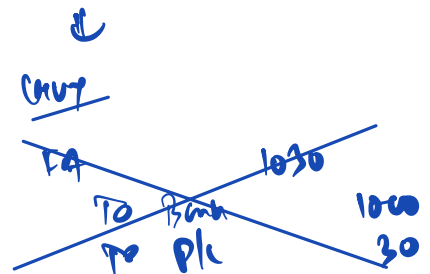
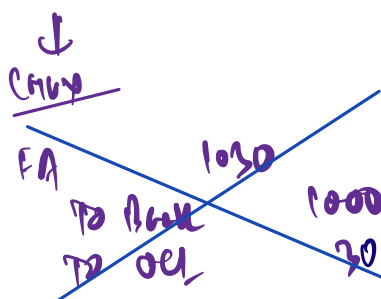
FVTPL

2/13
Inv in Govt Securities (FA) 1000
 To Payables (Li) 1000

31/3 B/S Date
Inv in Govt Securities (FA) 20
 To P/L 20

02/04 Settlement Date
Inv in Govt Securities (FA) 10
 To P/L 10
Payables 1000
 To Bank 1000

P/L > 20 + 10	B/Sheet	FA 1000
Payables 1000		+ 20
(1000)		+ 10
<u>NIL</u>		<u>1030</u>
		Bank (1000)



Settlement Date Accounting
(Practice)

↑ Non Derivative Accounting. However FA will be recognised at settlement date instead of Trade date

<u>ACM</u>	
30/3	No Entry
31/3	B/S Date No Entry
02/04	
Inv in Govt Securities	1000
TO Bank	1000

<u>FVTOCE</u>	
30/3	No Entry
31/3	B/S Date
Fair Value Change	20
TO OCI Reserve	20
02/04	
Inv in Govt Securities	1020
TO Bank	1000
TO Fair Value Change	20
TO OCI Reserve	10

<u>FVTPLE</u>	
30/3	No Entry
31/3	B/S Date
Fair Value Change	20
TO P/L	20
02/04	
Inv in Govt Securities	1020
TO Bank	1000
TO Fair Value Change	20
TO P/L	10

↓
OR

Inv in Govt Securities	1000
TO Bank	1000
Inv in Govt Securities	20
TO Fair Value Gain	20
Inv in Govt Securities	10
TO OCI Reserve	10

OR

Inv in Govt Securities	1000
TO Bank	1000
Inv in Govt Securities	20
TO Fair Value Gain	20
Inv in Govt Securities	10
TO P/L	10

Illustration 3: Regular way purchase of financial asset

On 1 January 20X1, X Ltd. enters into a contract to purchase a financial asset for 10 lakhs, which is its fair value on trade date. On 4 January 20X1 (settlement date), the fair value of the asset is 10.5 lakhs. The amounts to be recorded for the financial asset will depend on how it is classified and whether trade date or settlement date accounting is used. Pass necessary journal entries.

Trade Date Accounting

ACM

1/1
Financial Asset 1000000
 To Payables (PL) 1000000

4/1
Payables 1000000
 To Bank 1000000

EVTCU

1/1
Financial Asset 1000000
 To Payables (PL) 1000000

4/1
Financial Asset 50000
 To O/R Reserve 50000

Payables 1000000
 To Bank 1000000

EVTRU

1/1
Financial Asset 1000000
 To Payables (PL) 1000000

4/1
Financial Asset 50000
 To PL 50000

Payables 1000000
 To Bank 1000000

Settlement Date Accounting

ACM

1/1
No Entry

4/1
Financial Asset 1000000
 To Bank 1000000

EVTCU

1/1
No Entry

4/1
Financial Asset 1050000
 To Bank 1000000
 To O/R Reserve 50000

EVTRU

1/1
No Entry

4/1
Financial Asset 1050000
 To Bank 1000000
 To PL 50000

STRATEGIC DEBT RESTRUCTURING

→ Substantial modification

1. Extinguishment Accounting

If 10% test is passed, Extinguishment A/cing is applied. Revised terms of Cash Flows discounted using old EIR which is compared with C.A. of old liability

EXTINGUISHMENT ACCOUNTING (10% test passed)

1. Derecognition of Existing liabilities.
2. Recognition of New liabilities.

Revised terms of Cash Flows discounted using new EIR.

Any difference is debited / credited to P/L

Any fees or cost incurred is charged to P/L

CRUX

1. measure C.A. of old liability at modification date.
2. If 10% test passes, Apply Extinguishment A/cing.
3. Extinguishment A/c ∴

CA of old liability derecognised, Fair value of New liab recognised, Difference in P/L.

2. Modification A/cing

If 10% test is failed, Modification A/cing is applied.

MODIFICATION ACCOUNTING.

1. Any fees or cost incurred is netted against Existing liability. (Any payments made is assumed as discharge of old liabilities)

2. New EIR is Calculated.

CRUX

1. measure C.A. of old liability at modification date.
2. If 10% test fails, Apply modification A/cing.
3. Modification A/c ∴

- a) Any payments made reduced from CA of old liab.
- b) calculate New EIR.

→ 10% test should be passed.

Example 3: Extinguishment accounting

On 1 January 20X0, XYZ 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 therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which:

- 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.

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

Amortisation Schedule of FL ap. bal Interest Payments cf. balance

1 Jan 2000				1000000
1 Jan 2001 (1st yr)	1000000	100000	(100000)	1000000
1 Jan 2002 (2nd yr)	1000000	100000	(100000)	1000000
1 Jan 2003 (3rd yr)	1000000	100000	(100000)	1000000
1 Jan 2004 (4th yr)	1000000	100000	(100000)	1000000
1 Jan 2005 (5th yr)	1000000	100000	(100000)	1000000
31.12.2009				1000000

∴ C.A. of FL of 5m yr and on B/L = 1000000

1 Jan 2005 → XYZ & Bondholders agree to a modification.

1st step: To check if 10% test passes or not

5 ^m (Present)	6 ^m	7 ^m	8 ^m	9 ^m	10 ^m	11 ^m	12 ^m
↓	50000	50000	50000	50000	50000	50000	50000
							1500000

(+) Present value of CF = 1013158
 Cost to be incurred = 100000
1113158

← Old EIR i.e. 10%
 ↓ only for testing purpose (one to one comparison)

∴ Increase in liabilities = 1113158 - 1000000 = 113158

∴ % increase = $\frac{113158}{1000000} \times 100$

= 11.32% (10% test passed)
 ↓

Therefore Extinguishment Acing is applied.

2nd step

1. Old C.A. of liabilities is derecognised = £ 1000000

2. New liability is recognised at Fair Value = £ 958097
 (see below)

Calc of New Liability

5 ^m (Present)	6 ^m	7 ^m	8 ^m	9 ^m	10 ^m	11 ^m	12 ^m
	50000	50000	50000	50000	50000	50000	50000
<u>Present Value</u>							1500000
958097	← <u>NEW EIR = 11%</u>						

Journal

1. Old Financial Liab	1000000	
To New Financial Liab		958097
To P/L		41903
2. P/L (T. Cost)	100000	
To Bank		100000

Handwritten notes in blue:
 Old Financial Liab → Derecognise.
 New Financial Liab → newly recognised.

Suppose if 10% test fails, Apply modification A/cing

C.A. of old liability	=	1000000
Legal fees (Assumed payment for discharge of old liab)		<u>100000</u>
C.A. of old liability		<u>900000</u>

0 ^m	1 st	2 nd	3 rd	4 th	5 th	6 th	7 th
PA = 900000	50000	50000	50000	50000	50000	50000	50000
							(500000)
	← <u>Calc of EIR = ??</u>						

Example 4: Modification accounting if 10% test fails

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;
- fees paid by the borrower to lender ₹ 50,000

1 Jan 2000				1000000
1 Jan 2001 (1st yr)	1000000	100000	(100000)	1000000
1 Jan 2002 (2nd yr)	1000000	100000	(100000)	1000000
1 Jan 2003 (3rd yr)	1000000	100000	(100000)	1000000
1 Jan 2004 (4th yr)	1000000	100000	(100000)	1000000
1 Jan 2005 (5th yr)	1000000	100000	(100000)	1000000

CA of FC at 5th yr end = 1000000

1 Jan 2005 → XYZ & Bondholders agree to a modification.

5 th (Present)	6 th	7 th	8 th	9 th	10 th
	X	X	X	X	X
					1600000

Present value of C/F = 993474

Legal & other cost to

be incurred = 50000

1043474

← Old EIR = 10%

∴ Increase in liabilities = 1043474 - 1000000 = 43474

% increase = $\frac{43474}{1000000} \times 100 = 4.35\%$ (10% test Failed)

Modification Accounting

1. Any fees on cost incurred (i.e. £50000) reduced from old liabilities

Old liabilities 50000

TO Bank 50000-

∴ Revised C.A. of old liabilities = (100000 - 50000) = 950000

2. New EIR is calculated

<u>5thyr</u>	<u>6th</u>	<u>7th</u>	<u>8th</u>	<u>9th</u>	<u>10th</u>
C.A. = 950000	X	X	X	X	X
					1600000

New EIR = 10.99%

At 10% = 993474

At 11% = 949522

At 10.99% = 949949 → i.e. Approx 950000

	<u>Op. loan</u>	<u>Int. @ 10.99%</u>	<u>Payments</u>	<u>Cl. loan</u>
<u>6th</u>	950000	104405 (Int)	-	1054405
<u>7th</u>	1054405	115879 (Int)	-	1170284
<u>8th</u>	1170284	128614 (Int)	-	1298898
<u>9th</u>	1298898	142749 (Int)	-	1441647
<u>10th</u>	1441647	158497 158353 (Int)	(1600000)	-

Debt to Equity Swaps.

Example 5: Extinguishment of part of a financial liability through issue of equity instruments

JK Ltd. has an outstanding unsecured loan of ₹ 90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, JK Ltd. is unable to service the debt and approaches the bank for a settlement.

The bank offers the following terms which are accepted by JK Ltd.:

- 60 Cr 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is ₹ 80 crores. 56 Cr
- 30 Cr 1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is ₹ 25 crores. The fair value of the cash flows as per these revised terms is ₹ 28 crores.

When Equity Instruments are issued to a Creditor

1. An Entity shall measure them at **Fair Value of Equity Instruments** issued
2. If Fair Value cannot be reliably measured, Equity Inst. shall be measured to reflect **fair value** of **Financial Liability extinguished**.

Any Difference recognised in P/L

SOP

C.A. of Financial Liability = 90 Cr

2/3rd settled through Equity Inst.

$$\begin{aligned} \text{i.e. C.A. of } 2/3 \text{ Liab.} &= 60 \text{ Cr} \\ \text{Fair Value} &= \underline{56} \text{ (} 80 \times 70\% \text{)} \\ \text{Profit (P/L)} &= 4 \text{ Cr} \end{aligned}$$

1/3rd not settled but modified

$$\begin{aligned} \text{10\% EIR} & \\ \text{C.A. (1/3)} &= 30 \text{ Cr} \\ \text{P.V. of revised CF using old EIR} &= \underline{25} \text{ Cr} \\ \text{Dec. in Liab.} &= 5 \text{ Cr} \end{aligned}$$

<
24 cr recognised as gain in statement
of profit or loss

$$\therefore \% \text{ dec} = \frac{5}{30} \times 100 = 16.67\% \quad (710\%)$$

↓
Extinguishment A/c

1. CA of old Liab Renowned = 30 cr
 2. Fair value of New Liab = 28 cr
- Profit (PL) = 2 cr

Old Financial Liab	30 cr
To New Financial Liab	28 cr
To PL	2 cr

2 cr recognised as gain in statement
of profit or loss

10% test

2nd yr End
↓

3rd	4 th	5 th	6 th	7 th	8 th	9 th	10 th	11 th	12 th
4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr
6cr	5.4cr	4.8cr	4.2cr	3.6cr	3cr	2.4cr	1.8cr	1.2cr	.6cr
10	9.4	8.8	8.2	7.6	7	6.4	5.8	5.2	4.6

45, 15, 22, 790
CA of Job of
family of
using old ER

old ER = 11.5%

∴ Increase in Job = 451522790 - 397489650 = 54033141

∴ % inc = $\frac{54033141}{397489650} \times 100$

= 13.59% < 7 10%

∴ 10% test passed

∴ we should Apply Extinguishment Act

1. C.A. of old Job derecognised = 397489650

2. New Job of New Fair value = 400000000

∴ Difference in PL = 2510350

2nd yr 31/12/02
↓

↓

3rd 31/12/03	4 th	5 th	6 th	7 th	8 th	9 th	10 th	11 th	12 th
4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr	4cr
6cr	5.4cr	4.8cr	4.2cr	3.6cr	3cr	2.4cr	1.8cr	1.2cr	.6cr
10	9.4	8.8	8.2	7.6	7	6.4	5.8	5.2	4.6

P.V.
40,00,00,000

← Pooled at market rally 15%

31/12/01

Interest Exp.	56824938
To loan	56824938
(494129904 x 11.5%)	
loan	15,50,00,000
To Bank	15,50,00,000

ICAI

Interest Exp.	56824938
loan	98175062
To Bank	155000000

31/12/02

Interest Exp.	45534807
To loan	45534807
(395954842 x 11.5%)	
loan	44000000
To Bank	44000000

ICAI

Interest Exp.	45534807
To Bank	44000000
To loan	1534807

31.12.2002

old CA of loan	397489650
PL (Loss)	2510350
To New loan	400000000

31.12.03

Interest Exp (PL)	60000000
To loan	60000000
(40 cr x 15%)	
loan	100000000
To Bank	100000000

ICAI

Interest Exp	60000000
loan	40000000
To Bank	100000000

Question 2 (Similar Q asked in PP Jan'21) 📍📍

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:

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income 7%	Interest income 4%	
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		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 ₹)

Date	Outflows	Inflows			Principal outstanding
		Principal	Interest income 7%	Interest income 4%	
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.

8ml
4ml
16000
8000
200000
200000

<u>0th yr</u>	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>	<u>5th</u>
	200000	200000	200000	200000	200000
	16000	16000	16000	16000	8000
	42000	28000	14000	X	X
	<u>258000</u>	<u>244000</u>	<u>230000</u>	<u>216000</u>	<u>208000</u>

P.V.
843879

12% market rate of Interest

Initial Recognition (1/Jan/01)

<u>0th yr</u> loan to Emp. (FA)	843879	
Prepaid staff cost	156121	
To Bank		1000000

Amortise over 5 yrs

$$\frac{156121}{5 \text{ yrs}} = 31224$$

Amortisation table

	<u>OP. loan</u>	<u>Int @ 12%</u>	<u>Receipts</u>	<u>Cl. loan</u>
1st yr	843879	101265	(258000)	687144
2nd yr	687144	82457	(244000)	<u>525601</u>

1st yr 31.12.01

Loan to Emp. (FA)	101265	
To Interest Income (P/c)		101265
<hr/>		
Bank	258000	
To Loan to Emp.		258000

<u>1000000</u>	
Asset	258000
To Int Income	101265
To Loan	156735

** Employee Benefit Exp (P/c)	31224	
To Prepaid staff cost		31224
$\left\{ \frac{156121}{5 \text{ yrs}} \right\}$		

2nd 31.12.02

Loan to Emp. (FA)	82457	
TO Interest Income (P/c)		82457
<hr/>		
Bank	244000	
TO Loan to Emp.		244000

<u>ICOL</u>		
Bank	244000	
TO Interest		82457
TO Loan		161543

Employee Benefit Exp (P/c)	31224	
TO Prepaid Staff Cost		31224
<hr/>		
{ 156121 5 yrs }		

At 2nd yr End → C.A. of FA = 525601
 C.A. of Prepaid Asset = 93673

After Prepayment of \$ 200000 on 31.12.02

<u>2nd yr End</u>	<u>3rd</u>	<u>4th</u>	<u>5th</u>
Pre pay 200000	16000 (4% x 4%)	8000 (2% x 4%)	x
	20000	20000	x
	<hr/> 216000	<hr/> 208000	
	← <hr/> <hr/> 12%		

P.V. 358673

At 2nd yr End (Adjustment of Prepayment Amount)

Bank A/c	200000
TO Loan (525601 - 358673)	166928
TO Prepaid Staff Cost	33072

Revised C.A. of Loan (FA) = 358673
 " " " Prepaid Staff Cost (93673 - 33072) = 60601 (Amount in 2 yrs)

FA Amortisation Schedule

	<u>OP. FA</u>	<u>Int @ 12%</u>	<u>Receipt</u>	<u>Cl.</u>
3rd year	358673	43041	(216000)	185714
4th year	185714	22286	(208000)	NIL

3rd year 31.12.03

Loss to Emp. (FA)	43041
TO Interest Income (P/L)	43041
<hr/>	
Bank	216000
TO Loan to Emp.	216000
Employee Benefit Exp (P/L)	30300
TO Prepaid Staff Cost	30300
($\frac{60600}{2 \text{ yrs}}$)	

4th year 31.12.04

Loss to Emp. (FA)	22286
TO Interest Income (P/L)	22286
<hr/>	
Bank	208000
TO Loan to Emp.	208000
Employee Benefit Exp (P/L)	30301
TO Prepaid Staff Cost	30301

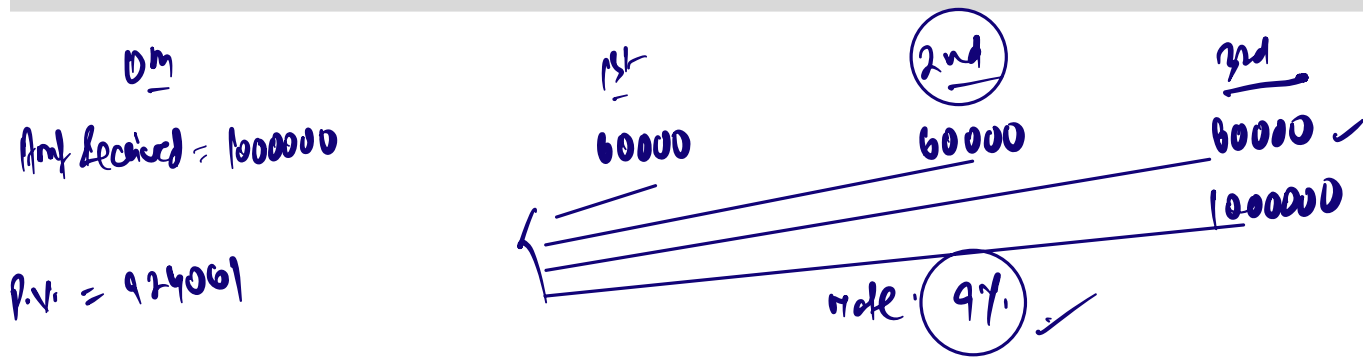
Unit 3 - Illustration 34 Imp.

Illustration 34 (OLD SM 33) 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
1 July 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.



Bank A/c 1000000
TO FL 924061
TO Equity 75939 (Not remembered)

Amortisation Schedule

	Op.	Int @ 9%	Paymt.	Cl. bal.
1st 30th June 2002	924061	83165	(60000)	947226
2nd 30th June 2003	947226	85250	(60000)	972476
3rd	972476	87524	(1060000)	X

C.A. of Loan at 30th June 2003 = 972476 → Fair value 1009523
 " " Equity " " " = 75939 → 90477
 1100000

2nd yr End

8

Repayment option

3rd yr End

60000

1000000

1060000

Fair value of liability

= 1009523

← Current market rate 5%

∴ out of ₹ 1100000 paid for redemption,

Am't Paid for Liability = 1009523

" " " Equity = 90477

Journal

	<u>Liability</u>	
Liability	972476	
PL	37047	
		TO Bank 1009523

	<u>Equity</u>	
Equity	75939	
Equity	14538	
		TO Bank 90477

↓

2)

	<u>Single Entry</u>	
Equity	90477	
		TO Bank 90477

Merged Entry

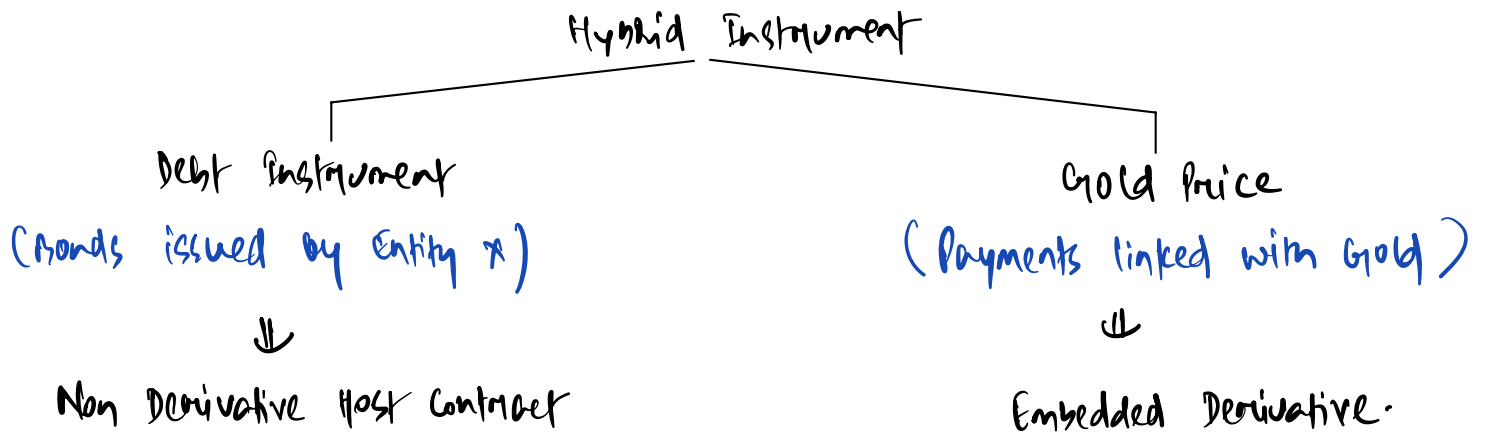
Liability	972476	
PL	37047	
Equity	90477	
		TO Bank 1100000

Examples of Embedded Derivatives

E.Q.1

Entity X issues Bonds to Entity Y

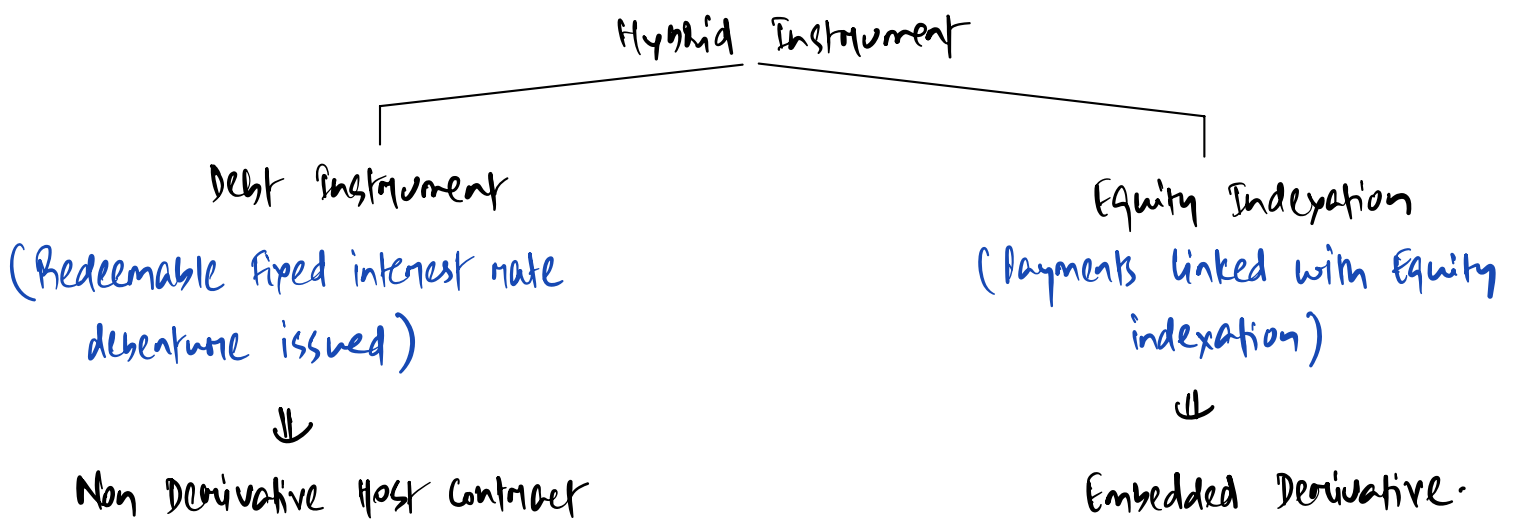
However the payment of coupon and Principal component of the Bond is indexed with the price of the Gold.



E.Q.2

Entity X issues a redeemable fixed interest rate debenture to Entity Y.

Amount of interest and Principal is indexed to the value of Equity instruments of Entity X.



EMBEDDED DERIVATIVES

An embedded derivative is:

1. a **component** of a hybrid contract
2. that also **includes a non-derivative host**
3. with the effect that **some of the cash flows** of the combined instrument **vary in a way similar** to a stand-alone derivative.

An embedded derivative is required to be separated from the host contract and accounted for separately as a financial instrument provided all the below conditions are satisfied:

1. **Economic characteristics and risks** of the embedded derivative are not closely related to those of the host.
2. A **separate instrument** with the same terms as the embedded derivative would meet the definition of a derivative.
3. Hybrid contract not measured at fair value through profit or loss.

"A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:

- a) the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; OR
- b) the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. Lost interest is the product of the principal amount prepaid multiplied by the interest rate differential. The interest rate differential is the excess of the effective interest rate of the host contract over the effective interest rate the entity would receive at the prepayment date if it reinvested the principal amount prepaid in a similar contract for the remaining term of the host contract.

Hybrid Instrument

Non Derivative Host
Contract



~~Financial Asset (ACM / FVTPL / FVOCI)~~

Financial liabilities (ACM / FVTPL)

Equity (NO Re-measurement)

Non financial items (Expenditure contracts)

↑ E.g. Convertible Bonds, Debentures,
Machinery, tools etc

Embedded Derivatives (Attached)



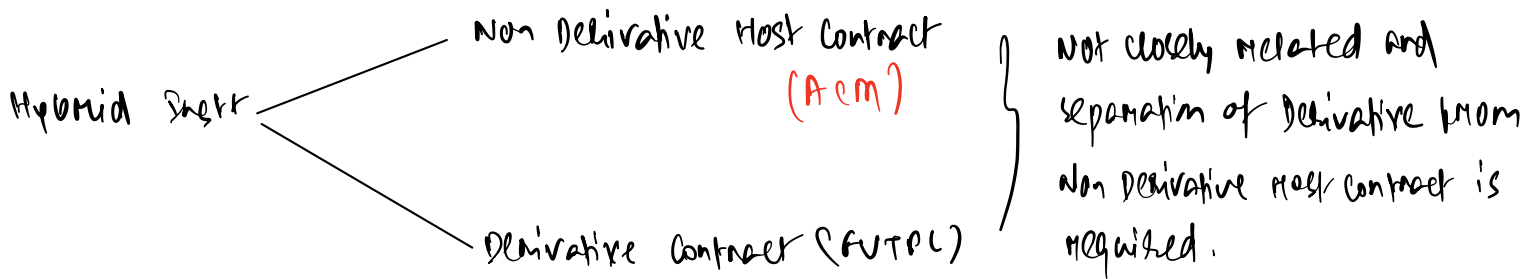
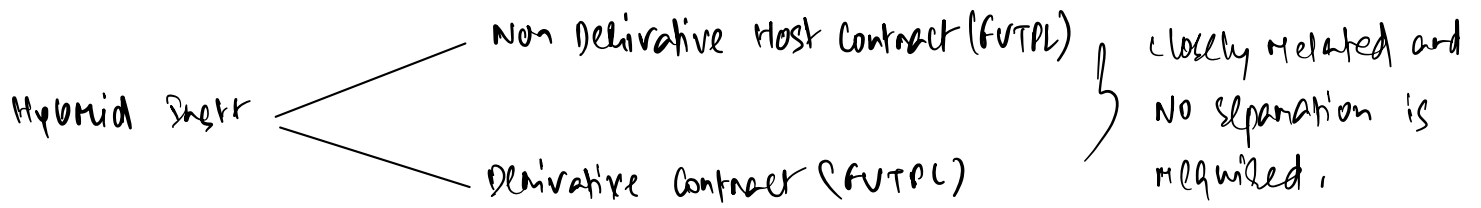
Conversion option, warrants,
Settlement in Foreign Currency
etc.

(FVTPL Accounting only)

FVOCI / ACM cannot be
applied in derivatives Accounting.

Note

Separation of Attached Derivative Contract from Non Derivative Host Contract is not required if FVTPL method is applied in Non Derivative Host Contract.



Note In case of Financial Asset, if Embedded Derivatives is Attached then Instt. is not paying solely interest and principal and therefore only FVTPL Acing is done. Also in case of Attached Derivatives, only FVTPL method is applied. Therefore in case of financial asset, both are closely related and hence separation is not required.

Separation is not required only if any below conditions are satisfied.
(closely related)

(i) Hybrid Instrument measured at FVTPL

(ii) Characteristic and risk of Embedded Derivatives closely related to Non Derivative Host Contract.

An Embedded Foreign Currency derivatives is considered closely related to Host Contract in below cases where separation is not required. $\frac{0}{2}$

1. Payments denominated in Functional Currency of any Substantial Party to the Contract.
2. Currency Routinely denominated in Commercial transactions around the world (Dollar Currency from crude oil transactions)
3. Relatively stable and liquid currency commonly used in local business transaction or external trade.

In all other cases, Embedded Foreign Currency Derivative should be separated from Host Contract.

Certain Guidance on How to Carry out separation are enumerated below in detail.

Host Contract

1. Host Contract (Sale or Purchase) should be denominated in Functional Currency (F.C.)
2. The F.C. is determined using forward exchange rate (Delivery Date Forward rate) at the date the contract is entered into.

Embedded Derivatives

3. The Embedded Derivative is a Forward Currency Contract to Buy or SELL applicable amount of Contract Currency from the Functional Currency at the same Forward Exchange Rate.

The effect is that Fair Value of Embedded Derivative is initially zero.

4. Subsequent changes in Fair Value of Embedded Derivatives recorded in P/L.

5. On Delivery of Non Financial item, Host Contract is fulfilled and Embedded Derivative is settled.

A Foreign Currency debt on Creditor is recognised from the Contract amount translated at Spot rate.

The closing Carrying Amount of Embedded Derivative is added to F.C. Carrying amount of Host Contract to give initial C.A. of Debt on Creditor.

Trade Receivables (102 \$ x 60) 60M

To Revenue

To Other Income (P/L)

{ 1M loss, 1.5M Profit }

1M

2.5M

5.5M → Ordinary course Sales.

1.5M → Derivative Profit

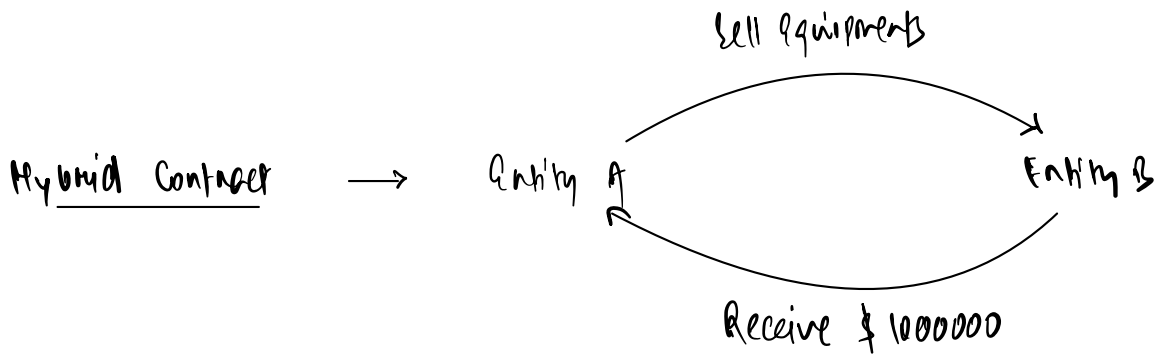
Illustration 4

Entity A (an ₹ functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an ₹ functional currency entity) to sell equipment on 30 June 20X1.

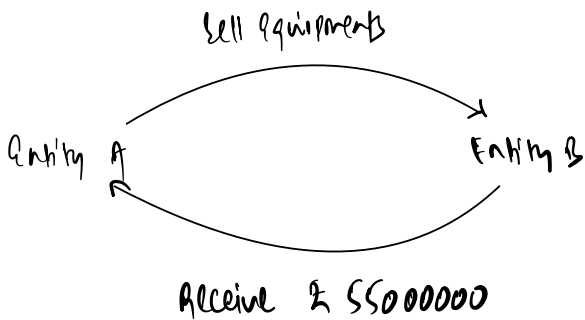
Spot rate on 1 January 20X1: ₹/USD	45
Spot rate on 31 March 20X1: ₹/USD	57
Three-month forward rate on 31 March 20X1: ₹/USD	45
Six-month forward rate on 1 January 20X1: ₹/USD	55
Spot rate on 30 June 20X1: ₹/USD	60

Assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.

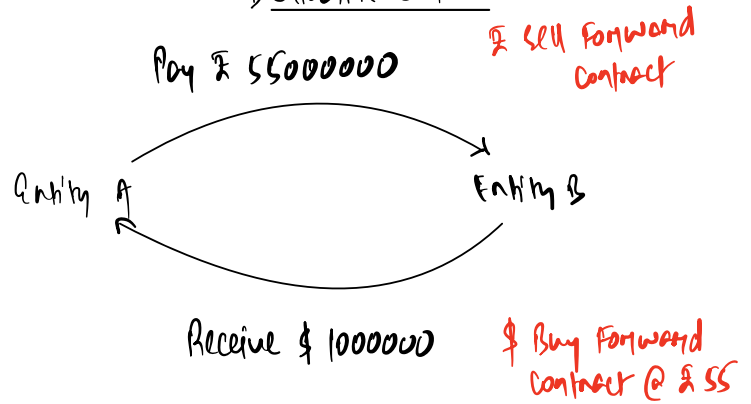
Illustration 4



Non Derivative Host Contract



Derivative Contract



Non Derivative Host Contract

1st Jan X

31st March X

30th June

Trade Receivables @ 5cm

To Revenue 5.5cm

Derivative Contract

1st Jan X

31st March P/L 1cm
To D.F.L. 1cm

30th June D.F.L. (Reverse) 1cm
D.F.A. 1.5cm
To P/L 1.5cm

30th June

Trade Receivables 1.5cm

To D.F.A. 1.5cm

Impairment of Financial Assets

→ changed in P/L.

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

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

Recognition of Impairment loss not required if ÷

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

Q What is Credit loss Allowance ?

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

Loss allowance to be provided are of two types ÷

(i) Lifetime Expected Credit loss

↓

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

(ii) 12 months Expected Credit loss

↓

Other FA whose credit risk not increased significantly.

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

Credit risk Impaired (Very high risk) Lifetime ECL ↓ Interest on NET FA	Significant increase in Credit risk (moderate to high risk) Lifetime ECL Interest on GROSS FA	No significant increase in Credit risk (low risk) 12 months ECL Interest on GROSS FA
---	--	---

An Entity may use **Practical Expedient** when measuring Expected credit loss on Trade Receivables.

↓

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

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

1% Provision → If not Past due.

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

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

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

E.g.

	<u>0m</u>	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>	<u>5th</u>
Amount Due →		50000	50000	50000	50000	50000
Amount Expected to be received →		40000	40000	40000	40000	350000
		100000	100000	100000	100000	2000000

∴ Expected Credit loss

2 1692378 → lifetime ECL
↳ Loss given default

Original EIR = 8%

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

(ii) 12 months Expected Credit loss = 92592 { Assume credit risk not increased significantly }
< 100000 ÷ 1.08 >

∴

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

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

E.g. Investment in 10% debentures = 50000 (3 years)

Transaction cost = 3000 (FV to CF method)

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

10% EIR = 7.685%

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

Year 1 ÷ Loss Allowance = 20000, Fair Value = 450000

Journal

(i)	FA	40730	
	To Interest Income		40730
(ii)	Bank	50000	
	To FA		50000

(iii)	Loss Allowance (PL)	20000	
	OCF		50730
	To FA		70730

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

Journal

(i)	FA	40018	
	To Interest Income		40018
(ii)	Bank	50000	
	To FA		50000

(iii)	Loss Allowance (PL)	15000	
	OCF		20000
	To FA		35000

Year 3 No loss, All recovered

(i)	FA	39252	
	To Interest Income		39252
(ii)	Bank	550000	
	To FA		444270
	To PL		105730

(iii) PL 70730
To OCF 70730
↑ Recycling OCF to PL on Disposal / Derecognition

(iii) & (ii)	Bank	550000	
	To FA		444270
	To OCF		70730
	To PL		35000

1st year

B/S sheet (1st yr end)

PL Interest → 40730 (1st yr)

Loss Allowance → -20000 (1st yr)

OCF F.V. loss → -50730 (1st yr)

2nd yr

PL Interest → 44018 (2nd yr)

Loss Allowance → -15000 (2nd yr)

OCF

FV loss → -20000 (2nd yr)

3rd yr

PL Interest → 39252 (3rd yr)

De-recognition → 105730 (3rd yr)

Reclassification from OCF → -70730

OCF → 70730

Bank → (530000) + 50000 + 50000 + 550000

FA 530000

(+) Int @ 7.685% 40730

(-) Receipt (50000)

520730

Fair Value Change 70730

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

(+) Int @ 7.685% on 520730 40018

(-) Receipt (50000)

440018

(-) F.V. Change (35000)

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

(+) Int @ 7.685% on 40748 39252

(-) Receipt 550000

-105730

+105730

De-recognition

Nil

When Financial Asset credit risk has increased significantly → Calculate interest on Gross FA

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

Determining whether credit risk has increased significantly.

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

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

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

Solution

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

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

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

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

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

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

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

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

Solution:

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

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

On Sale of debt instrument

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

By Sheet (for understanding)

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

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

Question 6 (RTP May'21, MTP Nov'21)

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.

	<u>1st year</u>	<u>2nd year</u>	<u>3rd year</u>
Cash flow based on 11% interest	110000	110000	110000
" " " " 8% "	80000	80000	80000
Differential	<u>30000</u>	<u>30000</u>	<u>30000</u>

Present value = ₹3320

P.V. @ 11%

Bank ₹3320
To DFL ₹3320

Dr Investment in Subsidiary ₹3320
To Financial Guarantee (DFL) ₹3320

Amortisation table

	<u>Int. @ 11%</u>		
₹3320	8065	(30000)	51385
51385	5652	(30000)	27037
27037	2974	(30000)	—

1st yr

$$12m \text{ Expected Credit loss} = 1\% \text{ of } 1000000 = 10000$$

$$\text{C.A. of liability } \{ 30000 \times \text{PVIFA}(11\%, 2yrs) \} = 51385 \text{ (Higher)}$$

$$\therefore \text{Liability should be recognised} = \text{£ } 51385$$

$$\text{Reduction in liability} = 73320 - 51385 = \underline{21935}$$

Journal

Financial Guarantee 21935
 TO P/L 21935

2nd yr

$$12m \text{ Expected Credit loss} = 3\% \text{ of } 1000000 = 30000 \text{ (Higher)}$$

$$\text{C.A. of liab } \{ 30000 \times \text{PVIFA}(11\%, 1yr) \} = 27037$$

$$\therefore \text{Liability should be recognised @ } \text{£ } 30000$$

$$\therefore \text{Reduction in liability} = 51385 - 30000 = \underline{21385}$$

Journal

Financial Guarantee 21385
 TO P/L 21385

3rd year { If Amount fully paid by subsidiary }

Financial Guarantee 30000
 TO P/L 30000

Question 6 Hedge Accounting (MTP April'21)

Besides construction activity, Buildings & Co. Limited is also engaged in the trading of Copper. On 1st April, 20X1, it had 100 kg of copper costing Rs. 70 per kg - totalling Rs. 7000. The Company has a scheduled delivery of these 100 kgs of copper to its customer on 30th September, 20X1 at the rate of USD 100 on that date. To protect itself from decline in currency exchange rate (USD to Rs.), the entity hedges its position by entering into currency futures contract for equivalent currency units at Rs. 76 / USD. The future contract mature on 30th September, 20X1. The management performed an assessment of hedge effectiveness and concluded that the hedging relationship qualifies for cash flow hedge accounting. The entity determines and documents that changes in fair value of the currency futures contract will be highly effective in offsetting variability in cash flow of currency exchange. On 30th September, 20X1, the entity closes out its currency futures contract. On the same day, it also sells its inventory of copper at USD 100 when the spot rate is Rs. 72 / USD.

You are required to prepare detailed working and pass necessary journal entries for the sale of copper and the corresponding hedge instrument taken by the company. Pass the journal entries as on the initial date (i.e., 1st April 20X1), first quarter end reporting (i.e. 30th June 20X1) and date of sale of copper and settlement of forward contract (i.e. 30th September 20X1).

Assume the exchange rates as follows and yield @ 6% per annum.

Date	Future price for 30th September 20X1 delivery (Rs. / USD)
1st April, 20X1	76 (future sell)
30th June, 20X1	74
30th September, 20X1	71

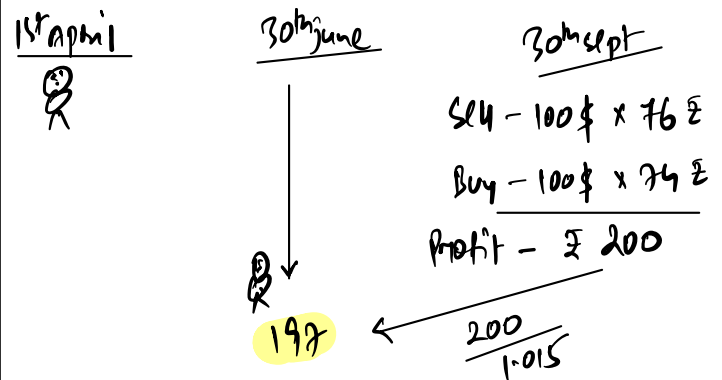
Derivatives

1/4/01 - No Entry

30/6/01 - D.F.A. 197
 TO P/L 197
 (100 \$ x 2 x 1.015)

30/9/01 - D.F.A. 303
 TO P/L 303
 (100 \$ x 3 - 197)

30/9/01
 ↓
Settlement
 Bank 500
 TO DFA (Revenue) 500



Hedging

Copper (Hedged item)

1/4/01 - No Entry

30/6/01 - No Entry

30/9/01 - Bank/TR 7200
TO Revenue 7200

Hedging Instrument

1/4/01 - No Entry.

30/6/01 - D.F.A. (Future Contract) 197
TO CFHR - OCI 197

30/9/01 - D.F.A. (Future Contract) 303
TO CFHR - OCI 303

30/9/01 - CFHR - OCI 500
TO Revenue 500
(At the time of delivery of copper)

30/9/01 - Bank 500
TO D.F.A. (Future Contract) 500

* CFHR - OCI = Cash Flow Hedge Reserve - OCI

Derecognition of Financial Asset

Financial Asset is derecognised if \circ

i) Right to cash flows from Asset expires.

(Payment of entire due amount on legal release of Debtor by Creditor)

ii) Entity transferred its right to receive cash flows

AND

Entity transferred substantially all risks & reward.
(Discussed in Note 1)

E.g. Sale of FA on Factoring Arrangements with Non Recourse.

iii) Entity neither retained nor transferred substantially all risks and reward. *(Discussed in Note 1 & 2)*

AND

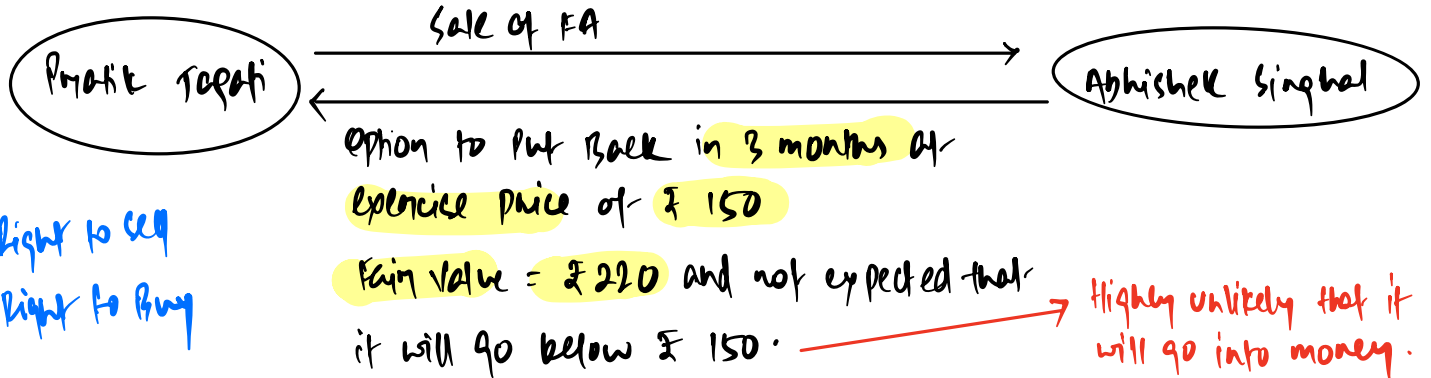
Not retained control of the Asset *(Transferee has right to sell without Approval)*
(Discussed in Note 3)

Note 1 - E.g. on Transferred substantially all risks and reward.

1. Unconditional Sale

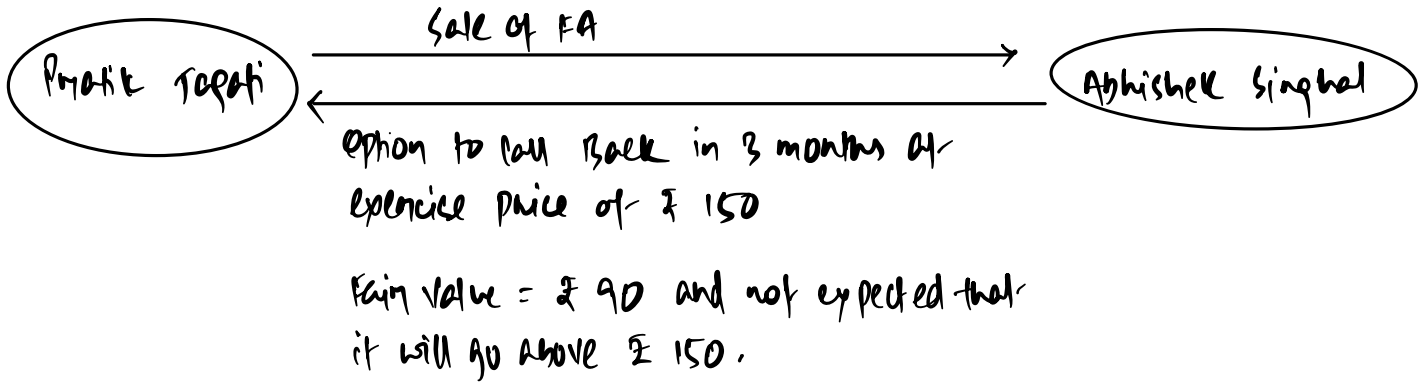
* 2. Sale + Repurchase at Fair Value. Risk & Reward Hfd.

* 3. Sale + Put option / call option that is deeply out of the money.



Put \Rightarrow Right to Sell
Call \Rightarrow Right to Buy

Sale + Put option deeply out of the money = Sale of FA (Risk & Reward Hfd)
 \Downarrow
Derecognise FA



Sale + ~~Call option deeply out of the money~~ = Sale of FA
 \Downarrow Risk & Reward Hfd.
 Derecognise FA

Note 2 - Examples of when Entity **retained** substantially **all** risks & rewards.

1. A **sale and Repurchase** transaction where Repurchase price is **Fixed Price** on **sale price plus lender's return**. *(Risk & Reward not transferred)*
2. Securities lending Arrangements.
3. A **sale of FA together with deep in the money put or call option**.
(i.e. so far in the money that it is highly unlikely to go out of the money)
4. A **sale of short term Receivables** in which entity **guarantees to compensate transferee from credit losses** likely to occur.
5. A **sale of FA together with total return swap** that transfers market risk exposure back to the entity. *(Illustration 10)*

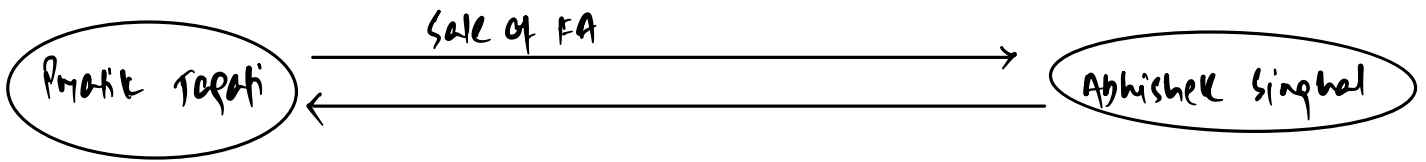
In Above Cases, FA cannot be derecognised.

Note 3

Whether the entity has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee,

- a) Has the **practical ability to sell the asset in its entirety** to an unrelated third party, and
- b) Is **able to exercise that ability unilaterally and without needing** to impose additional restrictions on the transfer the entity has not retained control.

In all other cases, the entity has retained control.



1. Sale of FA + Put option by Abhishek
 Exercise Price = 150 → Chances of Put option to be exercised.
 Market Price = 90
 i.e. Put option deeply in the money.

∴ Sale of FA + Put option highly expected to be exercised

∴ Pramit Jagati has retained risk & rewards

2. Sale of FA + Call option by Pramit
 Exercise Price = 150 → Call option expected to be exercised.
 Market Price = 220
 i.e. Call option deeply in the money.

∴ Sale of FA + Call option highly expected to be exercised.

∴ Pramit Jagati has retained risks and reward.

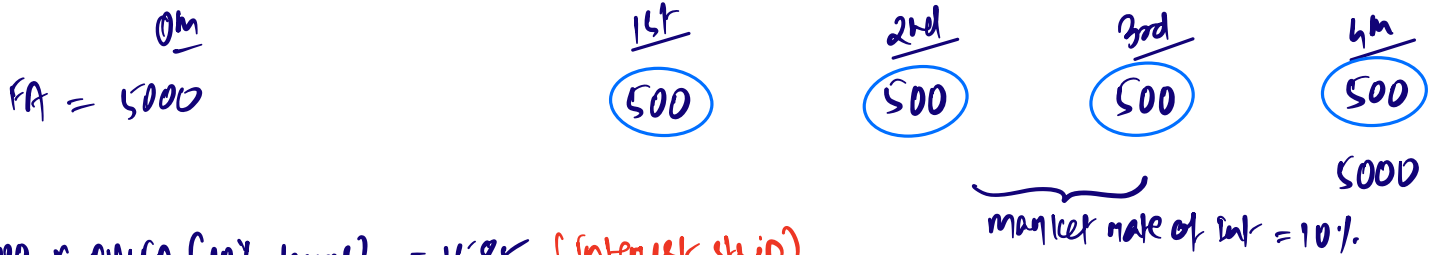
Another Example (Not retained / Not transferred substantially risk & reward)

Sale of FA + Put option by Abhishek
 Exercise price = 150
 Market Price = 152 / 148
 Put option out of the money but not deeply.
 Neither deeply in the money nor deeply out of the money.

∴ Pramit Jagati has neither transferred nor retained substantially all risks and reward.

To derecognise part of a Financial Asset if it meets any below conditions

a) The part comprises only specifically identified cash flows from a Financial Asset (say interest strips sold)



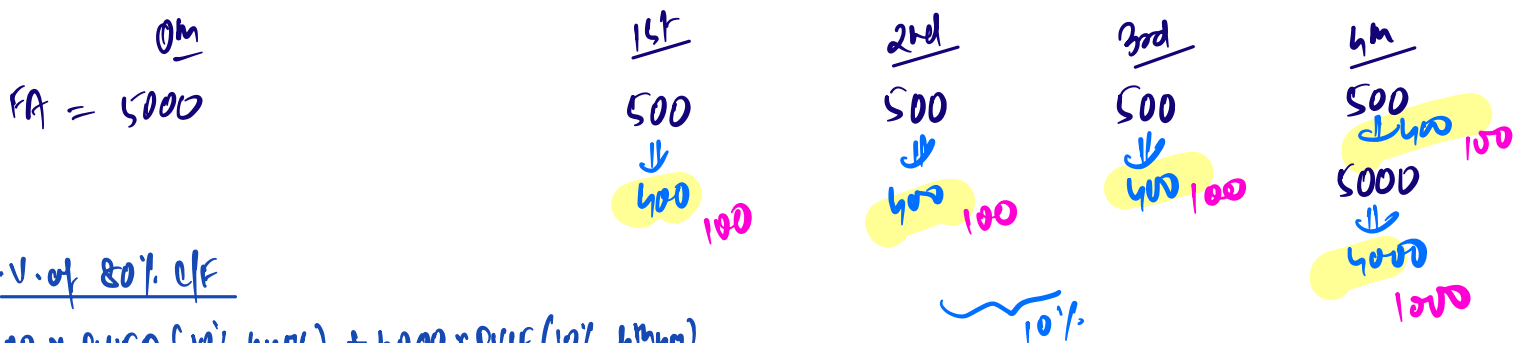
$$500 \times PVIFA(10\%, 4yrs) = 1585 \text{ (Interest strip)}$$

$$500 \times PVIF(10\%, 4m) = \frac{3415}{5000} \text{ (Principal strip)}$$

if interest CF are transferred, then FA to the extent of £ 1585 will be derecognised.

if Principal CF are transferred, then FA to the extent of 3415 derecognised.

b) The part comprises only bulky proportionate cash flows from FA. (say 80% CF sold)



P.V. of 80% CF

$$400 \times PVIFA(10\%, 4yrs) + 4000 \times PVIF(10\%, 4m)$$

$$= 4000 \text{ (to be derecognised)}$$

FA of £ 1000 continue to be recognised.

c) The part comprises only bulky proportionate share of specifically identified cash flows

Say Entity transferred right to 60% part of Interest strip.

60% of Interest strip Sold

0m	1st	2nd	3rd	4m
FA = 5000	500 ↓ 300	500 ↓ 300	500 ↓ 300	500 ↓ 300 5000

P.V. of 60% Interest strip

$300 \times PVIFA (10\%, 4 \text{ yrs}) = 951 \text{ (Derecognise)}$

Remaining £ 4049 continue to be recognised.

ACCOUNTING TREATMENT OF TRANSFER THAT QUANTIFY FOR DERECOGNITION

If the arrangement results in de-recognition of the financial asset in its entirety:

any new financial assets obtained, financial liabilities assumed and any servicing obligations are recognised at fair value new asset is part of the proceeds of sale.

Any liability assumed, even if it is related to the transferred asset, is a reduction of the sales proceeds the difference between the carrying amount and the consideration received is recognised in the statement of comprehensive income.

In the case of assets included in the "fair value through other comprehensive income" category, any gain or loss previously recorded in equity is recycled to the statement of comprehensive income.

E.g. C.A. of Financial Assets = 50000

Sale Proceeds

Cash = 30000, Service charge = 500 ∴ Net Cash = 29500

Financial assets received = 18000

Liabilities assumed = 2500

$$\begin{array}{r} 29500 \\ + 18000 \\ - 2500 \\ \hline 45000 \end{array}$$

Net loss = 50000 - 45000 = 5000

<u>Journal</u> Bank	29500
FA	18000
PL (Profit)	5000

TO C.A. of FA	50000
TO Liabilities	2500

TRANSFER THAT DOES NOT QUALIFY FOR DERECOGNITION

If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset (for example, in a situation when the transferor guarantees transferee against any default losses), the entity shall:

- continue to recognise the transferred asset in its entirety,
- recognise a financial liability for the consideration received, recognised at fair value less any transaction costs incurred.

The liability is subsequently measured at Amortised Cost using the effective interest method and in subsequent periods, recognise any income on the transferred asset and any expense incurred on the financial liability.

⇓

N.A. of Financial Assets = ₹ 300000

↓

Sold for ₹ 280000 & Amt received in Cash.

↳ But such sale of FA do not qualify for derecognition. ↘

Continue to recognise FA

		B/Sheet	
Sh Cap	300000	Financial asset	300000
Other Eq.		CF Int Income	
FL	280000	Bank	280000
CF Int Exp.			

Continuing Involvement Asset - Refer Unit 5 911 12 A, 12 B, 12 C.

Illustration 12A: Debt factoring with recourse - continuing involvement asset

Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company D agrees to pay ₹ 91.5 crores, less a servicing charge of ₹ 1.5 crores (net proceeds of ₹ 90 crores), in exchange for 100% of the cash flows from short-term receivables.

The receivables have a face value of ₹ 100 crores and carrying amount of ₹ 95 crores.

The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses upto ₹ 5 crores, over and above the expected credit losses of ₹ 5 crores. The guarantee is estimated to have a fair value of ₹ 0.5 crores.

Calculate the amount of continuing involvement asset.

Illustration 12B: 👁️👁️

Debt factoring with recourse - associated liability

Continuing illustration 12A, calculate the amount of associated liability.

Illustration 12C: 👁️👁️

Illustration 12C: 👁️👁️

Debt factoring with recourse - gain or loss on derecognition

Continuing illustration 12A and 12B, pass the necessary Journal Entry.

Worksheet

FA

Short term

Receivables = 95 cm

C.A. of short term Receivables - 95 cm (Cash received = 90cm)

Remaining FA = 90 cm (derecognition)

C.A. = 5cm (continue to report)

Cash 85cm

Cash = 5cm ✓

Derecognition

No derecognition

Bank 85cm
Loss on Derecog. (PL) 5cm
To short term Receivables 90cm

Bank A/c 5cm
To Guarantee Liab 5cm
C.F.A. 5cm
To short term Receivables 5cm

Single Entry

C.F.A. 5cm + 5cm
Bank 90cm
Loss on Derecog. (PL) 5cm
To short term Receivables (FA) 95cm
To Guarantee Liab 5cm + 5cm

Rs/Sheet

Sh. Cap + other Eq.

9500

Loss on Derecog. (P/L)

(500)

FA

9500

Less: Derecog.

(9000)

FA

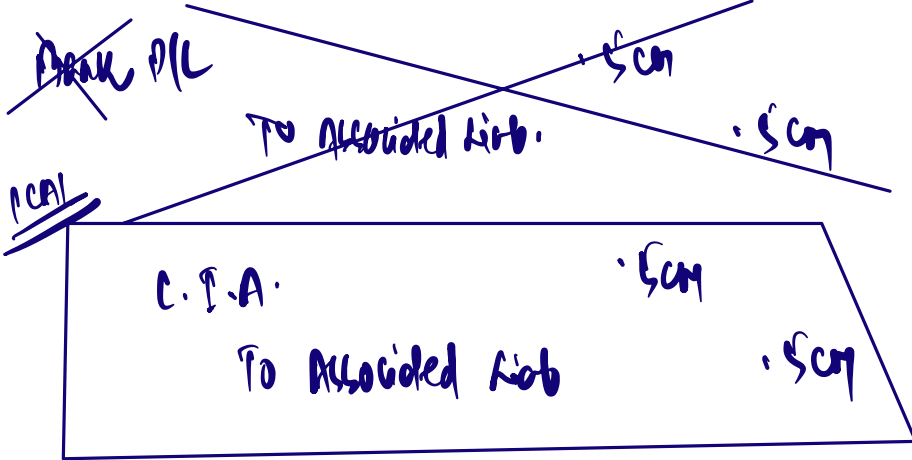
500

C.I.A.

500

Bank

8500



P.I.A.

5500

Bank

9000

Loss (P/L)

500

PD share from receivable

9500

To Associated Liab

5500

DERECOGNITION OF FINANCIAL LIABILITIES

TIMING OF DERECOGNITION

An entity shall **remove a financial liability** (or a part of a financial liability) from its statement of financial position **when, and only when, it is extinguished** i.e., when the **obligation** specified in the contract is **discharged or cancelled or expires**.

A **financial liability** (or part of it) is **extinguished** when the debtor either:

- discharges the liability (or part of it) **by paying the creditor, normally with cash, other financial assets, goods or services;** or
- is **legally released from primary responsibility for the liability** (or part of it) either by process of law or by the creditor.

(If the debtor has given a guarantee this condition may still be met.)

a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the **debtor does not derecognise the debt obligation** unless the condition in paragraph B3.3.1(b) is met.

If the debtor pays a third party to assume an obligation and **obtains a legal release from its creditor, the debtor has extinguished the debt.**

However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor **recognises a new debt obligation to the third party.** (Paragraph B3.3.4 of Ind AS 109)

ACCOUNTING TREATMENT FOR EXTINGUISHMENT

The difference between the **carrying amount of a financial liability** (or part of a financial liability) **extinguished or transferred to another party** and the **consideration paid**, including any non-cash assets transferred or **liabilities assumed**, shall be **recognised in profit or loss.**

Further, in some cases, **a creditor releases a debtor** from its present obligation to make payments, but **the debtor assumes a guarantee obligation** to pay if the party assuming primary responsibility defaults.

In these circumstances the debtor:

- recognises a new financial liability** based on the **fair value** of its obligation **for the guarantee** and,
- recognises a gain or loss** based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

Accounting for Extinguishment of Financial Liability

E.g.

Financial Liability = 50000

B/sheet
FL 50000

Liability is discharged by

Payment of Cash = 30000

Financial Asset Hld. = 10000

40000

$$\begin{aligned} \text{Other Asset Pf'd.} &= 3000 \\ \text{Liabilities assumed} &= 2000 \\ \hline &45000 \end{aligned}$$

$$\begin{aligned} \therefore \text{Difference bet? C.A of FL \& Proceeds Paid recognised in P/L.} \\ &= 50000 - 45000 \\ &= \underline{5000} \end{aligned}$$

Journal

Financial Liab (& derecognised) on 50000

TO Bank	30000
TO FA	10000
TO other Asset	3000
TO FL	2000
TO Profit & loss	5000

		<u>Atsheek</u>
P/L 5000		Swp. 50000
Liab. 50000		Bank → (30000)
- 50000		FA → (10000)
<u>P/L</u>		O/A → (3000)
Liab. → 2000		
<u>7000</u>		<u>7000</u>

Eg. Amount due to Abhishek singhal = 70000
 Amt paid = 40000

for rest ₹ 30000 due to Abhishek, Liab. is Lfd. to Pankaj Tapati son which Abhishek agrees and legally released its debtor Pratik Tapati

Pratik Tapati **Guarantees** to pay Abhishek if Pankaj Tapati Defaults.
 Fair value of Guarantee = **25000**.

Journal

Financial Liab. 70000

TO Bank	40000
TO Guarantee Liab.	25000
TO P/L	5000

Securitisation

In some situation, Entity retains right to receive cash flows but it does assume contractual obligation to pay cash flows to other entities. Such arrangements are often pass through arrangements.

To qualify Transfer, below all conditions to be met

1. No obligation to pay unless it collects equivalent amounts.
2. obligation to remit any CF it collects without material delay.
3. Prohibited from selling or pledging the asset
4. Not entitled to reinvest except for short period in cash or cash eq. and interest earned is passed to recipients.

Illustration 6: Proportionate "pass through" arrangement

Entity A makes a five-year interest-bearing loan (the 'original asset') of ₹ 100 crores to Entity B. Entity A settles a Trust and transfers the loan to that Trust. The Trust issues participatory notes to an investor, Entity C that entitle the investor to the cash flows from the asset.

As per Trust's agreement with Entity C, in exchange for a cash payment of 90 crores, Trust will pass to Entity C 90% of all principal and interest payments collected from Entity B (as, when and if collected). Trust accepts no obligation to make any payments to Entity C other than 90% of exactly what has been received from Entity B. Trust provides no guarantee to Entity C about the performance of the loan and has no rights to retain 90% of the cash collected from Entity B nor any obligation to pay cash to Entity C if cash has not been received from Entity B. Compute the amount to be derecognised.

Solution

If the three conditions are met, the proportion sold is derecognised, provided the entity has transferred substantially all the risks and rewards of ownership. Thus, Entity A would report a loan asset of ₹ 10 crores and derecognise ₹ 90 crores.

Entity A B/sheet

FA	= 100 Cr
(-) FA	90 Cr → <u>derecognise</u>
FA	= 10 Cr
Bank	90 Cr

Trust B/sheet

Participatory notes = 90 Cr	Bank	90 Cr
	(-) Bank	(90 Cr)
		<u>NIL</u>
	FA	= 90 Cr