

Sums on announcement made by GOI March 2009 related to AS – 11

Question 1 (Nov 2009)

Pankaj Ltd. is a company engaged in manufacture of Nuclear Power Stations. The Company usually resorts to long term Foreign Currency borrowings for its fund requirements. The Company had on 1st April, 2005 borrowed U.S. \$100 million from Global Fund Consortium based in Washington, USA. The funds were used by Pankaj Ltd. for purposes other than acquiring 'Depreciable Capital Assets'. The loan carries an interest rate of 3 per cent on reducing balance and is repayable in two installments, the first one due on 1st April, 2010 and the next on 1st April, 2012. The interest due on the loan has been paid in full on 31st March of each year. The exchange rate on the date of borrowing was 1 U.S. \$ = INR 40. The accounting treatment followed by the Company for the subsequent three years with exchange rates prevailing on those dates were as under:

<u>Year ended</u>	<u>Exchange Rate</u>	<u>Accounting Treatment</u>
31st March, 2006	1 US \$ = 41	Forex Loss of Rs.10 crore charged to Profit and Loss Account;
31st March, 2007	1 US \$ = 39	Forex gain of Rs.20 crore recognised in Profit and Loss Account;
31st March, 2008	1 US \$ = 48	Forex Loss of Rs.90 crore charged to Profit and Loss account;

Note: Interest payment were charged to Profit and Loss account of each year at transaction value on payment dates.

Pankaj Ltd. is in the process of finalising its accounts for the year ended 31st March, 2009 and understands that AS 11 has been amended and opts to follow the Companies (Accounting Standards) Amendment Rules, 2009.

- (i) You are required to show treatment of the Forex Losses/gains in the light of the above amendment to AS 11 for the years 2005-06; 06-07; 07-08 & 08-09. The exchange rate to 1 US Dollar on 31st March, 2009 is Rs.50. Assuming that the rates of Exchange on 31st March, 2010 and 31st March, 2011 will be Rs.51 and Rs.52 respectively the accounting for the Forex Losses/gains may also be shown for these years also.
- (ii) What are the disclosure requirements to be complied with by Pankaj Ltd. as a result of having opted to follow the amendment in the Companies (Accounting Standard) Rules, 2006.
- (iii) Would your answer to (i) above be different if Pankaj Ltd. was not a Company and were a Co-operative Society.

Answer

According to the Notification by GOI, any exchange gain or loss resulting from the translation of foreign currency monetary items not attributable to a depreciable asset should be accumulated in the Foreign Currency Translation Difference (FCTD) Account and should be written off on

SLM basis by 31st March, 2011. The treatment availed at the option of the company shall be irrevocable and shall be exercised till 31st March, 2011.

Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, i.e. 1.4.2007 previously, recognised in the profit and loss account before the exercise of the option shall be reversed in case of non-depreciable asset by transfer to Foreign Currency Translation Difference (FCTD) Account, and by debit or credit, as the case may be, to the general reserve.

31st March, 06 Forex loss of Rs. 10 crores which has already been charged to P&L Account can not be reversed as the effectiveness of this notification starts from 1.4.2007.

31st March, 07 Forex gain of Rs. 20 crores which has already been credited to P&L Account can not be reversed as the effectiveness of this notification starts from 1.4.2007.

31st March, 08 Forex loss of Rs. 90 crores which has already been charged to P&L Account can be reversed in the year 08-09.

But as it is to be written off in 4 years @ 22.50 (90/4) each, we can only reverse (90 – 22.50) 67.50

FCTD	Dr.	67.50	
To General Reserve			67.50

31st March, 09 Forex loss of Rs. 20 crores which shall be debited to FCTD Account.

FCTD	Dr.	20	
To Loan			20

P&L (22.50 + 20/3)	Dr.	29.17	
To FCTD			29.17

31st March, 10 Forex loss of Rs. 10 crores which shall be debited to FCTD Account.

FCTD	Dr.	10	
To Loan			10

P&L (29.17 + 10/2)	Dr.	34.17	
To FCTD			34.17

31st March, 11 Forex loss of Rs. 5 crores which shall be debited to FCTD Account. Half of the loan is repaid. So loss = 1 x 5 crore = 5 crores

FCTD	Dr.	5	
To Loan			5

P&L (34.17 + 5)	Dr.	39.17	
To FCTD			39.17

(ii) Disclosure Requirements:

1. The company has chosen to avail the option provided by way of amendment in the Companies (AS) Amendment Rules, 2009.
2. According to AS 1 “Disclosure of Accounting Policies”, Exercise of option due to amendment in AS 11 is a change in accounting policy.

(iii) This notification is relevant only for companies. If Pankaj Ltd., is a cooperative society, then the said notification would not be applicable. In that case, option to amortise FOREX losses over the period till 31.03.2011 will not be available to it. So all the losses and profits on FOREX will be transferred to P&L Account.

Question 2

Pankaj Ltd. resorts to long term Foreign Currency borrowings for Fixed Assets purchases. The company had on 1st April, 2007 borrowed U.S. \$ 4 lakhs . The loan carries an interest rate of 3 per cent on reducing balance and is repayable on 1st April, 2012. The interest due on the loan has been paid in full on 31st March of each year.

The exchange rate on the date of borrowing was 1 U.S. \$ = INR 40.

On 31st March, 2008 US \$ = 41 Forex Loss of Rs.4 lakh charged to Profit and Loss Account;

Pankaj Ltd. is in the process of finalising its accounts for the year ended 31st March, 2009 and understands that AS 11 has been amended and opts to follow the Companies (Accounting Standards) Amendment Rules, 2009.

You are required to show treatment of the Forex Losses/gains in the light of the above amendment to AS 11 for the years 2007-08; 08-09. The exchange rate to 1 US Dollar on 31st March, 2009 is Rs.44. Assuming that the rates of Exchange on 31st March, 2010 and 31st March, 2011 will be Rs.46 and Rs.50 respectively the accounting for the Forex Losses/gains may also be shown for these years also.

Answer

According to the Notification by GOI , any exchange gain or loss resulting from the translation of foreign currency monetary items attributable to a depreciable asset should be charged to Fixed Assets Account.

Any difference pertaining to accounting periods which commenced on or after 7th December, 2006, i.e. 1.4.2007 previously, recognised in the profit and loss account before the exercise of the option shall be reversed in case of non-depreciable asset by transfer to Fixed Assets Account, and by debit or credit, as the case may be, to the general reserve.

31st March, 08 Forex loss of Rs. 4 lakhs which has already been charged to P&L Account can be reversed in the year 08-09.

Fixed Assets	Dr.	4	
To General Reserve			4

31st March, 09 Forex loss of Rs. 12 crores which shall be debited to Fixed Assets.

Fixed Assets	Dr.	12	
To Loan			12

31st March, 10 Forex loss of Rs. 8 lakhs which shall be debited to Assets Account.

Fixed Assets	Dr.	8	
To Loan			8

31st March, 11 Forex loss of Rs. 12 lakhs which shall be debited to Fixed Assets Account.

Fixed Assets	Dr.	16	
To Loan			16

Depreciation has not been provided as no information on depreciation was there.

Sums on Brand valuation

1) Evaluate the brand of X Ltd. Based on the following data.

Profit before interest and Tax	30,000
Non Brand income (Investment income)	4,000
Capital employed in the business	1,00,000
Required return on capital employed (Before tax)	15%
Tax rate	30%
Brand multiple	12.38

Solution

Profit before interest and Tax	30,000
Non Brand income (Investment income)	4,000
Adjusted PBT	26,000
Less: Remuneration on capital	<u>15,000</u>
Brand related profits	11,000
Taxes	<u>3,300</u>
Brand earnings	8,700
Brand multiple	12.38
Brand value	1,07,706

2) Evaluate the brand of X Ltd. Based on the following data as On 31.3.2010.

	09-10	08-09	07-08
Profit before interest and Tax	30,000	24,000	22,000
Non Brand income (Investment income)	4,000	3,000	2,000
Capital employed in the business (31.3.2010)			1,00,000
Required return on capital employed (Before tax)			15%
Tax rate			30%
Brand multiple			11

Solution

Profit before interest and Tax	30,000	24,000	22,000
Non Brand income (Investment income)	4,000	3,000	2,000
Adjusted PBT	26,000	21,000	20,000
Weight	3	2	1
Average profits			23,333
Less: Remuneration on capital			<u>15,000</u>
Brand related profits			8,333
Taxes			<u>2,450</u>
Brand earnings			5,883
Brand multiple			11
Brand value			64,713

Financial Instruments

1.

Entity A which owes Rs. 1,000,000 to Entity B agrees to pay Rs. 1,000,000 to Entity C at a future date to assume its obligation to Entity B. Entity B legally releases Entity A from any further obligation under the debt. What will entity A do.

Solution:

In this case, Entity A derecognises its obligation to pay Rs. 1,000,000 to Entity B and recognises a new obligation to pay this amount to Entity C.

2.

On 1 January 20x7, Entity A identifies a portfolio comprising assets and liabilities whose interest rate risk it wishes to hedge. The entity uses monthly time periods and schedules items for the next five years (i.e., it has 60 separate monthly time periods).

Entity A has scheduled assets of Rs. 100 million and liabilities of Rs. 80 million into this time period. All of the liabilities are repayable on demand.

Entity A decides, for risk management purposes, to hedge the net position of Rs. 20 million and accordingly enters into an interest rate swap on 1 January 20x7 to pay a fixed rate and receive LIBOR, with a notional principal amount of Rs. 20 million and a fixed life of three months.

The fair value of an equivalent asset of Rs. 20 million, on 31 Jan 20x7 is 20,047,408

The fair value of the swap on 31.1.2007 (47,408)

On 1 January 20x7, Entity A designates as the hedged item an amount of Rs. 20 million of assets in the three-month time period. It designates as the hedged risk the change in the value of the hedged item (i.e., the Rs. 20 million of assets) that is attributable to changes in LIBOR.

On 31 January 20x7, Entity A estimates the amount of assets scheduled into this time period (excluding new assets originated during the month) as Rs. 96 million.

Suggest the accounting treatment

Solution:

- a) Percentage of the initial estimate of the assets in the time period that was hedged
= (Rs. 20 million / Rs. 100 million) = 20%
- (b) Amount that is the hedged item based on its revised estimate
= 20% of 96 = 19.2 million.
- (c) Change in the fair value of this revised estimate of the hedged item (Rs. 19.2 million) that is attributable to changes in LIBOR

$$= (\text{Rs. } 47,408 \times (\text{Rs. } 19.2 \text{ million} / \text{Rs. } 20 \text{ million})) = 45,511.$$

Journal

Profit and loss (loss)	Dr.	47,408	
To Derivative liability			47,408
<i>To recognise the change in the fair value of the swap.</i>			
Fair value Adjustment	Dr.	45,511	
To Profit and loss (gain)			45,511
<i>To recognise the change in the fair value of the hedged amount.</i>			

The net result on profit or loss (excluding interest income and interest expense) is to recognise a loss of (Rs. 1,897). This represents ineffectiveness in the hedging relationship that arises from the change in estimated prepayment dates.

3.

Entity XYZ enters into a fixed price forward contract to purchase one million kilograms of copper in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the copper at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of copper. Is the contract accounted for as a derivative?

Solution:

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of copper, and it is to be settled at a future date.

However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the copper and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under AS 30. Instead, it is accounted for as an executory contract.

4.

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for Rs. 150 million. The current value of the building is Rs. 175million. The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?

Solution:

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net.

The investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement. So the option writer does not have the ability to require delivery.

5.

Is gold bullion a financial instrument (like cash) or is it a commodity?

Solution:

It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

6.

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

Solution:

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

7.

On 29 December 20x8 (trade date) Entity A enters into a contract to sell Note Receivable A, which is classified under the category 'Held-to-Maturity (HTM) Investments' and, therefore, carried at amortised cost, in exchange for Bond B, which will be classified as held for trading and measured at fair value. Both assets have a fair value of Rs. 1,010 on 29 December, while the amortised cost of Note Receivable A is Rs. 1,000. Entity A uses settlement date accounting for loans and receivables and trade date accounting for assets held for trading. On 31 December 20x8 (financial year-end), the fair value of Note Receivable A is Rs. 1,012 and the fair value of Bond B is Rs. 1,009. On 4 January 20x9, the fair value of Note Receivable A is Rs. 1,013 and the fair value of Bond B is Rs. 1,007.

Pass journal entries:

29 December 20 x 8

Bond B	Dr.	1,010	
To Payable			1,010

31 December 20x8

P&L	Dr.	1	
To Bond B			1

4 January 20x9

Payable	Dr.	1,010	
P&L	Dr.	2	
To Note Receivable A			1,000
To Bond B			2
To P&L (Realisation gain)			10

8.

For an available-for-sale monetary financial asset, the entity reports changes in the carrying amount relating to changes in foreign exchange rates in the statement of profit and loss in accordance with AS 11 and other changes in the carrying amount in the Investment Revaluation Reserve Account in accordance with AS 30. How is the cumulative gain or loss that is recognised in the Investment Revaluation Reserve Account determined?

Solution:

It is the difference between the amortised cost (adjusted for impairment, if any) and fair value of the available-for-sale monetary financial asset in the functional currency of the reporting entity. For the purpose of applying AS 11, the asset is treated as an asset measured at amortised cost in the foreign currency.

To illustrate: on 31 December 20x7, Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC 1,000. The bond has five years remaining to maturity and a principal amount of FC 1,250, carries fixed interest of 4.7 per cent that is paid annually ($FC\ 1,250 \times 4.7\text{ per cent} = FC\ 59$ per year), and has an effective interest rate of 10 per cent. Entity A classifies the bond as available for sale, and thus recognises gains and losses in the Investment Revaluation Reserve Account.

The entity's functional currency is its Indian currency (Rs.). The exchange rate is FC1 to Rs. 1.5 and the carrying amount of the bond is Rs. 1,500 ($= FC\ 1,000 \times 1.5$).

Bond	Dr.	Rs. 1,500	
To Cash			Rs. 1,500

On 31 December 20x8, the foreign currency has appreciated and the exchange rate is FC1 to Rs.2. The fair value of the bond is FC 1,060 and thus the carrying amount is Rs. 2,120 ($= FC\ 1,060 \times 2$).

The amortised cost is FC 1,041 ($FC1000 + 100 - 59 = 1,041 \times 2 = Rs.\ 2,082$).

In this case, the cumulative gain or loss to be recognised directly in the Investment Revaluation Reserve Account is the difference between the fair value and the amortised cost on 31 December 20x8, i.e., Rs. 38 ($= Rs.\ 2,120 - Rs.\ 2,082$).

Interest received on the bond on 31 December 20x8 is FC 59 ($= Rs.\ 118$). Interest income determined in accordance with the effective interest method is FC 100 ($= 1,000 \times 10\text{ per cent}$).

The average exchange rate during the year is FC1 to Rs. 1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest income during the year (AS 11.). Thus, reported interest income is Rs. 175 ($= \text{FC}100 \times 1.75$) including accretion of the initial discount of Rs. 72 ($= [\text{FC}100 - \text{FC}59] \times 1.75$). Accordingly, the exchange difference on the bond that is recognized in the statement of profit and loss is Rs. 510 ($= \text{Rs. } 2,082 - \text{Rs. } 1,500 - \text{Rs. } 72$). Also, there is an exchange gain on the interest receivable for the year of Rs. 15 ($= \text{FC } 59 \times [2.00 - 1.75]$).

Bond	Dr.	Rs. 620	
Cash	Dr.	Rs. 118	
To Interest income			Rs. 175
To Exchange gain (510 + 15)			Rs. 525
To Investment Revaluation Reserve Account			Rs. 38

Next year

On 31 December 20x9, the foreign currency has appreciated further and the exchange rate is FC1 to Rs. 2.50. The fair value of the bond is FC 1,070 and thus the carrying amount is Rs. 2,675 ($= \text{FC } 1,070 \times 2.50$). The amortised cost is FC1,086 ($1041 + 104 - 59$) = ($1086 \times 2.50 = \text{Rs. } 2,715$).

The cumulative gain or loss to be recognised directly in the Investment Revaluation Reserve Account is the difference between the fair value and the amortised cost on 31 December 20x9, i.e. negative Rs. 40 ($= \text{Rs. } 2,675 - \text{Rs. } 2,715$).

Thus, there is a debit to the Investment Revaluation Reserve Account equal to the change in the difference during 20x9 of Rs. 78 ($= \text{Rs. } 40 + \text{Rs. } 38$).

Interest received on the bond on 31 December 20x9 is FC 59 ($= \text{Rs. } 148$). Interest income determined in accordance with the effective interest method is FC104 ($= \text{FC } 1,041 \times 10$ per cent). The average exchange rate during the year is FC1 to Rs. 2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest income during the year (AS 11.). Thus, recognised interest income is Rs. 234 ($= \text{FC}104 \times 2.25$) including accretion of the initial discount of Rs. 101 ($= [\text{FC}104 - \text{FC}59] \times 2.25$). Accordingly, the exchange difference on the bond that is recognised in the statement of profit and loss is Rs. 532 ($= \text{Rs. } 2,715 - \text{Rs. } 2,082 - \text{Rs. } 101$). Also, there is an exchange gain on the interest receivable for the year of Rs. 15 ($= \text{FC}59 \times [2.50 - 2.25]$).

Bond	Dr.	Rs. 555	
Cash	Dr.	Rs. 148	
Investment Revaluation Reserve Account	Dr.	Rs. 78	
To Interest income			Rs. 234
To Exchange gain			Rs. 547

Q.9

AS 11 states that all exchange differences resulting from translating the financial statements of a non-integral foreign operation should be accumulated in the foreign currency translation reserve

until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets classified as at fair value through profit or loss and financial assets that are available for sale.

AS 30 requires that changes in fair value of financial assets classified as at fair value through profit or loss should be recognised in the statement of profit and loss and changes in fair value of available-for-sale investments should be reported in the appropriate equity account.

If the non-integral foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are paragraph 61 of AS 30 and AS 11 applied?

Solution:

AS 30 applies in the accounting for financial instruments in the financial statements of a nonintegral foreign operation and AS 11 applies in translating the financial statements of a nonintegral foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in India and its functional currency and reporting currency are the Indian Rupees (Rs.)). A has a foreign subsidiary (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which is held for trading and therefore carried at fair value under AS 30.

In B's financial statements for year 20x6, the fair value and carrying amount of the debt instrument is LCY 100 in the local currency of Country Y. In A's consolidated financial statements, the asset is translated into the Indian Rupees at the spot exchange rate applicable at the balance sheet date (2.00). Thus, the carrying amount is Rs. 200 ($= \text{LCY } 100 \times 2.00$) in the consolidated financial statements.

At the end of year 20x7, the fair value of the debt instrument has increased to LCY 110 in the local currency of Country Y. B recognises the trading asset at LCY 110 in its balance sheet and recognises a fair value gain of LCY 10 in its statement of profit and loss.

During the year, the spot exchange rate has increased from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from Rs. 200 to Rs. 330 ($= \text{LCY } 110 \times 3.00$) in the Indian Rupees. Therefore, Entity A recognises the trading asset at Rs. 330 in its consolidated financial statements.

Entity A translates the statement of profit and loss of B "at the exchange rates at the dates of the transactions" (AS 11). Since the fair value gain has accrued through the year, A uses the average rate as a practical approximation ($[3.00 + 2.00] / 2 = 2.50$, in accordance with AS 11). Therefore, while the fair value of the trading asset has increased by Rs. 130 ($= \text{Rs. } 330 - \text{Rs. } 200$), Entity A recognises only Rs. 25 ($= \text{LCY } 10 \times 2.5$) of this increase in the consolidated statement of profit and loss to comply with AS 11. The resulting exchange difference, *i.e.*, the remaining increase in the fair value of the debt instrument ($\text{Rs. } 130 - \text{Rs. } 25 = \text{Rs. } 105$), is accumulated in the foreign currency translation reserve until the disposal of the net investment in the non-integral foreign operation in accordance with AS 11.

Q.10

In each case, FC = foreign currency, Indian Rupees (Rs.) = local currency (which is the entity's functional currency), and TC = treasury centre.

Subsidiary A has trade receivables of FC100, due in 60 days, which it hedges using a forward contract with TC. Subsidiary B has payables of FC50, also due in 60 days, which it hedges using a forward contract with TC.

TC nets the two internal derivatives and enters into a net external forward contract to pay FC50 and receive Indian Rupees in 60 days.

At the end of month 1, FC weakens against Rupees. A incurs a foreign exchange loss of Rs. 10 on its receivables, offset by a gain of Rs. 10 on its forward contract with TC. B makes a foreign exchange gain of Rs. 5 on its payables offset by a loss of Rs. 5 on its forward contract with TC. TC makes a loss of Rs. 10 on its internal forward contract with A, a gain of Rs. 5 on its internal forward contract with B, and a gain of Rs. 5 on its external forward contract.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting intra group transactions or events are shown in italics.

A's entries

Dr	Foreign exchange loss	Rs. 10
Cr	Receivables	Rs. 10
<i>Dr</i>	<i>Internal contract TC</i>	<i>Rs. 10</i>
<i>Cr</i>	<i>Internal gain TC</i>	<i>Rs. 10</i>

B's entries

Dr	Payables	Rs. 5
Cr	Foreign exchange gain	Rs. 5
<i>Dr</i>	<i>Internal loss TC</i>	<i>Rs. 5</i>
<i>Cr</i>	<i>Internal contract TC</i>	<i>Rs. 5</i>

TC's entries

<i>Dr</i>	<i>Internal loss A</i>	<i>Rs. 10</i>
<i>Cr</i>	<i>Internal contract A</i>	<i>Rs. 10</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>Rs. 5</i>
<i>Cr</i>	<i>Internal gain B</i>	<i>Rs. 5</i>
Dr	External forward contract	Rs. 5
Cr	Foreign exchange gain	Rs. 5

In the consolidated financial statements, the internal derivative transactions are eliminated. In economic terms, the payable in B hedges FC50 of the receivables in A. The external forward contract in TC hedges the remaining FC50 of the receivable in A. Hedge accounting is not

necessary in the consolidated financial statements because monetary items are measured at spot foreign exchange rates under AS 11 irrespective of whether hedge accounting is applied.

The net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries to meet the requirements of AS 30.

Payables	Dr.	Rs. 5	
External forward contract	Dr.	Rs. 5	
To Receivables			Rs. 10

11.

Entity A has the Indian Rupees (Rs.) as its functional currency and reporting currency.

On 30 June 20x7, it enters into a forward exchange contract to receive Foreign Currency (FC) 100,000 and deliver Rs. 109,600 on 30 June 20x8 at an initial cost and fair value of zero. It designates the forward exchange contract as a hedging instrument in a cash flow hedge of a firm commitment to purchase a certain quantity of paper on 31 March 20x8 and the resulting payable of FC100,000, which is to be paid on 30 June 20x8. All hedge accounting conditions in AS 30 are met. The financial year has been presumed to be the accounting year.

As indicated in the table below, on 30 June 20x7, the spot exchange rate is Rs. 1.072 to FC1, while the twelve-month forward exchange rate is Rs. 1.096 to FC1.

On 31 December 20x7, the spot exchange rate is Rs. 1.080 to FC1, while the six-month forward exchange rate is Rs. 1.092 to FC1.

On 31 March 20x8, the spot exchange rate is Rs. 1.074 to FC1, while the three-month forward rate is Rs. 1.076 to FC1.

On 30 June 20x8, the spot exchange rate is Rs. 1.072 to FC1.

The fair value of the forward exchange contract is negative Rs. 388 on 31 December 20x7, negative Rs. 1,971 on 31 March 20 x 8, and negative Rs. 2,400 on 30 June 20x8.

Pass journals

The accounting entries are as follows.

30 June 20 x 7

Dr	Forward	Rs. 0
Cr	Cash	Rs. 0

31 December 20 x 7

Dr	Appropriate equity account	Rs. 388
Cr	Forward liability	Rs. 388

31 March 20 x 8

Dr	Appropriate equity account	Rs. 1,583
Cr	Forward liability	Rs. 1,583

31.3.2008

Dr	Paper (purchase price)	Rs. 107,400
Dr	Paper (hedging loss)	Rs. 1,971
Cr	Appropriate equity account	Rs. 1,971
Cr	Payable	Rs. 107,400

30 June 20 x 8

Dr	Payable	Rs. 107,400
Cr	Cash	Rs. 107,200
Cr	Statement of profit and loss	Rs. 200

Dr	Statement of profit and loss	Rs. 429
Cr	Forward liability (i.e., Rs. 2,400 – Rs. 1,971 = Rs. 429)	Rs. 429

Dr	Forward liability	Rs. 2,400
Cr	Cash	Rs. 2,400

CAPITAL MAINTENANCE

SUM NO.1

Note: 1

Balance of Reserves and Surplus after disposal of Fixed Asset (1.1.1998)

	(Rs in lakhs)
Profit earned in 1 st 10 years =	175
Profit on sale of Fixed Asset =	<u>140</u>
Reserve & Surplus (Closing)	<u>315</u>

This Reserves and Surplus was entirely invested in working capital.

Note: 2

Additional funds required

For fixed asset =	1000
For Working Capital = 400 – 315 =	85
Total	1085 lakhs.

This will be raised by issuing equity shares.

Note: Physical capital maintained or not should be judged, based on the operating profits i.e. excluding Capital Profit or other profit if any.

BALANCE SHEET AS ON 1.4.98

Equity Capital	1085	Fixed Asset	1000
Reserve & Surplus	<u>315</u>	Working Capital	<u>400</u>
	<u>1400</u>		<u>1400</u>

Retained Earning under physical capital maintenance:-

Based on Opening profit (before sale of Fixed Asset)

N.W. as per Book (140 +175) =	315
N.W. as per index (140x200/100) =	<u>280</u>
RETAINED EARNINGS	<u>35</u>

However if we calculate the retained earning after taking profit on sale of fixed asset then our retained earning under the concept of P.C.M. will be (140 + 35) = 175 lakhs.

SUM NO. 2

Balance sheet As on 1.1.1980

Equity Share Capital	20	Fixed Assets	100
Preference share capital	30		
Debentures	<u>50</u>		
	<u>100</u>		<u>100</u>

Since everything was invested in Fixed Asset.

31.12.89

NAV/Shares Rs. 80 Face value taken as Rs. 10/- share

Net worth Rs. 80

No of share

Hence Net worth= 2 x 80 = Rs. 160 crore.

Capital = Rs. 20 crores

Reserves & Surplus= Rs. 140 crores

Balance Sheet As on 31.12.1989

Equity	20	Fixed asset	16
R&S	<u>140</u>	W/Cap	<u>144</u>
	<u>160</u>		<u>160</u>

Details of new issue

	Capital	Premium	Total
Rights Issue	20	10	30
Public Issue	<u>32</u>	<u>64</u>	<u>96</u>
	<u>52</u>	<u>74</u>	<u>126</u>

BALANCE SHEET AS ON 1.1.1990

Equity share capital	72	Fixed Assets	142
Securities Premium	74		
Reserve & Surplus	<u>140</u>	Working Capital	<u>144</u>
	<u>286</u>		<u>286</u>

31.12.1998

NAV/Share	=		410
Closing Net worth	=	7.2 x	410
	=		2952
Capital	=		<u>72</u>
Reserves & Surplus			<u>2880</u>

BALANCE SHEET AS ON 31.12.1998

Equity Share Capital	72	Fixed Asset	29.52
Reserves & Surplus	<u>2880</u>	Working Capital	<u>2922.48</u>
	<u>2952</u>		<u>2952</u>

PHYSICAL CAPITAL MAINTENANCE

Physical capital maintained:

Closing Net worth as per book	=	2952
Closing Net worth as per index		
20 x 15/1	=	300
126 x 15/3	=	<u>630</u>
		<u>930</u>
Retained Earning		<u>2022</u>

Capital in this case means investment and not capital in the books, therefore securities premium shall also be considered.