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Assurance EYe

A Newsletter from Ernst & Young

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NEWS FOR YOU

IFRS and SEC

Currently, foreign companies filing IFRS financial statements with the Securities and Exchange Commission (SEC) must reconcile their financial reports with U.S. GAAP. Alternatively, full fledged US GAAP financial statements can be filed. The SEC has proposed changing its rules to allow foreign filers to file financial statements using IFRS's without the requirement to provide reconciliation with US GAAP. If approved, the changes would go into effect in 2009. The change would also mean quicker results for investors, because the current reconciliation process happens only once a year, and sometimes six months after financial results already have been reported, and investors show little interest in the information, no matter how GAAP-friendly it is.

The proposal marks a significant milestone in the global convergence of accounting standards, since currently more than 100 countries follow IFRS. This move will cut filing costs for foreign companies and encourage more companies to raise capital in the United States. The ultimate result of this proposal would be more comparable and understandable financial statements, which in turn would lead to seamless flow of capital across the world.

It is predicted that many current foreign filers will take advantage of being able to file in only IFRS. The foreign filers will not only reduce cost, but would have one common accounting platform across all their subsidiaries all across the world. While the SEC's proposal may be good news for foreign filers, where does that leave U.S. companies? Would the proposal mean that U.S. issuers could also have the option of filing their financial statements in IFRS?

U.S. companies hoping to stay competitive with foreign issuers may also want to use IFRSs. The US business community would welcome the option of using IFRS, to cut costs and have one reporting language for all their subsidiaries irrespective of their geography. The SEC is mulling over these questions. SEC chairman, Cox hinted that SEC is thinking about whether to give U.S. companies the same choice. It is predicted that the SEC will soon face a lot of pressure from US corporations and the outcome is inevitable.

SEC's proposal for elimination of IFRS-US GAAP reconciliation for foreign filers, comes as a pleasant surprise, more so because it raises the possibility of allowing US domestic registrants to use IFRS's. The latter was wistfully imagined, but never expected in one's life time. If this indeed happens, it would eventually lead to the demise of US GAAP. Probably, in a few years, US GAAP may not be taught in US universities.

However, it does not seem so simple that US domestic registrants will take to IFRS like a fish takes to water for a number of reasons:

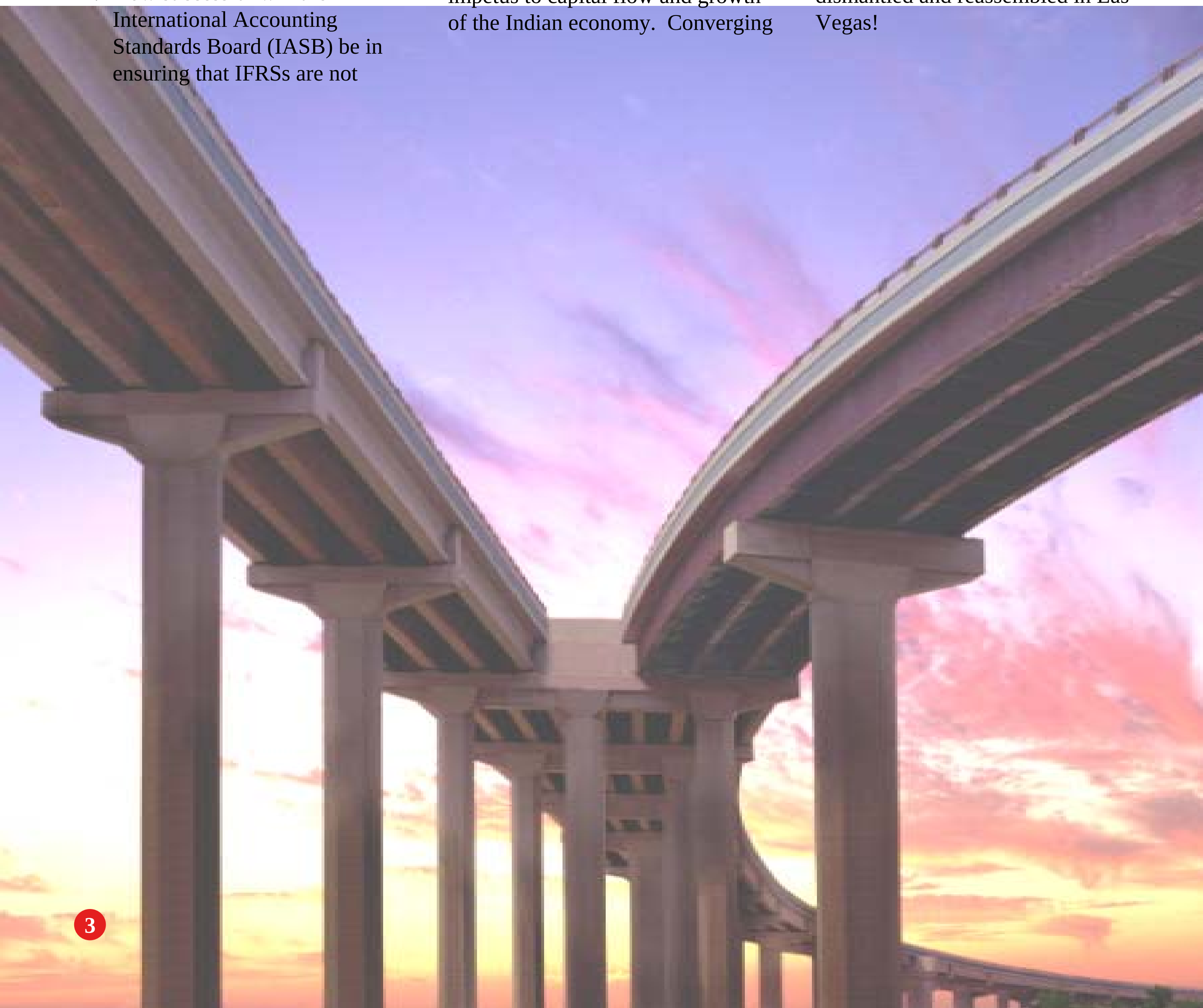
- US GAAP has developed under the shadow of a very litigious environment. As a result it has become safer for US companies in a defence to show that a stated rule was followed. That would be extremely difficult in the case of IFRS which are principle based, and require application of judgement. Therefore a mindset change would be required, if IFRS were to be followed in the US
- IFRS standards have been muddled in problem, because regulators have been endorsing IFRS standards with their own variations, eg, EU endorsed IFRS standards. The SEC will demand a full IFRS application rather than a EU endorsed IFRS. This may become a potential problem for EU based US filers

With SEC accepting IFRS, it has truly become a numero uno standard. However, there are some key concerns, which should be addressed in the coming days. These are:

1. In the coming days, will SEC have any influence in interpretation or drafting of IFRS's? The SEC's acceptance of IFRS, does not mean that it will withdraw from interpreting accounting regulations. Indeed it will continue to issue comment letters to registrants and may want to position itself as the numero uno regulator for interpreting IFRS
2. How successful will the International Accounting Standards Board (IASB) be in ensuring that IFRSs are not interpreted inconsistently by various regulators across the world including the SEC?
2. How will IASB ensure that the genuine concerns of all countries are adequately reflected in the accounting standards?

In India, the ICAI has announced the IFRS convergence date as 1 April, 2011. This is subject to regulatory approvals. When IFRS becomes mandatory in India, Indian companies filing with SEC under US GAAP would prefer IFRS both for local as well as US filing. Besides, if India were to converge with IFRS, it would provide a significant impetus to capital flow and growth of the Indian economy. Converging to IFRS will also enhance the value and mobility of Indian Chartered Accountants globally. However, two key challenges would be (a) convergence to IFRS would require amendments to various legislations, and (b) existing and prospective accountants would require significant training in IFRS. Those challenges can be easily addressed with appropriate planning and action.

It now appears, that the days of multiple reports under different GAAPs are numbered. This was probably unimaginable just a couple of months ago. There was more likelihood of Eiffel Tower being dismantled and reassembled in Las Vegas!



Accounting of Duty Entitlement Pass Book (DEPB) Benefits

The objective of DEPB scheme is "to neutralise the incidence of customs duty on import content of an export product". For achieving this objective, import duty credit is granted to the exporter at a specified percentage of the specific finished products. This credit can be utilised for payments of customs duty on freely importable items. DEPB could also be made transferable to third parties after payment realisations. DEPB is issued on post export basis and granted against exports already made.

There are certain obligations or conditions which an exporter has to fulfill as per DEPB Scheme such as:

- Export for which payments are not received in freely convertible currency, DEPB is not allowed
- DEPB is valid for 24 months and no revalidation is granted
- DEPB on post-export basis is freely transferable. The transfer shall however be for imports at the port specified in the DEPB which shall be the port from where the exports have been made.

The above provisions are modified by the Government from time to time.

The following accounting issues arise. What should be the accounting treatment of DEPB credit with reference to: (a) recognition of benefit (in which period should the benefit be recognised) (b) valuation of inventory procured under the DEPB benefit scheme (c) accounting treatment to be followed if DEPB credit is held for sale/transfer?

The benefit of DEPB should be recognised in the year of export itself (provided no uncertainty exists). This is on the basis of matching concept. The activity of export results in an entitlement of DEPB credit and accordingly, this credit cannot be related to duty payable at the time of subsequent imports. At the time of subsequent imports the full duty payable on such imports would form part of cost of purchase which is paid partly or fully by way of adjustment of DEPB credit. The benefit is available against the exports made. This should be booked separately as revenue by creating claim against it on the asset side. This is also the current position of the ICAI, though the Expert Advisory Committee of ICAI in earlier opinions, had expressed the view that DEPB benefit should not be recognised unless the benefit is actually utilised, i.e, finished product using the imported raw material is sold.

Earlier opinions of the EAC did not permit recognition of the DEPB credit at the time of export because of uncertainties (though their occurrence could have been remote). The current position is that recognition of DEPB at time of export is precluded only if there is high probability that the uncertainty would result in an adverse situation. For example, if there are general uncertainties relating to realisation of export proceeds or sale of DEPB certificates that would not result in non recognition of DEPB credit. However where the uncertainty level is high, for example, a most likely change in the Government policy or a debtor going bankrupt, would preclude revenue recognition.

In case the DEPB credit is held for sale, the treatment of DEPB credit would be similar as explained above. However, significant uncertainty regarding the amount of consideration realisable and uncertainty regarding its ultimate collection would be taken into account.

As regards the valuation of items imported, which are lying in inventory, the same would be recorded in the books at actual cost. The full duty payable on such imports would form part of cost of purchases which is paid partly or fully by way of adjustment of DEPB credit.

Subprime Lending – Accounting Woes

Subprime lending, also called B-Paper, near-prime, or second chance lending, is a general term that refers to the practice of making loans to borrowers who do not qualify for the best market interest rates because of their deficient credit history. For lenders the downside of high credit risk is accompanied by the upside of high interest rates. However, lenders may have transferred a sizable risk (and rewards) to investors through securitisation structures. These investors include financial institutions such as commercial and investment banks, real-estate investment trusts, hedge funds, pension plans and other asset management entities. The subprime crisis initially surfaced in the US but has global implications as securities collateralised by subprime assets have been sold to financial institutions and individual investors around the world.

Till the time, home prices rose, fewer loans went sour, because borrowers could typically refinance or sell the property at a profit. However, once the US market changed in late 2005, many subprime borrowers could no longer cash in on rising home values, leading to a sharp rise in delinquencies. Moreover, the increased use of 'stated income' or no/low documentation loans increased the number of fraudulent loans. It is expected that this trend of defaults would continue because of 'teaser rate' feature, which allows lower interest rate or no interest in the first few months of loan, followed by high rates subsequently. Undoubtedly, the above events have significant accounting implications, some of which are discussed below.

Going concern issue: Significant exposure to subprime lending could result in a going concern issue and consequently preparation of accounts on a liquidation basis. These entities would not only include lenders or investors but other entities as well that are exposed to the subprime crisis, for example, a BPO company exclusively catering to subprime lenders.

Determination of fair value: In a deteriorating credit environment, fair values would be under stress. Further where there is a limited secondary market liquidity, determining fair values would become very subjective and judgemental. Entities that own highly rated debt securities, such as tranches of subprime securitisations rated AA and above, may maintain that since they expect to receive all their principal and interest as originally forecasted, the instrument has not suffered a diminution in fair value. This approach is not necessarily consistent with the concept of fair value which is the amount a current buyer of such assets would be expected to pay. Notwithstanding fairly certain cash flows, if spreads are widening then, all else being equal, the fair value of an investment will decline. The use of fair values for loan portfolio is more a feature of IFRS and US GAAP. In India, under Indian GAAP, loan portfolios are not marked to market, but the losses are provided for by making an appropriate provision.

Loan loss provisions: The proliferation of non-traditional loan products that include unique principal and interest terms such as reduced payments in the early part of loan terms, negative amortization (i.e., loans in which the periodic payment does not cover the amount of interest due for that period resulting in the loan balance increasing by the amount of the unpaid interest), and step-ups in interest rates, or options for borrowers to enact such features, presents challenges in determining an appropriate allowance for credit losses. Most entities would have limited historical data on how these types of products perform in a deteriorating credit environment. For determining appropriate amount of provision, the entity should also consider factors such as the origination channel of the loans (e.g., through broker network versus internally through branch network); the declining housing market, the potential for overstated appraisals; concentrations of loans to particular types of borrowers or geographic areas that may have experienced greater weakness; increases in consumer real estate loan delinquencies, non-accruals, and charge-offs; and other factors that affect losses inherent in the loan portfolio. In India, as regards banks, the RBI has a detailed set of rules for determining loan loss provision.

Securitisation/credit enhancements: In many cases, the originator of subprime loans may transfer the loans to other investors by creating securities out of those loans. In many transfers of financial assets, the transferor continues to hold all or some portion of the credit risk associated with the transferred financial assets. For example, by providing credit enhancement in the form of financial guarantee or holding subordinated interest or by providing put option. With increasing delinquencies and defaults, and the declining housing market, transferees are being more aggressive in identifying reasons to make claims against transferors for the credit enhancements. Because the accounting for various forms of credit enhancement may vary depending on how the specific arrangement is structured, the documentation related to various transactions should be analysed thoroughly to determine the accounting consequences. Entities should regularly reassess credit enhancement agreements to determine whether it is necessary to record an increased obligation.

Investments in debt and equity securities impacted by the credit crisis: Several subprime mortgage lenders in the US have recently experienced financial distress and in some cases have filed for bankruptcy protection. In addition, the share prices of many other US mortgage industry participants, including lenders and servicers, and the returns of some hedge funds have been adversely affected by their exposure to subprime and other non-traditional loans products. Investors in these entities and funds need to determine whether there is any objective evidence that the financial asset is impaired.

Finally, it would be incorrect to say that India does not have a subprime market, though, there is no subprime crisis and the risks associated are comparatively lesser. Thanks to better monitoring by the RBI. In the US home owners used rising value of their assets to raise second mortgages. Second mortgages are not allowed in India. In the US, subprime borrowers are people who have a bad credit history; whereas, in India, the banks and financial institutions are generally wary of defaulting borrowers or borrowers are first-time borrowers with collateral security or good employment history.

The success of certain non-banking financial companies in India has encouraged several others players to enter the consumer lending business, and a sizable portion of that is subprime. Also aggressive home lending is supported by an increase in property market, high salaries and stable employment. Should those trends reverse, lenders would start seeing significant defaults.

India is not insulated from global happenings. What has happened in US could very well happen in India. It is important for all stakeholders to learn from the US experience and try to build in checks and balances to avert any such crisis in India. Finally, Winston Churchill once said "Wise men learn by other men's mistakes, fools by their own."

Creation of Debenture Redemption Reserve

Section 117C of the Companies Act, 1956, was inserted in the Act in the year 2000 as a measure of protecting the interests of debenture holders. It requires every company which has issued debentures to create a Debenture Redemption Reserve (DRR). As per this section, a company shall credit adequate amounts to DRR, from out of its profits every year until such debentures are redeemed. The amounts credited to the DRR shall not be utilised by the company except for the redemption of debentures. Recognising the insertion of section 117C in the Companies Act, 1956, the Securities and Exchange Board of India (SEBI), which had earlier prescribed separate requirement for creation of DRR by listed companies, has amended its earlier Guidelines. Now, SEBI Guidelines also require listed companies to create DRR as per section 117C of the Companies Act, 1956. Thus, both listed and unlisted companies are subject to the same requirements of section 117C for creation of DRR.

Though, the above requirements of section 117C seem to be quite simple and straightforward, there are various practical issues in its implementation, some of which are listed below:

1) Section 117C requires DRR to be created out of profits for the year. Is DRR required if a company does not have any profits during the year?
2) What would be the position in case the company has profits but these are not sufficient to create 'adequate amount' of DRR?
3) What is meant by adequate amounts to be transferred to DRR? Whether it implies that the Company should create DRR equal to 100% of Debenture amount or a lower amount may also be acceptable?
4) Whether or not companies are required to create DRR for all types of debentures, including convertible debenture and short-term debentures?
5) Once debentures are extinguished, what happens to the DRR?

To clarify the applicability of section 117C, the Department of Company Affairs (now Ministry of Corporate Affairs) has issued General Circular No. 9/2002 dated April 18, 2002. The Circular provides the following guidance on some of the issues listed above:

a) There is no obligation on the part of the company to create DRR, if there is no profit for the particular year.

b) The Circular also sets out the following limits for adequacy of DRR in case of certain classes of companies. For other companies there is no specific guidance in the circular:

Nature of Company	DRR Required	
	Public issue	Private placement
All India Financial Institutions regulated by RBI and Banking Companies	Nil	Nil
NBFCs and other financial institutions	50%	Nil
Manufacturing and infrastructure companies	50%	25%

c) Section 117C will apply to non-convertible portion of debentures issued whether they are fully or partly convertible.

Regarding the issues which are not specifically addressed in section 117C or in the DCA Circular, according to the Editorial Team, the following views may be possible:

1. If the profits are not adequate, on a conservative side, the company should transfer the entire amount of profit to DRR. If such profits are applied for payment of dividends, it could be interpreted as giving preference to equity holders as against debenture holders. This could be construed as a violation of law and a debt covenant.
2. Though the DCA Circular does not make it very clear, the limits prescribed in the Circular for creation of DRR should be considered as minimum and in case a company desires to create higher DRR, it can do so.
3. Regarding the companies, e.g., service companies or trading companies, for which no specific percentages have been laid down in the DCA Circular, they may also be required to create DRR. Such companies would have to decide 'adequate amount' for creation of DRR after considering factors such as amount of debentures outstanding, tenure of debentures and adequacy of profits including future projections, etc. However, on a conservative side, such companies should atleast create DRR to the extent prescribed for manufacturing companies
4. On reading of section 117C, SEBI Guidelines and the DCA Circular, it seems that there is no exemption from creation of DRR with respect to short term debentures. However, since creation of DRR is done annually, whereas short-term debentures may have been paid before the annual accounts are approved or shortly thereafter, keeping the spirit of the law in mind, it may not be necessary to create a DRR.
5. Once debentures are extinguished, the DRR may be transferred to P&L surplus balance or the General Reserve Account.

Since creation of DRR is a legal matter, and at times complex, our advise to Companies is to act based on an appropriate legal opinion. The purpose of DRR is to ensure that debenture holders are protected and that profits generated by a company, are first allocated for payment to debenture holders rather than equity holders. Whilst there could be debate on the details, this fundamental principle cannot be compromised.

Telecom – Industry Insights

Prashant Singhal is the Director, Ernst & Young Pvt.Ltd and Telecom Industry Expert

Q1. What's your take on the Telecom industry, and where do you see it 5 years from now?

Telecom industry is the poster boy of the sweeping liberalization and reforms process unleashed in the country since 1991. As one of the most deregulated Telecom market in the world, the total Telecom base has changed from 7 million in 1992 to more than 225 million at the end of June 2007, making it the 5th largest in the world. India added more mobile lines per month than China this year. In the next 3 years, Telecom in India will continue its brisk pace and will garner more mobile users than the US by 2008 end.

Q2. What trends do you see in telecom industry?

Each new subscriber lowers average revenues, and still telecom companies continue to post better results than most estimates. Reduction in Average Revenue Per User is not a worry anymore because the ramp-up in subscriber base is so strong that marginal revenue for every new subscriber is much higher than the marginal cost.

Going ahead, we expect consolidation in the market place. As a clutch of global Operators eye to penetrate the India Telecom market, we will see intense activities on the Mergers and Acquisitions front. Also, many Indian companies will seek to become global players. Bharti has sought licences in protected or underserved markets like the Middle East. In fact many global Telcos like Vodafone are competing with Indian companies for this atrophying space. We are also awaiting vigorous IPO activity in the coming years.

In order to help operators expedite network roll out in rural and remote areas of the country and meet the government's target of 500 million subscribers by 2010, we will witness heightened interest among Operators in the area of Hiving Off of Towers Business and Passive Infrastructure Sharing.

Secondly, realization of a series of initiatives in the Indian telecom sector by cellular operators as well as the Regulator will lead to further growth. Aided by a significant decrease in tariffs, low cost handsets, low cost prepaid & lifetime validity schemes (introduced in 2005) will increase affordability and penetration in Tier 2 and 3 cities in the country.

Q3. What are some of the challenges that Telecom industry face?

In an evolving Telecom landscape, there are also some prolonged unresolved challenges such as the Spectrum conundrum and spectrum auction for roll out of 2G and 3G services in India. Operators need to work on are Point-of-Interconnection congestion and response time at service centers.

Issues concerning excessive duties and levies need urgent attention as India faces one of the highest sales tax and duties levy on the subscribers in the entire South Asia region. Benign regulatory policies on reduction in taxes like Licence Fee, Spectrum Charges or Service Tax shall be the major driver for tariff fall leading to an accelerated subscriber growth in future. Lastly, even as the stage has been set to usher in the broadband revolution in the country and three years after the DoT unveiled India's first broadband policy, and heralded 2007 as the Year of Broadband, we stand at a meager 2.43 million broadband subscribers by the end of April 2007, giving immense scope for growth. Very little is done by way of making local loop unbundling mandatory for access by telecom operators on non-discriminatory basis as well as enhancing PC penetration in the country. Other issues like roll-out of IPTV are still unresolved, the telecom sector and the cable industry are involved in a wrestle over who can provide this service. One of the challenges that IPTV may face in India is the low penetration of broadband, lack of content and head-end infrastructure being made available. And, lastly, it needs to be a low cost and convenient way for consumers to be able to operate the device. Many Indian companies meet the international standards in terms of technology and skill base to handle rolling out of next generation services like 3G or WiMAX. WiMAX is a telecom technology that enables high data output. The technology would be very helpful in extending the broadband penetration across the country, especially in the rural areas. The Department of Telecom is also in talks with the Department of Space and other users of the 2.5 and 3.0 gigahertz spectrum for the use of WiMAX technology. India will soon join the selected group of nations having their own WiMAX concept certification laboratories. Presently, there are only nine certifying labs for WiMAX equipment across the globe including those in South Korea, China, Russia, Spain and Brazil. The proposed lab would be the tenth worldwide.

Q4. Run us through some key accounting challenges that telecom industry face?

The conventional accounting principles are getting challenged in the areas of revenue recognition on offerings like lifetime/long term validity products, bundled multiple service offerings, free promotion offerings, accounting of the subscriber acquisition costs and deferral of one time charges and costs. Indian GAAP does not provide specific guidance on many of these issues enforcing telecom companies to rely on US GAAP and IFRS literature for guidance.

With the Telecom Operators focusing more on their core strength of providing Telecom services, critical network and IT contracts are getting outsourced, and Operators are delving into 'managed service contracts' with equipment vendors for payments linked to the quantum of traffic generated. Though, internationally the practice of many Telcos on bandwidth capacity sharing in the nature of IRU's are more or less defined and standard, the concept of lease and service offerings in case of passive infrastructure sharing, Towers De-merger by the Telecom Operators, are giving rise to many new streams of outstanding Accounting Issues.

ACCOUNTING SOLUTIONS

Revenue Recognition for Customer Loyalty Schemes

Query

Retail Ltd (RL) operates a customer loyalty programme. For every rupee that a customer spends in any of RL's stores, they receive one point. Once a customer has accrued 1,000 points they are entitled to buy a free product to the value of Rs200 from any of RL's department stores. During August the total sales price of items sold to loyalty card holders is Rs 20,000. Prior experience has shown that 20% of customers do not redeem their points. How should RL account for the cash received of Rs20,000 in the month of August?

Response

The customer loyalty programme terms indicate that there are two elements to every sale transaction. The recognition criteria in AS-9 need to be applied to the separately identifiable components of the transaction with card holders. The Rs 20,000 received from customers needs to be allocated between the amount received for the goods sold and the amount received for the undelivered goods (the points). The entity should develop a reasonable method to determine the fair values of the two components. The accounting would be as follows.

Dr Cash Rs 20,000
Cr Revenue Rs 16,800
Cr Liability Rs 3,200
(20,000 points/1,000 points * 80% * Rs 200)

As the award credits are redeemed and the entity provides the remaining goods, the liability will be settled resulting in additional revenue being recorded.

The above view is one of the interpretation based on AS-9. Under IFRS, there is a specific interpretation (IFRIC 13), which requires the above treatment.

An alternate view under Indian GAAP, would be to recognize the entire revenue of Rs 20,000, and separately recognize the customer loyalty provision (as we do in the case of warranty provision) of Rs 3,200. This view has the support of AS-29. The entries would be as follows.

Dr Cash Rs 20,000
Cr Revenue Rs 20,000

Dr P&L Rs 3,200 (see note)
Cr Liability Rs 3,200 (see note)

Dr Liability Rs 3,200 (see note)
Cr Inventory Rs 3,200 (see note)

Note: The amount of Rs 3,200 should be reduced by the profit margin included in it, since provisions are measured at the cost to settle the obligation.

Impairment of Goodwill

Query

Holding Ltd owns 75% in Subsidiary Ltd. Holding Ltd recorded Rs 7,500 of goodwill from the purchase of Subsidiary Ltd. The goodwill relates to a cash generating unit (CGU) in subsidiary with a carrying value (excluding the goodwill) of Rs 30,000. Management have determined that the recoverable amount of the CGU is Rs 32,000. What impairment (if any) should be recognised?

Response

The total assets which comprise the CGU are:

- The identifiable assets of Rs 30,000, recorded in Holding's accounts;
- Holdings's portion of the goodwill of Rs 7,500, recorded in Holding's accounts and;
- The minority's portion of the goodwill of Rs 2,500 (7,500 ÷ 0.75 x 25%) which is not recorded in Holding's accounts.

The CGU's recoverable amount for impairment testing purposes is therefore Rs 40,000. The resulting impairment of Rs 8,000 is first allocated against the total goodwill of Rs 10,000 as required by AS 28, *Impairment of Assets.* Holding only recognised its portion of the goodwill, so it does not make sense to impair the minority's portion which is not recognised in the Holding's account. Therefore, the impairment charge recognised by Holding is Rs 6,000 (Rs 8,000 x 75%).

Obligation as a Result of New Legislation

Query

Hotel Ltd operates a number of restaurants. The Government passed legislation that will only allow smoking in a restaurant provided it is physically partitioned into smoking and non- smoking zones. The legislation became effective on 1 March 2007. Hotel Ltd's year-end is March and on 31 March Hotel Ltd has not yet carried out the partitioning. Hotel Ltd, however, still allows customers to smoke in the Hotels and restaurants which have not yet been partitioned. Can Hotel Ltd record a provision in its March 2007 accounts for the cost of partitioning?

Response

No. Hotel Ltd does not have a present obligation at the balance sheet date to partition its restaurants. The decision to partition or not to partition the restaurants is wholly within the control of Hotel Ltd. However, there may be an obligation to pay fines or penalties for non-compliance. Whether a provision is recognised for this amount depends on the probability of the government imposing fines or penalties on Hotel Ltd.

Equity Kicker on Loan Default

Query

Borrower Ltd has obtained a loan from a bank. One of the covenant states that if the outstanding amounts are not paid within a period of one year, the bank would have a right to convert the loan into equity shares. According to Borrower Ltd, this is a normal clause which banks incorporate in the lending agreement. Would this arrangement result in potential dilutive equity share?

Response

One of the example of potential dilutive equity share is given in Paragraph 7(d) of AS-20 as follows: "7(d) shares which would be issued upon the satisfaction of certain conditions resulting from contractual arrangements (contingently issuable shares), such as the acquisition of a business or other assets, or shares issuable under a loan contract upon default of payment of principal or interest, if the contract so provides." Therefore the arrangement with the bank would lead to potential dilutive equity shares for Borrower Ltd. If the borrower violates the loan covenant, the potential equity shares should be included in calculating the diluted EPS, only if the same is dilutive in nature.

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