

financial instruments:-

Ind AS - 32 - Presentation of fs in B/S & P&L

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→ What is financial instrument?

It is any contract that gives rise to a financial asset for one entity and a financial liability or equity instrument to/for another entity.

→ ~~financial~~ Asset:- A financial asset is an asset which is a

- cash (cash & cash equivalents)

- An equity instrument of another enterprise

- An asset that gives a contractual right to receive cash - A contractual right to exchange financial asset/financial liability with another entity under favourable terms

→ Here favourable term means increase in financial asset and decrease in financial liability

→ Types of financial Asset:- 3 types (In case of debt)

- a) financial asset measured at amortised cost

- b) financial asset measured at FVTOCI

- c) financial asset measured at FVTPL

→ a) financial asset at amortised cost:- (i) A financial asset can be measured at amortised cost if both the contractual cash flow test and business model test are satisfied.

contractual cash flow test:- It says that the asset gives-

- Rise to cash flows which are solely the payment of interest and principal [interest + principal]

Business model test:- It says that the asset is held in order to collect the contractual cash flows till the maturity (held to maturity)

(ii) At the time of acquisition we record them at fair value + Transaction cost.

(iii) There after this asset will be measured at amortised cost using effective interest rate (EIR)

→ EIR is the IRR which is computed by using trail & error method. [PV of outflows = PV of cash flows of future]

Example 1) Mr. A bought a debt instrument face value ₹1000. Interest rate @12% at 891. The brokerage paid was ₹8. The remaining life of bond is 5 years. Collected Amount

∴ Effective interest rate using trail & error approach is 15% Amortised

Years	Opening	Effective interest	Interest receipt	Amortised closing
1	899	135	120	914
2	914	137	120	931
3	931	140	120	951
4	951	143	120	974
5	974	146	120	1000
		P&L	Carrying	will be received

→ b) financial asset at F.V.T.O.C.I:-

(i) It is an asset that generates cash flow of interest and principal and held with an objective of collecting contractual cash flows as well as cash flow on selling asset.

(ii) When they are purchased they are recorded at fair value + transaction cost

(iii) At each year end we will find the fair value of the instrument (market value). And the difference between the value carrying in books and fair/market value is going to OCI (reserves) as investment revaluation reserve.

(iv) Interest portion which is received will go to P&L separately

(v) When we sell the asset the difference between the selling price and carrying amount will go to P&L.

(vi) The investment revaluation reserve which was earlier recorded will also go to P&L (This will be called as reclassification).

Ex-2) Mr A bought a bond at 899 (inclusive of transaction cost of ₹8) of face value ₹1000. Interest rate is 12%. At the first year end and second year end the market price was 909 & 913. On the middle of the 3rd year it was sold at 918.

Sol:- 2nd year:-

a) Investment a/c Dr 899 (Inclusive - T.C)

TO Bank a/c 899

b) Bank a/c ₹ 120
 TO interest a/c 120

c) Investment a/c ₹ [909-899] 10
 TO investment revaluation reserve a/c 10

d) Interest a/c ₹ 120
 TO P&L a/c 120

IInd year e) Bank a/c ₹ 120
 TO interest a/c 120

f) Investment a/c ₹ [913-909] 4
 TO investment revaluation reserve 4

g) Interest a/c ₹ 120
 TO P&L a/c 120

IIIrd year h) Bank a/c ₹ 948
 TO investment a/c 913
 TO P&L a/c 35

i) Investment revaluation reserve ₹ 14
 TO P&L a/c 14

→ c) Financial asset at FVTPL

(i) It is an asset which is not the amortized cost or FVOCI. Generally this is an asset which is held for trading purposes.

(ii) At that time of acquisition it is recorded at fair value. [Transaction cost goes to P&L a/c]

(iii) At each year end it will be recorded at fair/market value. Difference between the carrying amt and fair market value goes to P&L

Ex:- 3) Continuing with 2nd example if asset is treated as FVTPL

I a) Investment a/c Dr 891

To Bank a/c 891

b) Transaction cost a/c Dr 8

To Bank a/c 8

c) Bank a/c Dr 120

To Interest a/c 120

d) Investment a/c Dr [909-891] 18

To P&L a/c 18

e) Profit & Loss a/c Dr 8

To Transaction Cost 8

f) Interest a/c Dr 120

To P&L a/c 120

Bank a/c Dr 948

To Investment a/c 913

To P&L a/c 35

→ Financial Asset in case of Equity.

- An investment in equity shares can't be measured at Amortised cost - Because also CCFC & BM

- Generally an equity shares investment is measured at FVTPL

- However an entity may make an irrevocable election at the beginning for a particular equity investment to measure it at FVOCI

→ Accounting procedure same as case of debt.

→ loan given to employee at lower interest rate or no interest rate:-

- We will find the fair value of the asset by discounting the future cash flow at normal market rate of interest.
- The difference between the amount of loan given and the fair value of asset is the value of gift (reward) given to the employee which will go into P&L.
- The asset initially recorded at fair value and thereafter be measured at amortised cost.

→ Q15) Given a loan to employee by company of ₹10L @ 4% interest. Market interest rate is 10%. Repayment in 5 equal instalments. Give treatment.

(i) calculation of fair value of loan

Year	Int flow	@ 10% Discounted factor	Present value
1	240000	0.909	218160
2	232000	0.826	191702
3	224000	0.751	168269
4	216000	0.683	147506
5	208000	0.621	129126
Fair value of loan			<u>854763</u>

(ii) Employee benefit expenses - 10L - 854763 = 145237 → P&L.

(iii) calculation of Amortised cost

Years	opening	@ 10% Interest	Repayment	Amortised closing
1	854763	85476	240000	700239
2	700239	70024	232000	538263
3	538263	53826	224000	368089
4	368089	36809	216000	188898
5	188898	19102 (r.o.f)	208000	0

Journal entries:-

a) Start loan a/c Dr 854763
Employee benefit exp a/c Dr 145237
TO Bank a/c 1000000

b) Start loan a/c Dr 85476
TO interest a/c 85476

c) Bank a/c Dr 240000
TO Start loan a/c 240000

d) P&L a/c Dr 145237
TO Employee benefit exp a/c 145237

e) Interest a/c Dr 85476
TO P&L a/c 85476

(Repeat for remaining years)

→ Issue of convertible debentures:- (Embedded derivatives)
(compound financial instruments, hybrid instruments):-

a) Sometimes a company issues bonds to the investors in which it gives an option to them to get the bond converted into equity. This is totally left on the holders to exercise the option or not. If they don't exercise the option the bond redemption will be normal.

b) A holder will generally exercise the option if the share price of the company increases so this is a benefit given to the holders. The company charges some premium for that.

→ The instruments - total proceeds will be divided in 2 parts:-

a) Liability component :- which is to be valued first as fair value is p.v of future cash outflows.

b) Equity component :- which is the option premium is the balancing figure.

Q-6) On 01-04-2008, Alpha Ltd issued ₹30L 6% convertible debenture of face value ₹100. These are redeemable at a premium of 10% after 4 years or these may be converted into ordinary equity shares at the option of the holder. The interest rate for equivalent debenture without conversion is 10%. Being a compound f.g you are required to ^{separate} find

sol:- fair value of liability component

$$= 180000 \times (\text{PVAF of } 10\%, 4\text{ yrs}) + (30L + (30L \times 10\% \times \text{PV of } 4\text{ yrs}))$$

$$= 180000 \times 3.17 + 330000 \times 0.68$$

$$= 570600 + 224400$$

$$= 795000 \rightarrow \text{This is debt component.}$$

$$\text{Equity component} = 3000000 - 795000 = 2205000$$

Q-7) On 01-03-2016 Sigma Ltd issued 6% convertible debenture face value 100 per debenture at par. Debentures are redeemable at premium of 10% after 4 years or this may be convertible into equity shares at the option of holder. The interest rate for equivalent debenture without conversion is 10%.

Being a cf2 you are required to separate equity and debt. The equity portion is 185400 find debt portion

sol:- let the face value of bond is ₹

$$\text{interest per annum} = 0.06$$

$$\begin{aligned} \text{Redemption outflow} &= 1.12 \\ \text{Fair value of liability component} &= 0.062 \times 3.17 + 1.102 \times 0.93282 \\ &= 0.93282 \end{aligned}$$

$$\text{Equity liability} = \text{Total amount}$$

$$185400 - 0.93282 = x$$

$$x - 0.93282 = 185400$$

$$x = 185400 / 0.0618 = 3000000$$

$$\text{Liability portion} \Rightarrow 0.93282 \times 3000000$$

$$\text{L.P} = 2814600$$

$$+ \text{E.P} = 185400$$

$$\text{T.V} = 3000000$$

→ Impairment of financial asset:-

a) If a company finds that there is an objective evidence that future cash inflows from an asset is going to be lower than what is expected earlier, then the company must calculate the impairment loss.

b) FVTPL asset:- No impairment is needed [why becu difference is immediately accounted]

c) FVTOC asset:- The balance in investment revaluation reserve should be immediately transferred to P&L a/c

d) Amortised cost:- we have to find out the fair value of the asset as on the impairment date, by finding the present value of future cash inflows using the original effective interest rate.

e) The difference between the carrying amt & fair value goes to P&L as impairment loss. The remaining carrying amt will be treated as A.C for future accounting.

→ Q11) Mr A was having an asset in his books at ₹31 at the end of 2nd year. He bought it at ₹992 years back and he is not going to realize not more than 6% interest and 40% of the maturity. The original rate was 12% and the face value was 1000. Find the impairment loss and prepare amortisation table for next 3 years.

Sol:- Carrying cost = ₹31

$$\text{Fair value} = 1000 \times 6\% \times \text{PVAF}(15\%, 3) + 1000 \times 40\% \times \text{PVF}(15\%, 3)$$

$$= 60 \times 2.2832 + 400 \times 0.6575$$

$$\text{F.V} = 400$$

Impairment loss = ₹31 - 400 = 531 → transfer to P&L a/c.

→ Revised carrying amt of asset is 400.

New Amortisation cost table:-

Year	Opening	15% Interest	Onflow	Amortised closing
1	400	60	60	400
2	400	60	60	400
3	400	60	460	Nil

⇒ Reclassification of financial assets:-

a) It is only possible if the entity changes its business model. The objective of holding the asset changes. b) It is applied prospectively from the reclassification date.

→ Reclassification of Amortised cost financial asset.

ci) If it is reclassified into FVTPL then it will now be stated at its fair value and the difference goes to P&L.

(ii) If it is reclassified into FVOCI then it will now be stated as its fair value and difference goes to P&L.

→ Reclassification of FVTPL asset

(i) If it is reclassified into amortised cost then its fair value will become the carrying amount.

(ii) If it is reclassified into FVOCI then its fair value will become the carrying amount (it will continue to be same).

→ Reclassification of FVOCI asset:-

(i) If it is reclassified into FVTPL then it will continue at fair value however earlier recognised balance of OCI shall be shifted to P&L.

(ii) If it is ^{classified} ~~reclassified~~ into amortised cost then OCI balance will be merged with existing fair value and the revised amount will become amortised cost.