FINANCIAL INSTRUMENTS (20-25 marks)

- **Ind AS 32** → Presentation of Financial Instruments → Core theory (Def)
- **Ind AS 109** → Recognition & Measurements
- **Ind AS 107** → Disclosures → Not so imp from exam point of view.

Ind AS 32

① **Financial Instrument** → is a Contract which is

- Financial Asset for One Entity (Holder)
- Financial liability (or) Equity for another entity. (Issuer)

② **Financial Asset** → Any asset which is

- ① Cash & Bank balance
- ② Equity Instrument of another Entity
- ③ Contractual right to receive Cash (Not legal (or) Statutory right.)
  - Eg Sale of goods
  - Drs
  - B/R
  - Purchased Deb
  - Inv in pref shares
  - loan issued
- ④ Contractual right to receive Equity instruments of other Entity
  - Eg Inv in Convertible Pref Shares / Deb of any Entity.
- ⑤ Contractual right to receive any other F.A
- ⑥ Derivative Contracts i.e Contract to xchange F.A (or) F.L with another Entity that are potentially fav to Entity.

Examples

P	FA (or) not	Bcoz of
Cash & Bank Balance	FA	(1)
Trade receivables	FA	(3)
Inventory	No	–
PPE	No	–
loans & Advances given	FA	(3)
Inv in E Shares of Relevance	FA	(2)
Inv in bonds	FA	(3)
Inv in Convertible bonds → Int (cash)	FA	(3)
Inv in Convertible bonds → Principal (E Shares)	FA	(4)
Inv in pref Shares → Divd (cash)	FA	(3)
Inv in pref Shares → Principal (cash)		
Gold	No	–
Inv in Gold bonds → Int (cash)	FA	(3)
Inv in Gold bonds → Principal (cash)		
Prepaid expense (Right to receive goods / Service)	No	–
Prepaid expense (Service refused) → Refundable	FA	(3)
Int receivable	FA	(3)
Sec deposit given (refundable)	FA	(3)
B/R	FA	(3)
Trade receivable (Promises to give B/R)	FA	(5)
Income tax refund (Statutory Not Contractual)	No	–
Inv in Sub / J.V / Associate	Not in Scope (Ind AS 110, 111, 28)	

③ Financial liability → is any liability that is

① Contractual obligation to pay cash

② Contractual obligation to deliver other F.A

③ Contract to deliver own Equity instrument in variable no:

④ Derivative Contracts i.e Contract to xchange F.A (or) F.L with another Entity that are potentially unfav to Entity.

Eg Purchase of goods (crs)
Trade payab
loans
Redeemable Deb / Pref Shares
B/p

Int ③

S. No.	Particulars	Whether FL or not	Remarks
1	Loans payable or bank loan	FL	• Contractual obligation to pay cash.
2	Trade and other payables	FL	• Contractual obligation to pay cash
3	Bills payable / acceptance	FL	• Contractual obligation to pay cash.
4	Deposits received	FL	• Contractual obligation to pay cash.
5	Mandatory redeemable preferences shares	FL	Contractual obligation to pay cash.
6	Financial guarantee given (Also see the scope section to understand when financial guarantee contract can be regarded as insurance contract)	FL	• Contractual obligation to pay cash, due to the occurrence of certain events.

7. O/s Salary — FL — ①

8. Advance Income — No — —
(like liability)
↓
I have obligation to give you Service

9. Advance Income — FL — ①
(Contract cancelled)
↓
So refund

10. Deb issued → Int (Cash) — FL — ①
→ Principal (Cash)

11. Issue of own E. Shares → Equity — –

12. Convertible deb | Pref Shares
↓
Principal — Equity — –
(own E Shares)

* Your own Company E Shares is not FA/FL, it is Equity

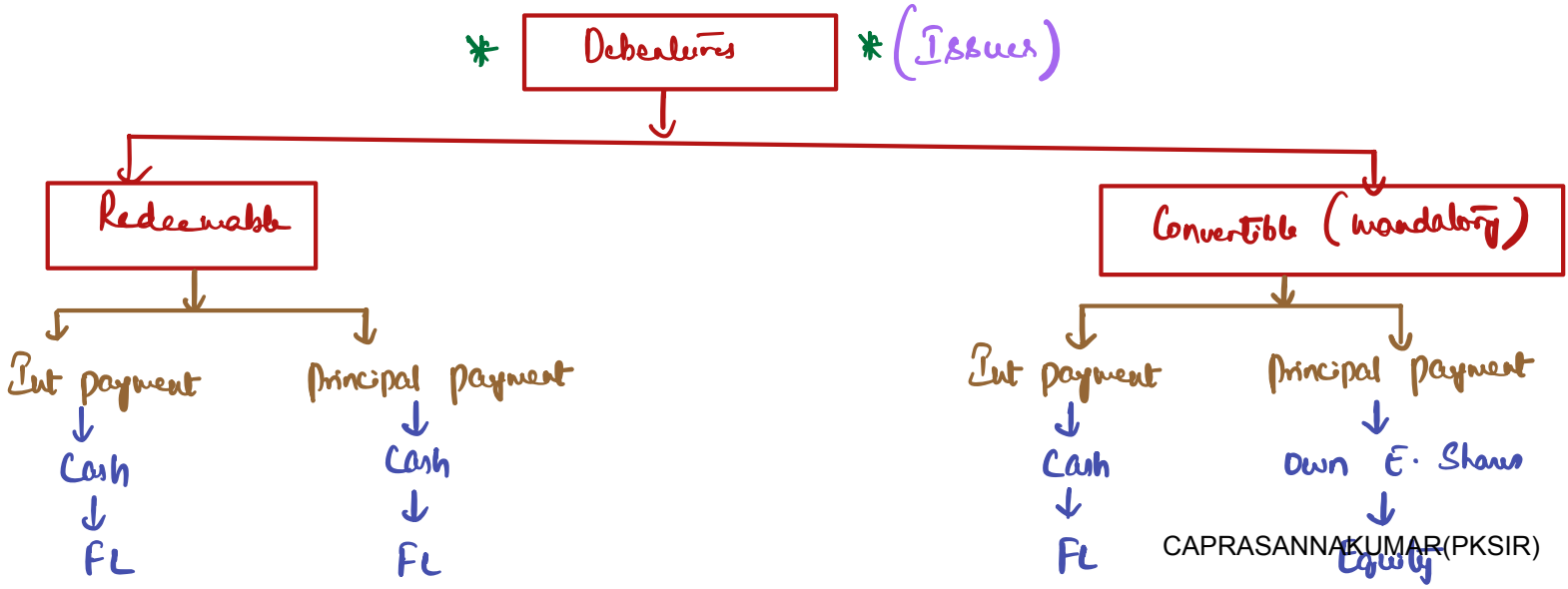
13. Normal Pref Shares / Deb
→ Divd/Int — FL — ①
→ Principal

i.e PSC can be FL (or) Equity depends on Convertible / not
Substance over form → Same logic applies for Debentures.

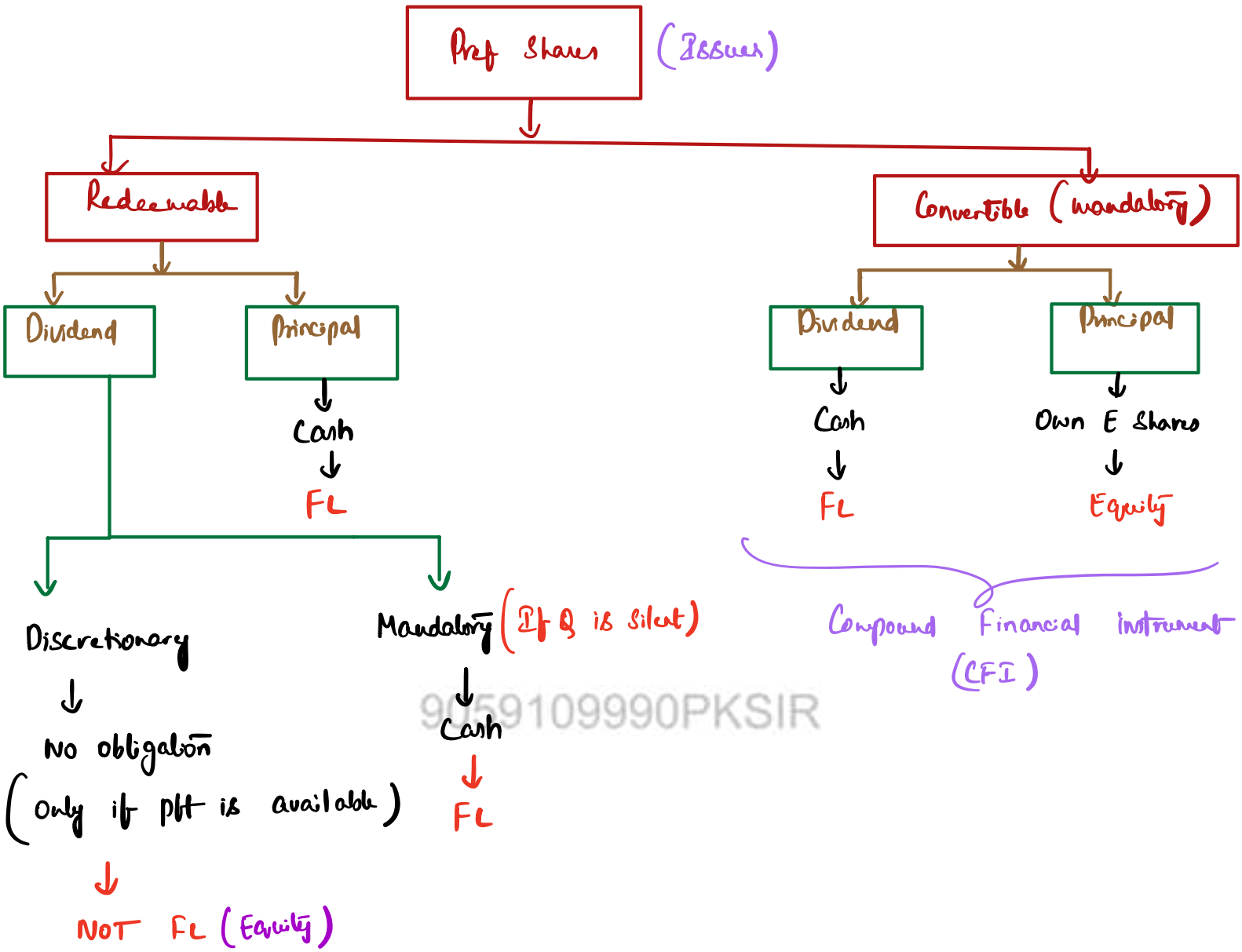
14. Trade payable (I will give Trade receivable) — FL — ②

15. Income tax payable (Not in scope) — NO — –

16. Prov for Bad debt (Not in scope) — Ind AS 37



(CFI) Compound Financial Instrument



Pk Sirs back on Ind AS 32, 109

This slot is not about what usually happen, its about what can happen

④ Equity (or) Equity Instrument

Any Contract that evidences residual interest in Net Assets of the Entity.

Contract to issue Issuer's own Equity Instruments in Fixed No: & No Contractual Obligation

Explanation by Pk sir

* It means a financial Instrument that gives the holder Ownership rights in Entity & does not Create any Contractual Obligation on the part of the issuer to deliver Cash (or) other financial asset.

↓ Key Characteristics

No obligation to deliver Cash (or) other FA (or) exchange FA (or) FL under potentially unfavourable conditions

Represents ownership interest like Shares

Returns to holders (like dividends) are discretionary & not Contractual.

* Now Suppose a Company Pk ltd issues Redeemable preference shares after 5 yrs with fixed dividend, these may be classified as FL (Not Equity) bcoz The Company has a Contractual obligation to repay (redeem) and pay dividends.

* Irredeemable pref Shares with discretionary dividend → Equity Instrument

* Deb with life of 5 yrs which are Convertible in to Equity Shares @ end of 5th year.

? { Fixed → Equity (Issuer)
Variable → FL (Issuer)

Eg Structured Convertible bond with anti dilution clause.

Pk ltd issues Convertible bond with following terms.

① Bond holder pays ₹ 100000 to Purchase the bond

② Convertible to 1000 E Shares of Pk ltd after 3 yrs

(So far good, fixed for fixed)

But there is anti dilution Clause. i.e

" If Pk ltd issues additional Shares before Conversion at a price lower than 100/share, the no: of Conversion Shares will inc

Proportionately to protect the bondholders value".

This clause protects the investor from dilution if the Company issues new shares cheaply.

Condition	Assessment
Fixed Cash recd →	Yes, 100000
Fixed NO: of Shares to be issued →	NO, Due to anti dilution clause
Nature of Δ in Share NO:s →	Variable, Can inc based on future events (new shares issuance)
Result →	Fails Fixed to Fixed test
Classification →	FL (or embedded derivative) NOT Equity

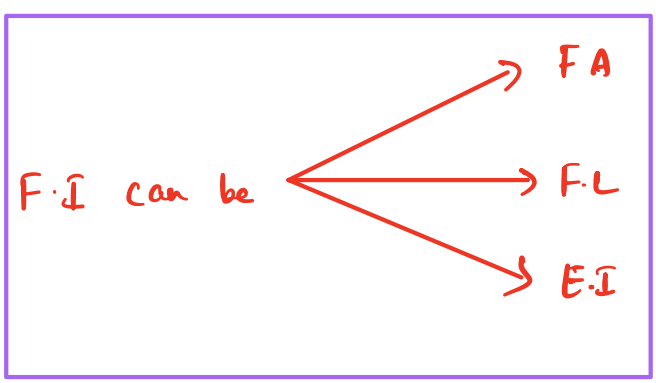
S. No.	Particulars	Whether FA or not	Remarks
1	Investment in bonds debentures	FA	• Contractual right to receive cash.
2	Loans and receivables	FA	• Contractual right to receive cash.
3	Deposits given	FA	• Contractual right to receive cash.
4	Trade & other receivables	FA	• Contractual right to receive cash.
5	Cash and cash equivalents	FA	• Specifically covered in the definition.
6	Bank balance	FA	• Contractual right to receive cash.

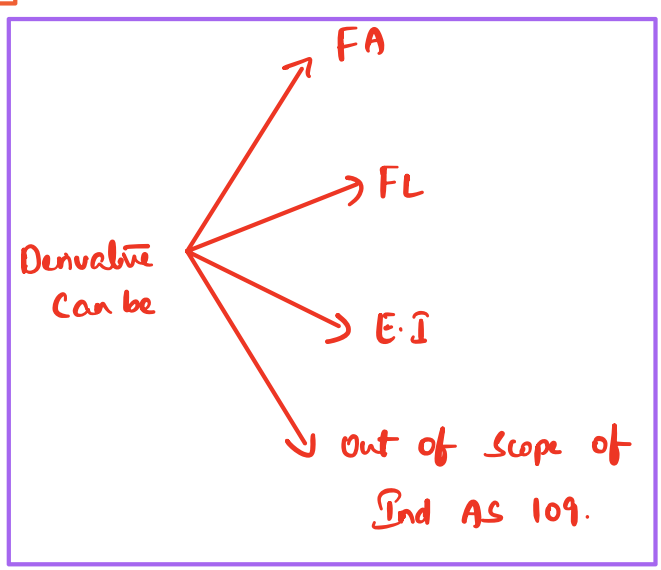
S. No.	Particulars	Whether FA or not	Remarks
7	Investments in equity shares	FA	• Equity instrument of another entity.
8	Perpetual debt instruments Eg. perpetual bonds, debentures and capital notes.	FA	• Such instruments provide the contractual right to receive interest for indefinite future or a right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

Summary of the transaction outside the scope Financial Instruments:

Sl. No.	Particulars	Covered under Ind AS 109	Covered under Ind AS 32	Under Ind AS 107	Applicable Ind AS
1	Interest in subsidiaries (At Costs)	No	No	No	Ind AS 27
2	Interests in associates (At Costs)	No	No	No	Ind AS 27
3	Interest in joint ventures (At Costs)	No	No	No	Ind AS 27
4	Rights and obligations under leases	No	No	Yes	Ind AS 116
5	Employers' rights and obligations under employee benefit plans	No	No	No	Ind AS 19
6	Rights and obligations under an insurance contract	No	No	No	***Ind AS 117***
7	Forward contract arising within the scope of business combination	No	No	Yes	Ind AS 107
8	Loan commitment other than covered under Ind AS 109 and Ind AS 32	No	No	Yes	Ind AS 107
9	Shared based payments	No	No	No	Ind AS 102
10	Reimbursement right in respect of provision	No	No	Yes	Ind AS 37 and Ind AS 107
11	Rights and obligations under revenue for contracts with customers	No	No	Yes	Ind AS 115 and Ind AS 107

DERIVATIVES





* Derivative Def

3 conditions

- Value changes due to an underlying asset
- No (or) little Initial Net Investment
- Future Settlement

* Derivative Contracts can be entered in either
  - Exchange market
    - Stock exchange, T&C decided by exchange
  - Over the Counter
    - Private Contracts & parties decide terms & conditions of Contract

Eg Future Contract (exchange), Forward Contract (with bankers), Options Contract

Same

Interest rate swap, Currency swap

Forward Contract (Basic Idea)

- Contract entered today
- To buy / sell an asset on future date
- @ price pre-determined today i.e Forward rate

* In forward Contract, Buyer is obligated to buy and Seller is obliged to sell at agreed price
* Forward Contract is OTC Contract. (over the Counter)

I. FORWARD CONTRACT / FUTURE CONTRACTS (Legalised Betting Contracts)

a) These are contracts entered to buy / sell the underlying asset in future @ pre-determined rate.

b) A forward contract is an over the counter contract, whereas Futures contract is exchange traded contract.

c) The predetermined rate is called as Forward rate (or) Future's rate.

d) Party who agreed to buy the underlying asset is said to have a LONG position. This party will gain, if MP of underlying asset increases.

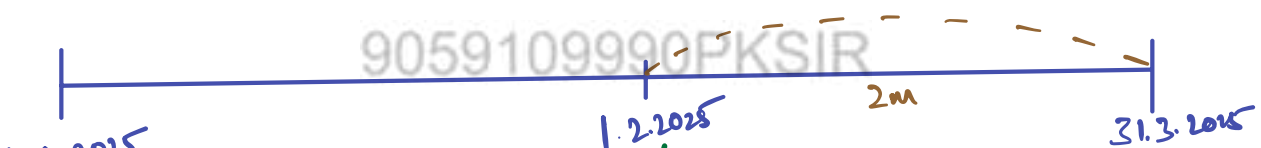
e) Party who agreed to sell the underlying asset is said to have a short position. This party will gain, if MP of underlying asset decreases.

f) The value of Forward contract / Futures contract fluctuates on the basis of fluctuation in market price of underlying asset.

g) The parties in the contract can close the contract before the maturity date by Entering into an opposite contract.

Original position	Position to be taken now for closing / squaring up.
LONG POSITION	Now take short position for remaining maturity period
SHORT POSITION	Now take long position for remaining maturity period.

Eg Cancellation of Forward Contract (FC)



ABC cancels the Contract & Enters opposite position for balance 2M

ABC : To sell 1000$ @ 87 on 31.3.25

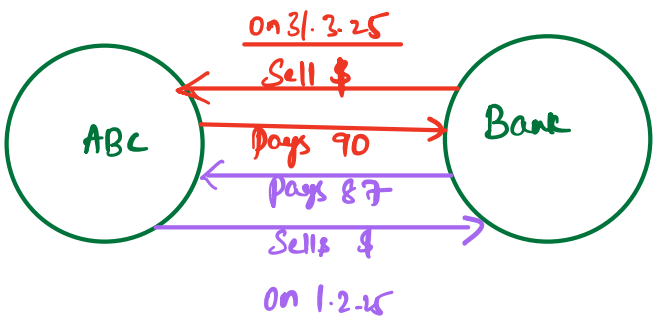
Bank : Buy 1000$ @ 87 on 31.3.25

ABC Hdg in a forward Contract

3M Fwd

ABC → To Buy 1000 $ @ 90 on 31.3.25

Bank → Sell 1000 $ @ 90 on 31.3.25



$$\text{Gain / loss to ABC} = (\text{Sell rate} - \text{Buy rate}) \times \text{Qty}$$

$$= (87 - 90) \times 1000\$$$

$$= 3000 \text{ loss}$$

Gain / loss to Bank = (90 − 87) × 1000 ₹ = 3000 gain

∴ A ltd pays ₹3000 to Bank.

Original position	Squaring up (or) Cancellation Contract
① long	Take Short position
② Short	Take long position.

F.C can be settled in two ways

Case ①

Settlement by delivery

Net Settlement in Cash

1.1.25

F.C agreed to Sell @ 1000 →

31.3.25

MP = 9500

↓

You buy @ 9500 & Sell @ 1000

31.3.25

Gain / loss = 500

Just receive 500 cash

Future Contract

Future Contract is Standardised forward Contract traded at Stock exchange with margin requirement and regulations. No Counter party default & risk.

There are 2 parties in future Contract

- Future Buyer → Contract to buy → long position
- Future Seller → Contract to sell → Short position

↓ expects the price to rise

↓ expects the price to fall.

Forward (vs) Future Contract

Forward	Future
① OTC	① Exchange traded
② Customised	② Standardised (lots)
③ No margin requirement	③ Margin requirement
④ Counter party default risk	④ No Counter party default risk
⑤ Settlement only on Maturity	⑤ Daily Settlement in Margin balance (Mark to Market Settlement)
⑥ less liquidity	⑥ High liquidity
⑦ less regulations	⑦ More regulations
⑧ Generally used by hedgers	⑧ Generally used by Speculators

Eg for Futures :-

Reliance Shares

Cash market

2000 (Today) → Pk wants to exit → 15.2.25

To square up take Short position for 1.5 months @ 2400

Maturity date On 31.3.25 → MP = 2500

Futures market

(Pk) 3 mn futures 31.3.25

2200 (Future price)

You took long position

Gain = 2500 − 2200

= 300

Options

Example ①

CALL OPTION → right to buy

Pk ⟵ ₹5 (Premium amount) ⟶ Ak

CMP = 100

{ option to buy after 3 months at 110 }

↓

Exercise price (or) Strike price

Pk: Option buyer (or) Holder

Ak: Option Seller (or) Writer

After 3 months = MP = 130, Pk will exercise the option

Suppose MP = 100, Pk will lapse the option

Pk Profit

⇒ (130 − 110)

⇒ 20 − 5

⇒ 15

* Right but not Obligation
* Unlimited profit, but loss limited to premium
* Premium ← Advance
* Volatility ↑

Ak loss

⇒ 130 − 110

⇒ 20 − 5

= 15

* Obligation but not right
* Profit limited to premium amount, but loss is unlimited
* Margin ← Advance (Should be deposited)
* Volatility ↓

Example ②

Right to Sell.

PUT OPTION

Pk — ₹ 5 premium amt (CMP = 115) → Ak

Right to Sell Share at 110 after 3 months

Pk: Option holder

Ak: Option writer

After 3 months, MP = 90, Pk will exercise the option

If MP = 120, Pk will lapse the option.

Pk profit

⇒ 110 − 90 − 5

⇒ 15

Ak loss

110 − 90 − 5

⇒ 15

Settlement Choices

- **Net Cash Settlement** → Ak pays Pk 15
- **Delivery of underlying Asset** (Physical delivery) → You take delivery of share instead of just Cash Settlement.

* Over the Counter market means parties know each other.

SUMMARY

	CALL	PUT
Holder (Buyer)	Right to buy	Right to sell
Writer (Seller)	Obligation to sell	Obligation to buy

Decision of Settlement date

	MP > X	MP < X
Call option	Exercised by holder	lapsed by holder
Put option	lapsed by holder	Exercised by holder

Eg Call option, Reliance Share, X = 1500, 3m → 1.1.25

On 3.2.25 → MP = 1700 → So ITM option
(option likely to be exercised)

On 15.2.25 → MP = 1400 → So option is OTM
(not likely to be exercised)

On 20.2.25 → MP = 1500 → So option is ATM

* LETS GET BACK TO IND AS 32 *

CONTRACTS ENTERED ON NON-FINANCIAL ASSETS TO BE EXECUTED IN FUTURE (NFA)

(goods, Commodities) Other than financial assets (land, Gold etc)

Eg ABC Ltd agreed to buy 100 tonnes of Cocoa beans from XYZ Ltd in 12m @ 1000 per tonne.

Case ① ABC Ltd entered in to the Contract to buy Cocoa beans to meet his own Consumption requirement in business & this Contract will be closed by Physical delivery of Cocoa beans in 12m

↓

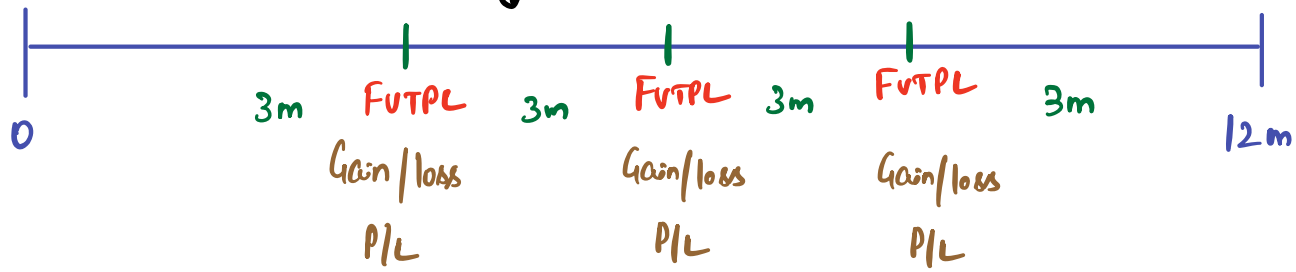
No Speculative intent So out of scope of Ind AS 109.

This is Executory Contract means no accounting done initially & for 12 m period, accounting will be done only on delivery. This exemption from Ind AS 109 is called Own - use exemption

Case 2 ABC Ltd entered in to the Contract to buy Cocoa beans to meet his own Speculation needs & this Contract will be closed by Net Cash Settlement in 12m

↓

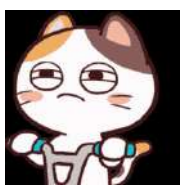
Covered in Ind AS 109.



Case 3 The Contract has to be closed only by way of physical delivery. But ABC Ltd is not in Cocoa beans business & Cocoa beans is highly marketable.

↓

Ind AS 109 says → I caught you



Case 4 ABC Ltd has the option of taking physical delivery of Cocoa beans (or) Doing net cash Settlement. Both options are available, now what?

↓

We need to Check past history of Settlements of ABC Ltd in Similar Contracts & Check Current intention of ABC Ltd. If it is established that objective of

ABC Ltd is to get Physical delivery to meet its own Consumption, then it is out of scope of Ind AS 109. even if small insignificant Cash Settlements may have been done in the past.

* Suppose if Intention Changes i.e from physical delivery to Cash Settlement in the middle of the Contract Period, then Ind AS 109 will apply from the moment intention Changes.

Case 5 **Readily Convertible to Cash (Market Tradability)**

Contract is readily Convertible to Cash i.e actively traded on market (or) exchange, regardless of intent to Settle Physically. So in this Case even if Physical delivery is possible, Market tradability means it can be Settled net & hence FI (Ind AS 109)

Case 6 **Option Contracts on Non-financial items**

ABC Ltd buys call option to buy Copper at a fixed price in 2m. ABC plans to Settle in cash to gain from favourable price movements.

↓

It is not own use, so the option is derivative & Covered by Ind AS 109.

Case 7 — Embedded Derivatives in Contracts for NF Assets

Bangladesh enters in to Contract with India Adani to buy electricity in $ & includes a clause where the price adjusts based on foreign exchange rate ($-₹) although delivery in Bangla. So the Fx Component is an embedded derivative which must be accounted as per Ind AS 109.

Case 8 — Partial physical delivery + Net Settlement for balance

A Contract to deliver 1000 Tonnes of Coal allows the buyer to take 500 tonnes physically & settle rest in Cash. So unless historically used only for full delivery, this Contract is likely not "own-use".

Case 9 — Designation of Contract at Inception as "Held for Trading".

i.e Entity designates the Contract at Inception as held for trading regardless of delivery intention.

* A power generator company enters in to a Contract to buy natural gas, but marks it as held for trading in its books. So it is derivative and Ind AS 109 applies.

Case 10 — Contract settled by delivery but has Derivative pricing

A Steel Company signs a Contract to buy iron ore where the price is linked to LME (London Metal exchange) futures. So Contract should be bifurcated in to host Contract under normal accounting & Embedded derivative as per Ind AS 109.

SUMMARY

TRICKY SCENARIO	FI (or) NOT	REASON
Net Settlement allowed	Yes	Fails "Own-use"
Held for Trading	Yes	Speculative
Readily marketable	Yes	Can be Net Settled
option with no delivery intent	Yes	Speculative
Embedded Derivatives	Partially	Derivative part separated
Partial delivery partial cash	Likely yes	Check past history
Marked held for Trading	Yes	Declared trading intent
Index linked pricing	Partially	Embedded derivative may exist.

CONTRACTS TO BE SETTLED BY ENTITY S OWN EQUITY INSTRUMENTS

* Now when a Contract is Settled in the Entitys Own Equity instrument, the key Q is Should it be classified as Equity (or) FL ?

Two broad Segments

Where Entity has to deliver its own Equity

(i) CFI

(ii) Fixed to Fixed Test

(iii) Contingent Settlement provisions

Where Entity receives its own Equity

(i) Treasury Shares

(ii) Written put option on own Equity

(iii) Buyback.

Eg ↓ Convertible Debt
SBP
Written options
Forward Contract to issue Equity

Key Q ⇒ Is delivery of Equity Equivalent to an Equity Instrument (Q) is it liability / Derivative ?

Fixed to Fixed Test

→ This test Checks whether a derivative (Or) Contract Settled in an Entity's own Equity instrument Should be classified as Equity (Or) liability ?

Def :- A Contract is Classified as an Equity instrument only if it will be Settled by delivering a fixed no of Entity's own Equity Instruments in exchange for a fixed amount of Cash | another F.A.

Pk Sir's hack ⇒ Is the deal Simply : I give you 'x' shares, You give me ₹ 'y' no matter what!

YES → Equity
NO → Anything Changes based on future Conditions then its F.L (Or) DFL

logic behind test :- Equity means ownership, it Should not Create repayment (Or) delivery obligation.

If the Company might need to pay Cash (Or) Deliver more (Or) fewer shares based on future events, that not true ownership, its like a financial debt (Or) derivative obligation.

Ind AS 32 says → If both the no: of Shares & price are fixed, then only call it Equity & there's no way it turns in to Cash deal.

Consideration (Cash / Another FA)	No: of Shares	
Fixed	Fixed	Equity
Variable	Fixed	F.L
Variable	Variable	F.L
Fixed	Variable	F.L

Examples

Case (1) Company 'A' issues a Contract where Investor prepays 100000 today (or) raised money through Debenture for ₹ 100000

After 6m, Company will issue exactly 1000 Shares

Fixed price = 100000 (already paid)

Fixed Shares = 1000

Is FTF test passed → (Yes)

No future CFlows, No variability, just a delayed Share issue

This mirrors Share Capital → So its Equity

Now Suppose after 6m, M.P of Company 'A' Share is

Case	M.P	Value of 1000 Shares
1	120	120000
2	110	110000
3	100	100000
4	90	90000

So the holder of the Shares takes risk just like Equity Share holder of Company 'A' by getting himself exposed to 1000 Shares Variable returns. So in issuers books i.e Company A's books it is Classified as Equity.

Case 2 Investor agrees to pay 100000 in 6m (or) raised 100000 worth debentures. On Settlement Company will issue Shares equal to the then Current market value of 100000.

Fixed Cash → ₹ 100000

Variable Shares → Depends on future price

Is FTF test passed → (NO)

* Company must adjust no: of Shares to match value
* This is no longer Equity → PK Sir says its like paying debt using Shares as Currency.
* The Company has to Satisfy a financial obligation → FL

Case 3 Company 'PK' ltd raised 1000000 through Deb which will be Converted in to 1000 E. Shares after 3 yrs. However it Contains **Anti dilution Clause** i.e If Company issues Bonus Shares / Shares split, then Shares promised to Debenture holders Shall be increased Proportionately.

Q. **F To F Test passed** → Inc in no: of Shares is to protect the rights of instrument holders but not to protect their returns. They preserve original ownership percentage.

Anti dilution Clause adjusts for

→ Stock splits, Bonus shares, Reverse splits, Capital Consolidation
FTF test passed (Equity)

→ New shares issue @ lower price in future
FTF test failed (DFL)
This is also called Future down round pricing.

DFL = Derivative Financial liability

Case 4 PK ltd writes a call option towards AK ltd on its own Shares 1000 Nos in 3m.

Case ① (fixed)
X = ₹ 40 / Share (fixed)
Derivative is Equity

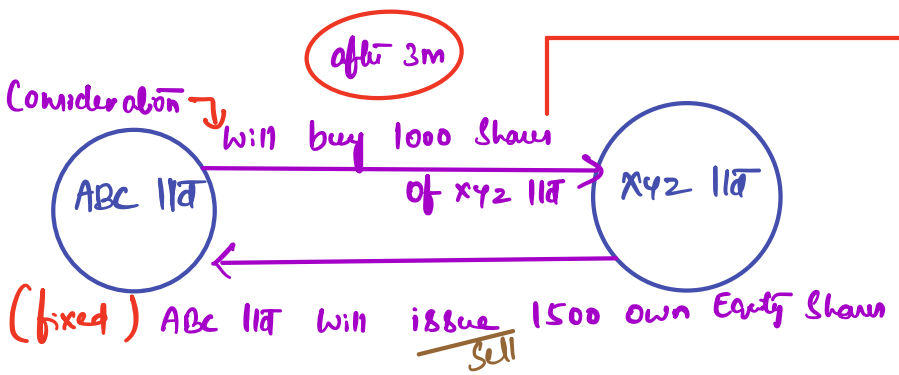
Case ② (Variable)

If M.P of Share	X price is
> 50	40
≤ 50	30

Derivative is FL

Note There is no direct accounting for Derivative, first classify them as Equity (or) F.A (or) FL & then do accounting.

Case 5



No: of shares is fixed, but value of Consideration is not fixed
↓
So FTF test failed → F.L

Case 6 ABC ltd raises 1000000 through 10000 deb @ 100 each that are Convertible in to Equity Shares. i.e

Consideration ↓ fixed

This is also fixed, they are Variable to time not M.Price

1:2 @ end of Yr ②
1:3 @ end of Yr ③
1:4 @ end of Yr ④

(Not Contingent) Time is Certain ↓ & not like M.P which is uncertain

↓

So Equity as FTF test passed.

* Deb holders may exercise conversion @ the end of 2nd yr (or) 3rd (or) 4th, but No: of shares with respect to time is already fixed.

Case 7 Conversion ratio depending on Conditions

(A) Pk Ltd issued (writes) call option on its own E. Shares @ X price = 50

① 100 Shares if Profit Yr① > 10 cr
② 200 Shares if Profit Yr② > 30 cr
③ 300 Shares if Profit Yr③ > 40 cr

} Conditions are independent & not linked to one another.

↓

So basically there are 3 Separate Contracts

↓

So Each Contract has fixed No: of Shares

↓

So FTF test passed → Equity.

(B) Pk Ltd issued (writes) call option on its own E. Shares @ X price = 50

① 100 Shares if Profit Yr① > 10 cr
② 200 Shares if Profit Yr① > 30 cr
③ 300 Shares if Profit Yr① > 40 cr

} Conditions are dependent & linked to one another.

↓

So basically in Substance 1 Contract

↓

So 1 Contract has Variable No: of Shares

↓

So FTF test failed → F.L.

Note All above examples are Question from ICAI Study material.

* Pk or hade } FS Consideration → Value Should be fixed not number
FS Shares → No: Should be fixed not value *

COMPOUND FINANCIAL INSTRUMENTS (CFI)

* Single Instrument that Contains both * (HYBRID)

- Liability Component
- Equity Component

Eg ESOPs with Cash alternative → E.C

TO SBP (R)
TO SBP (L)

} Remember !

Case ① ABC Ltd issued Redeemable pref Shares with discretionary dividend

Liability (cash) — Equity

(as it is obligation for ABC) (No obligation to pay)

So It is CFI

Cumulative (&) Non-Cumulative Pref Shares	→ Dividend is discretionary
Pref Shares with Mandatory divd Clause	→ Dividend is mandatory.

Case 2 Irredeemable deb issued (Perpetual bonds) with mandatory interest

- Principal amount → No need to pay → Equity
- Interest → Obligation to pay → FL

→ C.F.I

Case 3

Compulsory Convertible pref Shares @ 1:3 with mandatory dividend.

- Dividend → obligation → F.L
- Convertible (Principal portion) → Equity Shares (No: is fixed) → Equity
  - FTF test passed

→ CFI

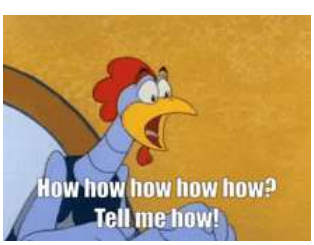
Case 4

Debenture (convertible) with mandatory interest.

Conversion at the option of Holder | Investor

- Int → Cash → FL
- Principal (Issuer at his own will Cannot avoid paying cash) → FL (obligation to pay cash)

→ This is also CFI (***)



See below

Conversion at the option of Issuer

- Int → Cash (Issuer at his own will Can avoid paying Cash) → Equity
- Principal → FL

→ CFI

No obligation to pay cash although eventually it may pay cash.

* Rarely, if issue of E Shares is not possible, then only option is to pay cash, then it may be appropriate to clarify as F.L.

* SAME LOGIC CAN BE APPLIED FOR CONVERTIBLE PREF SHARES *

Logic → Inv wants 18%. →

Company PK IIT issued these deb on same day

- Red deb @ 18% for 10 yrs
- Red deb @ 15% Compulsorily Convertible to 10000 E Shares @ Yr 10
- Red deb @ 13% Convertible in to 10000 Shares @ the option of Investor.

Practical Example = See Illustration 3

* Bcoz of Equity Share option (Convertible option), int got reduced from 18% to 15%.

∴ bcoz of option in the hands of holder (there is no free lunch) Int got further reduced from 15% to 13%. So this is CFI.

CONTINGENT SETTLEMENT PROVISIONS (CSP)

Def A FI may Contain a provision that requires the issuer to deliver Cash (or) another FA (i.e Settle the instrument) Only on the Occurance (or) Non-occurance of a future uncertain event i.e Contingency that is beyond the Control of both the issuer & the holder.

→ NOW we need to find out whether this CSP is Liability (or) Equity!

Now ask yourself Is the issuer obligated to Settle in Cash (or) F.A ?

If yes, even if only under certain conditions (i.e contingent) still it F.L

If settlement is only optional (or) in the issuers own Equity (fixed no: of shares) then it may be Equity.

Standards logic ① ⇒ Substance over form

Even if instrument appears to be Equity, if in substance the issuer might have to settle in cash, its a liability.

Standards logic ② ⇒ Protecting Investors

CSP is not about what usually happens, its about what can happen. Even if there is a slight hint (of) possibility of cash outflow outside Companys Control, it is classified as FL.

Case 5

X Ltd has issued debentured for 5 years on the following terms

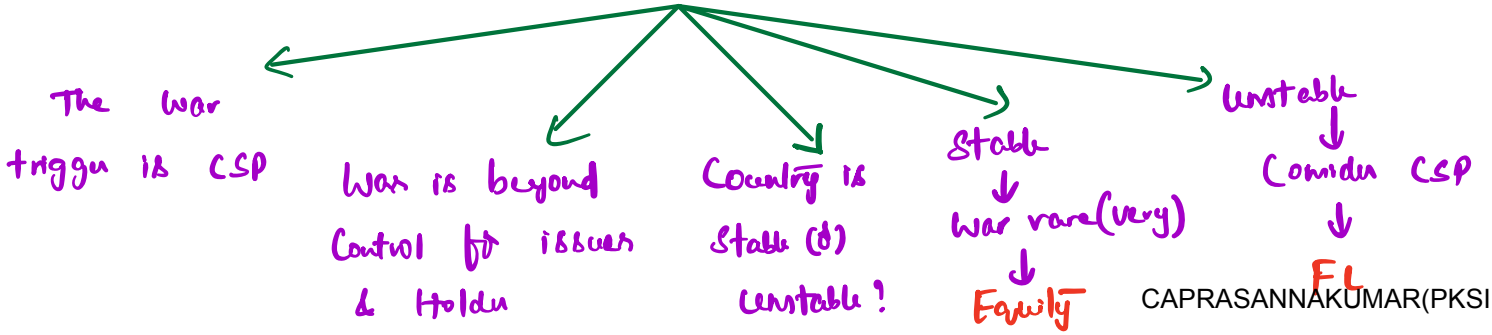
Case (i): Debentures are converted into Equity shares in the ratio of 10:1, if the Fair Market value of share is > 100, otherwise it will be redeemed in cash. This will be classified as FL. Any expectation about future market price of the share is irrelevant for the classification today. F.L

Case (ii): The debentures are converted into 10 equity shares if market price > Rs 100, otherwise it will be converted into 15 shares. Even though the settlement will happen only by issue of shares, the debentures cannot be classified as Equity since the no of equity shares is not fixed. F.L

Case (iii): The debentures will be converted into equity shares @ 5:1 only when the MPS > Rs 100.The debenture issued will be classified as Equity Instrument since there is no possibility of making any cash payment. E.I

Case 6

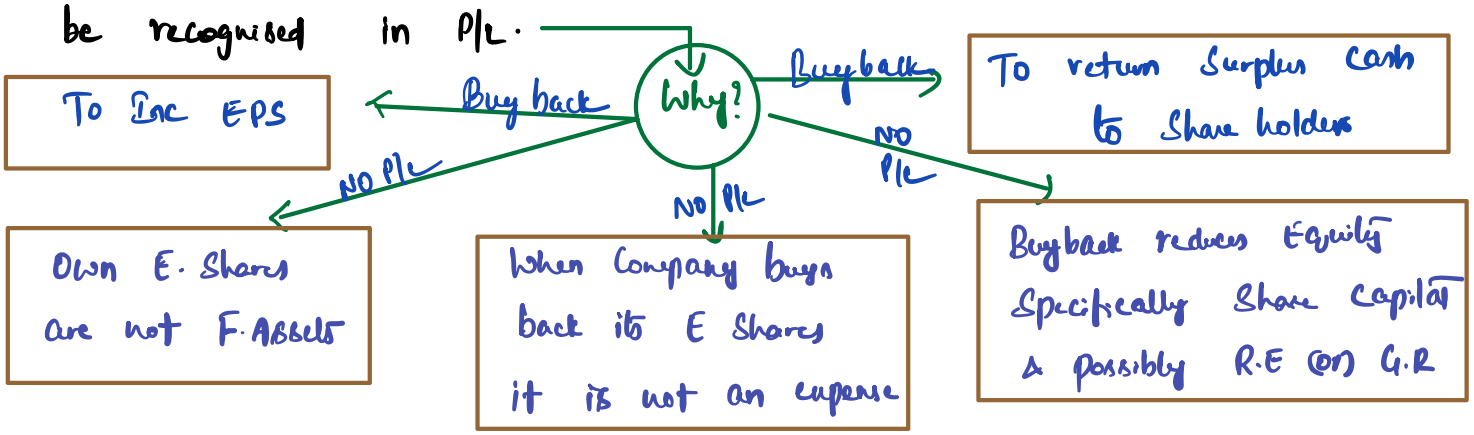
Pref shares redeemable in E shares but if war breaks out will be settled in cash.



Buy Back

* Buy back (repurchase) is when a Company buys its own Equity Shares from Shareholders. These Shares are usually Cancelled, reducing Outstanding Share Capital.

* Ind AS 32 says when an entity purchases its own E. instruments, those instruments are deducted from Equity. No gain/loss shall be recognised in P/L.



(Face value) Esc Dr 10
(R.E, G.R, See prem) Other Equity Dr → Premium on buyback 5
To Bank A/c 15

* Ind AS 32 view point → liability (or) Equity?

Does Company have an obligation to deliver cash / F.A to Share holders.

- Yes → F.L
- No & its entirely at Company's discretion → Its E.I

* If Company has a Contractual obligation to buy back its own shares at a fixed amt, then that obligation is F.L even though Shares are usually Equity.

Case 1 — Company Sold (Written) put option on own E shares

Face value = 50 , X = 65 , Option premium = 5 , Period : 6m

Ind AS 32 Says → If an Entity has an obligation to buy its own E. instruments for cash (or) another F.A , this gives rise to F.L . Why? Bcoz Company has to deliver cash & that F.L .

Bcoz W.K.T → Equity = No Contractual Obligation to deliver Cash

F.L = There is (& Could be) an obligation to deliver cash

At Start of period (Day 1)

Bank A/c Dr 5

To R.E 5

Recognise F.L (Day 1)

Retained Earnings Dr 59

To F.L(Put) 59 (PV of future liability) $\left(\frac{65}{1.10}\right)$

Recognising FL @ PV applying ACM.

↓

Although Shares not yet bought, the Company has potential cash obligation

↓

logic behind entry ⇒ Fair value of Obligation is recognised as liability with corresponding reduction in Equity.

At the end of period (After 6m)

This Effectively you debit R.E only ← Int Cost Dr 6

To F.L 6 (59×10%) (unwinding of discount)

Holder exercises

① F.L Dr 65

To Bank 65

↓

Now Cancel E Shares you purchased just now

↓

ESC Dr 50

To R.E 50

↓ Why

If you do normal Buyback what will be your entry

ESC Dr 50

R.E Dr 10

To Bank 60

↓

But here you have debited R.E by −5 + 59 + 6 ⇒ 60, so Credit 50 to get R.E to '10'

Holder lapses the put option

FL is no more required

↓

FL Dr 65

To RE 65

TREASURY SHARES (Not permitted in India)

* Company's own Equity Shares that it has re-acquired but not yet cancelled i.e purchasing our own E.Shares & holding them as Investment. You cannot show this as Investment in BS & can't call it as F.A

↓

Accounting is done by adjusting R.E

↓

R.E	XXX	
To Bank A/c		XXX

(Purchase of own shares)

↓

Bank Dr	XXX	
To R.E		XXX

(Sale of shares subsequently)

TRANSACTION COSTS

* Incremental Costs that are directly attributable to the acquisition, issue (or) disposal of F.A (or) F.L

* When you buy, issue (or) sell a F.I → Brokerage fee, legal fee, Stamp duty, Transaction taxes, underwriting commissions

key words

Incremental costs → They would not have been incurred if transaction has not taken place.

Directly attributable → They relate only to that specific transaction, not general OH.

Transaction Costs

- **Relating to F.A & F.L** → Accounting treatment covered in Ind AS 109 & depends on method of accounting (ACM, FVTPL, FVTOCI)
- **Relating to E. Instruments** → Directly adjusted in R.E i.e Other Equity.

Eg You issue Share & raise 1000000, paid 50000 as brokerage

Bank A/c Dr 950000
(RE) Equity Issue Costs Dr 50000
TO Equity 1000000

ACCOUNTING OF EQUITY INSTRUMENTS (E.I)

* Any Contract identified as E.I, once recorded
@ Initial Value will not be Subsequently re-measured.

(ESOP's → SBP(R) → Fv on Grant date)

TREATMENT OF INTEREST & DIVIDENDS

① F.A → Int | Dividends are Income → Recognise in P/L
② F.L → Int | Dividends are Expense → Recognise in P/L

Student doubt: Pref dividend (Exception) → mandatory dividend → You may call it dividend but nature is interest so

③ E.I → Recognised directly in Equity (Debit to R.E / GR)

↓

Eg Ordinary Equity Shares → Dividend

Pref Shares with discretionary dividend → Dividend

Compulsorily Convertible Deb with (Exception) Discretionary Interest → Interest (Still)

(Any discretionary payments made from Instruments classified as F.L (Part) in CFI)

↓

Q) Why Pk Sir ?

a) Bcoz the Substance of payment is more like distribution of Profit rather than financing cost.

↓

Q) Then why the Instrument is classified as F.L ! (CFI)

↓

a) Bcoz due to some features like redemption obligation, it is classified as F.L

One rare exception → B.Cost with Interest for Q.A → Capitalise it.

If some other Standard is specifically saying something follow it ← Mean Ind AS 23

OFFSETTING OF F.A & F.L

(Just presentation, no accounting)

* In BIs any Asset & liability Cannot be presented on net basis unless any Ind As permits you to do so.

Eg Ind AS 37 → Provision can be presented net off reimbursement

Ind AS 20 → Govt Grants → Grant related expense & Govt Grant Can be presented net.

An entity shall offset a F.A & F.L only when both of the following Condition are met.

① legally enforceable right

② Intention to settle net

Real life example

* HDFC bank enters in to derivative Contracts (like Interest rate Swaps , Currency forwards) with other financial institutions say ICICI bank.
* These Contracts results in
  Receivables (If HDFC is In the money)
  Payables (If HDFC is OTM)
* Now suppose HDFC has receivable of 500 Cr from ICICI & payable of 450 Cr to ICICI
* Two banks has legally Enforceable master netting agreement (like ISDA)
* So Both Banks intend to Settle the net amount.

FOREIGN CURRENCY CONVERTIBLE BOND (FCCB)

* A bond issued in foreign Currency (USD, Euro) issued by an Indian Company to foreign investors.
* It pays interest like normal bond , It also gives the bond holder , the option to Convert the bond in to E. Shares of issuing Company at a later date , at a fixed price.

Eg Issued a Convertible deb in foreign Currency, FCCB (Fv = 1$)

Case ①

10th year Deb will be Converted to E Shares

1 E Share = 0.25 $ (Issue price of Share)

No: of Shares to be issued = Value of 1 deb / Value of 1 Share

= 1 $ / 0.25 $

= 4 Shares

FTF test passed

Case ②

10th year Deb will be Converted to E Shares @ ₹ 20 per Share

No: of Shares to be issued = 1$ x ? / ₹ 20 / Share

1$ = 80 → 1$ x 80 / 20 = 4 Shares

1$ = 100 → 1$ x 100 / 20 = 5 Shares

1$ = 60 → 1$ x 60 / 20 = 3 Shares

FTF test failed

CARVE OUT point ⇒ IAS 32 says it is F.L

But Ind AS 32 says it is Equity bcoz issue price is fixed.

PUTTABLE FINANCIAL INSTRUMENTS (PFI)

* PFI is a F.I that gives holder the right to put (redeem @ return) the instrument back to the issuer for cash (or) another F.A
* This generally make it a F.L bcoz the issuer has a contractual obligation to deliver cash / F.A
* However Ind AS 32 provides an exception, where certain puttable F.I can be classified as Equity despite having this repayment obligation.

logic → Why is this exception required ?

* Normally any F.I redeemable at the option of holder is a F.L
* But in certain cases, like MF, co-operative Societies (or) partnerships, the residual interest in the entity is often structured as puttable instruments.
* Bcoz these entities do not have traditional share capital
* Ownership interests are redeemable on demand, but they still represent residual interests in net assets.
* So to avoid misclassification of such ownership interest as liabilities, Ind AS 32 allows an exception.

Conditions for exception :-

Memory trick : P M I N C N (Pick me in College now)

- P — Pro-rata Share of net assets
- M — Most Sub Ordinated
- I — Identical terms for all holders
- N — No other Obligation to pay
- C — Cash flow depend on performance
- N — No other Instrument restricts returns.

What is PFI ? (Easy).

Example to understand PFI

* Imagine you invest money in a mutual fund. The fund gives you units & you can return these units anytime & get your money back based on NAV.
* The right to return the unit is called a Put option. thats why it is called puttable instrument.

Example to understand conditions

Lets say a MF issues 1000 units. Everyone can redeem their units anytime. But these units.

* Dont promise any fixed return.
* just give you a share of profits
* Everyone has same kind of unit
* Units are the last ones to get money if fund shuts down.

If all above Conditions are Satisfied → then redeemable units are Equity, not liability.

Another Eg

Preference Share with Put option

- Redeemable at holders option
- Provides fixed dividend
- Have priority over Equity holders on liquidation.

This do not qualify as Equity bcoz

- There is fixed return
- Not most Sub-ordinated class
- Hence it is F.L

SUMMARY

Puttable Financial Instrument as per Ind AS 32

A puttable financial instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset

Generally classified as a financial liability

Exception: Ind AS 32 allows classification as equity if all the following are met:

- Pro rata share of net assets in case of liquidation
- Most subordinated class of instruments
- All instruments in that class are identical
- No other contractual obligation to deliver cash or financial asset
- Cash flows based substantially on profits or change in recognized net assets
- No other instrument restricting or fixing return

Treated as equity

SHARE SWAP ARRANGEMENT

* A Share Swap is when two parties exchange Shares instead of Cash.

Eg Pk ltd acquires Sk ltd, Instead of paying money, Pk ltd gives its own E.Shares to Shareholders of Sk ltd

Ind AS 32 logic ⇒ Is it F.L (or) E.I ?

E.I if Shares issued by acquirer

1. Gives residual interest in net assets
2. Has no Contractual obligation to deliver Cash (or) other F.A
3. Is non-redeemable at holders option

F.L If Shares issued by acquirer

1. Are redeemable at the option of the holder (or) mandatorily after some time
2. Involve fixed returns

Eg Pk ltd acquires Sk ltd, Instead of paying money, Pk ltd gives its own redeemable pref Shares with ₹ 10 crore The Shares are redeemable after 5 yrs @ fixed amount.

↓

So Company Pk ltd has Contractual obligation to pay Cash in future. So these pref Shares are not Equity & is Classified as F.L

Another Eg

Pk ltd issued Ordinary E shares (non-redeemable, no fixed dividend)

These shares dont involve any obligation for payment (or) redemption. So classified as E.I.

Ind AS 32 logic by Pk Sir

Form of the Instrument called share is not Enough

What matters is Substance → does it create an obligation to pay.

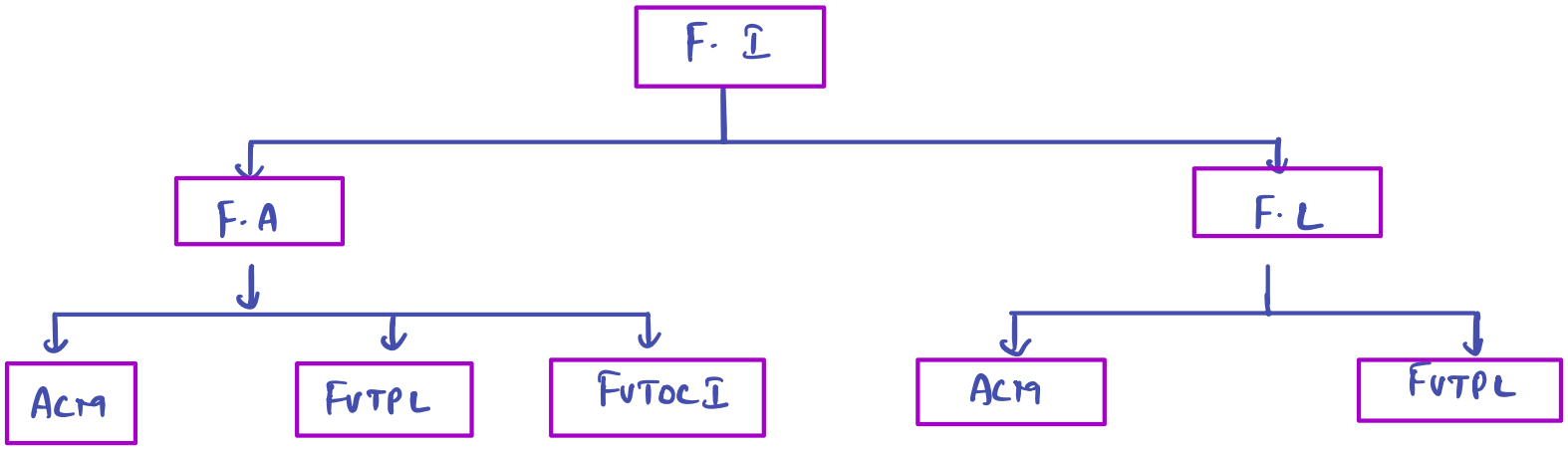
↓

Substance over form

Ind AS 109

Recognition & Measurement

* Different methods of Accounting for F.I



ACM

* Initial recognition is done at Fair value adjusted with Transaction Costs
* Interest Income/expense is measured using EIR (Ind AS 23)

Measurement is Covered here

Accounting is already Covered in Ind AS 32

* NO Subsequent fair valuation on each B/s date.

↓

Why? look at the name its COST method not fair value

FVTPL

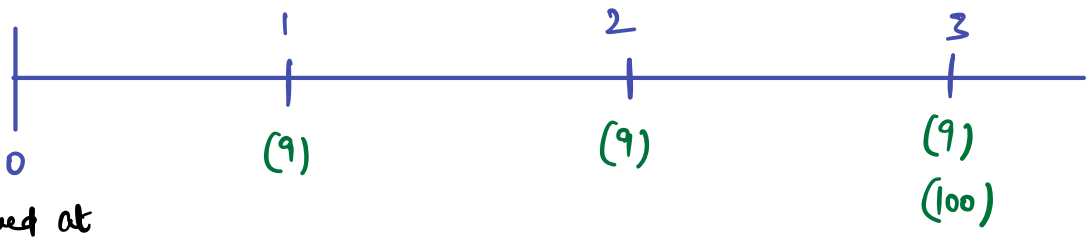
* Initial recognition at Fair value. Transaction Costs are directly recognised in P/L.
* Interest Income/expense is recognised directly in P/L at the Coupon rate. EIR method need not be applied.
* On B/s date F.A (or) F.L has to be fair valued & resulting gain/loss are recognised in P/L.

Applies only for F.A ← **FVTOCI** → Statement of P/L has two parts (SPL)

- P/L
- OCI
  - * Accounts for unrealised gain/loss
  - * Will not be considered for EPS Calculation

* Initial recognition is done at Fair value adjusted with Transaction Costs
* Interest Income is measured using EIR as if ACM method is applied
  - Income: No expense
* On B/S date F.A has to be fair valued & resulting gain/loss are recognised in OCI
* The accumulated gain/loss in OCI reserve may/may not be reclassified (recycled) to P/L (or) R.E. ?

Q A Ltd has issued 9% debentures of the FV Rs 100 each @ 5% discount. These debentures are redeemable after 3 years @ par value. Show the Accounting in the books of A Ltd applying amortized cost Method.



Deb issued at 95

E.I.R = 11.0481. (will be given in 99% of the Cases)

1st yr

(Beg) Bk 95
To P/L 95

(End) Int exp 10.50 → measured @ EIR (Int exp for Company recognised)
To F.L 10.50

(End) F.L 9 → Rs Contractual Cash flows paid
To Bk 9

In the books of 'A' Ltd

Deb - F.L (ACM method)

		@ Beg of Yr ①	
		By Bank	95
@ end of Yr ①		@ end of Yr ①	
To Bank (Contractual cash outflow)	9	By Int exp (95 × 11.048%)	10.50
To bal c/d	96.50		
		By bal b/f	96.50
		@ end of Yr ②	
To Bank	9	By Int exp (96.50 × 11.048%)	10.66
To bal c/d	98.16		
		By bal b/d	98.16
To Bank (9 + 100)	109	By Int exp (98.16 × 11.048%) (B.F in last year)	10.84

ACM TABLE (This is what you need to write in exam)

P	1	2	3
Opg bal	95	96.50	98.16
(+) Int exp	10.50	10.66	10.84
(-) Contractual CF	(9)	(9)	(109)
Clg bal	96.50	98.16	0

PV PV PV

$98.16 = \frac{109}{1+0.11048}$

* Each year Closing balance represents PV of remaining cash flows.

→ i.e 95 represents PV of 3 remaining Fv CF's (9, 9, 109)

96.50 represents PV of 2 remaining Fv CF's (9, 109)

98.16 represents PV of 1 remaining Fv CF's (109)

* The Closing balance of FA (or) FL under ACM represents (very imp for Solving ICAI Problems)

PV of Future CF discounted @ E.I.R

Q. A Ltd has advanced an amount of Rs 1,00,000 to B Ltd on 01.04.2015. It has collected Processing charges of Rs 10,000 on the same day from B Ltd. This loan carries an interest of rate 10%. The loan is repayable after 3 years at a premium of 5%. Show the accounting in the books of A Ltd for all the 3 years using amortized cost method. [EIR = 15.88%]

You are 'A' Ltd

0	1	2	3
(100000)	10000	10000	10000
10000			105000
(90000)			

Even though Contractual Int rate is 10%.
Actually 'A' Ltd is earning more than 10%. i.e 15.87% EIR

Accounting of Int Income (1st yr)

F.A A/c Dr 14283 @ E.I.R

To Int Income 14283

For receipt of Contractual CF's (1st yr)

Bank A/c Dr 10000

To F.A A/c 10000

In the books of 'A' Ltd

Loan Receivable (F.A) (ACM method)

1.4.2015 To Bank	90000		
31.3.2016 To Int Income (90000 × 15.671.)	14283	By Bank (Contractual CF Inflow)	10000
		By bal c/d	94283
1.4.2016 To bal b/d	94283		
31.3.2017 To Int Income (94283 × 15.671.)	14963	By Bank	10000
		By bal c/d	99246
1.4.2017 To bal b/d	99246		
31.3.2018 To Int Income (99246 × 15.671.)	15754 (B.F)	By Bank (10000 + 105000)	115000

ACM Table

P	1	2	3	
Opg bal	90000	94283	99246	
(+) Int @ 15.87%	14283	14963	15754	⇒ 45000
(-) CF received	(10000)	(10000)	(115000)	
Clg bal	94283	99246	NIL	

* The Closing bal under ACM will always represent PV of future CF discounted @ EIR.

logic You gave 90000 & received 105000 ⇒ 15000 (benefit
+ 10000 for 3 yrs ⇒ 30000
45000

Q On 01.05.2016 A Ltd has purchased Investment in shares of X Ltd @ Rs 40,000. The transaction cost paid is Rs 2,000. The fair value of shares on different dates is as under

Date	Fair value
31.05.2016	48,000
30.06.2016	45,000
31.07.2016	38,000

Show the accounting of the Investment A/c under
Case (i) FVTPL
Case (ii) FVTOCI

a) **FVTPL**

Inv in Shares

1.5.16 To Bank	40000		
31.5.16 To gain on fair value (To P/L)	8000	31.5.16 By bal c/d	48000

→ 2000 will directly go to P/L

→ go & directly dump fair value in clg balance

To bal b/d	48000	By loss on fair value (P/L)	3000
		30.6.15	
		By bal c/d (Fair value)	45000
To bal b/d	45000	By loss on fair value (P/L)	7000
		By bal c/d (FV)	38000

FVTOCI

Inv in Shares @ FVTOCI

To Bank (40000 + 2000)	42000		
To OCI - Reserve (FV gain)	6000	31.5.16	
		By bal c/d	48000
To bal b/d	48000	By OCI - Reserve (FV loss)	3000
		31.6.16	
		By bal c/d	45000
To bal b/d	45000	By OCI - Reserve (FV loss)	7000
		31.7.16	
		By bal c/d	38000

Accounting for F.A

Investment in Equity

→ Apply FVTPL (Default method)

(or)

Entity can apply FVTOCI at its choice but irrevocable Choice (optional)

↓

Accumulated OCI – Reserve

Subsequently cannot be reclassified to P/L i.e directly transfd to R.E when Investment is de-recognised.

logic decoded by Pk Sir

Equity Instruments have variable, uncertain CFlows, do not meet SPPI test. Their value Δ with market movement. Hence FVTPL reflects their true economic risk & volatility.

All other Financial Assets

(Debentures, loans given, Bonds, Trade receivables, Fixed deposits, Govt Securities)

↓

These have Contractual CF (Int + principal) (or) SPPI

↓

Now we need to do 2 tests

↓

Test ① Business model test

(Means → Why the asset is being held?)

① Hold to Collect

(What? Interest & Principal)

② Hold to Collect & Sell

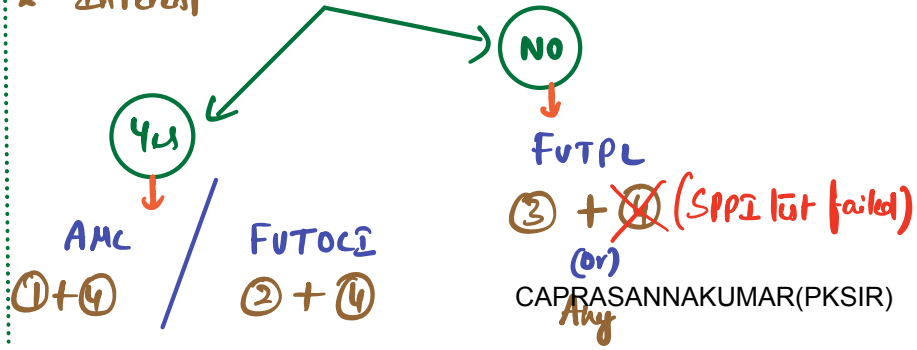
(May sell to manage liquidity (or) Interest rate risk)

③ Trading | Speculative

(Holding for fair value gains)

Test 2 SPPI (or) Contractual CF Test

④ Are cash flows Solely payments of Principal & Interest



↓

Accumulated gain/loss in OCI - Reserve will be reclassified to P/L on derecognition of F.A.

Q) When to apply FVTPL for F. Assets ?

↓

3 specific cases

↓

- SPPI Test fails
- Held for Trading
- Voluntary designation @ FVTPL

↓

If this test is failed it means the F.A has uncertain CF's that are not just Interest & principal variable & carry market risk. So its more transparent to show Δ in Fair value in P/L.

↓

You are aiming for trading gains & Ind AS 109 wants your P/L to reflect real time performance (Short term profit objective)

↓

Ind AS 109 allows you to Irrevocably Choose FVTPL @ Initial recognition if It eliminates an accounting mismatch b/n assets & liabilities.

Example

* A Company lends 1000000 to a borrower a fixed 8% Int rate (Loan A) At the same time, Company enters in to Interest rate swap (Derivative) where it pays fixed & receives floating basically trying to hedge Interest rate risk. (You are worried about ↑ in Int rate)

↓

- The loan (F.A) ↓
- Interest rate swap (F.L) ↓ (SPPI test failed)

Principal 10 00 000

Int 8%/a ⇒ 80000/year

Maturity = 3 yrs

SPPI test = Passed (Only principal & Interest)

As per Ind AS 109 → AC M method is by default applied

You pay 8% fixed Int

You receive floating Int (Market rate)

So if Market rate ↑

Value of loan ↓ drops

But Swap gains ↑

This gives you natural hedge (FVTPL method)

But the Accounting mismatch problem

Item	Default treatment	Fair value Δ go where!
Loan	AMC	Not in P/L
Swap	FVTPL (always)	Yes in P/L

So now your derivative loss/gain is shown in P/L, but your loan stays at Amortized Cost. with no fair value movement.

This Creates Accounting mismatch.

Eg Scenario if Market rate inc from 8% to 10%, So loan value drops, Swap gains

Fair value Changes

Item	Value impact	Explanation
loan	(60000)	Market now wants 10%.
Swap	70 000	You are receiving higher floating rate.

Now lets see what happens when you do accounting with AMC & not FVTPL designation

↓

Item	Treatment	Impact in P/L
loan	AMC	Int Income of 80000 (P/L) Fair value loss not shown.
Swap	FVTPL	Fair value gain 70000

Total P/L ⇒ 80000 (Int) + 70000 (Fv gain)

⇒ 150000/-

* But thats misleading as fair value drop of loan isn't shown

Now lets see what happens when you do accounting with FVTPL designation

↓

Item	Treatment	Impact in P/L
loan	FVTPL	Fv loss (60000)
		Int Income 80000
Swap	FVTPL	Fv gain 70000

Total P/L = 80000 - 60000 + 70000

= 90000

↓

More accurate reflection of how your economic position changed.

SPECIAL CASES

Case ① Stress Case Scenario, Investor needs funds (ACM perspective)

An Institutional Investor (MF) holds Corporate bonds, loans Classified at Amortized Cost intending to hold them till maturity to earn interest income. It meets SPPI Criteria & are not traded actively.

Stress Case trigger: Liquidity crisis (Cash outflow > Available liquid assets)

Due to unexpected cash flow pressure (large redemption requests, operational losses), the investo needs to raise funds urgently, so he sells a portion of amortized cost asset before maturity.

This raises a red flag.

According to Ind AS 109, this could force re-classification of F.A from AC to FVTPL / FVTOCI

But If it is one-off sale !

No re-classification needed. Must disclose reason.

Frequent / Pattern of sales ?

Re-assess busines model. Remaining bond may need to be reclassified at fair value i.e FVTPL / FVTOCI

Case 2 If risk of the Investee has ↑ beyond acceptable levels & you sold your Investment → Standard says No problem it is not a contradiction to Business model of Hold till maturity.

Case 3 Every year selling insignificant no: of bonds (100 out of 100000 bonds) to demonstrate liquidity. (to prove investment is liquid enough)

↓

Not a violation of Busines model of HTM

Case 4 In SPPI → Int should represent = Time value of money (Risk free rate) Rf + Compensation for Risk taken (Risk premium) Rp

PK ltd → Risk appetite = 18%.

AK gave loan @ 15%. 100000 @ 9% loan will be converted to 1000 E-shares → 15% ok bcoz you will recover remaining from E-shares. (4) SPPI test failed

So FVTPL will apply

Case 5 loan @ 15% to PK Ltd, at the end of Yr ② have option to choose either 100000 (B) 1000 Shares.

④ SPPI test failed So FVTPL will apply.

↓

as you have extra E Share right, also Int of 15% is termed low Interest due to E Share Conversion option.

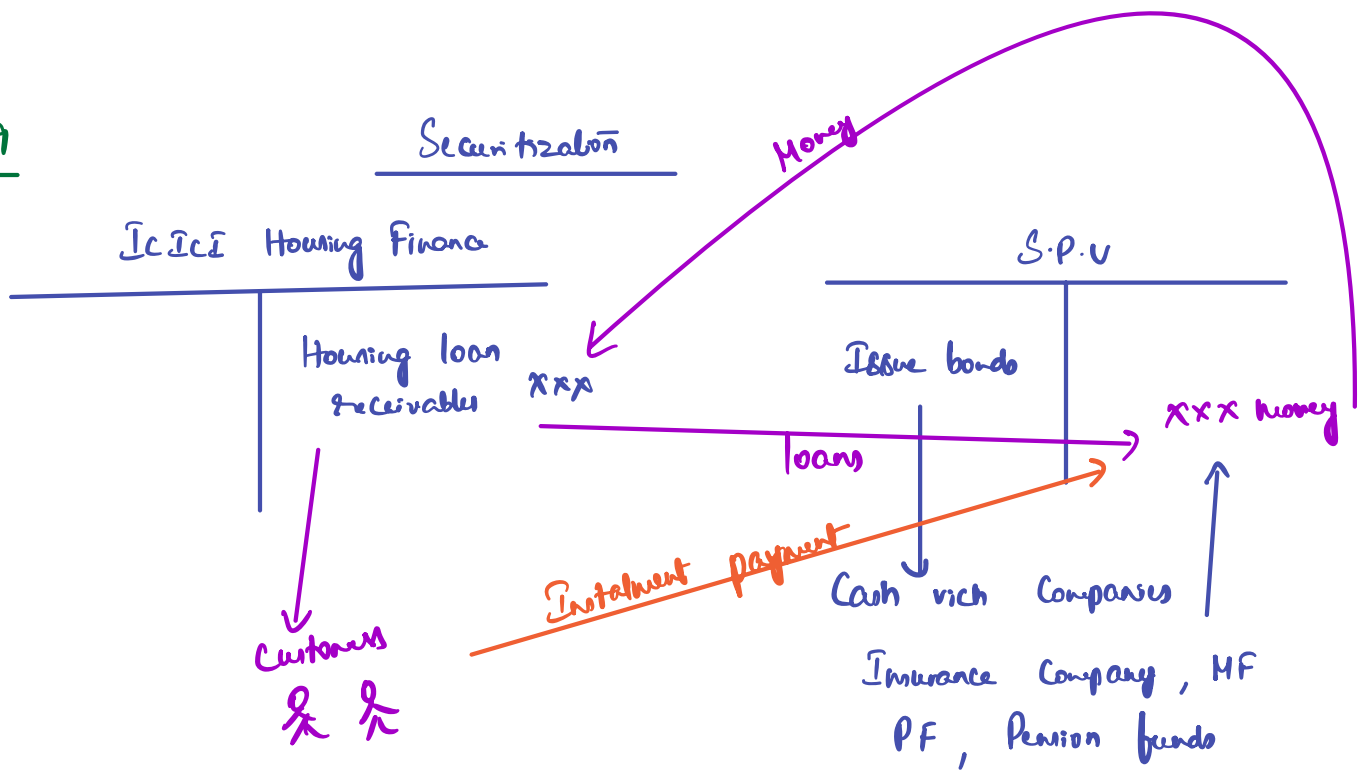
Case 6 loan to PK Ltd, where PK Ltd agreed to pay 3% of EBIT to Investor ④ SPPI test failed So FVTPL will apply

Case 7 loan to PK Ltd, where PK Ltd agreed to pay Variable Int rate based on LIBOR + 4%. → If 4% is good Compensation for additional risk then ④ SPPI test passed.

Int can be fixed (B) floating rate.

Case 8 loan to PK Ltd, where PK Ltd pays Int based on Inflation rate. ④ SPPI test passed.

Case 9



* In books of ICICI → till loans are trsfd they will be accounted @ FVTPL coz of intention to sell.

* In books of SPV → Hold till Maturity → ACM method.

* If ICICI & SPV are Group i.e Parent & Subsidiary, then from Group point of view → HTM → ACM method.

Case 10 An entity can hold diff F.A with diff objective

loan given to clen → HTM

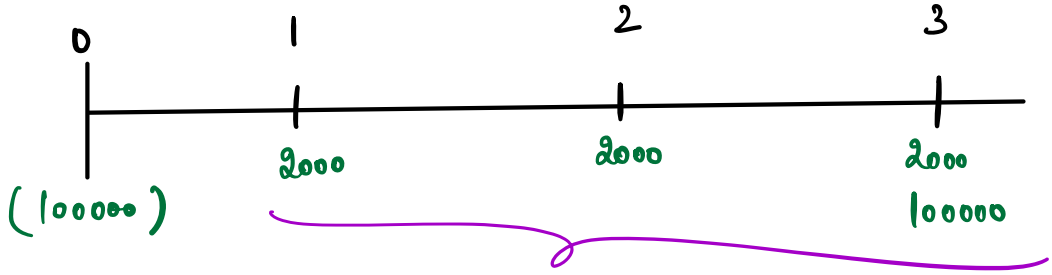
Inv in bonds → objective to sell

Case 11 **Staff loans (clea loans)**

Staff loans are often provided at Concessional (or) zero Int rate which means Int is Charged below market rate. This makes them a F.A below market terms & therefore Special accounting treatment is required.

PK Ltd gave loan of 100000 to their clea for 3 yrs @ 2% p.a

Market rate = 10% p.a



Discount this @ Market rate of 10%.

Fair value of loan ⇐ 80105

(2000 × PVAF (10%, 3yrs) + 100000 × PVF (3rd year 10%)

⇒ (2000 × 2.48685) + (100000 × 0.75131)

⇒ 80105

SCENARIO	ACCOUNTING TREATMENT
loan given with no Condition	Entire diff is EB expenses upfront (P/L)
loan tied to future Service	Diff is prepaid staff cost (amortized over service period) using SLM

Entry

Staff loan A/c Dr 80105

Prepaid staff Cost / Staff Cost (P/L) Dr 19895

To Bank A/c 100000

↓

If Service Condition is present in Q

* **Day 1 Difference** * (This applies when Counter party is market participant not employee)

* Sometimes the transaction price (price agreed b/n parties) differs from fair value (determined independently, as per Level 1 Inputs of Ind AS 113) This is called Day 1 difference as per Ind AS 109. ↓ Quoted M.P of the asset

If fair value (80105) is Calculated using Level 1 Input ↓ Then diff is to be recognised in P/L immediately.

If NO Level 1 input is used ↓ Recognise the diff as an asset if appropriate else this to P/L immediately.

* In the above Staff loan case, the fair value of 80105 is not based on level 1 input. The gap of 19895 may be recognised as an asset (Prepaid staff cost) (or) Expense (staff cost) in P/L as appropriate.

Day ①

Staff loan A/c Dr 80105

Prepaid staff Cost Dr 19895

To Bank A/c 100000

At the end of each year

	Year ①	Year ②	Year ③
① Int Income @ EIR			
Staff loan (F.A) Dr	8011	8612	9272
To Int Income (PL)	8011 (80105 x 10.1.)	8612 (86116 x 10.1.)	9272 (92728 x 10.1.)
② FA amortization of staff cost			
Staff Cost (PL) Dr	6632	6632	6631
To prepaid staff cost (19895/3)	6632	6632	6631
③ FA receipt of CF's			
Bank A/c Dr	2000	2000	102000
To Staff loan (F.A)	2000	2000	102000
④ Closing balance of F.A (Staff loan)	86116	92728	NIL

SECURITY DEPOSIT

* Machinery on lease (4yrs)

₹ 1000000
Deposit paid by lessee

₹ 1000000
Will be received from lessor

Discount @ 10%

Fair value of deposit ← 683013

(F.A) Security deposit	Dr	683013	
Prepaid lease rent	Dr	316987 (B.F)	
To Bank			1000000

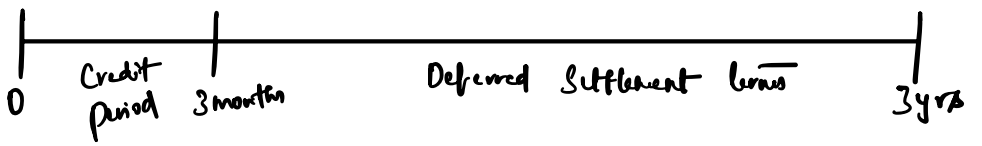
Demand Deposit

* Since the Deposit is recoverable on demand, It will be accounted at the transaction value, there is no need to apply amortized cost method.

* No need to do any interest accounting as there is no interest. fo Demand loans | deposit. S.D is like fixed deposit, so it is different from Demand deposit

Trade receivables

* Debtors and other receivables are initially recorded at the transaction value. However if Extended credit period is provided, then amortized cost Method will be applicable.



16100

discount to find PV

Drs 16100
To Sales 16100 → X

Drs 11200 (Cash price)
To Sales 11200 (Say)

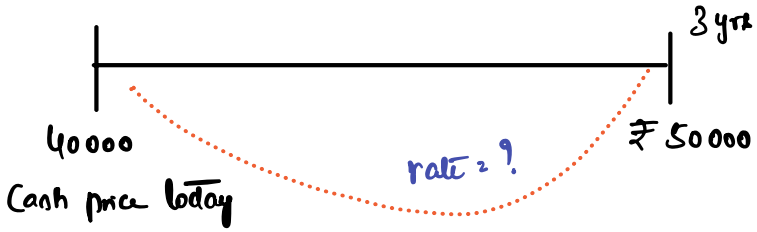
↓

Next do unwinding of discount as usual.

Eg

A Ltd sold goods for Rs 50,000 to B Ltd on 3 years credit. The normal credit period offered is only 30 days and sale would have been at 40,000. Show the accounting in the books of A Ltd.

a)



Debtor (F.A) & Sales are recorded @ 40000

* $(1.25)^{1/3}$

① 1.25 √ √ √ .... 15 times
② -1 =
③ $\times 1/3$ =
④ $+1$ =
⑤ x = ... 15 times

$FV = PV(1+r)^n$

$50000 = 40000(1+r)^3$

$1+r = \left(\frac{5}{4}\right)^{1/3}$

$r = (1.25)^{1/3} - 1$

$r = 1.0772 - 1$

$r = 0.0772$ (or) 7.72% p.a

Accounting in books of 'A' Ltd

ⓐ For Sales

Drs 40000
To Sales 40000

ⓑ @ end of each yr

	1	2	3
Drs	3088	3326	3586
To Int Income	3088	3326	3586 (B.F)
	(40000 × 7.72%)	(43088 × 7.72%)	
Bk	NIL	NIL	50000
To Debtors	NIL	NIL	50000
Clg balance	43088	46414	NIL

LOANS WITH IN GROUP

(group = Parent + Subsidiary)

① loan repayable on demand

* The lender can ask for repayment at anytime and the borrower must repay immediately irrespective of originally expected loan duration

Parent gives loan to Subsidiary

Parent books

loan to Subsidiary xxx (Fair value = Face value) (or) Transaction value
To Bank xxx

Subsidiary books

Bank A/c Dr xxx (Transaction value)
To loan from parent xxx

Subsidiary gives loan to Parent

Parent books

Bank A/c Dr xxx (Transaction value)
To loan from Subs xxx

Subsidiary books

loan to Parent xxx (Fair value = Face value) (or) Transaction value
To Bank xxx

② loan repayable on Specific date

Eg Pk ltd gave loan to Sk ltd of 1000 000 for 3 yrs @ No Interest

Market Int rate = 10%.

Fv of loan today = Pv of 1000000 @ market Int rate

= 1000 000 × PVF (10%, 3 yrs)

= 751 310

Actual amount given = 1000 000

Excess amount given today = 1000 000 − 751310

= 248690

logic Fair value reflects what an independent third party would pay (or) receive considering time value of money.

Diff b/n Disbursed amount & Fair value is accounted based on relationship.

Parent → Subsidiary : Treated as additional Inv in Subsidiary

Subsidiary → Parent : Treated as Equity Contribution (or) Deemed dividend

Subsidiary → Subsidiary : often recorded as Equity Contribution

(1) Parent gave loan to Subsidy

(PK - Parent, SK - Subsidiary)

Parent books (PK)

loan to Subsidiary Dr 751310 (F.A)

Inv in Subsidiary Dr 248690 (B.F)

To Bank 1000000

Subsidiary books (SK)

Bank A/c Dr 1000 000

(F.L) To loan from parent 751310

To Capital Contribution from Parent 248690

(2) Subsidiary gave loan to Parent

Parent books (PK)

Bank A/c Dr 1000 000

(F.L) To loan from Subsidiary 751310

To Dividend received (Income) 248690

Subsidiary books (SK)

loan to Parent 751310 (F.A)

(Retained earnings / Dividend distribution) 248690

To Bank 1000000

③ loan repayable when funds are available

* A Subsidiary gives loan to parent to be returned when Parent has excess funds.
* A Parent Supports a financially weak Subsidiary and agrees to take repayment only when Subsidiary can afford it.
* Estimate Should be made as to when loan repayment will be made (estimate date of loan CF's) if there is reliable evidence, then once you knows date, accounting will be done Similar to Case ② & apply EIR
* If you Cannot estimate repayment timing reliably (or) if CFs are irregular / unpredictable, then you treat it as loan repayable on demand Case ① & apply Impairment for unrecoverable Amount.

Note The above accounting is only applicable in SFS of Parent & Subsidiary. In CFS no accounting is to be done as this is an Inter - Company transaction with in the group.

PERPETUAL BONDS

* These instruments do not have any redemption but they pay interest cash flows for indefinite period. Any Investment in such Instruments will be initially recognized at fair value which is Fair value of Perpetual Investment = $\frac{\text{Interest cash flow}}{\text{Market Int rate}}$
* If the Issuer is not obligated to repay principal / Interest, it is classified as Equity. If there is obligation to pay Cash, it is F.L (i.e If Int payment is mandatory)

Eg A Ltd issues perpetual bonds of ₹ 100 crore,

Coupon int rate = 8% p.a, No maturity.

A Ltd has discretion to Skip Int payment (Non-Cumulative)

a) No Contractual obligation to pay Int
No maturity (or) redemption clause } Equity.

Bank A/c Dr 100 cr
To perpetual bonds (Equity) 100cr

Suppose If Int is declared (No Int - NO Entry)

Perpetual bond Coupon (Int exp) 8 00 00 000
To Bank A/c 8 00 00 000

* Now Suppose, Issuer is Contractually bound to pay 8% Coupon regardless of profits.

* Contractual obligation to pay Int → F.L

Assume Issued at par

Bank A/c Dr 100 cr
To perpetual bonds (F.L) 100cr

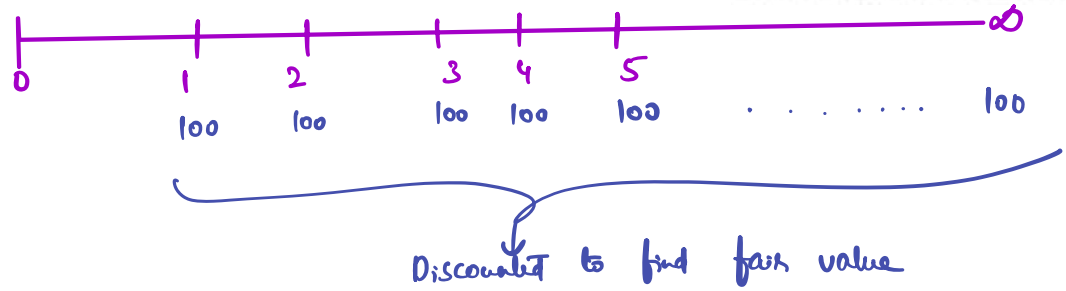
Subsequent measurement (Amortized Cost)

Int exp A/c Dr 8 00 00 000
To Bank A/c 8 00 00 000

* Suppose Bonds were issued at disc (or) premium apply EIR

Another Eg

Investor point of view



$$FV = \frac{CF}{\text{Market Int rate}} = \frac{100}{0.12} = 833$$

Inv in bonds	Dr	833	(Fair value)
P/L	Dr	167	
To Bank			1000

- loan to Elec
- S. Deposit
- loan with in group

$\Rightarrow$ Fair value of loan = PV of future CFs discounted @ Market Int rate on Initial recognition date

Regular way purchase / Sale of Financial Asset

* You buy / sell a F.A (like Shares, bonds) in a Stock xchange, the Contract requires delivery with in a Standard Settlement Period i.e T+2 i.e Trade date + 2 days. So on Wed (Monday) (Tue + Wed)

in Demat A/c (Share will be added) & money will be deducted from Bank A/c. In real time Broker will Collect money on Monday itself but Share will be delivered on Wed.

Why is this Imp in Ind AS 109 ?

a) Bcoz it determines when to recognise & de-recognise a F.A

Standard gives you two Choices but apply Consistently

- Trade date accounting
- Settlement date Accounting

Eg * X ltd has purchased on investment in bonds Rs 100 on 30.03. on 31.03, the FV of these bonds is 101.The above transaction was settled on 01.04, and the FV on that date is Rs 103. Show the accounting in the Books of X Ltd assuming trade date accounting and settlement date accounting.

Case ① Investment accounted @ ACM

	P	Trade date accounting	Settlement date accounting
30.3.25	Purchase of Inv		
	Inv in Bonds Dr	100	— N.A —
	To Payable	100	
31.3.25	Fair valuation of F.A		
	— N.A —	— N.A —	— N.A —
		(ACM method so no fair valuation)	
1.4.25	ⓐ Amt paid for Bonds purchased		
	Payable	100	— N.A —
	To Bank	100	
	ⓑ Fo recognition of F.A		
	Inv in bonds Ac Dr	100	
	— N.A —		
	To Bank A/c	100	

Case ② Investment accounted @ FVTPL

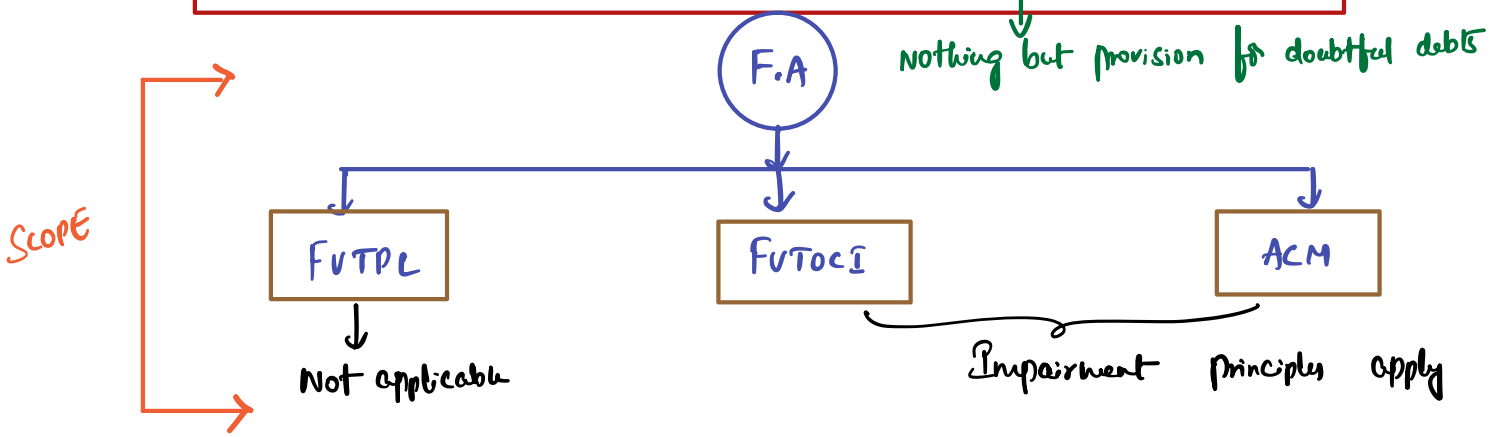
P	Trade date accounting	Settlement date accounting
30.3.25 Purchase of Inv	Inv in Bonds Dr 100 To Payable 100	— N.A —
31.3.25 Fair valuation of F.A Gain = 101 − 100 = 1	Inv in Bonds Dr 1 To P/L 1	Fv Change A/c Dr 1 To P/L 1
1.4.25 ⓐ Amt paid for Bonds purchased ⓑ FV Fair valuation gain = 103 − 101 = 2	Payable 100 To Bank 100 Inv A/c Dr 2 To P/L 2	Inv 100 To Bk 100 Inv A/c Dr 3 To Fv A/c 1 To P/L 2

Case ③ Investment accounted @ FVTOCI

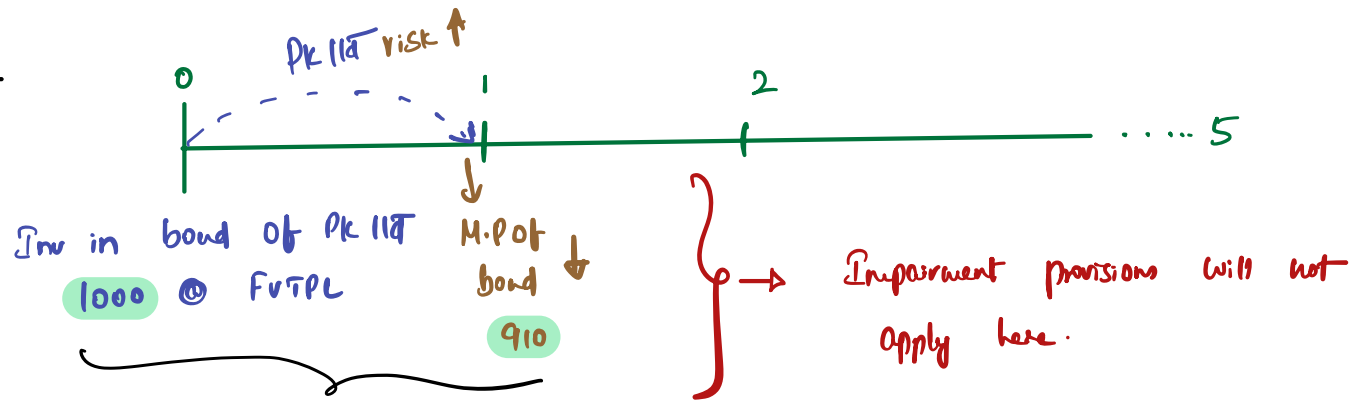
* Replace P/L in above with OCI | everything else same

** IMPAIRMENT OF F.A / LOSS ALLOWANCE ON F.A VIMP **

Nothing but provision for doubtful debts



Case ①



* With respect to AC M, it is very clear that since F.A will be shown in B/s @ FV on Inv'mt recognition date, Impairment principles should apply.

* But it is interesting when it comes to FVTOCI bcoz if this method is applied anyway your amt is already at fair value in B/s. Then why do we need to apply Impairment principles ?

* The Ans is Fair value Gain/loss is in OCI - reserve not P/L. So Calculate Impairment loss by applying Impairment principles and then reduce this Impairment loss amount from OCI - reserve & trfr it to P/L.

Imagine you are a bank

* You lend money to customers. Now you want to make sure that if some customers don't pay you back, you are financially prepared, that's where Impairment of F.A come in.

* Earlier (under old rules) you only accounted for losses after someone defaulted. But now under Ind AS 109 you must predict & prepare early for possible losses. This is called Expected Credit loss (ECL) model.

* Think of it like setting aside money for rainy days i.e if you think a customer might not pay, you set aside small amount today - just in case.

Lets Simplify the process in to 5 easy steps

Step ① What kind of money are we talking about!

Money people owe you (like loans, receivables) i.e F.A Not shares | stocks

Step ② Group customers in to 3 buckets (stages)

Stage	Whats happening	What do you do!
1	Customer is good no risk	Keep aside small amount (just for next 12 m risk)
2	Risk is growing (warning signs)	Keep aside more (Cover entire life of loan)