

Illustration 1 (Exchange of Financial Liability at Unfavorable terms)

A company borrowed ₹50 lacs @ 12% p.a. Tenure of the loan is 10 years. Interest is payable every year and the principal is repayable at the end of 10th year. The company defaulted in payment of interest for the year 4, 5 and 6.

A loan reschedule agreement took place at the end of 7 year. As per the agreement the company is required to pay ₹90 lacs at the end of 8th year. Calculate the additional amount to be paid on account of rescheduling and also the book value of loan at the end of 8th year when reschedule agreement took place.

Solution

Assumption: Interest is compounded in case of default.

$$\begin{aligned}\text{Outstanding Amount at the end of 8th year} &= ₹50,00,000 \times 1.12 \times 1.12 \times 1.12 \times 1.12 \times 1.12 \\ &= ₹88,11,708 \text{ (i.e. adding interest for 4th to 8th year)}\end{aligned}$$

Rescheduled amount to be paid at the end of the 8th year = ₹90,00,000

Additional amount to be paid on rescheduling = ₹90,00,000 - ₹88,11,708 = ₹1,88,292.

Illustration 2

Entity A holds an option to purchase equity shares in a listed entity B for ₹100 per share at the end of a 90 day period. Evaluate the contract whether a financial asset or a financial liability? What if the entity A has written the option?

Solution

The above call option gives entity A, a contractual right to exchange cash of ₹100 for an equity share in another entity and will be exercised if the market value of the share exceeds ₹100 at the end of the 90 day period. If the market value of a share will be such that the entity A will gain on the exercise date, it will exercise the call option.

Since entity a stands to gain if the call option is exercised, the exchange is potentially favorable to the entity. Therefore, the option is a derivative financial asset from the time the entity becomes a party to the option contract.

On the other hand, if entity A writes an option under which the counter party can force the entity to sell equity shares in the listed entity B for ₹100 per share at any time in the next 90days, then entity A will be said to have a contractual obligation to exchange its equity shares to another entity for cash of ₹100 per share on potentially unfavorable terms i.e. if the holder exercises the option, on account of the market price per share being above the exercise price of ₹100 per share at the end of the 90 day period.

Since entity a stands to lose if the option is exercised, the exchange is potentially unfavorable and the option is a derivative financial liability from the time the entity becomes a party to the option contract.

Illustration 3 (Mandatorily Redeemable Preference Shares With Mandatory Fixed Dividends)

A Company has issued 6% mandatorily redeemable preference shares with mandatory fixed dividends. Evaluate whether such preference shares are an equity instrument or a financial liability to the issuer entity?

Solution

In determining whether a mandatorily redeemable preference share is a financial liability or an equity instrument, it is necessary to examine the particular contractual rights attaching to the instrument's principal and return components.

The instrument in this example provides for mandatory periodic fixed dividend payments and mandatory redemption by the issuer for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment of principal) to the shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

Illustration 4 (Non-redeemable Preference Shares With Mandatory Fixed Dividends)

A Company issued non-redeemable preference shares with mandatory fixed dividends. Evaluate whether such preference shares are an equity instrument or a financial liability to the issuer entity?

Solution

When preference shares are non-redeemable, the appropriate classification is determined by the other rights attached to them. Classification is based on an assessment of the contractual arrangement's substance and the definitions of a financial liability and an equity instrument.

It is necessary to examine the particular contractual rights attaching to the instrument's principal and return components. In this example, the shares are non-redeemable and thus the amount of the principal has equity characteristics, but the entity has a contractual obligation to pay dividends that provide the shareholders with a lender's return. This obligation is not negated if the entity is unable to pay the dividends because of lack of funds or insufficient distributable profits. Therefore, the obligation to pay the dividends meets the definition of a financial liability.

The overall classification is that the shares may be a compound instrument, which may require each component to be accounted for separately. It would be a compound instrument if the coupon was initially set at a rate other than the prevailing market rate or the terms specified payment of discretionary dividends in addition to the fixed coupon. If the coupon on the preference shares was set at market rates at the date of issue and there were no provisions for the payment of discretionary dividends, the entire instrument would be classified as a financial liability, because the stream of cash flows is in perpetuity.

Illustration 5 (Non-redeemable Preference Shares with Dividend Payments linked to Ordinary Shares)

A company issued Non-redeemable preference shares with dividend payments linked to ordinary shares. Evaluate whether such preference shares are an equity instrument or a financial liability to the issuer entity?

Solution

An entity issues a non-redeemable preference shares on which dividends are payable only if the entity also pays a dividend on its ordinary shares.

The dividend payments on the preference shares are discretionary and not contractual, because no dividends can be paid if no dividends are paid on the ordinary shares, which are an equity instrument. As the perpetual preference shares contain no contractual obligation ever to pay dividends and there is no obligation to repay the principal, they should be classified as equity in their entirety.

Where the dividend payments are also cumulative, that is, if no dividends are paid on the ordinary shares, the preference dividends are deferred, the perpetual shares will be classified as equity only if the dividends can be deferred indefinitely and the entity does not have any contractual obligations whatsoever to pay those dividends.

A liability for the dividend payable would be recognized once the dividend is declared.

Illustration 6

Let us say on 30th March 2015 an entity enters into an agreement to purchase a Financial Asset for ₹100 which is the Fair Value on that date.

On Balance Sheet date i.e. 31/3/2015 the Fair Value is 102 and on Settlement date i.e. 2/4/2015 Fair Value is 103.

Pass necessary Journal entries on trade date and settlement date when the asset acquired is measured at

- (a) Amortized cost
- (b) FVTPL
- (c) FVTOCI

Solution**Financial Asset at Amortized Cost – Trade Date Accounting**

Dates	Journal Entry		Amount	Amount
30/3/2015	Financial Asset	Dr.	100	
	To Payables			100
31/3/2015	No Entry			
2/4/2015	Payables	Dr.	100	
	To Cash			100

Financial Asset at Amortized Cost – Settlement Date Accounting

Dates	Journal Entry		Amount	Amount
30/3/2015	No Entry			
31/3/2015	No Entry			
2/4/2015	Financial Asset	Dr.	100	
	To Cash			100

Financial Asset at FVTPL – Trade Date Accounting

Dates	Journal Entry		Amount	Amount
30/3/2015	Financial Asset	Dr.	100	
	To Payables			100
31/3/2015	Financial Asset	Dr.	2	
	To P&L			2
2/4/2015	Financial Asset	Dr.	1	
	To P&L			1
	Financial Asset	Dr.	100	
	To P&L			100

Financial Asset at FVTPL– Settlement Date Accounting

Dates	Journal Entry		Amount	Amount
30/3/2015	No Entry			
31/3/2015	Fair Value Change	Dr.	2	
	To P&L			2
2/4/2015	Fair Value Change	Dr.	1	
	To P&L			1
	Financial Asset	Dr.	103	
	To Cash			100
	To Fair Value Change			3

Financial Asset at FVTOCI – Trade Date Accounting

Dates	Journal Entry		Amount	Amount
30/3/2015	Financial Asset	Dr.	100	
	To Payables			100
31/3/2015	Financial Asset	Dr.	2	
	To OCI			2
2/4/2015	Financial Asset	Dr.	1	
	To OCI			1
	Payables	Dr.	100	
	To P&L			100

Financial Asset at FVTOCI – Settlement Date Accounting

Dates	Journal Entry		Amount	Amount
30/3/2015	No Entry			
31/3/2015	Fair Value Change	Dr.	2	
	To OCI			2
2/4/2015	Fair Value Change	Dr.	1	
	To OCI			1
	Financial Asset	Dr.	103	
	To Cash			100
	To Fair Value Change			3

Illustration 7 (Financial Asset Accounted as FVTPL)

A Company invested in Equity shares of another entity on 15th March for ₹10,000. Transaction Cost = ₹200

(Not included in ₹10,000)

Fair Value on Balance Sheet date i.e. 31st March 2015 = ₹12,000. Pass necessary Journal Entries

Solution

Dates	Journal Entry		Amount	Amount
15/3/2015	Investment A/c	Dr.	10,000	
	Transaction Cost A/c	Dr.	200	
	To Bank			10,200
31/3/2015	Investment A/c	Dr.	2,000	
	To Fair Value Gain A/c			2,000
31/3/2015	P&L A/c	Dr.	200	
	To Transaction Cost A/c			200
31/3/2015	Fair Value Gain A/c	Dr.	2,000	
	To P&L A/c			2,000

Illustration 8 (Financial Asset Accounted as FVTOCI)

A Company invested in Equity shares of another entity on 15th March for ₹10,000. Transaction Cost = ₹200 (not included in ₹10,000). Fair Value on Balance Sheet date i.e. 31st March 2015 = ₹12,000. Pass necessary Journal entries.

Solution

Dates	Journal Entry		Amount	Amount
15/3/2015	Investment A/c	Dr.	10,200	
	To Bank			10,200
31/3/2015	Investment A/c	Dr.	1,800	
	To Fair Value Gain A/c			1,800
31/3/2015	Fair Value Gain A/c	Dr.	1,800	
	To OCI A/c			1,800
31/3/2015	OCI A/c	Dr.	1,800	
	To Fair Value Reserve A/c			1,800

Illustration 9 (Financial Asset Accounted as Amortized Cost)

A Company lends ₹100 lacs to another company @ 12% p.a. interest on 1/4/2015.

It incurs ₹40,000 incremental costs for documentation.

Loan tenure = 5 years with Interest charged annually.

Fair Value of Loan = 100,40,000 (100 lacs + 40,000). Pass necessary Journal entries.

Solution

This is based on the assumption that interest rate is based on market rate of interest.

Dates	Journal Entry		Amount	Amount
1/4/2015	Loan A/c	Dr.	100 lacs	
	To Bank A/c			100 lacs
1/4/2015	Loan Processing Expense A/c	Dr.	40,000	
	To Bank A/c			40,000
1/4/2015	Loan A/c	Dr.	40,000	
	To Loan Processing Expense A/c			40,000

Illustration 10

An entity is about to purchase a portfolio of fixed rate assets that will be financed by fixed rate debentures. Both financial assets and financial liabilities are subject to the same interest rate risk that gives rise to opposite changes in fair value that tend to offset each other. Comment if the assets are FVTOCI and liability at authorized cost.

Solution

In the absence of the fair value option, the entity may have classified the fixed rate assets as FVTOCI with gains and losses on changes in fair value recognized in other comprehensive income and the fixed rate debentures at amortized cost. Reporting both the assets and the liabilities at fair value through profit and loss i.e. FVTPL corrects the measurement inconsistency and produces more relevant information.

Example:

Bonds for ₹1,25,000 reclassified as FVTPL

Fair Value on reclassification ₹90,000

Bonds (FVTPL) A/c	Dr.	90,000	
P&L A/c	Dr.	35,000	
To Bonds (Amortized Cost) A/c			1,25,000

Illustration 11

Sea Ltd. has lent a sum of ₹10 lakhs @ 18% per annum for 10 years. The loan had a Fair Value of ₹12,23,960 at the effective interest rate of 13%. To mitigate prepayment risks but at the same time retaining control over the loan, Sea Ltd. transferred its right to receive the Principal amount of the loan on its maturity with interest, after retaining rights over 10% of principal and 4% interest that carries Fair Value of ₹29,000 and ₹1,84,620 respectively. The consideration for the transaction was ₹9,90,000. The interest component retained included a 2% fee towards collection of principal and interest that has a Fair Value of ₹65,160. Defaults, if any are deductible to a maximum extent of the company's claim on Principal portion. You are required to show the Journal Entries to record de recognition of the Loan.

Solution:**(i) Calculation of securitized component of loan**

		₹	₹
Fair Value			12,23,960
Less: Principal strip receivable (fair value)		29,000	
Less: Interest strip receivable (fair value)	1,19,460		
Less: Value of service asset (fair value)	<u>65,160</u>	<u>1,84,620</u>	<u>2,13,620</u>
			<u>10,10,340</u>

(ii) Apportionment of carrying amount in the ratio of fair values

	Fair value (₹)		Apportionment (₹)
Securitized component of loan	10,10,340	$10,10,340 \times 10,00,000$ <u>12,23,960</u>	8,25,468
Principal strip receivable	29,000	$29,000 \times 10,00,000$ <u>12,23,960</u>	23,694
Interest strip receivable	1,19,460	$1,19,460 \times 10,00,000$ <u>12,23,960</u>	97,601
Servicing asset	65,160	$65,160 \times 10,00,000$ <u>12,23,960</u>	53,237

(iii) Entries to record the de recognition of the Loan

		₹	₹
Bank A/c	Dr.	9,90,000	
To Bank A/c			8,25,468
To Profit & Loss A/c			1,64,532
(Being entry for securitization of 90% principal with 14% interest)			
Interest strip A/c	Dr.	97,601	
Servicing asset A/c	Dr.	53,237	
Principal strip A/c	Dr.	23,694	
To Loan A/c			1,74,532
(Being entry for interest, servicing asset and principal strips received)			

Illustration 12 (Factoring with / without recourse)

Entity A (the transferor) holds a portfolio of receivables with a carrying value of ₹1,000,000. It enters into a factoring arrangement with entity B (the transferee) under which it transfers the portfolio to entity B in exchange for ₹900,000 of cash.

Entity B will service the loans after their transfer and debtors will pay amounts due directly to entity B. Entity A has no obligations whatsoever to repay any sums received from the factor and has no rights to any additional sums regardless of the timing or the level of collection from the underlying debts. Comment.

Solution

Entity A has transferred its rights to receive the cash flows from the asset via an assignment to entity B. Furthermore, as entity B has no recourse to entity A for either late payment risk or credit risk, entity A has transferred substantially all the risks and rewards of ownership of the portfolio.

Hence, entity A derecognizes the entire portfolio. The difference between the carrying value of ₹1,000,000 and cash received of ₹900,000 i.e. ₹100,000 is recognized immediately as a financing cost in profit or loss.

Had Entity A not transferred its rights to receive the cash flows from the asset or there would have been any credit default guarantee given by entity A, then it would have not led to complete transfer of risk and rewards and entity A could not derecognize the portfolio due to the same.

Illustration 13

Entity XYZ enters into a fixed price forward contract to purchase 10,00,000 kilograms of copper in accordance with its expected usage requirements.

The contract permits XYZ to take physical delivery of the copper at the end of 12 months or to pay or receive a net settlement in cash, based on the change in fair value of copper. Is the contract covered under Financial Instruments standard?

Solution

The above contract needs to be evaluated to determine whether it falls within the scope of the financial instruments standards.

The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of copper and it is to be settled at a future date.

However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash, or of taking delivery of the copper and selling it within a short period after delivery for the purpose of generating a profit from short term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under Ind AS 109.

Instead, it is accounted for as an executory contract and if it becomes onerous then Ind AS 37 would apply.

Illustration 14

On 1 April, 2015, Delta Ltd. issued ₹30,00,000, 6 % convertible debentures of face value of ₹100 per debenture at par. The debentures are redeemable at a premium of 10% on 31.03.19 these may be converted into ordinary shares at the option of the holder; the interest rate for equivalent debentures without conversion rights would have been 10%.

Being compound financial instrument, **you are required** to separate equity and debt portion as on 01.04.15.

Solution:**Computation of Equity and Debt Component of Convertible Debentures as on 1.4.15**

Present value of the principal repayable after four years	22,44,000
[30,00,000 x .680 at 10% Discount factor]	
Present value of Interest	5,70,600
[1,80,000 x 3.17 (4 years cumulative 10% discount factor)]	
Value of debt component	28,14,600
Value of equity component	1,85,400
Proceeds of the issue	30,00,000

Example:

A Limited buys back 1,00,000 of its own equity shares in the market for ₹5 per share. These shares will be held as treasury shares to enable A Limited to satisfy its obligations under its employee share option scheme. The following entry will be made to recognize the purchase of the treasury shares as a deduction from equity:

Dr Equity	₹5,00,000	
		Cr Cash
		₹5,00,000

Illustration 15

Entity B places its privately held ordinary shares that are classified as equity with a stock exchange and simultaneously raises new capital by issuing new ordinary shares on the stock exchange.

Transaction costs are incurred in respect of both transactions. Determine the treatment of the incurred transaction costs?

Solution

Since the issue of new shares is the issue of an equity instrument, but the placing of the existing equity instruments with the exchange is not, the transaction costs will need to be allocated between the two transactions.

Transaction costs in respect of the new shares issued will be recognized in equity where as the transaction costs incurred in placing the existing shares with the stock exchange will derecognized in profit or loss.

Illustration 16

An entity issues a non-redeemable callable subordinated bond with a fixed 6% coupon. The coupon can be deferred in perpetuity at the issuer's option. The issuer has a history of paying the coupon each year and the current bond price is predicated on the holder's expectation that the coupon will continue to be paid each year. In addition the stated policy of the issuer is that the coupon will be paid each year, which has been publicly communicated. Evaluate?

Solution

Although there is both pressure on the issuer to pay the coupon, to maintain the bond price, and a constructive obligation to pay the coupon, there is no contractual obligation to do so. Therefore the bond is classified as an equity instrument.

Illustration 17

A zero coupon bond is an instrument where no interest is payable during the instrument's life and that is normally issued at a deep discount to the value at which it will be redeemed. Evaluate?

Solution

Although there are no mandatory periodic interest payments, the instrument provides for mandatory redemption by the issuer for a determinable amount at a fixed or determinable future date. Since there is a contractual obligation to deliver cash for the value at which the bond will be redeemed, the instrument is classified as a financial liability.

Illustration 18

XYZ Ltd grants loans to its employees at 4% amounting to ₹10,00,000 at the beginning of 2015-16. The principal amount is repaid over a period of 5 years whereas the accumulated interest computed on reducing balance at simple interest is collected in 2 equal annual installments after collection of the principal amount.

Assume the benchmark interest rate is 8%.

Show the accounting entries on 1-4-2015 and 31-3-2016.

Solution**Computation of Fair Value at Initial Recognition**

Year	Estimated Cash Flows	PVIF @8%	Present Value
1/4/2015		1	Nil
31/3/2016	2,00,000	0.9259	1,85,185
31/3/2017	2,00,000	0.8573	1,71,468
31/3/2018	2,00,000	0.7938	1,58,766
31/3/2019	2,00,000	0.7350	1,47,006
31/3/2020	2,00,000	0.6806	1,36,117
31/3/2021	60,000	0.6302	37,810
	See Working note		
31/3/2022	60,000 See Working note	0.5835	35,009
	Fair Value of Loan		8,71,361

Working Notes:**Computation of Interest to be paid on 31/3/2021 and 31/3/2022**

Year	Cash Flows	Principal outstanding	Interest	Cumulative Interest
31/3/2016	2,00,000	8,00,000	40,000	40,000
31/3/2017	2,00,000	6,00,000	32,000	72,000
31/3/2018	2,00,000	4,00,000	24,000	96,000
31/3/2019	2,00,000	2,00,000	16,000	1,12,000
31/3/2020	2,00,000	Nil	8,000	1,20,000
31/3/2021	60,000 (1,20,000/2)			
31/3/2022	60,000 (1,20,000/2)			

Computation of Fair Value Loss

Fair Value of Loan	8,71,361
Loan Amount	10,00,000
Fair Value Loss	1,28,639

Journal Entry at Initial Recognition

Dates	Particulars	Dr.	Cr.
1/4/2015	Loans to Employee A/c	8,71,361	
	Employee Benefits A/c	1,28,639	
	To Bank A/c		10,00,000

Note: Employee benefit is transferred to Statement of Profit and Loss.

Computation of Interest on Amortized Cost

Year	Opening Balance (1)	Interest @ 8% (2)	Repayment (3)	Closing Balance (1+2-3)
1/4/2015				8,71,361
31/3/2016	8,71,361	69,709	2,00,000	7,41,070
31/3/2017	7,41,070	59,286	2,00,000	6,00,356
31/3/2018	6,00,356	48,028	2,00,000	4,48,384
31/3/2019	4,48,384	35,871	2,00,000	2,84,255
31/3/2020	2,84,255	22,740	2,00,000	1,06,995
31/3/2021	1,06,995	8,560	60,000	55,555
31/3/2022	55,555	4,445	60,000	Nil

Journal Entry on 31/3/2016

Dates	Particulars	Dr.	Cr.
31/3/2016	Loans to Employee A/c	69,709	
	To Interest Accrued A/c		69,709
31/3/2016	Bank A/c	2,00,000	
	To Loan to Employees		2,00,000

Note: Similar entries would be done at the end of each year.

Illustration 19

ABC Ltd. Issued Debentures amounting to ₹100 lacs.

As per the terms of the issue it has been agreed to issue equity shares amounting to ₹150 lacs to redeem the debentures at the end of 3rd year.

Assume comparable market yield is 10% for year 0 and 1, and 10.5% for Year 2 end.

Show accounting entries.

Solution:**Value of Debentures to be recorded at initial:**

Present Value of 150 lacs at 10%

= 150 lacs x PVIF (10% at the end of 3rd year)

= 150 lacs x 0.7513

= 112,69,500

Journal Entries at Inception:

Dates	Particulars	Dr.	Cr.
1st Year Beg	Bank A/c	100,00,000	
	Profit & Loss A/c	12,69,500	
	To Debentures		112,69,500

Journal Entries at 1st Year End:

Dates	Particulars	Dr.	Cr.
1st Year End	Interest A/c	11,26,950	
	To Debentures (10% of 112,69,500)		11,26,950

Journal Entries at 2nd Year End:

Dates	Particulars	Dr.	Cr.
2nd Year End	Interest A/c	11,78,550	
	To Debentures A/c		11,78,550

Working Note:

Present Value of 150 lacs at 10.5% compared to Book Value

i.e. 150 lacs x 0.905 = 135,75,000 compared to 123,96,450 = 11,78,550

Journal Entries at 3rd Year End:

Dates	Particulars	Dr.	Cr.
3rd Year End	Interest A/c	14,25,000	
	To Debentures A/c		14,25,000

Working Note:

Present Value of 150 lacs at 10.5% compared to Book Value

i.e. 150 lacs x 1 = 150,00,000 compared to 135,75,000 = 14,25,000

On conversion to Equity Shares

Dates	Particulars	Dr.	Cr.
3rd Year End	Debentures A/c	150,00,000	
	To Equity Share Capital		100,00,000
	To Securities Premium		50,00,000

Illustration 20

As point of staff welfare measures, Y Co. Ltd. has contracted to lend to its employees sums of money at 5 percent per annum rate of interest. The amounts lent are to be repaid along with the interest in five equal annual installments. The market rate of interest is 10 per cent per annum.

Y lent ₹16,00,000 to its employees on 1st January, 2015.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31st December, 2015 for the transaction and also calculate the value of the loan initially to be recognized and the amortized cost for all the subsequent years.

For purposes of calculation, the following discount factors at interest rate of 10 percent may be adopted

At the end of year

1	.909
2	.827
3	.751
4	.683
5	.620

Solution:**(i) Calculation of initial recognition amount of loan to employees**

Year end	Cash Inflow		Total ₹	P.V. factor @10%	Present value ₹
	Principal ₹	Interest @ 5% ₹			
2015	3,20,000	80,000	4,00,000	0.909	3,63,600
2016	3,20,000	64,000	3,84,000	0.827	3,17,568
2017	3,20,000	48,000	3,68,000	0.751	2,76,368
2018	3,20,000	32,000	3,52,000	0.683	2,40,416
2019	3,20,000	16,000	3,36,000	0.620	2,08,320
Present value or Fair value					14,06,272

(ii) Calculation of amortized cost of loan to employees

Year	Amortized cost (Opening balance) [1] ₹	Interest to be recognised@10% [2] ₹	Repayment (including interest) [3] ₹	Amortized Cost (Closing balance) [4]=[1]+ [2]- [3] ₹
2015	14,06,272	1,40,627	4,00,000	11,46,899
2016	11,46,899	1,14,690	3,84,000	8,77,589
2017	8,77,589	87,759	3,68,000	5,97,348
2018	5,97,348	59,735	3,52,000	3,05,083
2019	3,05,083	30,917*	3,36,000	Nil

* ₹3,05,083 x 10% = ₹30,508. The difference of ₹409 (₹30,917 – ₹30,508) is due to approximation in computation.

(iii) Journal Entries in the books of Y Ltd.

For the year ended 31st December, 2015 (regarding loan to employees)

		Dr. Amount (₹)	Cr. Amount (₹)
Staff loan A/c	Dr.	16,00,000	
To Bank A/c			16,00,000
(Being the disbursement of loans to staff)			
Staff cost A/c ₹(16,00,000 –14,06,272) [Refer part (ii)]	Dr.	1,93,728	
To Staff loan A/c			1,93,728
(Being the write off of excess of loan balance over present value thereof in order to reflect the loan at its present value of ₹14,06,272)			
Staff loan A/c	Dr.	1,40,627	
To Interest on staff loan A/c			1,40,627
(Being the charge of interest @ market rate of 10% on the loan)			
Bank A/c	Dr.	4,00,000	
To Staff loan A/c			4,00,000
(Being the repayment of first installment with interest for the year)			
Interest on staff loan A/c	Dr.	1,40,627	
To Profit and loss A/c			1,40,627
(Being transfer of balance of staff loan Interest account to profit and loss account)			

Illustration 21

K Ltd. issued 5,00,000, 6% Convertible Debentures of ₹10 each on the 1st April 2015. The debentures are due for redemption on 31st March, 2019 at a premium of 10% convertible into equity shares to the extent of 50% and the balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%. You are required separating the debt & equity components at the time of the issue and showing the accounting entry in the company's books at initial recognition.

The following Present Values of ₹ 1 at 6% and at 10% is supplied to you.

Interest Rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

Solution**Computation of Debt Component of Convertible Debentures as on 1.4.2015**

Particulars	₹
Present value of the principal repayable after four years [50,00,000 x 50% x 1.10 x 0.68 (10% Discount factor)] (a)	18,70,000
Present value of Interest [3,00,000 x 3.17 (4 years cumulative 10% discount factor)](b)	9,51,000
Total present Value of debt component (I) (a + b)	28,21,000
Issue proceeds from convertible debenture (II)	50,00,000
Value of equity component (II – I)	21,79,000

Journal entry at initial recognition

	Dr. (₹)	Cr. (₹)
Cash / Bank A/c	50,00,000	
To 6% Debenture (Liability component) A/c		28,21,000
To 6% Debenture (Equity component) A/c		50,00,000
(Being the disbursement recorded at fair value)		
		21,79,000