Chapter Tests of FR of
CA Ashish Lalaji
9825856155

Solution of FR Test 5: Financial Instruments

Q 1

(a) Determination of Fair Value of Loan:

Year	Cash Outflows	PVF (8%)	PV	
1 – 5	1,00,00,000	3.993	3,99,30,000	
5	20,00,00,000	0.681	13,62,00,000	
			17,61,30,000	

The above fair value is extremely close to the amount of loan provided net of origination fees i.e. 20 – 2.4 i.e. Rs.17.60 crores. Hence, the loan is recognized in the books of B Ltd. at Rs.17.60 crores.

Determination of Income to be recognized at effective interest rate of 8%:

Year	Amortised Cost at Beginning	Interest Income @ 8%	Total Amount	Instalment Received	Amortised Cost at the End
1	17,60,00,000	1,40,80,000	19,00,80,000	1,00,00,000	18,00,80,000
2	18,00,80,000	1,44,06,400	19,44,86,400	1,00,00,000	18,44,86,400
3	18,44,86,400	1,47,58,912	19,92,45,312	1,00,00,000	18,92,45,312
4	18,92,45,312	1,51,39,625	20,43,84,937	1,00,00,000	19,43,84,937
5	19,43,84,937	1,56,15,063*	21,00,00,000	21,00,00,000	Nil

(b) Determination of Value of Debt Component:

Year	Cash Outflows	PVF (12%)	PV	
1 – 4	8,00,000	3.038	24,30,400	
4	1,12,00,000	0.636	71,23,200	
			95,53,600	

Determination of Value of Equity Component:

Equity Component = Total Amount Collected – Value of Debt
= 1,00,00,000 – 95,53,600
= Rs.4,46,400

Q 2 This contract comprises of two components:

Host Contract:
Contract to buy solar panels on 30.09.2022 @ Rs.78 per $ (Forward rate on 01.04.17 for settlement on 30.09.17

Embedded Derivative:
Forward contract to sell USD on 30.09.2022 @ Rs.78 per $

Determination of Change in Fair Value for Embedded Derivative:

Date	Spot Rate in Forward Market (buy)	Forward Rate (sell)	Change in FV p.u.	Change in FV Total (Rs. in milion)
01.04.22	78	78	---	---
30.09.22	77	78	1	50

Journal Entries on 30.09.22:

(all Rs. in million):

			Dr.	Cr.
1.	Derivative Financial Asset A/c	Dr.	50	
	To Profit & Loss A/c			50
	(Being loss on currency forward)			
2.	Purchases A/c ($50 X 78)	Dr.	3,900	
	To Trade payables (financial liability)			3,900
	(Being inventory recorded at forward exchange rate determined on date of contract)			
3.	Trade payables A/c	Dr.	50	
	To Derivative Financial Asset A/c			50
	(Being translation of trade payables at spot rate prevailing on 30.09.17 i.e. Rs.77 / $)			

Q 3

(a) 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 recognised in other comprehensive income and the fixed rate debentures at amortised 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.

(b) 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 recognised once the dividend is declared.

Solution prepared by CA. Ashish Lalaji