NEWSLETTER

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)

NOIDA BRANCH OF CIRC

For in house Circulation No. – 17 (2017-2018) August-2017

FROM THE DESK OF THE CHAIRMAN ….

Respected Professional Colleagues,

It is indeed a matter of immense pleasure to communicate with you all again through this newsletter after enjoying a month of festival for our fraternity as a foundation month as our prestigious Institution was founded on 1st July 1949 and successfully completed 68 glorious years. Friends, though it was really a challenging time for we all Chartered Accountants due to adverse remarks passed on by our honorable Prime Minister in his speech on the eve of Chartered Accountants' Day.

I am of the firm belief that we, as Chartered Accountants are discharging our professional liabilities with due Integrity and honesty with full independence. There might be very few members who may be indulged into certain unethical practices and because of them entire fraternity cannot be blamed. The Institute of Chartered Accountants of India and its members are constantly serving the Nation, Society and Citizens of India by promoting all schemes of Government of India whether it is ***"Swach Bharat Abiyan" or "IDS – 2016" or "PMGKY – 2017" or "Drafting, Implementation & Awareness of GST"*** in the Country.

Friends, I am delighted to share that all my fellow Committee Members are engaged in spreading awareness and educating the citizens at ***"GST Sahayta Desk"*** operational at our Branch Premises every day from 2 pm till 5 pm since 24th May' 2017.

As a part of professional development and for continuing professional education, we are oragnising Full day Symposium on 11th August' 2017 at the Hotel Park Ascent, Sector 62, NOIDA, where all the speakers like CA Bimal Jain, CA Manmohan Khemka, and Advocate Vineet Bhatia will be addressing the audience for clearing their all kinds of doubts on GST. In the series of events we are going to celebrate 71st Independence Day on 15th August' 2017 at the branch premises.

In the month of September, we are going to organize CFO meet under the agies of CIRC of ICAI. Detailed program will be forwarded to you shortly.

Friends, as I mentioned in my last communication that we, NOIDA Branch are planning to organize an International tour to St. Petersburg/ Moscow in the month of October' 2017, a mail in this regard is being forwarded to you for confirmation of your participation so that necessary arrangements accordingly. As far as Residential Refresher Course at Jim Corbett is concerned, the same has been rescheduled for the last week of November, as the weather in the month of August is not suitable due to heavy rains.

Looking forward for your continuous support in furtherance to professional development and unity in our fraternity.

Take up one idea. Make that one idea your life - think of it, dream of it, live on that idea. Let the brain, muscles, nerves, every part of your body, be full of that idea, and just leave every other idea alone. This is the way to success.

~Swami Vivekananda~

With warm professional regards….

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SECRETARY WRITES……….

Respected Professional colleagues,

I am very glad to keep in touch with all of you through this e- news letter.

Friends, CIRC has organised a symposium on GST on 11th August, 2017 which is hosted by Noida Branch. the programme was wonderful with the delightful presence of all of you. Around 200 member had joined the programme. Further, The Branch has celebrated 71th Independence Day on 15th August, 2017 in our Noida Branch Premises. Thanks to all of you for your presence there. Now our next programs in the series shall be in the month of September 2017.

Dear Friends, We all will be highly busy in the month of September for Tax Audit and Income Tax filling. So, In the immediate next month, We Committee members of the Noida Branch have decided to organise a 6 days and 5 night International Study Tour to Saint Petersburg in Russia on around 22nd day of October, 2017. The cost the tour will be around 1 lakh per member. But final quote is still pending to come. The detail of the tour Programme will be intimated to all of you accordingly.

Your suggestions shall always be a source of inspiration for me and my other committee's colleagues.

With Best Wishes & Regards,
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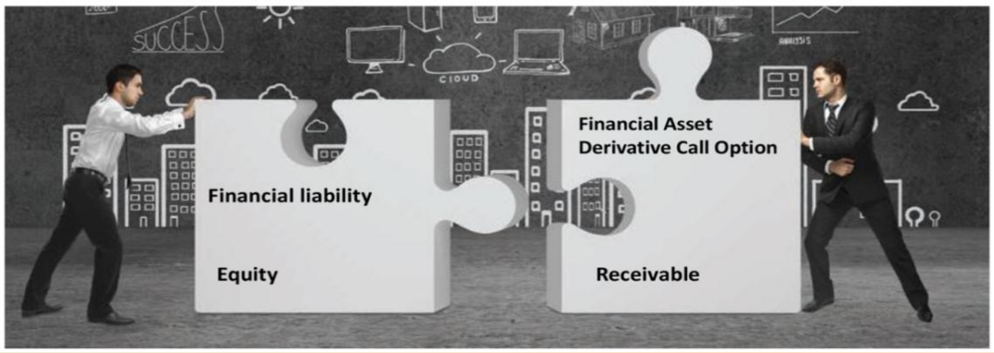
Accounting for Compound financial Instruments



Introduction

Companies in their normal course of business may structure the terms of a financial instrument in such a way that it contains both equity and liability components. It implies that the instrument is neither entirely a liability instrument nor an entirely equity instrument. *Ind AS 32:28* refers such instruments as compound instrument.

Indian Accounting Standards are primarily based upon the principle of substance over the legal form. Compound financial instrument takes the legal form of a single instrument, while the substance is that both a liability and equity instruments exit.

Accordingly, *Ind AS 32:28* requires that the liability and equity components of a compound financial instrument to be accounted for separately in the balance sheet. It means that the issuer of such an instrument cannot simply show it purely as a liability or purely as an equity, because this instrument contains a little bit of both.

Let understand this with the help of an example:-

A preference share that pays mandatorily dividend each year and is convertible at the redemption by the holder into a fixed number of ordinary shares of the issuer has the legal form of a debt contract while its substance is that of two instruments:

- financial liability to deliver cash which exists as long as the preference share is not converted; and
- written call option *(Right To Purchase)* granting the holder the right to convert the bond into a fixed number of ordinary share of the entity.

Splitting the liability and equity component

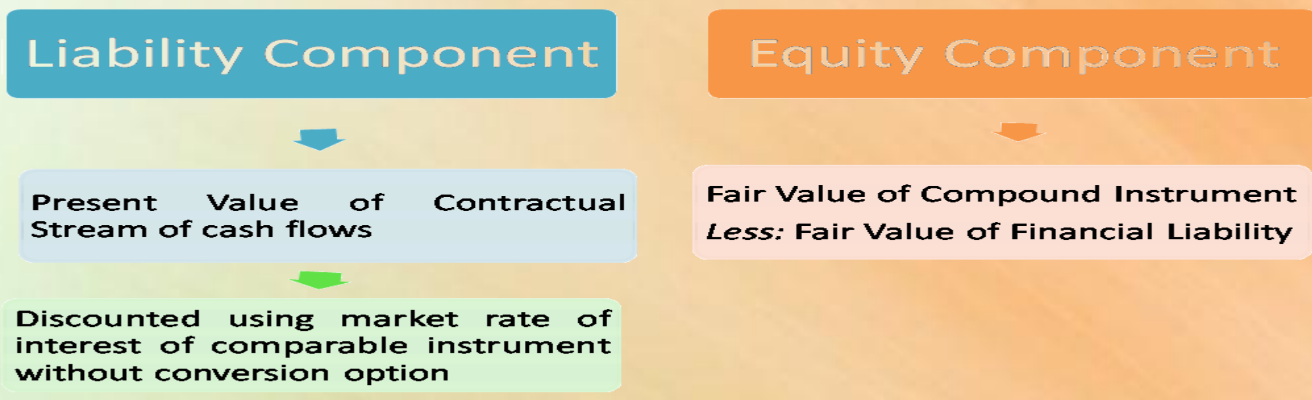
Initial Measurement

Compound financial instrument are separated into liability and equity component at initial recognition and is not subsequently revised. The following steps are performed for the separation:-

- ***Step -1*** the fair value of the liability component is computed and this fair value is the initial carrying amount of the liability component; and
- ***Step - 2*** since equity is defined as a residual interest in the interest of the entity after deducting all of its liabilities the fair value of the liability component is reduced from the fair value of the

instrument as whole, with the resulting residual amount is being recognised as an equity component.

The fair value of the liability component at the initial recognition is the present value of contractual stream cash flows discounted at the market rate of interest that would have been applied to instrument of comparable credit quality with substantially the same cash flows, on the same terms, but without the conversion option.



Case Study

Let understand the requirement of separating the equity and financial liability component of compound financial instrument with the help of a practical example:-

Jupiter ltd has issued 12% convertible bonds of Rs. 20,00,000 on 1 April 2017. These bonds are issued at par with face value of Rs. 100 per bond and having a life term of 4 years. Each bond is convertible at the option of holder at any time up to maturity into 1 share. Similar bonds without conversion option carry interest rate of 16%.

Calculation of fair value of liability component

Year	Cash Outflow	P.V. factor 16%	Amount
1	2,40,000	0.862	2,06,880
2	2,40,000	0.743	1,78,320
3	2,40,000	0.641	1,53,840
4	2,40,000	0.552	1,32,480
4	20,00,000	0.552	11,04,000
Fair Value of Liability Component			17,75,520

Calculation of Fair value of Equity component

Proceeds of Bond Issued – Fair Value of liability component

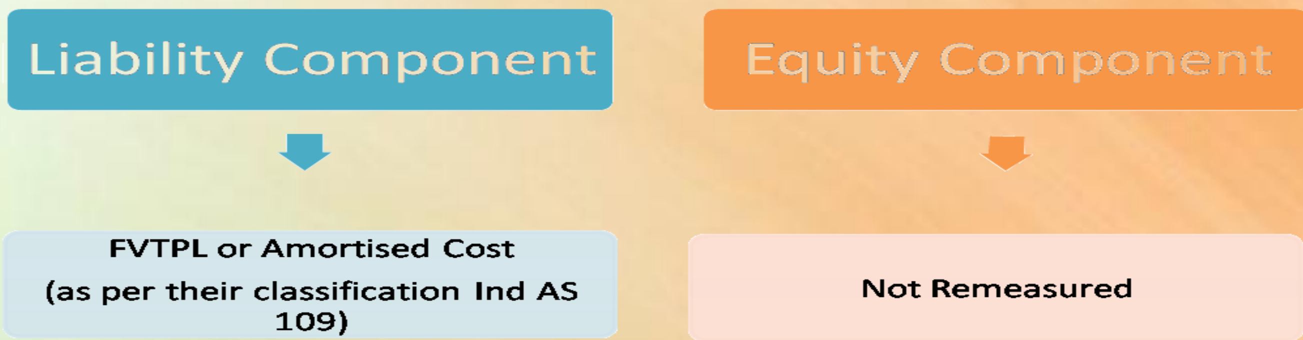
= Rs.20,00,000 – Rs.17,75,520
= Rs.2,24,480

Journal entry for recognition of convertible bond

	Rs.	Rs.
Debit: Bank	20,00,000	
Credit: Financial Liability		17,75,520
Credit: Equity		2,24,480

Subsequent Measurement

Depending upon the classification of financial liability component (either at FVTPL or amortised cost) it will be subsequently remeasured in accordance the measurement principle of *Ind AS 109* depending on its classification (either at FVTPL or amortised cost). However, the equity component will not be remeasured.



Conversion of compound instrument

At the time of conversion of compound instrument, equity is issued and the liability component is derecognised. Equity component originally recognised at initial recognition remains in equity (although it may be reclassified from one line item of equity to another). No gain or loss is recognised on conversion at maturity.

Case Study

Assume the facts are as same as in above case study, the holder of bonds exercises their right on 31 March 2019 (i.e. the end of year 2 of the instrument's life). The liability has been classified and measured at amortised cost using the effective interest method.

At 31 March 2019, the position of financial statement is as follows:

Amortisation Cost table:

Year	Opening balance of financial liability	Interest (16%)	Repayment	Closing balance of financial liability
1	17,75,520	2,84,083	2,40,000	18,19,603
2	18,19,603	2,91,136	2,40,000	18,70,739

The amortised cost carrying amount of the liability just before the conversion is Rs. 18,70,739;
The original equity component just before conversion still stands at the original Rs. 2,24,480; and
Upon conversion 20,000 ordinary shares will be issued with each equity share having a nominal value of Rs. 10.

The accounting entries upon conversion to remove the liability from the balance sheet and recognise the issue of shares as a result of conversion will be as follows:

	Rs.	Rs.
Debit: Financial Liability	18,70,739	
Credit: Equity		18,70,739

Note: the original component of equity Rs.2,24,480 may be reclassified to another line item within equity.

Early redemption of compound instrument

Sometimes an entity may redeems or repurchases a convertible instrument before its maturity through a gentle offer without altering the conversion features, in such situation, the consideration paid including transaction costs for the redemption or repurchase is allocated to the liability and equity component at the date of early redemption or repurchase.

The method used for the allocation is same as that used to make the original allocation of proceeds of the instrument between liability and equity component at the time of initial recognition.

Loss is recognised in respect of liability component where the amount of consideration allocated exceeds the carrying amount of the liability at that time. Conversely, the gain is recognised where consideration allocated is lesser than lesser than the carrying amount.

No gain or loss is recognised in respect of the equity component and any amount which remains un-eliminated may be reclassified into another line item within equity.

Amendment in terms of compound financial instrument

Sometimes, an entity may amend the terms of convertible instrument during its life so as to make conversion for attractive either through offering a more favourable conversion ratio, paying additional consideration in the event of conversion before specified date or a combination of both.

Under such circumstances, the difference between the fair value of the consideration that the holder receives upon conversion under the revised terms and the fair value of the consideration that the holder would have received upon conversion under the original terms, measured at the date when the terms are revised, should be recognised a loss.

Accounting treatment in holder's financial statements

The holder of the compound financial instrument also has 2 components:

- A derivative financial asset being the call option for issuer's bond being measured initially at fair value and
- A receivable towards issuer of convertible bond being measured at fair value as residual.

Conclusion

Accounting for compound financial instruments can become somewhat mind-twister and it is therefore advisable to work through each step in a logical manner. In current scenario there are financial instrument which contains a mix of debt and equity. The terms of the instrument has to be gone through more precisely to understand the substance of the instrument and doing accounting accordingly rather than by its legal form.

Regards:-

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SNAP DURING SEMINAR ON GST


FULL DAY SYMPOSIUM ON GST
ORGANIZED BY: CIRC, KANPUR

MOTTO

Ya esa suptesu jagarti kamam kamam Puruso nirmimanah I
Tadeva sukram tad brahma tadevamrtamucyate I
Tasminlokah sritah sarve tadu natyeti Kascan I etad vai tat I I

य एष सुप्तेषु जागर्ति कामं कामं पुरूषो निर्मिमाण : ।
तदेव शुक्रं तद् ब्रह्म तदेवामृतमुच्यते ।
तस्मिंल्लोकाः श्रिताः सर्वे तदु नात्येति कश्चन । एतद् वै तत् ।।

(That person who is awake in those that sleep, shaping desire after desire, that, indeed, is the pure. That is Brahman, that, indeed, is called the immortal. In it all the worlds rest and no one ever goes beyond it. This, verily, is that, kamam kamam : desire after desire, really objects of desire. Even dream objects like objects of wa-king consciousness are due to the Supreme Person. Even dream consciousness is a proof of the existence of the self.

No one ever goes beyond it : cf. Eckhart : 'On reaching God all progress ends.')

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