

CA FINAL FINANCIAL REPORTING

NEW COURSE



Notebook style *multicoloured*
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Sure Shot Notes

Financial Instruments

F.A.S.T
first attempt success tutorials

INDEX

Intro

INTRODUCTION TO IND AS
AND SCHEDULE III

1

Ind AS
1

PRESENTATION OF FINANCIAL
STATEMENTS

16

Ind AS
2

INVENTORIES

29

Ind AS
7

STATEMENT OF CASH FLOWS

34

Ind AS
8

ACCOUNTING POLICIES, CHANGES IN
ACCOUNTING ESTIMATES & ERRORS

40

Ind AS
10

EVENT AFTER THE REPORTING PERIOD

45

Ind AS
12

INCOME TAXES

48

Ind AS
16

PROPERTY, PLANT & EQUIPMENT

59

Ind AS
19

EMPLOYEE BENEFITS

70

Ind AS
20

ACCOUNTING FOR GOVT. GRANTS AND
DISCLOSURE OF GOVERNMENT ASSISTANCE

77

Ind AS
21

THE EFFECTS OF CHANGES
IN FOREIGN EXCHANGE RATES

81

Ind AS
23

BORROWING COSTS

85

Ind AS
24

RELATED PARTY DISCLOSURES

89

Ind AS
33

EARNINGS PER SHARE

94

Ind AS
34

INTERIM FINANCIAL REPORTING

104

Ind AS
36

IMPAIRMENT OF ASSETS

110

Ind AS
37

PROVISIONS, CONTINGENT
LIABILITIES & CONTINGENTS ASSETS

117

Ind AS
38

INTANGIBLE ASSETS

123

Ind AS
40

INVESTMENT PROPERTY

130

Ind AS
41

AGRICULTURE

134

Ind AS
101

FIRST TIME ADOPTION OF IND AS

137

Ind AS
102

SHARE BASED PAYMENT (SBP)

147

Ind AS
103

BUSINESS COMBINATIONS

164

Ind AS
105

NON-CURRENT ASSETS HELD FOR SALE
AND DISCONTINUED OPERATIONS

173

Ind AS
108

OPERATING SEGMENTS

179

FI

ACCOUNTING AND REPORTING
OF FINANCIAL INSTRUMENTS
(Ind AS 32, 109 & 107)

183

Group
Accounts

CONSOLIDATED AND SEPARATE FINANCIAL
STATEMENT OF GROUP ENTITIES
(Ind AS 110, 111, 112, 27 & 28)

219

Ind AS
113

FAIR VALUE MEASUREMENT

253

Ind AS
115

REVENUE FROM CONTRACTS
WITH CUSTOMERS

260

Ind AS
116

LEASES

270

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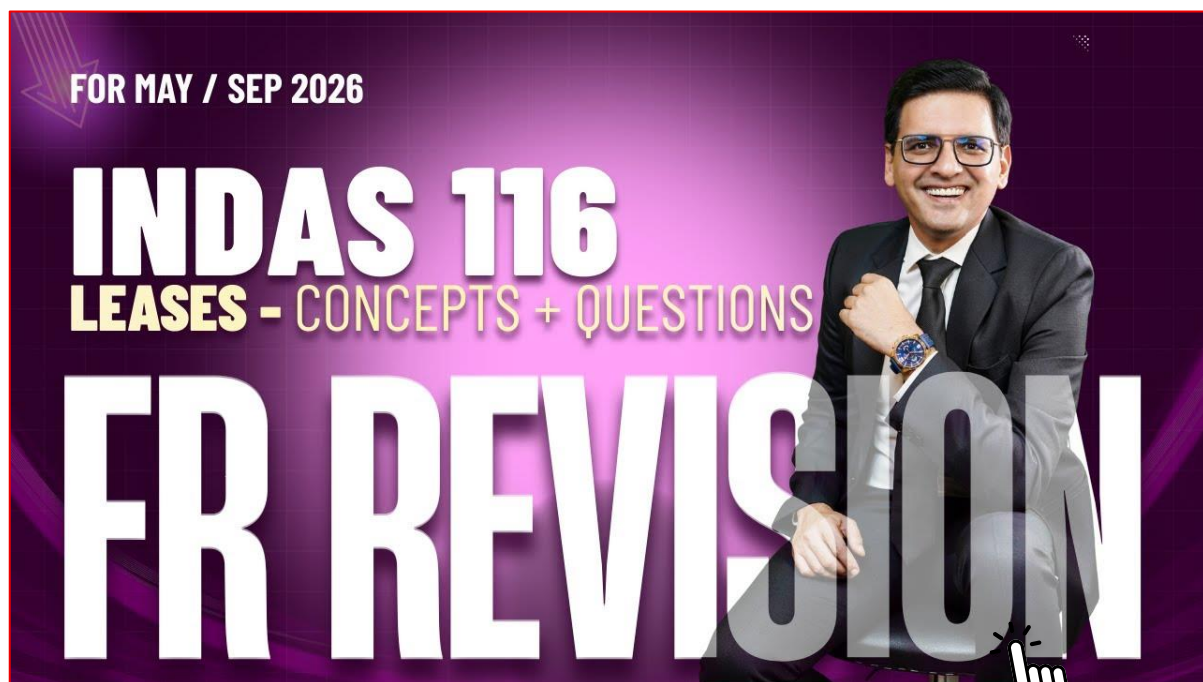
Watch my full video on  YouTube.



A video thumbnail featuring a man in a suit and glasses smiling. The background is a blurred office setting. Three yellow sticky notes with green checkmarks are floating around him, labeled 'Latest Questions', 'Conceptual Clarity', and 'Step-wise Question Solving'. To the right, there is a book cover for 'CA FINAL FINANCIAL REPORTING' with a 'FREE PDF' badge. The text 'FINANCIAL INSTRUMENTS' is in large white and yellow letters, and 'CA Final REVISION 2026' is in white and yellow letters. A hand cursor icon is pointing at the bottom right corner.

[Click Here](#)

 FR Revision Playlist:



A video thumbnail featuring the same man in a suit and glasses smiling. The background is a purple gradient with a grid pattern. The text 'FOR MAY / SEP 2026' is in white at the top left. Below it, 'INDAS 116' is in large white letters, followed by 'LEASES - CONCEPTS + QUESTIONS' in smaller white letters. At the bottom, 'FR REVISION' is in very large white letters. A hand cursor icon is pointing at the bottom right corner.

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- IndAS 116 Leases Revision
- ICAI UPDATES - FR Amendments May 26
- CA Final FR Revision Playlist for May 26
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Pro Notes For:

- CA Final FR - Revision Plan Hours per Chapter PDF
- CA Final FR QB PDF
- CA Final Audit MCQ PDF

FI

Accounting and Reporting of Financial Instruments (Ind AS 32, 109 & 107)

INDEX

1

Ind AS 32: FI - Presentation Definition & Scope

- 1 Definitions
- 2 Special Cases
- 3 Off-Setting
- 4 Accounting for Interest, Dividends, Transaction Cost etc.
- 5 Exclusions

2

Ind AS 109: FI - Recognition & Measurement Amortised Cost Method (for FA & FL)

- 1 Applicable when 2 Conditions meet
- 2 Method used for
- 3 IR Accounting
- 4 Transaction Cost
- 5 EIR
- 6 Amortisation Table (AT)
- 7 Accounting where FA/FL has other Consideration involved
- 8 Compound FI
- 9 Steps to solve questions of ACM
- 10 Transaction Costs

3

Modification of CFs: Accounting under ACM

- A Accounting for Lender (FA)
- B Accounting for Borrower (FL)

4

FV Method: for FA

- 1 Applicability & Method
- 2 Accounting: IR, SM & DR
- 3 Accounting

5

FV Method: FL

- 1 FL → ACM except 6 exceptions:
- 2 Exceptions:

6

Derecognition

- 1 FA - Derecognition (DR)
- 2 FI - Derecognition (DR)

7

Impairment of FA

8

Reclassification

- 1 When applicable?
- 2 How Accounted?

9

Regular Way Purchase Sale (RWPS)

10

Derivative Financial Instruments (DFI)

- 1 What is DFI?
- 2 Accounting for DFI - FVTPL
- 3 Net Settlement Option in Contracts Involving Non-Financial Items (NFI)

11

Embedded Derivatives

12

Hedging

FI

Accounting and Reporting of Financial Instruments (Ind AS 32, 109 & 107)

1. Definition & Scope (Ind AS 32)

1

DEFINITIONS: (SIMPLIFIED)

1

Financial Instruments: Financial Asset for one entity and Financial Liability or Equity Instruments for another entity.

2

Financial Asset: Financial Asset is

- a | Cash
- b | Equity instruments of another entity
- c | Contractual right to receive, Cash or Equity Instruments of another entity or another Financial Asset
- d | Contracts to exchange Financial Asset under conditions that are potentially favorable

3

Financial Liability: Financial Liability is “Contractual Obligation” to-

- a | Pay Cash or Deliver Financial Asset
- b | Exchange Financial Asset under Conditions that are potentially unfavorable
- c | Deliver equity instruments of entity in **variable number**.

4

Equity Instruments: Equity Instruments represents “Residual Interest” in net assets of company.



SJ Tip

- **Obligation:** Liability that is not in the hands of the entity to be avoided.
- **Liability:** Entails probable outflow of economic resources.
- Prepaid Expense, Advance to Supplier are not financial asset as no Contractual right to receive cash
- Tax payable is not a FL as it is a statutory obligation and not contractual
- Inventory, Investment in Gold, PPE, IA, CWIP are not FA
- Trade Receivables, Cash, Bank Balance or FD; Investment in shares, bonds, convertible bonds; Loan given; are all FA
- Trade Payable, Bank Loan, Outstanding Expenses, Refundable Deposits, Redeemable PSC are FL.

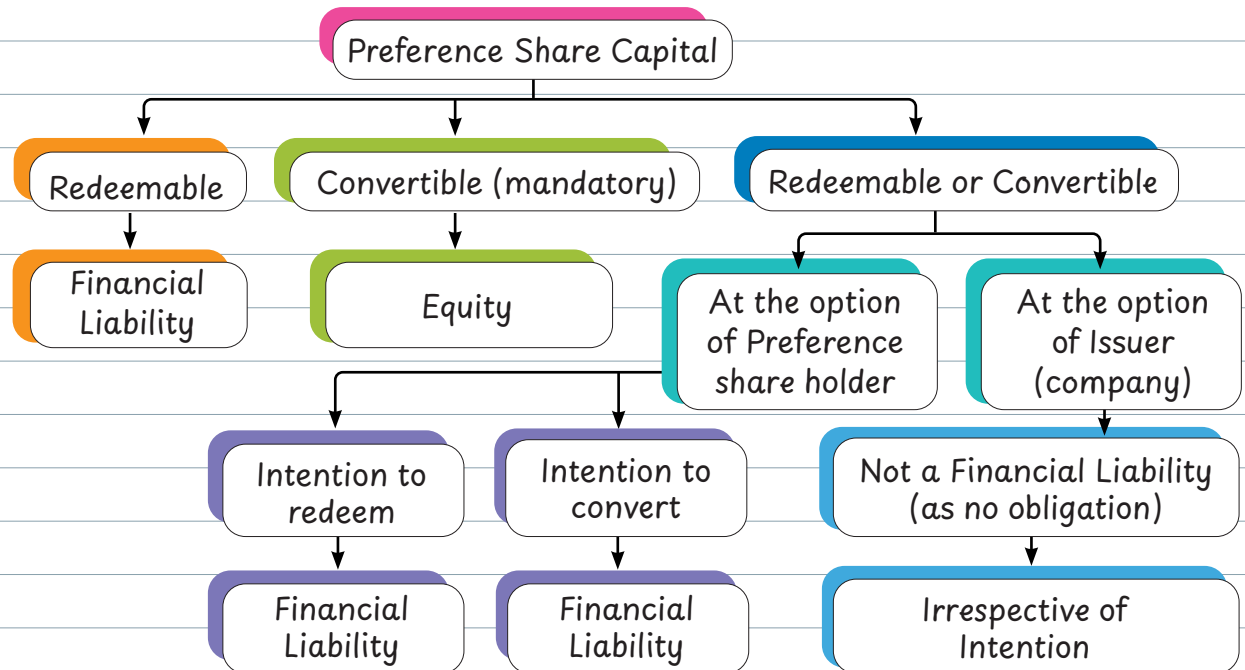
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SPECIAL CASES

Let us deal with special cases relating to definition of FA/FL:

Special

1.

Preference Share Capital:**Dividends on Preference Share Capital:**

- Dividends on Preference Share Capital (PSC) is payable (obligation arises) only when company declares dividend,
- Hence Preference Share Holders (PSH) **do not have a right to demand dividends**, even in case of cumulative PSC, but only to get a preference in dividends whenever declared.
- Therefore **Preference dividends are not 'Mandatory' payments but 'Discretionary' payments** (unless question specifies otherwise)



Convertible PSC: (See Next Point)

Special

2.

Contracts to deliver Own Equity Instruments: Fixed to Fixed Test (Convertible Fls)

Financial Instrument, where entity is required to settle the obligation in its own equity shares, will be classified as equity instrument if and only if it meets the Fixed to Fixed Test i.e.:

- Number of equity shares to be issued are fixed. Against
- Fixed Consideration in return for issue of such equity shares.

Case	Consideration Given	Consideration Received	Classification
1	Variable	Variable	Financial Liability
2	Variable	Fixed	Financial Liability
3	Fixed	Variable	Financial Liability
4	Fixed	Fixed	Equity

If Consideration of Number of Shares are varying based on 'Time' then they will be considered as Fixed



Carve Out: FCCB: If Fixed to Fixed test fails only due to the fact that the Financial Instruments involves foreign currency and consideration received changes only w.r.t forex fluctuations then it will be considered as meeting Fixed to Fixed test under Ind AS.

Special

3. Financial Liability Classified as Equity:

Puttable Financial Instrument (PFI)

Para 16A

1. PFI have right to claim only **proportional share in net asset (PSNA)** of the company
2. PFI should be **most sub-ordinate** instruments
3. PFI to have **identical rights** with the most sub-ordinate instruments
4. **No fixed** or minimum or **committed** cash flow entitlements
5. Total cash flows over the term of **PFI = PSNA**

Para 16B

- There are **no other Financial Instruments or Contract** that:
1. Have **effect of fixing/changing the cash flows** of PFI; and
 2. In **effect have a PSNA** of entity

Instruments Entitled to PSNA on Liquidation

Para 16C**(PSNA on Liquidation of Company)**

1. FI have right to claim **only proportional share in net asset (PSNA)** of the company
2. FI should **be most sub-ordinate** instruments
3. FI to have **identical rights** with the most sub-ordinate instruments
4. **Para 16C = Condition 1+2+3 of Para 16 A**

Para 16B

There are no other Financial Instruments or Contract that:

1. Have effect of fixing/changing the cash flows of PFI; and
2. In effect have a PSNA of entity

Para 16D = Para 16B

(a) Such Instruments are to be classified/presented under equity & not financial liability, categorised as PFI or Instruments entitled to PSNA only on liquidation under the heads of Equity Share Capital

(b) On reclassification of:

- **a.** PFI to FL - Transfer @ CA on date of reclassification
- **b.** FL to PFI - Transfer @ FV on date of reclassification

Special**4. Treasury Shares** (not permitted in India)

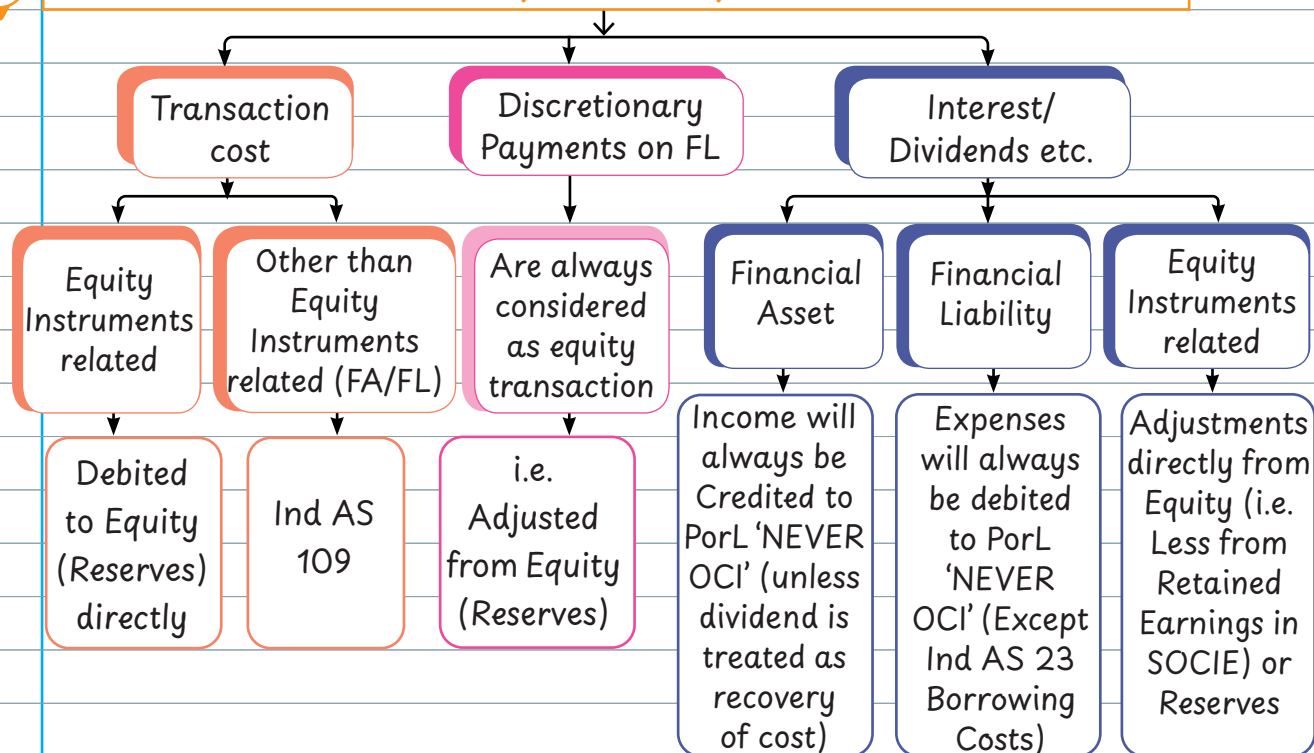
- In India, shares bought back have to be cancelled within 7 days and cannot be held for further reissue.
- However, under reconstruction schemes approved by court, shares may be surrendered by shareholders and held to be reissued to creditors;
- When company acquires its own shares and holds it as Treasury Shares to be reissued to others at later date (usually outside India) then:
 - a** ➤ Share capital cannot be reduced as company has not cancelled its shares;
 - b** ➤ Such treasury shares cannot be shown as asset, as company cannot invest in its own shares;
 - c** ➤ Hence, company should present treasury shares as a deduction from share capital in 'Notes to Financial Statements' and net share capital will be presented in the Balance Sheet.

3

OFF-SETTING

- Ind AS 1 permits off-setting only when any Ind AS requires;
- Ind AS 32 requires financial assets and financial liability off-setting when there:
 - (a) Is a legal contractual right to net-off the dues & receivables; and
 - (b) Entity intends to settle in net.

4

ACCOUNTING FOR INTEREST, DIVIDENDS, TRANSACTION COST ETC.-

5

EXCLUSIONS

- a **Investment in Subsidiary/J.V./Associate: (in Equity Instrument)**
 - (i) **In Consolidated F.S.:** Accounted for as per Ind AS on Consolidation i.e.
 - Subsidiaries: Ind AS 110
 - JV/Associate: Ind AS 28
 - (ii) **In Standalone F.S.:** Accounted for as per Ind AS 27, Ind AS 27 gives option to value such investments at Cost or as per Ind AS 109
- b **Share Based Payments:** Ind AS 102 applies to share based payments
- c **Employee Benefits:** Ind AS 19 prescribes accounting for employee benefits hence Ind AS 109 is not applicable except situations where Ind AS 19 requires accounting to be done as per Ind AS 109 & Treasury shares for employees
- d ★★ **Provisions (Liability/Payables related):** Accounted for under Ind AS 37 etc
- e **Insurance Contract (Issuer):** Ind AS 117 Applies

2. Amortised Cost Method (ACM) (for FA & FL)

(FA/FL accounted using Cost Method or FV Method.

Lets first discuss Cost Method termed as ACM)

1

APPLICABLE WHEN 2 CONDITIONS MET

[FI meets SPPI + BM is Hold only]

(i)

The FI has specified contractual cash flows that represent SOLELY PAYMENT of **PRINCIPAL*** and **INTEREST**** (SPPI): and

(ii)

Business model (BM) of entity is HOLD only i.e., to hold the FI to Collect its specified contractual cash flows only Land not to sale before maturity)

*Principal refers to fair value of FI on IR

**Interest means return for time value of Money + credit risk + foreign currency risk, etc. on principal amount.

2

METHOD USED FOR

>

All FL (Exceptions discussed later)

>

FA that meets SPPI test and BM is HOLD only.

↳ Example of FA whether meeting SPPI test:

- | | | |
|----|---|-------|
| a> | Investment in Equity shares | - No |
| b> | Investment in 10% Redeemable Debentures | - Yes |
| c> | Investment in Gold Bond (return - Gold rate return) | - No |
| d> | Interest free loan to Employees | - Yes |

3

IR ACCOUNTING

>

Recognise FA at = Fair value + Transaction Costs

>

Recognise FL at = Fair value - Transaction Costs

>

Fair Value on IR = Cash Flow on IR unless "Other Consideration" involved.

>

When Cash flows on IR not equal to fair value, difference, recorded in:

↳ **PorL:** If FV based on Level 1 input (Discussed in IndAS 113)

↳ **Deferred consideration:** In other cases (Interest free/ Concessional interest rate loans or deposits) and accounted as per applicable IndAS, further discussed below.

4

TRANSACTION COST

(Concept/Term used in several Ind AS)

- Means cost directly attributable to the transaction.
- DIRECTLY ATTRIBUTABLE means the cost that would not be incurred if the transaction was not executed.
- In Case of FA/FL accounted as per ACM, it affects E.I.R.

5

EIR

EIR will be the:

- (a) **Coupon Rate** → In Normal Question with no transaction cost, discount, premium, etc.
- (b) **Market Rate** → When other consideration involved.
- (c) **Computed Rate** → Question with premium/discount/tr. costs
- └─ Here compute EIR by equating PV of cash inflows and outflow, **Simply a rate which discounts future cash flows to IR value of FA/FL.**

6

SM ACCOUNTING: AMORTISATION TABLE (AT)

- (i) Prepare AT as follows and do subsequent accounting:

Year	Opening (a)	Interest (b)	CFs at year end (c)	Closing (d)
1	IR value	(a) × E.I.R%	Interest / Installment paid or received	a+b-c
2	P.Y. closing	and so on..	-	-
-	-	-	-	-
Last year	-	Note (ii)	-	NIL

- (ii) Remember to adjust last year's interest for rounding off differences
- (iii) Interest – Recognised in P or L
- (iv) Closing Balance – shown in BS under
- Current:** FA/FL = Next year repayment – next year interest (cannot be negative)
- Non-Current:** FA/FL = Balance amount

7

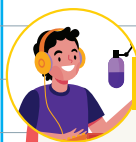
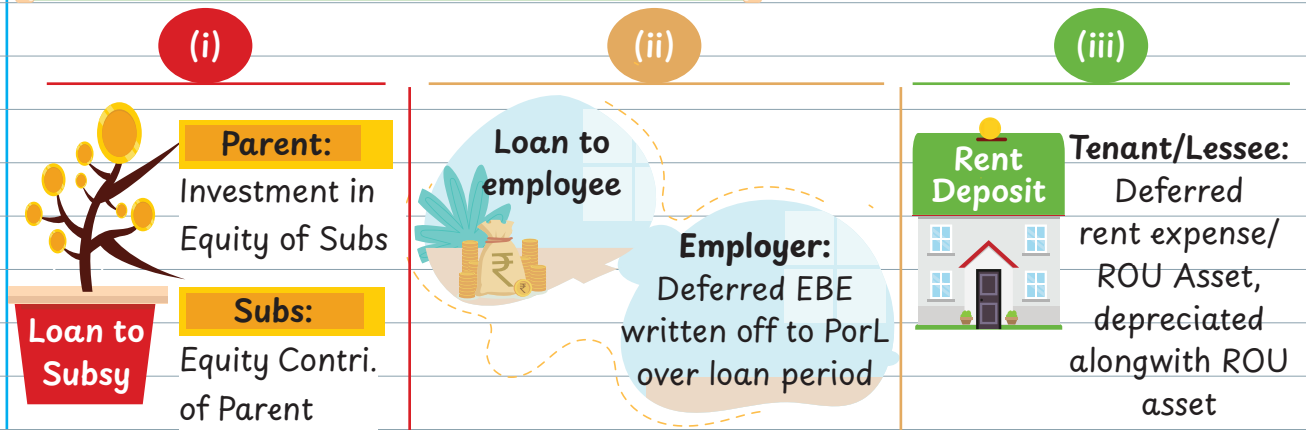
ACCOUNTING WHERE FA/FL HAS OTHER CONSIDERATION INVOLVED**Example****Concessional or Interest Free Loan**

- i. Loan to subsidiary
- ii. Loan to Employee
- iii. Rent deposit

Accounting

- In all above cases use market interest rate as EIR.
- Then discount FCFs to get PV of FCFs being FV on IR.
- Diff. of **actual Year 0 cash flow** and **FV** is deemed consideration for other benefits

Deemed Consideration: Recorded as:



अर्ज किया है

Thankfully, such questions do not have transaction costs. अगर होती Then allocate it to FA/FL and other considerations and recompute E/R on FA/FL as done in CFI with transaction costs आगे पड़ते हैं?

Note: Concessional interest rate loan to subsidiary Loan to subsidiaries may have repayment terms such as:

- **a > Repayable on Demand** → Then accounting to be: IR at face value, EIR = coupon rate
- **b > Repayable when funds available** → That as good as a usual loan and not a demand loan. Accounting to be: Based an estimate of expected cash flows.

8

COMPOUND FI

Convertible Debentures - Whether Principal outflow included in FI?

(i)

It is a FL with Equity component

(ii)

Eg. Convertible debenture / PSC, Debenture with concessional rates but favorable conversion options to holders, etc.

(iii)

IR involves **Splitting** year 'O' CFs into **FL** and **Equity Component**

(iv)

★ **FL component** is FV of FCFs (unavoidable outflows) discounted using market interest rates. 10% debenture of ₹100 face value convertible into equity shares at option of holder, after 5 years has unavoidable cash flows of ₹10 for 5 years and ₹100 after 5 years as it is not compulsorily convertible and holder have option to convert or redeem.

★ **Equity component** is **"Year 'O' CFs from the FI - FL"** (Bal. Fig.)

(v)

Tr. cost, if any, to be split pro-rata in ratio of IR amount of FL and Equity to:

★ FL (will ↓ Year 'O' CFs hence ↑ EIR%), and

★ Equity (Reserves से adjust)

(vi)

Then FL solved as per ACM using **EIR** as above

(vii)

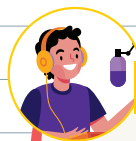
On due date if:

★ **CFI Converted** → FL balance t/f to Equity/Reserve, and SC increased

★ **CFI Paid** → Equity Component t/f to Equity/Reserve, and FL paid

ACM	Transactions at FV	Transactions with other consideration	Compound FI (CFI)
1. Example	Redeemable PSC/ Bonds issued at par/discount/premium	Deposits to Lessor, Concessional interest loans to employee or subsidiary	FL with equity conversion option like convertible deb.
2. EIR	Coupon rate adjusted to discount, premium or transaction costs	Market interest rates (adjusted for transaction costs)	Market interest rates for FL (adjusted for transaction costs relating to FL component)
3. IR of FA/ FL	FA or FL's measured at Year 'O' CFs	PV of FCFs discounted at market interest rates	FL: at PV of "UNAVOIDABLE" CFs discounted at market interest rates
4. IR Value - Difference of Yr O CFs and FV	NIL	Treated as deferred consideration adjusted in: → ROU Asset → Deferred EBE → Investment in Subs. or Equity Contribution from Parent	Equity portion of CFI

6. SM → FA/ FL	Prepare AT using EIR for FA/FL	Prepare AT using EIR for FA/FL	Prepare AT using EIR for FL
7. SM → IR difference	N.A.	(a) Lease Deposit: Depreciate with ROU Asset (b) Employee Loan: Write off over Loan period. (c) Loan to Subsidiary: No remeasurement	Equity Portion of CFI - No remeasurement. On due date Equity balance transferred to: (a) Securities Premium: If FI converted (b) Retained Earnings (R.E.). If FI redeemed



अर्ज किया है

Situation where EIR = Coupon Interest rate

Where apart from interest there is no other cost or return like transaction cost, discount, premium, any other consideration.

Situation where EIR = Market Interest rate

Transaction has other Consideration & no transaction costs.

9

STEPS TO SOLVE QUESTIONS OF ACM

Steps: (sequence of steps may change for different questions)

- 1 ➤ CFs year wise
- 2 ➤ EIR Computation by equation Year 'O' CF (after adjusting Tr. Costs) = PV of FCFs
- 3 ➤ IR value of FA/FL and deemed consideration, if any.
- 4 ➤ Amortisation Table (AT) for FA/FL:

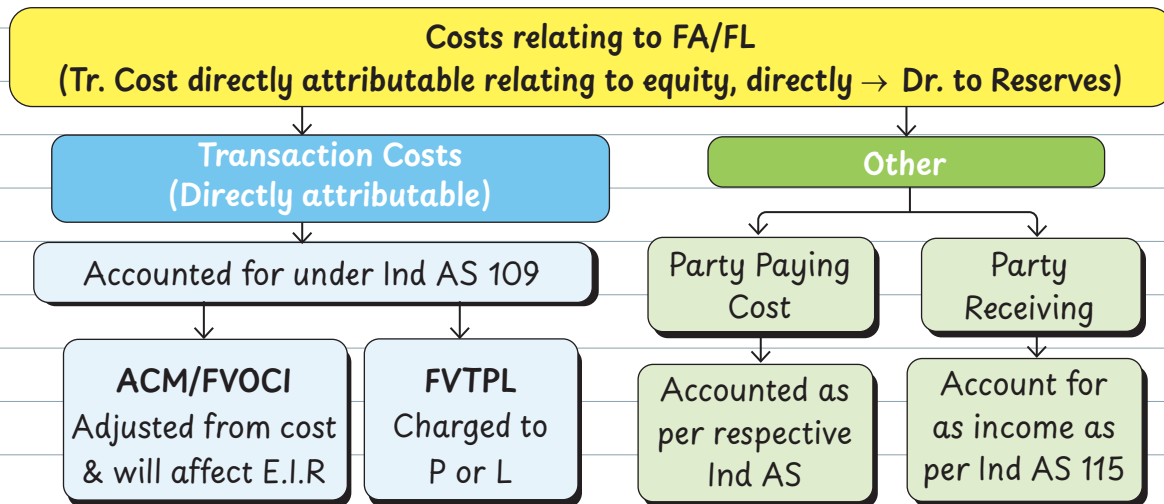
Year	Opening (a)	Interest (b)	CFs (c)	Closing (d)
1	IR Value	(a) × EIR%	Actual CF	a + b - c
..... Continue till derecognition				

- 5 ➤ Other consideration, if any, either continued as it is or transferred to P or L over term of FI.

10

TRANSACTION COSTS

- ▶ Ind AS 109 defines Transaction Costs as Costs directly attributable to FA or FL. Directly attributable means, the cost would have been avoided had FA/FL was not acquired/taken



- ▶ Processing fees of undisbursed loan:
- deferred if draw down of loan likely
 - written off if draw down unlikely (means further withdraw unlikely)

Student Notes

3. Modification of CFs: Accounting under ACM

A. Accounting for Lender (FA)

 **When Applicable?**

Re-negotiation of terms of loan given

How Accounted? 

CA of FA - PV of Revised FCFs using the same EIR, is to be booked to:

(a) When the change in FCFs is due to renegotiation of terms:

↳ **PorL** or **Deferred** in certain cases like concessional interest rate loans where difference is adjusted from Deferred amount of EBE.

(b) When the change in FCFs is due to increase in credit risk leading to lesser FCFs expected to be recovered from the FA

↳ **PorL** as impairment loss (However this is not treated as modification but accounting treatment is similar to modification hence discussed here)

B. Accounting for Borrower (FL)

 **When applicable?**

When the Borrower requests to renegotiate the terms

How Accounted? 

(a) If Substantial Modification

- a. DR existing FL
- b. Recognise New FL at PV of FCFs at current market rates
- c. Difference of above a and b recognized in PorL as gain / (loss)
- d. Transaction Costs if any - Debited to PorL
- e. EIR → Current rates based

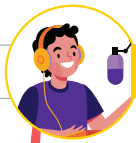
(b) Else

- a. Transaction Costs if any → Reduce from CA of FL
- b. Recompute EIR so that the CA of FL after reducing Transaction Costs equates to revised FCFs
- c. No G/L recognized in PorL
- d. EIR → Revised henceforth

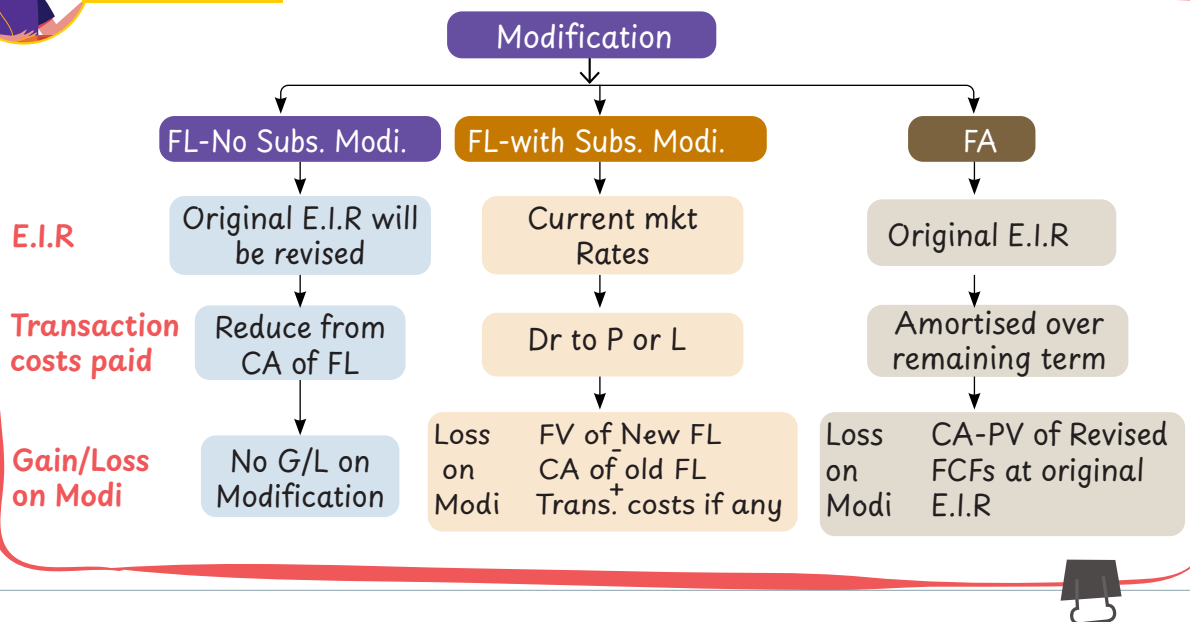
When Substantial Modification?

When using the same EIR as earlier, PV of FL under modified terms + Transaction Costs is different from the CA of FL before modification by 10% or more

Substantial Modification = $\frac{[\text{Carrying amount of FL} - \text{PV of revised cash flows after considering transaction cost using original E.I.R.}]}{\text{CA of FL}} \times 100 \geq 10\%$



अर्ज किया है



Student Notes

4. FV Method: for FA

(fair value means exit price, the selling price (SP) of asset & not net SP)

1 APPLICABILITY & METHOD

- 1 > **FVTOCI(R)** → Investment in FI that meet SPPI + BM is to Hold or Sell and not Hold only or Trade. Eg. Investment in redeemable bonds
- 2 > **FVTOCI(NR)** → Only for Investment in Equity shares, if opted on IR. Option Rules → Decide on IR, Decide Separately for each investment, irrevocable option
- 3 > **FVTPL** → All FIs, if BM is to trade, Derivative FI, to avoid accounting mismatch, Investment in equity shares where FVTOCI (NR) not opted on IR.

2 ACCOUNTING: IR, SM & DR

- 1 > **FVTPL** → IR @FV, Transaction cost @ Dr to PorL, SM @FV with G/L to PorL, DR, G/L to P or L
- 2 > **FVTOCI (R)** → IR @FV + Transaction Cost, SM @FV with G/L to OCI(R), DR G/L to PorL alongwith OCI - R balance to PorL
- 3 > **FVTOCI (NR)** → IR @FV + Transaction Cost, SM @FV with G/L to OCI(NR), DR G/L to PorL alongwith OCI - NR balance to R.E.

3 ACCOUNTING

Method	FVOCI (R)	FVOCI(NR)	FVTPL
Eg.	Invst in Redeemable Debenture Intention: Hold or sell	Invst in Equity Share. Co. not trading into it. Co. opts to measure at FVOCI(NR)	Invest in Equity Share
(1) IR	FV+Transaction Cost	FV+Transaction cost	FV
(2) Transaction cost	Added to Invst	Added to Invst	Debited to PorL
(3) Transaction Amt-FV	Difference will be accounted for as discussed earlier in ACM		

(4) SM	1. IR + Interest using E.I.R. - Interest Received = Closing CA, Simply follow ACM. 2. FV-CA will be Dr/Cr to FV gain/loss in OCI (R) 3. EIR % will be applied on amortised cost & not fair value.	At fair value & FV gain / loss booked in OCI(NR)	at FV & gain/loss to be Cr/Dr in PorL directly
(5) "Forex Gain or Loss"	It will be recognised thru 'P or L', unlike FV Gain / Loss which is recognised via OCI-R. Simply, first apply ACM, then convert foreign currency to INR and measure forex g/l for PorL. Then remeasure @ FV (in INR) with G/L to OCI-R.	Simply measured at FV on reporting date using reporting date E/R with total G/L recorded in OCI-NR	Simply measured at FV on reporting date using reporting date E/R with total G/L recorded in PorL
(6) Derecognition			
Step I	Do accounting of SM, till the date of DR (SM = Subsequent Measurement)		
Step II	Difference between sales consideration and CA as per Step I above will be recognised in P or L only		
(+)	G/L accumulated in OCI-R in CY or PYs will be reclassified to P or L in C.Y. as a reclassification adjustment in SPL	G/L accumulated in OCI - NR in CY / PYs will not be reclassified, rather transferred to reserves in SOCIE	N.A.
(7) Interest / Dividend Income	Interest income credited to P or L (using E.I.R.). Basically interest income is computed using amortisation table, same as done in ACM.	Dividend income credited to P or L, "unless it represents recovery of costs" where investment cost includes upcoming dividends.	Dividend Income/ Interest Income credited to P or L (Interest income using coupon rate & not E.I.R.)

Example for all Methods:

10% Deb. Face value 1000, Purchased at 1100, Tr. Cost. 50, EIR 8%, FV at Year 1 end 1200/- and Year 2 end 1225/-. Solve using all methods for year 1 and 2.

I.

ACM

(Year) Op.	Interest 8%	Repay	Cl. Balance
(1) 1150	92	100	1142
(2) 1142	91.36	100	1133.36

II.

FVOCI (R)

(Year) Op.	Interest 8%	Repay	Cl. Balance	Cl. FV	Gain (OCI-R)
(1) 1150	92	100	1142	1200	58(1200-1142)
(2) 1200	91.36 (8% on 1142 Amortised Cost and not 1200 FV)	100	1191.36	1225	33.64 (1225-1191.36)

III.

FVTPL

(Year) Op.	Interest 10%	Repay.	Cl Balance	Cl. FV	Gain (PorL)
(1) 1100	100	100	1100	1200	100 (1200-1100)
(2) 1200	100	100	1200	1225	25 (1225-1200)

Student Notes

5. FV Method: FL

(fair value is the amount at which the liability can be settled)

FL → ACM except 6 exceptions:

- (A) ◆ Financial Guarantee (FG)
- (B) ◆ FL measured at FV due to accounting mismatch
- (C) ◆ FG - Factoring with Partial Recourse
- (D) ◆ Loan commitments
- (E) ◆ Contingent Liability recorded in business acquisition
 - ↳ Discussed in Business Combination
- (F) ◆ Contingent consideration (non-equity in nature)
 - ↳ Discussed in Business Combination

Exceptions:

(A) FG:

🧐 When Applicable?

Where guarantor gives guarantee to the creditor against debt of a principal debtor, accounting for the guarantor is discussed in IndAS 109.

A1. Guarantor Accounting

1. IR - Record Liability for Unamortised Revenue (UR) for such FG

- ↳ UR as per Ind AS 115 = PV of consideration receivable for FG for remaining period.
- ↳ Where FG given without consideration, UR = PV of Interest savings to borrower company on loan with guarantee.

2. SM - Recognised at higher of:

- (a) Unamortised Revenue (UR) – on SM date
- (b) FV of FG

$$\text{Guarantee Amount (GA)} \times \text{Probability for Default \% (PFD)} \times \text{Loss Given Default \% (LGD)}$$

3.

Gain / Loss on SM -

- (a) Where closing liability < opening liability – Gain credited to PorL as revenue under Ind AS 115
- (b) Where closing liability > opening liability – Loss debited to PorL

Eg.

Loan taken for 10,000 @ 8% p.a. with FG from Parent company.

Principal repayable in 3 years.

Interest w/o FG 12% pa.

Parent did not charge any consideration for FG given as given to Subsidiary.

PFD at end of year 1 is 3% and year 28% and LGD is 100% in both years.

Ans.

On IR: UR = PV of Interest saved due FG = $400 \times AF_{12\%}^3 = 960/-$

Parent to record FG liability on IR at 960 and Debit Investment in Subsidiary

SM: Unamortised Revenue and FV of FG Table:

Opening UR (A)	Interest 12% (Market Rate)	Deemed Revenue for the year	Closing UR (B)	FV (GA x PFD% x LGD%) (C)	Closing FG (Higher of B or C) (D)	Revenue or Loss in PorL (A) - (D)
960	115	(400)	675	300 (10000*3%*100%)	675	285 Revenue
675	81	(400)	356	800 (10000*8%*100%)	800	125 Loss
356	44	(400)	NIL		NIL	800 Revenue

A2.**Principal Debtor Accounting for FG**

No accounting prescribed in Ind AS 109 so usual expense booked in books, for guarantee commission, if any.

(B)**Accounting Mismatch****When Applicable?**

For example, where a FL and FA belong to a single trading portfolio it is necessary to measure them both using same method. Hence FVTPL is used to measure the FA as well as the FL.

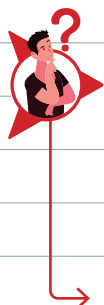
How Accounted? 😊

In such cases the **FV of FL on reporting date** = PV of contractual future cash outflows discounted at **current interest rates** at which borrower can raise fresh loan.

- (i) **CA - FV Gain / (Loss) debited to PorL or OCI (NR) and**
- (ii) **FL measured at FV in books**
- (iii) FV changes due to change in borrower's credit risk profile is adjusted in OCI-NR
- (iv) FV changes due to change in market interest rates, adjusted from PorL

(C) Loan Commitment :

Means lender has committed, usually against a premium, to provide loan in future period, at a pre-specified rate, at the option of the borrower. Accounting for entity committing to give loan same like FG.

**Let us illustrate with the help of an example:**

15% loan for 5 years of ₹10,000 measured at FVTPL to avoid accounting mismatch. Year-end interest rate is 18% p.a. Market rate has increased by 2% and credit risk profile has deteriorated leading to further increase in interest rates by 2%.

Solution

- a> Carrying amount of FL 10000
- b> Fair Value of FL @16% $(1500 \times AF_{16\%}^{4\text{years}} + 10,000 \times PV_{16\%}^{4\text{th years}}) = 9720$
- c> Fair Value of FL @18% $(1500 \times AF_{18\%}^{4\text{years}} + 10,000 \times PV_{18\%}^{4\text{th years}}) = 9193$
- d> Gain (10,000-9193) 807
 - Gain transferred to PorL (10,000 - 9,720) 280
 - Gain transferred to OCI(NR) (9,720 - 9,193) 527

(D) FG - Factoring with Partial Recourse**When Applicable?**

Where any receivable is sold to a factor with a guarantee to bear bad debts partially.

Note - If liability to bear bad debts for full amount, then no DR of asset is permitted

How Accounted? 😊

Journal Entry to be if a Debtor of 50,000 is sold to a factor for 45,000 with maximum recourse of bad debts upto 10,000 and no further. The expected amount

of BD to be reimbursed on this transaction to factories expected as 3,000:

	Account:	Dr./ Cr.	Amount	Reason	Amount in Eg.
A	Debtor A/c	Cr.	Gross amount of debtor sold	Control over debtor transferred to factor	50,000
B	Bank A/c	Dr.	Amount received from factor on transfer of Debtor	Money received	45,000
C	Continuing Involvement in Asset A/c #	Dr.	Recourse amount	As in case the liability to pay bad debts arises, company has right to recover from debtor	10,000
D	FL (FG) A/c #	Cr.	Recourse amount	As company has promised to pay in event of bad debts loss to this extent	10,000
E	FL (FG) A/c*	Cr.	FV on FG	As FG are measured at fair value -> Guarantee Amount x PFD% x LGD%. In this case given as 3000.	3,000
F	Loss on Derecognition A/c	Dr.	(A-B)+E	Total loss is sum of amount less received on factoring plus FV of FG which represents the expected loss to be borne in future	8,000

It is a contra entry with Continuing Involvement in Asset and FL – Financial Guarantee debited and credited with same amount respectively. This will be reversed when debtors are realized

*To be measured at FVTPL on every reporting date.

Note – D & E should be recorded together

6. DERECOGNITION

1

FA - Derecognition (DR)

(Triggered when cash flows from the assets no more accrue to the entity)

1. Any gain or loss on DR -

- a. Recognise in PorL.
- b. Balance in OCI-R if any reclassified to PorL
- c. If method in FVTOCI-NR then first measure the FA at FV through OCI-NR on date of DR. Balance in OCI-NR transferred to Reserves through SoCiE

2. Partial DR - (In such case profit/loss on part transferred is only recognised)

a) Applicable when:

- i. Pro-rata cash flows from asset transferred (Eg. 50% of FD cash flows sold) or
 - ii. Specific CFs transferred (Eg. Interest strip of debentures sold) or
 - iii. Pro-rata CFs from specific CFs transferred (Eg. 80% of Interest strip sold)
- If any of the above condition not met, account it as full DR

b) Accounting:

- i. **Part Retained** → Measured at CA, computed as
= **CA of full FA x FV of Part Retained/FV of FA**
- ii. **Part Sold** → Record gain or loss relating to part sold as
= Net proceeds from FA's sold part - **CA of part sold**
- iii. **CA of part sold** = CA of FA - CA of part retained

2

FI - Derecognition (DR)

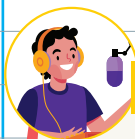
(When obligation is settled with no further liabilities to pay DR accounting applies.)

1. **DR of FL on due date** - No gain or loss if settled at contracted amount, else difference booked in PorL
2. **Early Redemption / DR of FL** → Loss (or Gain) on settlement booked in PorL
Computed as → Redemption or settlement amount - CA on date of DR
3. **Early Redemption of CFI** - Since it leads to DR of FL as well as Equity the G/L on DR needs to be split to both components as G/L relating to derecognition of:

- a. Gain (Loss) on DR of FL (adjusted from P or L):**

$$= CA - FV \text{ of FL on date of DR (i.e. PV of remaining FCFs diswanted at Current interest rates)}$$
- b. Gain/ (loss) on DR of Equity:** (adjusted from Reserves)

$$= \text{Settlement price} - FV \text{ of FL} - \text{Equity Component of CFI on IR}$$



अर्ज किया है

JE	FL	→	Dr	CA of FL
	Eq. component of CFI	→	Dr	CA of equity component
	P or L	→	Dr/(Cr)	FV of FL - CA
	Reserves	→	Dr/(Cr)	Bal figure
	Bank	→	Cr	Early redemption price



Student Notes

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and extend across the width of the page. There are no margins, text, or other markings on the paper.

7. Impairment of FA

a

Always debited to PorL

b

It is a loss recognised due to increase in credit risk (risk of bad debts) of borrower/debtor

c

Hence, applicable for FA only and that too in the nature of Debt and not Equity investments. Also applicable to FG, Lease Receivables and Trade Receivables

d

Impairment applies to only those FA that are measured at ACM or FVTOCI

e

J.E. for recording IL when:

a. FA accounted as per ACM

IL (PorL) A/c

Dr.

To Provision for IL (If asset is credit impaired credit FA instead of provision for IL)

b. FA accounted as per FVTOCI (R)

IL (PorL) A/c

Dr.

To IL Allowance (OCI)

f

Measurement of IL

a. Asset specific IL determination = IL is:

CA of FA - PV of reestimated FCFs discounted using original EIR

b. Generalised Approach

→ खराब नियत

IL = Exposure x PFD% x LGD% → खराब CFS

1. PFD (Probability for default) -

(i) Based on past experience

(ii) Indicates probability for default of payment or simply debts going bad

(iii) Affected on whether ECL approach is - 12 months ECL or Life Time (LT) ECL approach

2. LDR (Loss Default Rate) -

(i) Indicates if debts go bad then how much amount will entity be able to recover and what not.

c. Simplified Approach (used for Trade Receivables Mostly)

CA of FA x Provision rate as defined in the matrix. (Eg. NPA provisioning norms by RBI)

g

Expected Credit Loss Approach (ECL) - 😊 GF Vs Biwi 🤖

Probability for Default (2 approaches)

12 m Expected Credit Loss (ECL) Approach

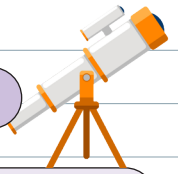


Here, we anticipate whether there is a probability of default in next 12m

If yes, then we estimate the ECL over the total term of asset

If there is no significant increase in credit Risk use 12m ECL approach

Life Time ECL Approach



We anticipate whether there is a probability of default over the complete remaining contractual period (incl. extension option period if any)

If yes

ECL over the Total term of asset

If there is a significant increase in Credit Risk use Life Time ECL approach

usually

h

Mandatory LT-ECL Approach -

- ▶ FA where there is 'Significant increase in credit risk' (indicative indicator-past due for more than 30 days)
- ▶ Trade Receivables (without significant interest component)
- ▶ Originally Credit Impaired Assets
- ▶ In case of Contract Assets (IndAS 115 defines) or Leases; company has a choice to follow LT-ECL approach. It is a matter of choice of accounting policy, and can be different for Finance Lease Receivable and Operating Lease Receivables and Contract Assets.



अर्ज किया है

"3 Stage Approach" to Impairment Loss

Stage I

No Significant incr. in credit risk
(Loan to Radi Hotel)

12m. ECL approach

Impairment Loss to be provided for as an allowance (provision)

Do not reduce the gross CA of FA

Hence E.I.R. will be on gross CA (without reducing IL provisions/allowance)

Stage II

Significant in cr. in credit risk
(Covid-19 affects)

LT ECL approach

Stage III

Credit impaired
(Radi goes for IBC)

LT ECL approach

Impairment loss to be written off from CA of FA

Hence E.I.R. applied on Amortised cost i. e. Gross CA-IL written off

Not to be revised. It is the original E.I.R.

8. Reclassification

(Change in method of accounting)

When applicable?

1. Applicable only for FA
2. **FA** - Investment in Equity shares only one method choice is available i.e. FVTOCI(NR) on IR and is irrevocable, so no reclassification permitted
3. **Hence only on FA** - In nature of debt investments reclassification may be relevant
4. Allowed at year beginning and only when there is a change in the Business Model of the entity

How

How Accounted?

- a) Prospectively always.
- b) Except if method changed from FVOCI to:
 - a. **PorL** → Transfer balance in OCI to PorL immediately
 - b. **ACM** → Reverse OCI balance from carrying amount of FA, to bring FA to its amortised cost on the date of reclassification.

Student Notes

9. Regular Way Purchase Sale (RWPS)

Where securities are exchange traded and settled.

1. FA recognized on Trade Date or Settlement Date as per choice of method
2. In both method the P or L for the period should be the same
3. **Trade Date Accounting** - FA recorded on date of Trade in books.
4. **Settlement Date Accounting** - FA recorded on settlement date. However gain / loss recognized for price movement from trade date itself (**FV Gain Asset / Loss Liability A/c used where gain or loss recorded before settlement date - Mostly where trade date and settlement date are in different years**)
5. **Example - Investment in Shares on 28 March for 10000 for cash, FV on 31 March 10500 and on settlement date 02 April 10600. Show Accounting is accounting year ends in March every year.**

Trade Date Accounting

28/03	Dr. FA: Investment in Shares a/c Cr. Bank a/c	10,000	10,000
31/03	Dr. FA: Investment in Shares a/c Cr. FV Change a/c (P or L)	500	500
02/04	For Settlement -No Entry. Entry For Fair Valuation Dr. FA: Investment in Shares a/c / FV Exchange a/c Cr. FV Change a/c (P or L)	100	100

Settlement Date Accounting

28/03	Dr. FA: Advance a/c Cr. Bank a/c	10,000	10,000
31/03	Dr. FA: FV Gain Asset [Study Mat: FV Exchange A/c term used] Cr. FV Change a/c (P or L)	500	500
02/04	Dr. FA: Investment in Shares a/c Cr. FA: FV Gain Asset a/c / FV Exchange a/c Cr. FA: Advance a/c Cr. FV Change a/c (P or L)	10600	500 10000 100

10. Derivative Financial Instruments (DFI)

1 What is DFI?

- 1 **Initial Investment** – Nil or nominal (Security deposit payable, if any not treated as part of initial investment)

Loan given	x
Investment in gold bonds	x
Investment in Equity shares	x
Long Future with 100% margin money	✓
(As margin money not considered as part of initial investment)	
Option with upfront premium (nominal amt)	✓

&

2 Settled in future

- Can settle in for cash i.e. Net Settlement (Not mandatory)
- May settle with delivery → but delivery should be of FI only else it is not a DFI
- Contract for Non-Financial Item meeting the own use exemption (OUE) are not treated as DFI even if it has net settlement option.

&

3 Value based on underlying

Such that the value of the contract is variable

Example

- Contract to buy an asset in future at price prevailing at that time is not a DFI as the contract has no value of its own apart from the value of asset to be acquired.
- Contract to buy an asset at future date @ fixed price with net settlement option → can be DFI if OUE not met.
- Contract to buy shares in future with variable value at a price fixed on date of contract – Will be a DFI, whether to be settled net or by delivery.

2 Accounting for DFI - FVTPL

a. IR

- Forward / Future – Nil value
- Options Contract – FA for holder and FL for writer @ Premium amount

b. SM - G/L to PorL**i. Forward / Future:**

Measured at FV i.e. rate for same contract for remaining term

ii. Options:

Measured at FV i.e. premium on similar contract for remaining term

J.E.

Gain			Loss		
DFI: FA A/c	Dr	✓	PorL	Dr	✓
To PorL		✓	To DFI: FL		✓

c. DR - G/L to PorL**i. Forward / Future: G/L on DR**

Spot Rate less CA, net of transaction costs on sale if any

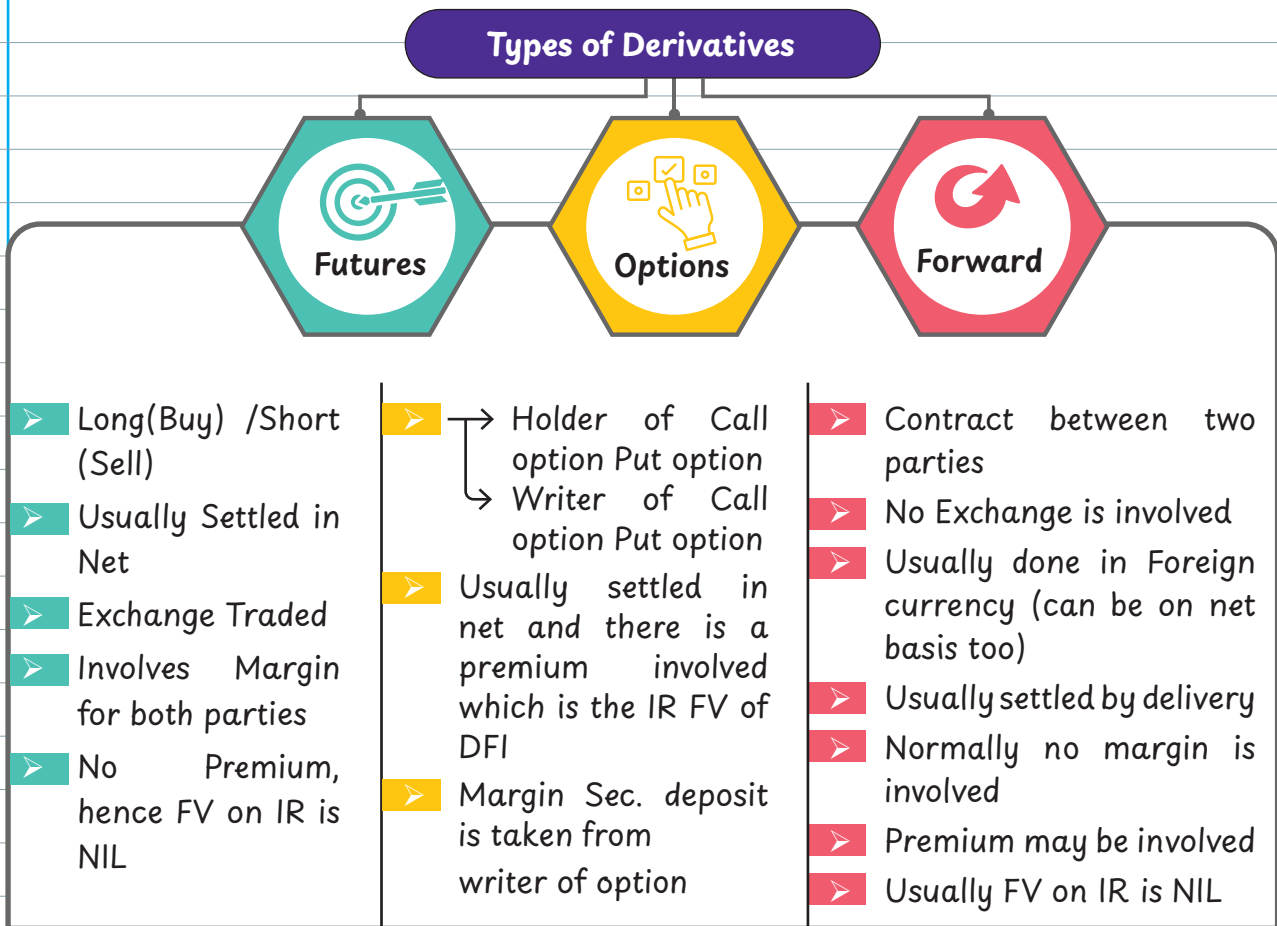
ii. Options: For Holder of the Option

- If favourable for holder to exercise the option
 → Gain / (Loss) = Settlement amount net of CA
- If unfavourable for holder to exercise the option
 → Loss = CA if any
- For writer of the option the gain or loss will be the opposite of gain or loss of holder

ProTip to compute gain / loss in DFI

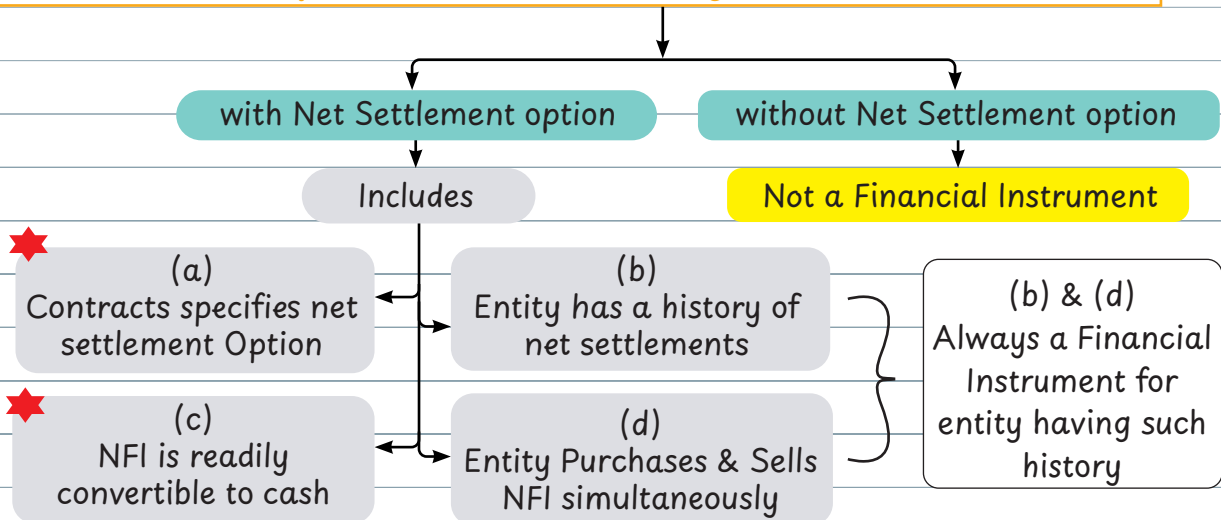
Gain is recorded when the price moves in the direction as the party entering the contract expected to move at the time of entering into the contract.

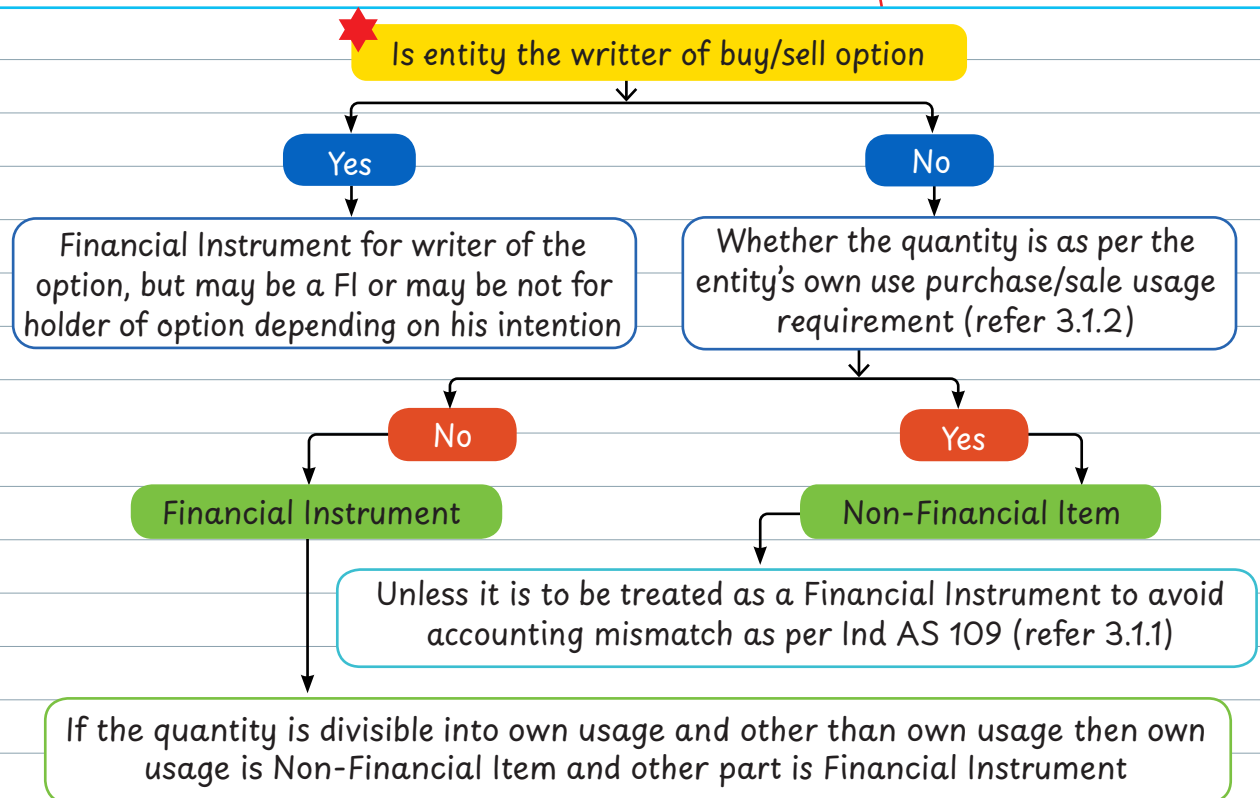
- ↳ So party taking a
 - Long position in future
 - Forward purchase of asset
 - Holder of Call Option
 - Writer of Put Option
- ↳ is bullish and will gain if prices increase
- ↳ and vice versa



3

Net Settlement Option in Contracts Involving Non-Financial Items (NFI)





Own Use Exemption:

Ind AS 32 prescribes that if entity:

- Enters into a contract** to buy/sell a Non-Financial item to meet its own expected requirement for purchase/usage/sale; and
 - Continues to hold the contract** to meet its requirement then such contract will be classified as a Non-Financial item (except if it leads to accounting mismatch)
- E.g.** Contract with net settlement option- Show classification on initial recognition and at year end:

Intention			Classification		Accounting for Reclassification
	Initial Date	Year End	Initial Date	Year End	
1	Delivery	Delivery	NFI	NFI	-
2	Delivery	Net Settlement	NFI	FI	Recognise FA/FL on such contract at year end
3	Net Settlement	Net Settlement	FI	FI	-
4	Net Settlement	Delivery	FI	FI	Note 1

Note 1:- Own use exemption to classify a contract with Net settlement option as a NFI applies only when intention is to meet own usage requirement (to give delivery) both at the time of initial date and subsequently. Hence, if initially intention was net settlement then entity cannot subsequently reclassify the contract to non-financial item.



SJ Tip

Option gives right to holder, at its own choice of exercise the option or let it lapse, 2 type options commonly seen:

- **Put Option** → Holder has Right to Sell
- **Call Option** → Holder has Right to Purchase

Student Notes

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11. Embedded Derivatives



Derivative + FL OR NFI

Like purchase contract for machine, goods, etc.
but with a unnatural currency derivative.



When accounted as ED?

→ Where:

- (a) Host contract (FL or NFI) not measured at FVTPL
- (b) Significant change in CFs of Host contract due to ED
- (c) DFI not closely related to Host
- (d) FV determinable of both

How Accounted?



DFI + FL

- (a) **On IR:** FL measured at FV, by disc. FCFs using mkt Interest rates in contract without ED (Say x%)
- (b) Initial CFs - IR of FL as in (a) above = IR value of DFI
- (c) FL accounted using → ACM (EIR will be market rates, x%)
- (d) DFI accounted as per → FVTPL
- (e) **Example:** Loan with PPO with significantly different CFs



DFI + NFI

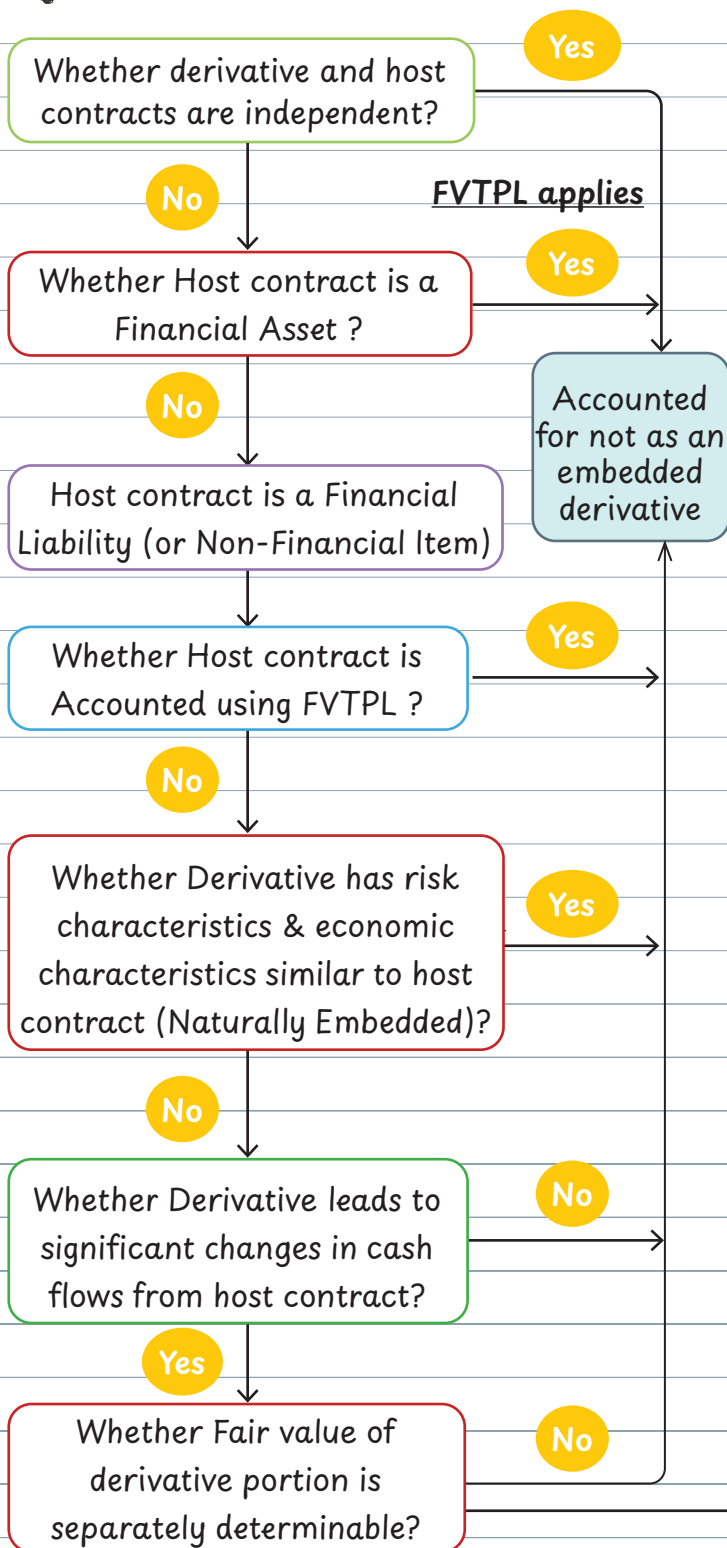
- (a) **NFI:** Recorded ← When acquired
Measured ← forward rate on IR
- (b) **DFI:** FVTPL with gain/loss due to changes in forward rate for similar position for remaining term.
- (c) **Example:** Indian buyer contracts to buy goods from Indian Seller at future date, with price Pre-Set in foreign currency
- (d) **SJ Note:** In above example if g/l to be computed for:
 - **Buyer:** Gain if foreign currency forward purchase rate declines
 - **Seller:** Gain of foreign currency forward purchase rate increases



Embedded Derivatives: Definition



S.J. exclusive



Definition :

An embedded derivative is:

- ▶ a component of a **hybrid contract**
- ▶ that also includes a **non-derivative host**
- ▶ with the effect that some of the **cash flows of the combined instrument vary** in a way similar to a stand-alone derivative.

An embedded derivative causes:

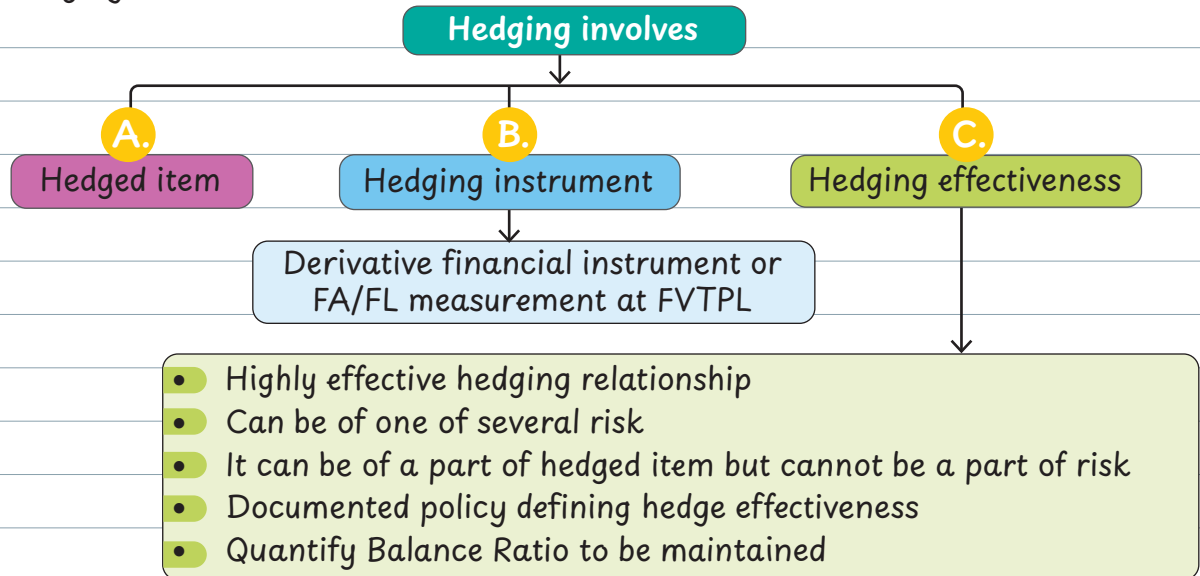
- ▶ some or all of the **cash flows** of the contract
- ▶ **to be modified** according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable,
- ▶ provided in the case of a non-financial **variable that the variable is not specific to a party to the contract.**

A derivative that is attached to a financial instrument but is contractually **transferable independently** of that instrument, or has a different counter party, is **not an embedded derivative**, but a separate financial instrument.

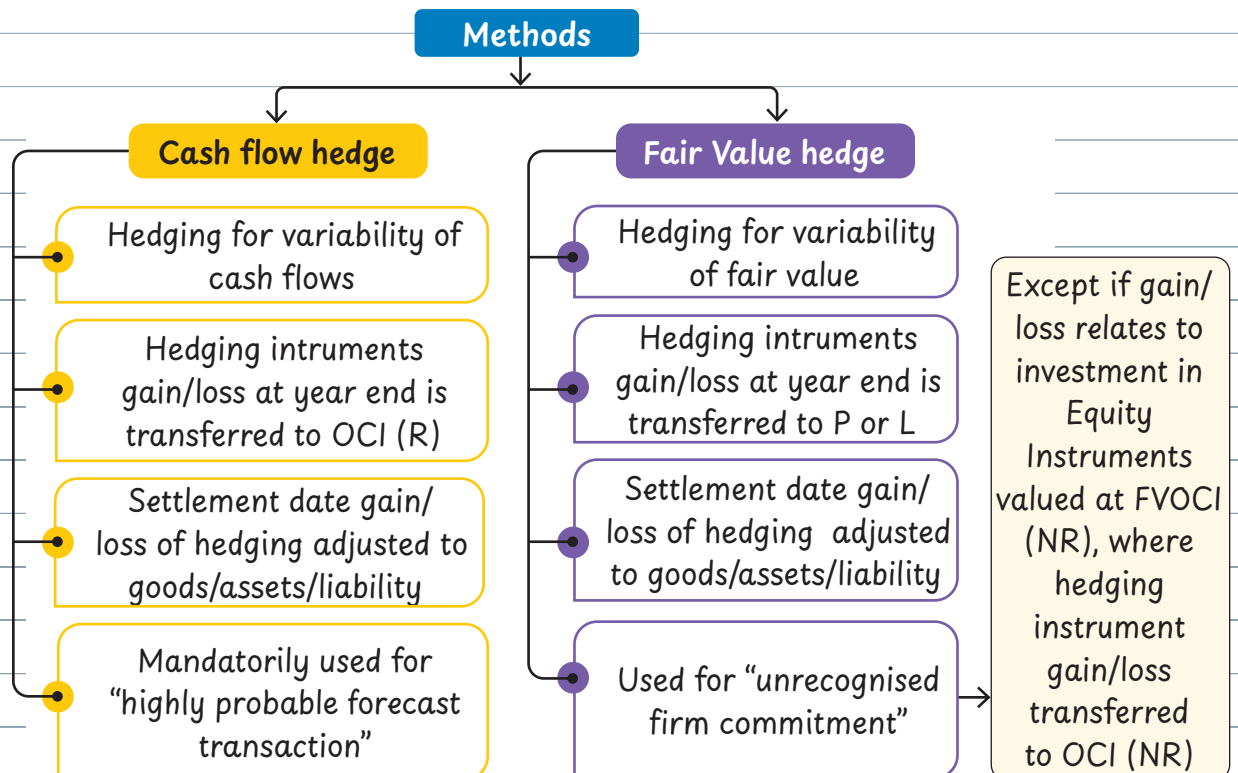
Embedded derivative accounting applies (split accounting)

12 Hedging

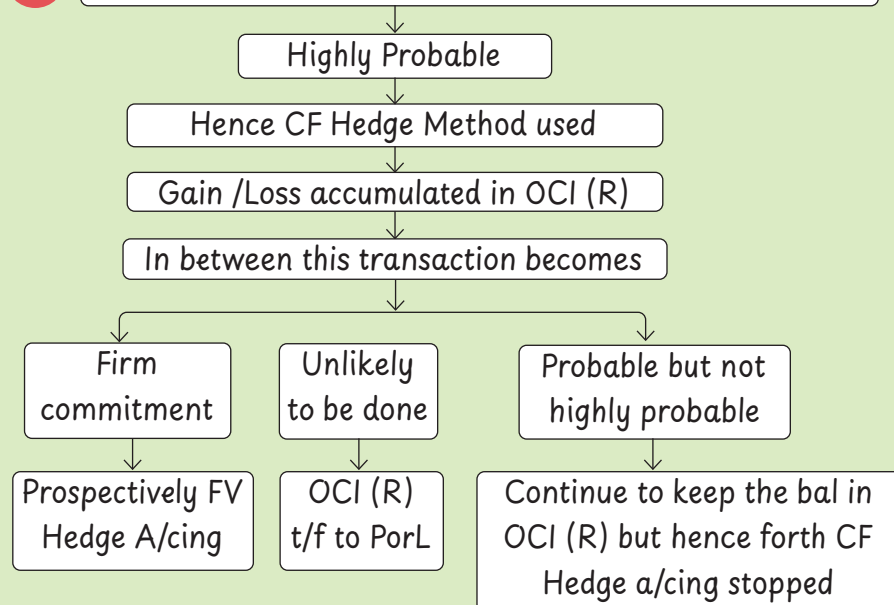
- > Company has a choice to apply hedge accounting.
- > The choice can be exercised on transaction to transaction basis
- > Transaction could be of a single item or a group of item
- > Hedging involves:



> Methods: of Hedge Accounting



- (a) **Firm Commitment:** Use 'FV Hedge Method'
- (b) **Cash Flow Hedge:** If Highly Probable Transactions



Remember!



Student Notes

[illegible]

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