# Accounting for Forward Exchange Contracts. (FEC)

## FEC for Hedging the Risk

↓

| | |
|---|---|
| Forward Rate | xx |
| (-) Spot Rate | (xx) |
| Fwd. Premium / Disc. | xx |
| ↓ Loss ↓ Gain | |
| (x) Contract value | xx |
| Total Loss / Gain | xx |

The Gain/Loss will be deferred over the contract period equally & w/off to P/L.

$10000
3m
1/2

Fwd. rate = 48
(-) Spot rate = 46.80
Fwd. Prem. = 1.20
x Cont. value = 10,000
Total Loss. ₹12000

Loss p.m. = 12000 / 3 = 4000

Feb & Mar. C.Y. = 4000 x 2 = ₹8000

Apr. Next year = 4000

## Speculation or Trading.

↓

- No fwd. premium or disc. is calculated.
- Calculate the gain/loss on settlement of contract.
- → on B/s. Date translate the FEC to Mkt. price of similar FEC & recognise the gain or loss to P/L.
- → on the date of settlement the gain/loss on FEC i.e. value recognised - settlement value, will be recognised to P/L A/c.

1/2 → 4m. FEC 1$ = ₹81
31/3 → FEC Mkt. price 1$ = 82.5
Gain → 82.5 - 81 = ₹1.5
↳ Record to P/L.
FEC = ₹82.5.
31/5 → FEC Mkt. price = 81.75
∴ Loss → 82.5 - 81.75 = ₹0.75
↳ Record to P/L immediately.

# AS-19 Accounting for Leases.

Lease.

Finance Lease* → Financial Arrangement.

Operating Lease. → Other than Finance Lease.

Finance Lease → Transfer of Risk & Rewards of Ownership to Lessee.

Any 1 out of 5 cond$^n$ to be met to be a Finance Lease

1) Lease term substantially (>50%) covers life of asset
2) Trf. of ownership at end of Lease term.
3) Option to Lessee to buy the asset at a price lower than FMV.
4) Modified Asset.
5) PV of MLP substantially (>90%) covers the initial FV of the asset

## Accounting for Finance Lease.

### I) In the BOOKS of lessee.

Minimum Lease Payment = Lease Payable + Guaranteed Residual value by the Lessee or any third party on behalf of Lessee.

100 RV → GRV 80, UGRV do

Bls.

| Lease Payable xx | Leased Asset xx |
|---|---|

↓ Same values i.e. Lower of :-

a) PV of MLP or
b) FV of the asset.

- MLP will be discounted to PV by using IRR of the lessor as the disc. rate & if IRR not available will use IBR.

JE 1) Asset taken on FL

Leased Asset A/c ..... Dr.
To Lease Payable A/c.

2) L.R. Paid.

Lease Payable A/c ..... Dr.
Finance charges A/c ..... Dr.
To Bank A/c.

II) In the Books of Lessor

MLP = Lease Rent Receivable + UGRV.

Gross Investment in Lease } = MLP + UGRV ← Future value

B/S.
Lease Receivable xx
← Net Investment in Lease.

Net Investment in Lease } = PV of Gross Investment
= PV of MLP + PV of UGRV.

Unearned Finance Income } = Gross Investment ⊖ Net Investment.

JE 1) Asset given under FL

Lease Receivable A/c ..... Dr.
To Asset A/c.

2) Lease Rent Received

Bank A/c ..... Dr.
To Lease Receivable A/c.
To Finance Income A/c.

At IRR, *

PV of outflows = PV of Inflows.

↓ ↓

FV of the Asset = Net Investments.

↓

FV = PV of MLP + PV of UGRV

Soln

Gross Investment = MLP + UGRV

= (800,000 × 5 + 160,000) + 140,000

= ₹ 4300,000

Net Investment = PV of of Gross Investment

= (800,000 × 3·3522 + 160000 × 0·4972)

+ 140,000 × 0·4972

= ₹ 2830,920

Unearned Finance Income = Gross Invt − Net Invt.

= 4300,000 − 2830,920

= ₹ 1469,080

Soln

In the books of S. Square Pvt. Ltd.

(Lessee)

Calⁿ of Lease Liability

Lease Liability is the Lower of

a) Fair value of Asset

or b) PV of MLP.

Fair value of asset = ₹ 2000,000

PV of MLP = PV of Lease Rentals + PV of GRV

= (625000 × 2.855) + 125000 × 0.5718

= 1784375 + 71475

= ₹1855,850

∴ Value of lease Liability = ₹1855,850

## Operating Lease.

| Lessor | Lessee. |
|---|---|
| 1) Asset will be shown in the Books of Lessor. | 1) – |
| 2) Lease Rentals received is an income, should be recognised to P/L on straight Line basis or in the pattern of benefit if any. | 2) Lease Rentals Payable are expenses, should be recognised to P/L on SLB or in the pattern of benefits derived if any. |



eg. Y Ltd. has taken a machine under op. Lease for 3yrs. details are as follows:-

| Year | L.R. Payable | Expected output |
|---|---|---|
| 1 | 50,000 | 60,000 |
| 2 | 75,000 | 40,000 |
| 3 | 125,000 | 50,000 |
| | 250,000 | 150,000 |

How will the L.R. be accounted in books of Y Ltd.

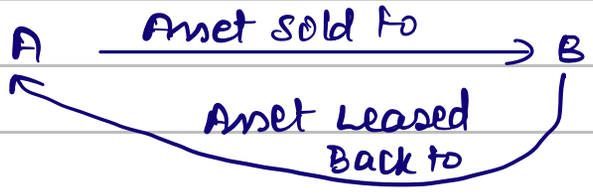
Soln ⇒ Calⁿ of L.R. to be charged to P/L.

| Year | Output | L.R. Payable | L.R. charged to P/L | O/s. L.R. | Prepaid L.R. |
|---|---|---|---|---|---|
| 1 | 60,000 | 50,000 | 100,000 (250 × 6/15) | 50,000 | — |
| 2 | 40,000 | 75000 | 66,667 (250 × 4/15) | — | 8333 |
| 3 | 50,000 | 125000 | 83,333 (250 × 5/15) | — | 41667 |
| | 150,000 | 250,000 | | 50,000 | 50,000 |

Yr 1 ⇒

| | | |
|---|---|---|
| Rent A/c ..... | Dr. | 100,000 |
| To Bank A/c. | | 50,000 |
| To Lease Adjustment A/c. | | 50,000 |

## Sale & Lease Back.




### Profit / Loss on sale of Asset.

Depends upon the type of lease back :-

1) Financelease :- Any gain / loss arising on sale of asset shall be deferred over the lease term in the same proportion of Depⁿ charged on asset.

## 2) Operating Lease :-

BV FV SP

1st compare BV & FV

a) BV = FV → No Profit, No Loss.

b) BV > FV → Loss, recognise immediately to P&L. (Impairment Loss)

50 43 c) BV < FV → Gain, recognise immediately to P&L.

2nd compare FV & SP

a) FV = SP → No Profit, No Loss.

b) FV > SP → Loss, 2 treatments.

a) If loss compensated by future lease payments below FV, defer the loss over lease term.

or b) If loss not compensated, recognise to P/L immediately.

50 60 c) FV < SP → Gain (Abnormal), defer over the lease term.

eg. 1 BV FV SP

40 < 43 45

E3 Gain, P/L E2 Gain, defer over lease term

2) 40 > 38 41

E2 Loss, P/L E3 Gain defer over lease term.

3) 40 42 39

E2 Gain, P/L E3 Loss < Defer P/L immediately.

Sol$^{n}$

| | |
|---|---|
| Excess Dep$^{n}$ as per I.T. Rules | 600,000 |
| (-) Amortised Preliminary Exp. as per I.T. | (10,000) |
| Net Timing difference | 590,000 |

∴ DTL to be recognise = 590,000 × 30% = ₹177,000

Sol$^{n}$:-

A/c

| Year | 1 | 2 | 3 |
|---|---|---|---|
| PBDT | 500 | 500 | 500 |
| (-) Dep$^{n}$ | (80) | (80) | (80) |
| PBT | 420 | 420 | 420 |
| (-) Prov. | (104) | (190) | (175) |
| (-) DTL | (60·8) | – | – |
| (+) DTL Reverse | – | 32·8 | 28 |
| PAT | 255·2 | 262·8 | 273 |

I.T.

| Year | 1 | 2 | 3 |
|---|---|---|---|
| PBDT | 500 | 500 | 500 |
| (-) Dep$^{n}$ | (240) | – | – |
| PBT | 260 | 500 | 500 |
| (-) Tax | (104) | (190) | (175) |
| PAT | 156 | 310 | 325 |

Year 1

Dep$^{n}$ as per I.T = 240

(-) Dep$^{n}$ as per A/c = (80)

T.D. arise. 160

∴ DTL to be recognised = 160 × 38% = ₹60·80

JE P&L A/c ..... Dr. 164·8

To Prov. for tax A/c. 104

To DTL A/c. 60·8

160 × 3% = 4.8 (4.8)

60.8 → 38%
↓
35% × 160 = 56

Year 2

| | | |
|---|---|---|
| Dep$^n$ as per I.T | = | Nil |
| (-) Dep$^n$ as per A/c | = | (80) |
| T.D. Reverse. | | (80) |

Reversal of DTL

a) w.r.t. changes in Tax rate from 38% to 35% } = 160 × 3% = 4.80

b) For Dep$^n$ T.D. Reversal = 80 × 35% = 28

32.80

JE P&L A/c ..... Dr. 157.8
DTL A/c ..... Dr. 32.80
To Prov. for Tax A/c 190

Year 3

| | | |
|---|---|---|
| Dep$^n$ as per I.T | = | Nil |
| (-) Dep$^n$ as per A/c | = | (80) |
| T.D. Reverse. | | (80) |

∴ Reversal of DTL = 80 × 35% = ₹28

JE P&L A/c ..... Dr. 147
DTL A/c ..... Dr. 28
To Prov. for Tax A/c 175

Soln

| | | |
|---|---|---|
| Tax Exp. | = 1500,000 × 20% | = 300,000 |
| Normal I.T. | = 250,000 × 20% | = 50,000 |
| MAT | = 750,000 × 7.5% | = 56,250 |

∵ MAT > Normal IT, pay MAT

∴ Excess of MAT over I.T. = 56250 − 50000
= ₹6250

TE = CT ± DT
300,000 = 50,000 + DTL
∴ DTL = 300,000 − 50,000
= 250,000

1250,000 × 20%
= 250,000

Tax Exp to be } = Prov. for Tax + DTL + Excess
or. to PIL } of MAT
= 50,000 + 250,000 + 6250
= ₹306,250