

6% debt is issued for £1,000. The debt is redeemable at £1,200 in three years' time. The effective interest rate on the debt is 12%.

How is this debt valued and recognised?

Solution

	b/f	interest 12%	interest 12%	c/f
1	1,000	120	(60)	1,060
2	1,060	127	(60)	1,127
3	1,127	135	(1,260)	² (rounding)
		382		

This financial liability should be valued at amortised cost.

The debt is initially recognised at £1,000. The total finance cost of the debt is the difference between the payments required by the debt which total £1,380 ($(3 \times £60) + £1,200$) and the proceeds of £1,000, that is £380.

The movements on the carrying amount of the debt over its term would be as follows:

- The amounts carried forward at each year end represent the amortised cost valuation to be shown in the balance sheet.
- The carrying amount of the debt (amortised cost) is the net proceeds, plus finance charges recognised in the accounts, less payments made.