FR
(CONCEPTS)

FOR CA. FINAL OLD SYLLABUS
(BOOSTER)

By

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Important Note:
Join Telegram group of Jai Sir to ask you queries or doubts – “Jai Chawla Sir Doubts & Discussion”
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VALUATION

Valuation of Goodwill


**Methods of Valuing Goodwill:**

- **Average Profit Method** - $FMP \times \text{No. of years purchased}$
- **Super Profit Method** - $(FMP - \text{Normal Profit}) \times \text{No. of years purchased}$ Capitalisation
- **Method** - Super Profit / Capitalisation Rate
- **Annuity Method** - $\text{SP} \times \text{Annuity Value (as per Present value factor)}$

**NO. OF YEARS PURCHASE** - It will always be given in the question, if not given we will use capitalization rate.

**NRR:** It means normal rate of return expected in the same business. It is generally given in question. If it is not given then it will be calculated as under:

$$\text{NRR} = \frac{\text{Div}}{\text{MPS}} \times 100$$

(Avg Dividends and Avg MPS is allowed) *(NRR is considered Post Tax Always)*

**FUTURE MAINTAINABLE PROFIT**

*Calculation of FMP* is based on Projected profits method and past profits method. While calculating Past profits approach following items will be adjusted:

1. Tax Expenses
2. Abnormal Items
3. Rectification of Errors
4. Effects of Changes in A/c Policy
5. Revaluation of Current Assets and Liabilities
6. Non recurring items (eg. Loss/profit on sale of assets)
7. Non operating Incomes (eg. Interest on investments)
8. Goodwill w/off added back

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9. Additional Depreciation due to revaluation of FAs
10. Future Incomes and Exp
11. Future Tax Rate

Note: When NRR is given after Tax for both SH then FMP after Tax is to be considered. When NRR is given for ESH then FMP after Tax after Pref. Dividend is considered.

**Average of FMP is not specified in Question**
- Check Trend in NP ratios if these are available: Apply Weighted Avg if trend is available otherwise Simple Avg.
- If NP ratios are not available then check trend in Adjusted Profits: Apply Weighted Avg is trend is available otherwise Simple Avg.
- Trend line average will be used only when asked in the question.

Trend Line average - \( Y = a + bx \), where \( Y \) is future profit, \( a \) is simple average, \( b \) is growth and \( x \) is distance from centre point.

**CAPITAL EMPLOYED**

**CAPITAL EMPLOYED:** Capital employed means Shareholders fund (Eqt + Pref) applied in the business for operating activities. It is calculated as under:

\[
\begin{align*}
&\text{All Assets} \quad XXX \\
&\text{Less: All Liabilities} \quad XXX \\
\end{align*}
\]

- Assets are to be considered after - Revaluation, Rectification and Change in Accounting Policy
- Non Operating Investment will be excluded in Capital employed. (if nothing is specified in question we always assume that Investments are Non Operating)
- If there is Purchased Goodwill in BS then it is considered otherwise it is will be excluded.
- These are not Liabilities for the purpose of capital employed - Proposed Dividend and Pref Share Capital. But if NRR given in question is for ESH then they are deducted.
- Capital employed may be "Closing Capital Employed" or "Average Capital Employed"
- Tangible capital employed means Closing Capital employed excluding Intangible Assets.

Avg. Capital Employed may be -

\[
\frac{1}{2} (\text{Opening CE} + \text{Closing CE})
\]  

Or

\[
\text{Closing CE} - \frac{1}{2} \text{Rectified PAT}
\]

**Which Capital Employed to Use ?**

If Not Specified in the question, then we have to check the basis of FMP. If FMP is based on Projected Profits, Trendline Avg. or Weighted Avg. then we may use Closing Capital Emp. and if FMP is based on Simple Avg. then we may use Avg. Capital Employed.

**Note:** Tangible Capital Employed means Closing Capital Employed excluding Intangible Assets.
Some Important Key Points:

- Investment for Replacement of P&M/Building is Trade Investment.
- RPAT is the actual profit earned after rectifications since we take capital emp after rectification also. Moreover RPAT also includes income on Non Trade Investment assuming that it is utilized in business activities.
- Abnormal Year is not to be considered in the valuation until and unless the loss due to abnormal activity is mentioned and quantified separately.
- If the Goodwill is shown in balance sheet and nothing is given in question about goodwill, then we will assume it as Self Generated and not to be considered.
- We need to consider the additional provision of Tax due to increase in Tax Rate.
- Rectification is required when there is any Error or Omission or any information is given which shows that there is wrong treatment in books. (Eg. Some trade receivables are bad – it is assumed as error and to be rectified)
Important Notes:
Valuation of Shares

Methods for Valuation of Shares:
- Intrinsic Value Method
- Total Earning Capitalization Method
- Dividend Capitalization Method
- Fair Value Method

Intrinsic Value Method:
(also called Net Asset method, Book value method, Breakup value method)
It shows the expected return or refund per share if the company is being liquidated.
It is calculated as under:

\[
\text{Closing Capital Employed} + \text{Goodwill (as per valuation)} + \text{Non Trade Investment} - \text{Pref. Share Capital} - \text{Pref. Dividend payable} - \text{Proposed Dividend on Equity} + \text{Uncalled capital/Calls in arrears due} = \text{Net Assets for ESH} \\
\text{÷ No. of Equity Shares or Total ESC} = \text{Intrinsic Value per share or per Rupee (Ex-Dividend)}
\]

Key Points:
- This method is only applicable for Equity Shares.
- If the equity shares are of different face values then we will use Total Equity Share Capital in rupees instead of No. of Equity Shares.
- To Calculate Cum-Dividend value per share, DPS is to be added to the Ex-dividend value per share.
- Goodwill will be valued if required data is provided in question.

Capitalization Method (Earning and Dividend Capitalization):
Earning Capitalization Method (ECM) is calculated as under

\[
\text{Value per Share} = \frac{\text{Expected EPS}}{\text{Ke}} \\
\text{Or} \quad \text{Value per Share} = \frac{\text{Earning Rate}}{\text{Ke}} \times \text{Paid up Value per Share}
\]

Earning Rate means - Earnings available for ESH ÷ Equity paid up capital x 100

\[
\text{Ke} = \text{NRR}
\]

Dividend Capitalization Method (DCM) is calculated as under:

\[
\text{Value per Share} = \frac{\text{Expected DPS}}{\text{Ke}} \\
\text{Or} \quad \text{Value per Share} = \frac{\text{Dividend Rate}}{\text{Ke}} \times \text{Paid up Value per Share}
\]

Dividend rate can be average of previous year's dividend rates.
**Key Points:**
- ECM is generally used for large lot of shares and DCM is used for Small lot of Shares.
- For DCM, future expected dividend rate will be given or prior year's dividend rate will be given.
- EAESH is calculated as under:
  
  FMP after Tax XXX
  (+) Non Operating Income (net of Tax) XXX
  (-) Pref. Dividend XXX
  (-) CDT on pref. dividend XXX

- For the calculation of Dividend rate in DCM, sometimes question mentions “transfer to general reserve” which implies the balance profits as expected dividend to be distributed and hence this is also the maximum possible dividend rate.

**Normal Rate of Return (NRR):**
NRR is to be calculated by any of the following two approaches:
1. \[ CAPM = R_f + (R_m - R_f) \beta \]
2. Estimation of NRR - Here the NRR of a company is estimated by considering the NRR of the industry for the similar class of shares in which the company operates. It is to be calculated as under:

\[
\begin{align*}
\text{NRR of the Industry for specific class of share} + 0.5\% \text{ for Poor dividend track record} \\
+ 0.5\% \text{ for Poor debt equity ratio or Capital gearing ratio} \\
+ 0.5\% \text{ for Poor dividend coverage ratio} \\
+ 0.5\% \text{ for Poor Asset backing ratio}
\end{align*}
\]

**Important Key Points:**
(a) The above 0.5% is the risk premium which the shareholder expects from a company for taking higher risk and this 0.5% are assumed figures, they might change according to the question's requirement. This may be 1% or 2% etc.
(b) Asset Backing Ratio - calculated for Equity Share valuation only. Higher the better.

\[
\text{Intrinsic Value Per Share ÷ Paid up value per share}
\]

c) Debt Equity Ratio - Lower the Better

\[
\text{Long term debts ÷ Shareholders fund (for PSH)}
\]

d) Capital Gearing Ratio - Lower the Better

\[
\text{(Long term debts + PSC) ÷ ESH Fund (for ESH)}
\]

e) Dividend Coverage Ratio - Higher the better

\[
\text{Profit after Tax ÷ Pref. Dividend (for PSH) ÷ Eqt. Dividend (for ESH)}
\]

**Fair Value Method:**
This method is used when large quantities of Shares are to be acquired or when the
controlling interest is to be acquired.

**Fair value of share** = \((\text{Intrinsic Value per Share} + \text{ECM}) \div 2\)

**BRAND VALUATION**

Brand may be **SELF GENERATED** or **ACQUIRED**.

Valuation of **Acquired Brand** is given below:
1. Brand Value = Price paid to acquire such brand; or
2. Brand Value = Purchase Consideration - Net Assets taken over

Valuation of **Self Generated Brand** is given below:

1. **Historical Cost Method**
   Brand Value = Actual Cost Incurred in Brand Building (Development + Marketing + Promotion Cost)

2. **Potential Earning Model**
   Brand Value = Profit arising due to Brand / Capitalisation Factor
   How to Calculate Profit due to Brand?
   \[ \text{PAT} \times \times \times \]
   Less: Expected Return due to unbranded Products (\(\times \times \)xxx)
   (From Tangible and Intangible Assets other than Brand)
Important Notes:
**CORPORATE RESTRUCTURING**

**Amalgamation Of Companies**

### Class Notes:

**Meaning of Purchase Consideration:**
Payment made in ANY form to the Equity and Preference Shareholders of Transferor Co. by Transferee Co.

**Calculation of Purchase Consideration**
PC can be calculated by (i) Net Payment Method i.e. Exchange Ratios basis and (ii) Net Asset Method.

- **We will always use Net Payment method in first priority**
- **Net Assets Method is generally used when not all the assets are taken over only certain assets & liabilities are taken over.**

**Net Payment Method:** Here we need Exchange Ratio (Swap Ratio) for calculation of PC.

- Exchange ratio is a ratio for exchange of No. of Shares. It can be given in the question.
- If it is missing in question, then we use Deemed Exchange Ratio as under:

\[
\text{Exchange ratio} = \frac{\text{Value of Share of Transferor} - \text{Cum Dividend}}{\text{Value of Share of Transferee} - \text{Ex Div}}
\]

- The above values can be Intrinsic Values, Market Values or any other values given in the question.
- In absence of any Information we will use Intrinsic Values.
- While calculating PC, there may be fraction in no. of shares. Here it is important to note that "we have to follow odd-even technique if proper information is given in the question.

### TRANSFEREE COMPANY

**ACCOUNTING ENTRIES**

<table>
<thead>
<tr>
<th>In the Nature of Purchase</th>
<th>In the Nature of Merger</th>
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<td>Business Purchase A/c</td>
<td>Business Merger A/c</td>
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<tr>
<td>Dr. (PC)</td>
<td>Dr. (PC)</td>
</tr>
<tr>
<td>To Liquidator of Transferor Co. A/c</td>
<td>To Liquidator of Transferor Co. A/c</td>
</tr>
<tr>
<td>(PC)</td>
<td>(PC)</td>
</tr>
<tr>
<td>Sundry Assets A/c</td>
<td>Sundry Assets A/c</td>
</tr>
<tr>
<td>Dr. (agreed value)</td>
<td>Dr. (Book value)</td>
</tr>
<tr>
<td>Goodwill/CR A/c</td>
<td>Gen. Res or P&amp;L A/c</td>
</tr>
<tr>
<td>Dr. (Bal. Fig)</td>
<td>(Bal. Fig)</td>
</tr>
<tr>
<td>To Sundry Liabilities A/c</td>
<td>To Sundry Liabilities A/c</td>
</tr>
<tr>
<td>(Payable Value)</td>
<td>(Payable Value)</td>
</tr>
<tr>
<td>To Business Purchases A/c</td>
<td>To Business Merger A/c</td>
</tr>
<tr>
<td></td>
<td>(PC)</td>
</tr>
<tr>
<td></td>
<td>To Reserves and Surplus (Book value)</td>
</tr>
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<td>Payment of PC:</td>
<td>Payment of PC:</td>
</tr>
<tr>
<td>Liquidator A/c Dr.</td>
<td>Liquidator A/c Dr.</td>
</tr>
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For Doubts – 7887 7887 05 (Whatsapp)

<table>
<thead>
<tr>
<th>To Cash A/c</th>
<th>To Cash A/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Equity Share Capital A/c</td>
<td>To Equity Share Capital A/c</td>
</tr>
<tr>
<td>To Pref. Share Capital A/c</td>
<td>To Pref. Share Capital A/c</td>
</tr>
<tr>
<td>To Security Premium A/c</td>
<td>To Security Premium A/c</td>
</tr>
</tbody>
</table>

**Cancellation of Receivables and Payables**

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<th>Payables A/c Dr.</th>
<th>Payables A/c Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Receivables A/c</td>
<td>To Receivables A/c</td>
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</table>

**For Payment of Liability:**

<table>
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<th>Liability A/c (eg. Debenture holders A/c)</th>
<th>Liability A/c (eg. Debenture holders A/c)</th>
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</thead>
<tbody>
<tr>
<td>To Cash A/c</td>
<td>To Cash A/c</td>
</tr>
<tr>
<td>To New Liability A/c</td>
<td>To New Liability A/c</td>
</tr>
</tbody>
</table>

(debentures are taken over at agreed value and settled by issue of new debentures in above entry)

**For Payment of Expenses/Unrecorded Liability:**

<table>
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<th>CR / Goodwill A/c Dr.</th>
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<tr>
<td>To Cash A/c</td>
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</table>

(in balance sheet goodwill and CR should set off to show net figure)

**For creation of Statutory Reserves:**

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<th>Amalgamation Adjustment Reserve Dr.</th>
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<td>To Statutory Reserves A/c</td>
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</table>

(Following are statutory reserves:

1. Invst. Allowance Res.
2. Export Profit Res.
3. Foreign Project Res.
5. Shipping Res.
6. Site Restoration Fund

*Amalg. Adjust. Reserve should be shown as a separate line item under the head R&S**

**For Elimination of Unrealised Profit:**

- **Upstream Transaction:**
  - Goodwill A/c Dr.
  - To Stock A/c

- **Downstream Transaction:**
  - General Reserve A/c Dr.
  - To Stock A/c

It is important to note that in case of Amalgamation in the nature of merger question may specify revalued figures or Market values of Assets, such values would be used for the purpose of calculation of PC.
## TRANSFEROR COMPANY

**Books of Transferor Company:**

1. Transfer all the Assets and Liabilities to Realisation A/c
2. EQ Share Capital, Reserves, Losses, Proposed Dividends, Fict. Assets shall be transferred to ESH A/c
3. PSC is to be transferred to PSH A/c
4. Investment in New Co. - Make Investment A/c Separately
5. Cash and Bank - If taken over then transfer it to Realisation A/c otherwise Make it separately.
6. Raise PC in Credit side of Realisation A/c
7. Before closing Realisation A/c, close Pref. Share Holder A/c after discharging PC to them so that if there remains any difference in PSH A/c it will be transferred to Realisation A/c
8. Close Realisation A/c, Balance of this account will be transferred to ESH A/c
9. Discharge PC to ESHs and Transfer Investment already held to ESHs A/c
IMPORTANT NOTES:
CONSOLIDATION OF FINANCIAL STATEMENTS OF GROUP COMPANIES

AS 21 & COMPANIES ACT, 2013


Holding Company: Sec 2 (46) of Companies Act, 2013

‘Holding Company in relation to one or more other companies, means a company of which such companies are subsidiary companies’.

In simple language, a company which enjoys ‘CONTROL’ over the other companies is Holding Company. Holding and Subsidiary companies are however separate entities but they work as a group. Therefore users of Holding company needs financial information of subsidiaries to understand the performance and financial position of the holding as well the group.

Subsidiary Company: Sec 2 (87) of Companies Act, 2013

Subsidiary Company means a company in which the holding company -
(a) Controls the composition of the Board of Directors; or
(b) Controls/Holds more the 50% of the total share capital either at its own or together with one or more of its subsidiary companies.

An enterprise is considered to control the composition of the board of directors or governing body of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company or members of the body. Control over composition of Board of Directors means holding company has Power to Appoint or Remove all or a majority of the Directors of the Subsidiary company.

Example: 1
If A Ltd. is proved to be a subsidiary company of B Ltd. by virtue of point (a) and also a subsidiary of C Ltd. as per point (b), then the problem arises that which company is liable to prepare Consolidated Financial Statement taking A Ltd. as its subsidiary. For this purpose, both B Ltd. and C Ltd. will prepare such Consolidated Financial Statement, group being constituted of themselves and A Ltd.

In addition to the above points, one should also consider the following points:
Determination of control in any company or organization, does not depend only on the share in capital, many a times even when the share in capital is less than 50% but still we consider the parent-subsidiary relationship as the voting power granted under special circumstances is more than 50%.

Example: 2
ICICI Bank advanced loan of Rs 40 crores to A Ltd., whose share capital is Rs 10 crores only. As per the loan agreement, in case company defaults to repay the principal or to pay the interest on due date three times, ICICI Bank will have right to participate in the decision making of the company and this right will come to an end with the repayment of the loan amount with all its interest. On happening of the event, ICICI Bank got the voting right in the company meetings (Board and AGM) and as its advances to company is 80% of shares plus advances, bank carry 80% voting right and we can say that there exists a parent-subsidiary relationship, where A Ltd. is subsidiary of ICICI Bank.

Notes:
(1) Together with one or more of its subsidiary companies - it denotes ‘Indirect control through the subsidiary companies’.
(2) Total Share Capital means: Sum of Paid up Equity Share Capital and Convertible Preference Share Capital.
(3) Subsidiary company can-not hold the shares in holding company (Sec 19 of CA, 2013) except in following circumstances:
   • Subsidiary co. is a shareholder even before it became a subsidiary company of the holding company; or
   • Subsidiary co. holds such shares as a trustee; or
   • Subsidiary co. holds such shares as a legal representative of a deceased member of the holding co.

Components of Consolidated Financial Statements: As per AS 21 Consolidated FS includes:
- Consolidated Balance Sheet
- Consolidated Statement of Profit and Loss
- Consolidated Cash Flow Statement
- Notes and statements and Explanatory schedules that forms part of FS

Holding Co. shall prepare two sets of Balance Sheet:
1. BS under Separate Financial Statements: under which value of Investment in Subsidiary co. will be shown at cost as per AS 13
2. BS under Consolidated Financial Statements: under which value of Investment in Subsidiary co. shall be replaced by the Net Assets of subsidiary co.
### Calculation of Cost of Control (Goodwill/Capital Reserve):

<table>
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<tr>
<th>Book Value of Investment held at Balance Sheet Date</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Net Assets of Subsidiary co. Owned by Parent co. on the date of investment, still held by subsidiary</td>
<td>XXX</td>
</tr>
<tr>
<td>(Share capital +/- Pre-Acquisition Share of P/L - Dividend Adjustment)</td>
<td>Goodwill/(CR)</td>
</tr>
</tbody>
</table>

**Net Assets = Share Capital + All Reserves and Surplus - Losses**

- **Goodwill** denotes that parent co. has paid extra amount as compared to the value of net worth acquired. Such extra amount may be paid for any future advantage. Goodwill will not be written off unless question requires.
- **Capital Reserve** denotes that parent co. has paid lesser than the value of net assets acquired by it. Under Ind AS 103 (Business Combinations) it is called "Gain on Bargain Purchase".
- **Pre-Acquisition profit** means all the reserves and surplus of subsidiary till the date of acquisition i.e. it is capital profit which is not earned by parent but acquired by parent co.
- **Post-Acquisition profit** means the share in profit & reserves earned by subsidiary after the date of acquisition of shares by parent co.

**Minority Interest (Non-Controlling Interest):**

1. That part of Net Assets of Subsidiary which is not owned by Parent Co. either directly or indirectly.
2. It represents the claim of outside shareholders of subsidiary.
3. Minority Interest should be presented in Consolidated Balance Sheet separately from liabilities and the equity of the parent's shareholders. It should be shown after 'Share Application Money' as separate head.

**Exclusion from Consolidation**

A Consolidated Financial Statement will not be prepared by the parent company when:

a. Control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future.

b. Or subsidiary company operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the parent.

When the parent company has some restrictions on bringing the resources of the subsidiary company to its main resources then consolidated financial statement is not required, as the control is not resulting in extra cash flow to parent company other than as mere investment in share of any other company i.e. dividend, bonus shares.

**Consolidation of its subsidiary which is a Limited Liability Partnership (LLP) or a partnership firm**

Holding company is required to consolidate its subsidiary which is an LLP or a partnership firm.

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D-Fortune Classes & Vsmart Academy – CA. Jai Chawla
**SPECIAL ADJUSTMENTS:**

| Balances of Reserves and Surplus - Missing | For Balance of Profit & Loss A/c : Assume Zero Balance as on 1st Day of the year. |
| For Balance of Other Reserves : Assume the Same amount as at the end of the year. |

| Treatment of Abnormal Items | While preparing AOP: |
| 1. Effect of Abnormal Items should be eliminated (Ab. Loss will be added and Ab. Profit will be deducted) - *(Jaha se already adjust hua hai vahi se eliminate karenge)* |
| 2. Apply time adjustment (if required) |
| 3. Re-instate the effect of Abnormal Items (Ab. Loss deducted and Ab. Profit added) - *(Jis period me A.Item occur hua hai vahi pe adjust karenge)* |
| Ab. Loss will be calculated net of claims |

| Treatment of Revaluation of Assets |
| • Revaluation of Assets of Parent co. is not relevant. |
| • Revaluation of Assets of Subsidiary co. is relevant to find out the fair value of Net Assets of Subsidiary co. for the calculation of Cost of Control. *(Net assets ki real aukaat pata karne k liye market value of assets dekhenge, book value nai)* |
| • Revaluation of Assets will be checked on the acquisition date of investments. |
| • Revaluation Profit or Loss is calculated as follows: |
| Book Value of Assets on the date of Acquisition - XXX |
| Less: Market Value of Assets on the date of Acquistions - XXX |
| • Revaluation Profit/Loss is treated as pre-acquisition profit/loss. *(profit ko plus aur loss ko minus karenge)* |
| • Additional Depreciation will be calculated in case of Revaluation profit and adjusted in post acquisition profit. *(minus karenge)* |
| • Saving in depreciation will be calculated in case of Revaluation loss and adjusted in post acquisition profit. *(plus karenge)* |
| • Revaluation adjustment will be done after applying Time Adjustment. |

| Treatment of Bonus issue of Shares by Subsidiary | Bonus issue of shares effects calculation of holding ratio. So we should be very careful while calculating holding ratio. |
| We will always assume that bonus is distributed out of past profits/reserves *(purane kamaye hue profits me se bonus issue hoga, na ki current year k profits me se)* |
| There can be either of the two possible cases: |
| 1. Bonus entry has been passed in books: Treat like Abnormal Loss/Dividend paid. |
| 2. Bonus entry has not been passed yet: |
| Pre-Acquisition Profits A/c Dr |
| To Share Capital A/c |
| Bonus shares receive karne wala koi bhi entry nai karega, kyunki usko |
### Unrealised Profit/Loss on assets/stocks transferred within the group

1. Calculate Book value of asset/stock transferred within the group (net of depreciation if any)
3. If such transaction is upstream (i.e. sale by subsy to parent) then eliminate profit/loss in AOP with similar effect in Asset/Stock value
4. If such transaction is downstream (i.e. sale by parent to subsy) then eliminate profit/loss Cons. P&L with similar effect in Asset/Stock value
   - If date of transaction is missing then assume such date to be the last date of period.

### Rectification of Errors

If question specifies any error then such errors should be rectified before time adjustment.

### Contra Items

Whenever Payable and Receivable are within group (i.e. H and S), then such payable/receivable should be eliminated.

- Payable A/c Dr.
- To Receivable A/c

**Note:**
1. If payable is less than receivable then difference is called cheque in transit
2. If payable is more than some Error will be given in the question. Such error will be rectified and then contra adjustment will be made.

### Contingent Liabilities

The Portion which is discounted and shown as Contingent liability will not to be shown in Consolidated BS

Contra Adjustment will be made only for that portion which is not yet discounted and shown under Bills receivable and Bills payable

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**Treatment of Proposed Dividend - Preference Shares:**

This dividend whether declared or not (irrespective of declaration – Para 27 of AS 21), will be appropriated from AOP and distributed among Parent and Minority in the ratio of Preference Shares held.

- **AOP A/c Dr.**
  - To CPL A/c (Parent’s Share - Post Acquisition)
  - To COC A/c (Parent’s Share - Pre Acquisition)
  - To Shot Term Provisions A/c (MI’s share)
**Unit - 2 (AS - 21)**

**Multiple Acquisition of Shares and Disposal of Shares in Single Subsidiary**

**Change in % of Holding of Parent Co.**
It may consist of following situations:
1. Further acquisition of Shares also known as Multiple acquisition
2. Disposal of Shares not resulting in loss of Control
3. Disposal of Shares resulting in Loss of Control

**Multiple Acquisitions (Further Acquisition of Subsidiary’s Shares)**
Following points should be kept in mind while solving the question:
1. For each Acquisition, AOP should be prepared separately.
2. Minority Interest is to be calculated at Balance Sheet date based on final proportionate share after all acquisitions. Minority Interest will be calculated as usual.
3. Share of Profit belonging to MI can be computed in any AOP.
4. Dividend paid after the 1st time acquisition of shares but before the 2nd time acquisition of shares may be Post acquisition dividend for 1st AOP and Pre - acquisition Dividend for 2nd AOP.

**Disposal of Shares:**

**Without Loss of Control**
1. Whenever the shares are partially sold by parent without loss of control then there will be no additional treatment except percentage of holding will be changed.
2. Sometimes the wrong entry may be passed by parent as under:
   
<table>
<thead>
<tr>
<th>Bank A/c</th>
<th>Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Investment A/c</td>
<td></td>
</tr>
</tbody>
</table>
   
   Then rectification entry is required by reversing the investment to recognize Profit or Loss
3. To Calculate the correct profit or loss on sale, First of all we shall calculate the correct value of Investments as under:  
   
   Original Cost - Pre acquisition Dividend received if any

**Full/Partial Disposal of Share (with loss of control)**
In case parent sells entire investments with loss of control or sells majority of investment and retain such portion which does not result in Significant Influence then
Consider following journal entry:

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank A/c</td>
<td>Dr.</td>
<td>Sale Proceeds</td>
</tr>
<tr>
<td>Investments A/c Dr.</td>
<td></td>
<td>Value of retained investments if any at Fair Value</td>
</tr>
<tr>
<td>Minority Interest Dr.</td>
<td></td>
<td>Proportionate share in NA</td>
</tr>
<tr>
<td>Capital Reserve Dr.</td>
<td></td>
<td>Proportionate share in NA (Previously recognised if any on COC)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To Net Assets A/c (Value on the date of sale)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To Goodwill A/c (Previously recognised if any on COC)</td>
</tr>
</tbody>
</table>

*(Any difference in above entry will be transfer to Profit and Loss A/c of Holding co.)*

**Partial Disposal of Share (with loss of control but retaining significant influence)**

In this situation, subsidiary co. will become Associate entity of Investor and the accounting will be made as per AS 23. It will be discussed in the next unit.
Important Notes:
UNIT - 3

AS 27 - INTEREST IN JOINT VENTURES
& AS 23 - INVESTMENT IN ASSOCIATES

JOINT VENTURES - AS 27

1. A Joint venture is defined as a Contractual Arrangement whereby two or more parties undertake an economic activity, which is subject to Joint Control.

   Example:
   IDBI gave loan to the joint venture entity of L&T and Tantia Construction, they signed an agreement according to which IDBI will be informed for all important decisions of the joint venture entity. This agreement is to protect the right of the IDBI, hence just signing the contractual agreement will not make investor a venturer.
   Similarly, just because contractual agreement has assigned the role of a manager to any of the venturer will not disqualify him as venturer.

2. Joint Ventures can be of Three Types –
   (a) Joint Control Operation - (JCO)
   (b) Joint Control Assets - (JCA)
   (c) Joint Control Entity - (JCE)

3. In case of JCO and JCA separate entity is not formed. In these cases Assets and Liabilities, Incomes and Expenses are shown in the financial statements of Ventures as “Share in JV”

   If any Investor in the JV has any transaction of Sale and Purchase with his JV then profit/loss on sale transaction should be ignored to the extent of own share. However loss can be recognized to the extent of own share if the loss is due to decline in market price.

4. JCE - A new entity is formed by Investors of JV. Such new entity is jointly controlled by investors through “Contractual Arrangement”

   Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

   JCE shall be consolidated with the parent only to the extent of own share. It is called “Proportioned Consolidation” and hence Minority Interest is not calculated.

   Contra and Unrealised profit adjustments are for Pro-rata part only.
   (Note – if the share in JV is more than 50% then it will be treated as subsidiary for
According to the Companies Act, 2013 and IND AS 111 (Joint Arrangement), JVs are to be Consolidated irrespective of any Subsidiary with parent.

**ASSOCIATE - AS 23**

1. Associate means an entity which is under the significant influence of another entity.
2. Significant influence means “Power to Participate in Financial and/or Operating decisions” of the company.
3. Associate can be formed due to any of the following ways:
   (a) **Through Voting Power** - If the entity acquires 20% or more voting power but up to 50% then the investor (acquirer) entity will have significant influence unless other proved. (In some situations a voting power of less than 20% can also be considered as significant influence if it is proved)
   (b) **Through application of Law** - If any law gives power to participate in the decision making of any entity then there will be significant influence even without acquiring voting power. (SBI and SBI associate banks, LIC and LIC housing finance)
   (c) **Through Agreement with Shareholders** - If the Shareholders holding 20% or more voting rights enter into any agreement that gives power to participate then also there will be significant influence.

**Treatment of Associates:**

1. If there is no Subsidiary then no consolidation, therefore there is no AS 23.
2. If there is Control over one company and significant influence over other company then in Consolidation Financial Statements, Investment in Associates shall be revalued according to EQUITY METHOD.
3. **Equity Method** - Investment will be revalued in CFS as under:
   - Investment Cost XXX
   - (+/-) Share in Post Acquisition Profits of Associates XXX
   - (-) Distribution received from Associates (if any) XXX
   - (+/-) Contra Adjustment and Unrealised Gains/losses adjustment to the extent of Investor’s share XXX
Important Notes:
When the Subsidiary company is in foreign country, then Consolidation should be done by considering following approach:

1. Prepare AOP in Foreign Currency.
2. Convert Balance Sheet of Subsidiary **including pre and post profits** by applying AS 11.
3. As per AS 11, subsidiary is treated as **Non integral foreign operation**. Following conversion rates are applied:
   - All Assets, All Liabilities - Closing Ex. Rate
   - Incomes, Expenses - Actual Rate or Avg. Rate
   - Share Capital - Earliest Opening Rate
4. Any difference in converted Balance Sheet of Subsidiary is called **FCTR** (Foreign Currency Translation Reserve as per AS 11) and it is treated as Capital reserve.
5. After conversion, apply consolidation normally.
6. FCTR will be accounted for as **Post Acquisition Profit/Loss** in the Consolidated Financial Statements. FCTR will be shown under Consolidated P&L in respect of Holding’s Share and Minority Interest in respect of its share.
Important Notes:
ECONOMIC VALUE ADDED

**Economic Value Added** means the Value created in excess of the required return (expectations) of the company's investors (Debentureholders and shareholders).

In other terms EVA is the Profit earned by the Firm less the cost of financing the Firm's Capital.
(But such profits excludes Non-operating profit)

**EVA Means** - Jo Tumne bachaya end me sabhi investors ki expectations ko pura karne k baad.

(What u have saved/retained our of Profits after distributing to all stakeholders for their expectations)

EVA is calculated as under:

\[
EVA = (ROOC - WACC) \times OC
\]

Where,

- **ROOC** = Return on Operating Capital
- **WACC** = Weighted Average Cost of Capital
- **OC** = Operating Capital

How to Calculate ROOC -

\[
ROOC = \frac{NOPAT \ (Net \ Operating \ Profit \ after \ Taxes)}{Operating \ Capital} \times 100
\]

NOPAT:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBIT</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Non-Operating</td>
<td>xxx</td>
</tr>
<tr>
<td>Income</td>
<td>xxx</td>
</tr>
<tr>
<td>Operating EBIT</td>
<td>xxx</td>
</tr>
<tr>
<td>Less Taxes</td>
<td>xxx</td>
</tr>
<tr>
<td>NOPAT</td>
<td>xxx</td>
</tr>
</tbody>
</table>

How to calculate Operating Capital -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>EQ Share Capital</td>
<td>xxx</td>
</tr>
<tr>
<td>Pref Share Capital</td>
<td>xxx</td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Losses</td>
<td>xxx</td>
</tr>
<tr>
<td>Add: Borrowed Funds</td>
<td>xxx</td>
</tr>
<tr>
<td>Total Capital</td>
<td>xxx</td>
</tr>
<tr>
<td>Less: Non-Operating</td>
<td>xxx</td>
</tr>
<tr>
<td>Assets</td>
<td>xxx</td>
</tr>
<tr>
<td>Operating Capital</td>
<td></td>
</tr>
</tbody>
</table>
How to calculate Weighted Average cost of Capital-
\[
\text{WACC} = \text{Cost of Debt (Kd)} + \text{Cost of Pref. Cap. (Kp)} + \text{Cost of Equity (Ke)}
\]
(Taking Book value weights)

<table>
<thead>
<tr>
<th></th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Kd</strong></td>
<td>Rate of Interest ((1 - \text{Tax Rate})) x Debt/Total Capital</td>
</tr>
<tr>
<td><strong>Kp</strong></td>
<td>Rate of Pref Divd. x Prf Share Capital / Total Capital</td>
</tr>
<tr>
<td><strong>Ke</strong></td>
<td>(R_f + (R_m - R_f) \text{Beta} \times \text{ESHF} / \text{Total Capital})</td>
</tr>
</tbody>
</table>
**Mutual Fund**

**MUTUAL FUND MEANS:**

- A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal.
- The money thus collected is then invested in capital market instruments such as shares, debentures and other securities.
- The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them.
- The profits or losses are shared by the investors in proportion to their investments.
- The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time.
- A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

**ORGANISATION OF MUTUAL FUNDS:**

- In India, mutual funds are regulated by SEBI (Mutual Funds) Regulations, 1996.
- A mutual fund is set up in the form of a trust, which has Sponsor, Trustees, Asset Management Company (AMC) and Custodian.
- The trust is established by a sponsor or more than one sponsor who is like promoter of a company.
- The trustees of the mutual fund hold its property for the benefit of the unitholders.
- Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody.
- The trustees are vested with the general power of superintendence and direction over AMC.
- SEBI Regulations require that **at least two thirds** of the directors of trustee company or board of trustees must be **independent** i.e. they should not be associated with the sponsors.
- Also, 50% of the directors of AMC must be independent.
- All mutual funds are required to be registered with SEBI before they launch any scheme.

**NET ASSET VALUE (NAV) OF THE SCHEME**

- The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV).
• Mutual funds invest the money collected from the investors in securities markets.
• In simple words, Net Asset Value is the market value of the securities held by the scheme.
• Since market value of securities changes every day, NAV of a scheme also varies on day to day basis.
• The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date.

\[
\text{NAV} = \frac{\text{Total Market Value of all MF holdings}}{\text{All MF Liabilities}} - \frac{\text{Total Units of the Scheme (Unit Size)}}{}
\]

**TYPES OF MUTUAL FUND SCHEMES:**

**CATEGORY – 1 “MATURITY PERIOD”**

(a) **Open - Ended Schemes:** An open-end fund is one that is available for subscription and repurchase all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value (“NAV”) related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

(b) **Close - Ended Schemes:** These schemes have a pre-specified maturity period. One can invest directly in the scheme at the time of the initial issue (New Fund Offer).

(c) **Interval Schemes:** Interval Schemes are that scheme, which combines the features of open-ended and close-ended schemes. The units may be traded on the stock exchange or may be open for sale or redemption during pre-determined intervals at NAV related prices.

**CATEGORY – 2 “INVESTMENT OBJECTIVES”**

(a) **Equity Funds:** Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences.

The Equity Funds are sub-classified depending upon their investment objective, as follows:

• Diversified Equity Funds
• Mid-Cap Funds
• Sector Specific Funds
• Tax Savings Funds (ELSS)

(b) **Debt funds:** The objective of these Funds is to invest in debt papers. Government authorities, private companies, banks and financial institutions are some of the major issuers of debt papers. By investing in debt instruments, these funds ensure low risk and provide stable income to the investors. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country.
(c) **Gilt Funds**: These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

(d) **Money Market or Liquid Fund**: These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

**FUND OF FUNDS (FOF) SCHEME**
A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FoF scheme. An FoF scheme enables the investors to achieve greater diversification through one scheme.

**INVESTMENTS OF MUTUAL FUND**
- For the purposes of the financial statements, mutual funds shall mark all investments to market and carry investments in the balance sheet at market value.
- However, since the unrealized gain arising out of appreciation on investments cannot be distributed, provision has to be made for exclusion of this item when arriving at distributable income.
- The profit/loss arising on the disposal of investment is the difference between the selling price and the cost. The profit arising on disposal of investment is recognised fully in the Revenue Account.
- The loss on disposal of investment is recognised fully in the revenue account, if the investments are sold in the same year in which they are purchased. However, if an investment is sold in any year subsequent to year of purchase, loss on disposal is charged first against provision for depreciation to the extent of balance available, and the balance of loss, if any, should be charged directly to the Revenue Account.

<table>
<thead>
<tr>
<th>Purchase of Investments</th>
<th>Investments A/c Dr. To Bank A/c</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation of Investment</td>
<td>Revenue A/c Dr. To Provision for Depreciation A/c</td>
</tr>
<tr>
<td>Appreciation of Investment</td>
<td>Investment A/c Dr. To Unrealised Appreciation Reserve A/c</td>
</tr>
<tr>
<td>Reversal of UAR in the Next Year</td>
<td>UAR A/c Dr. To Investments A/c</td>
</tr>
<tr>
<td>Sale of Investments</td>
<td>Bank A/c Dr. Provision for Depreciation A/c Dr. Revenue A/c Dr. (balance loss)</td>
</tr>
</tbody>
</table>
DIVIDEND EQUALISATION

- New investors are not entitled to any share of the income of a mutual fund scheme which arose before they bought their units.
- However, at the end of each distribution period the fund management allocates the same amount from the income of the fund to each unit.
- To compensate for this an equalisation payment is added to the cost of new units.
- This is the amount of income that has arisen up to the date of purchase of the unit.
- Because these payments are included in the amount available for distribution they are effectively repaid to the purchaser.

<table>
<thead>
<tr>
<th>Issue (Sale) of Units First Time</th>
<th>Bank a/c Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>To Unit Capital A/c</td>
</tr>
<tr>
<td></td>
<td>To Reserve A/c</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Issue (Sale) of Units Next Time</th>
<th>Bank a/c Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>To Unit Capital A/c (FV)</td>
</tr>
<tr>
<td></td>
<td>To Reserve A/c (NAV - FV)</td>
</tr>
<tr>
<td></td>
<td>To Dividend Equalisation Reserve (Extra)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distribution of Income to Unit Holders</th>
<th>Revenue A/c Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dividend Equalisation A/c Dr.</td>
</tr>
<tr>
<td></td>
<td>To Cash/Bank A/c</td>
</tr>
</tbody>
</table>
Important Notes:
**NON BANKING FINANCIAL COMPANIES**

**Asset Classification:**
In the interest of harmonization, the asset classification norms for NBFC are being brought in line with that of banks, in a phased manner, as given below:

1. **Lease Rental & Hire Purchase Assets shall become NPA:**
   - If they become overdue for 9 months (currently 12 Months) for the FY ending March, 2016
   - If overdue for 6 months for the FY ending March, 31 2017; and
   - If overdue for 3 Months for the FY ending March, 31 2018 and thereafter.

2. **Assets other than Lease Rental & Hire Purchase Assets shall become NPA:**
   - If they become overdue for 5 months (currently 6 Months) for the FY ending March, 2016
   - If overdue for 4 months for the FY ending March, 31 2017; and
   - If overdue for 3 Months for the FY ending March, 31 2018 and thereafter.

3. **For all loan and Hire Purchase & Lease Assets, Sub Standard would mean:**
   - An Asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the FY ending 31st March, 2016;
   - An Asset that has been classified as NPA for a period not exceeding 14 months for the FY ending 31st March, 2017;
   - An Asset that has been classified as NPA for a period not exceeding 12 months for the FY ending 31st March, 2018 and thereafter.

4. **For all loan and Hire Purchase & Lease Assets, Doubtful would mean:**
   - An Asset that has remained Sub Standard for a period not exceeding 16 months (currently 18 months) for the FY ending 31st March, 2016;
   - An Asset that has remained Sub Standard for a period not exceeding 14 months for the FY ending 31st March, 2017
   - An Asset that has has remained Sub Standard for a period not exceeding 12 months for the FY ending 31st March, 2018 and thereafter.

5. **Provisioning for Standard Assets:** Increased from 0.25% to 0.40%. The compliance to the revised norm will be phased in as given below:
   - 0.30% by the end of March 2016
   - 0.35% by the end of March 2017
   - 0.40% by the end of March 2018
SHARE BASED PAYMENT
& INDAS 102

This standard covers:
1. Equity settled share based payment transactions with Employees;
2. Cash Settled share based payment transactions with Employees; and
3. Transactions in which entity receives or acquires goods or services and either the entity or the supplier of goods or services has a choice of settling the transaction in cash, other assets or equity instruments.

This standard not applies to the following:
1. Transactions with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity. (i.e. Right Issue of Equity shares)
2. Transactions in which entity acquires goods as part of the net assets acquired in a business combination or the contribution of a business in the formation of Joint Venture.

Example:
An entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of those equity instruments. An employee receives such a right because he/she is a holder of equity instruments of that particular class. Whether this transaction is covered under Ind-AS 102?

Sol.: No. Granting or exercise of that right is not covered under Ind-AS 102.

TYPES OF SHARE BASED PAYMENT TRANSACTIONS:

- **Equity settled share-based payment transactions**
  - Entity receives goods/services as consideration for its own equity instruments (including shares or shareoptions)

- **Cash settled share-based payment transactions**
  - Entity acquires goods or services by incurring a liability to transfer cash/other assets to supplier for amounts that are based on entity’s or another group entity shareprice

- **Share-based payment transactions with cash alternatives**
  - Entity or the counterparty has choice to settle in equity instruments or in cash/other asset
**HOW TO RECOGNISE?**

Recognition of Equity Settled Share Based Payments - at FAIR VALUE:

- **Transactions with suppliers**: Fair value of goods or services received. (However if value of goods or services cannot be estimated reliably then measure their value by reference to the fair value of the equity instruments granted).
- **Transactions with employees**: Fair value of equity instruments awarded

**Recognition of cash-settled share-based payment transactions**

Typical examples of cash-settled share-based payment transactions are:

- **Share appreciation rights**: employee is entitled to the cash payment in the future based on the increase of entity’s share price over specified period of time from a specified level;
- **Rights to redeemable shares**: employee will receive the shares in the future that are redeemable in cash.
Similarly as in the equity-settled share-based payment transaction, the goods or services received are measured at the **fair value of the liability**.

The fair value of the liability has to be **remeasured at each reporting date** until this liability is settled and any changes of fair value are recognized in profit or loss. Vesting conditions are treated in the similar manner as in the equity-settled share-based payment transactions.

**How to determine fair value?**

There’s whole guidance on how to determine the fair value in *IND AS 113 – Fair Value Measurements*.

**How to deal with changes?**

Sometimes, an entity might change the terms of the share-based payment transaction.

**(a) Modification:**
If the fair value of the new instrument is **greater** than the fair value of the old instrument, then the incremental amount is recognized **over the remaining vesting period** (or immediately if modification happens after the vesting period).
If the fair value of the new instrument is **lower** than the fair value of the old instrument, the original fair value of the equity instruments granted should be **expensed** as if the modification never occurred.

**(b) Cancellation:**
If an entity **cancels or settles** the equity instruments, then it is recognized as an acceleration of the vesting period and any remaining unrecognized amount is **recognized immediately**.

**Vesting condition**

Some share-based payment transactions include **vesting conditions** that must be met before any payment is made.

*IND AS 102* recognizes 2 types of vesting conditions:
1. **Service conditions**: They require the counterparty to complete a specified period or service;
2. **Performance conditions**: They require the counterparty to complete a specified period of services **AND** specified performance targets to be met.

A performance condition might include a **Market Condition** upon which upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of the entity’s equity instruments such as attaining a specified share price or a specified amount of intrinsic value of a share option.

**How to deal with vesting conditions?**
Here, the principal question is whether vesting condition exists or not.
• **NO:** If the share-based payment *IS vested immediately*, or there are no vesting conditions, then INDAS 2 regards this transaction as granted in return for the supplier's (employee's) service in the past. Therefore, an entity needs to recognize the services received *immediately in full at the grant date*, with the corresponding increase in equity.

• **YES:** If the share-based payment *DOES NOT vest until the counterparty meets some vesting conditions*, then IFRS 2 regards this transaction as granted in return for the supplier's (employee's) service *rendered during the vesting period*. In this case, an entity should recognize an amount for the goods or services received during the vesting period *based on the best available estimate of the number of equity instruments expected to vest*.

**Vesting Condition Not Satisfied?**

*No Amount is recognised* for goods or services received on a cumulative basis if the equity instruments granted do not vest because of such failure.

**All Vesting Conditions Satisfied except Market Condition?**

*Recognition shall be done*, when all other vesting conditions are satisfied irrespective of whether that Market Condition is satisfied.

**MODIFICATIONS/REPRICING:**

Repricing means decline in the exercise price of options, so as to make options more attractive. In such case:

1. Calculate fair value as on the date of Repricing before the effect of modification
2. Calculate fair value on the date of repricing after the effect of modification
3. Calculate incentive due to repricing (1-2)
4. Such incentive should be written off over the remaining vesting period.
IMPORTANT NOTES:
<table>
<thead>
<tr>
<th>ATTEMPT</th>
<th>INDAS</th>
<th>REMARKS</th>
<th>MARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov. 2018</td>
<td>INDAS 17 – Leases</td>
<td>Simple Theory Question</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>INDAS 8 – Accounting Policies, Changes in Estimates &amp; Errors</td>
<td>Simple Theory Question</td>
<td>4</td>
</tr>
<tr>
<td>May 2018</td>
<td>INDAS 7 – Cash Flows Statements</td>
<td>Differences between AS 3 &amp; INDAS 7</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>INDAS 37 – Provisions, Cont. Liabilities &amp; Assets</td>
<td>Differences between AS 29 &amp; INDAS 37</td>
<td>4</td>
</tr>
<tr>
<td>Nov. 2017</td>
<td>INDAS 20 – GOVT. GRANTS</td>
<td>Difference between AS 12 &amp; IndAS 20</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>INDAS 1 &amp; 8</td>
<td>Differences in relation to Extra ordinary items &amp; Contingencies</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>INDAS 101 – FIRST TIME ADOPTION OF INDAS</td>
<td>Carves outs (Difference between IndAS 101 &amp; IFRS 1)</td>
<td>4</td>
</tr>
<tr>
<td>May 17</td>
<td>INDAS 103 – Business Combinations</td>
<td>Carve Outs in IndAS 103 from IFRS 3</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>(All questions were asked by referring IndAS but actual was same as AS)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nov. 2016</td>
<td>INDAS 24 – Related Party Disclosures</td>
<td>Differences between AS 18 &amp; INDAS 24</td>
<td>8</td>
</tr>
<tr>
<td>May 16</td>
<td>IndAS 8 – Accounting Policies, Changes in Estimates &amp; Errors</td>
<td>Question on change in method of depreciation – leads to change in accounting estimate</td>
<td>4</td>
</tr>
</tbody>
</table>

Avg. Marks per Exam – Approx 8 Marks
**APPLICABILITY OF INDIAN ACCOUNTING STANDARDS (Ind AS)**

**Who is the regulating Authority for applicability of Ind AS to corporate?**

Ministry of Corporate Affairs (MCA) is the regulatory authority and has issued a notification dated 16th Feb 2015 announcing the Companies (Indian Accounting Standards) Rule, 2015 for phase wise roadmap for adoption and applicability of all 39 Indian Accounting Standards (Ind AS) for companies other than Banking and Insurance Companies and NBFCs.

The application of Ind AS is mainly based on the listing status and net worth of a company. As per the roadmap for implementation of Ind AS, all listed companies (except companies listed on SME exchanges) and companies having a net worth of ₹250 crore or more shall be required to adopt Ind AS.

**What is the Phase wise compliance of IND AS**

**Phase- I: Obligation to Comply with Ind AS from 1st April, 2016**

In accordance with clause (ii) of sub-rule (1) of Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015, the following companies shall comply with Ind AS w.e.f. April 2016:

(a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth of ₹500 crore or more;

(b) Unlisted Companies having net worth ≥ ₹500 crore;

(c) Holding (Parent), subsidiary, joint venture or associate companies of above.

<table>
<thead>
<tr>
<th>COMPLIANCE</th>
<th>CURRENT FY</th>
<th>COMPARATIVE PERIOD</th>
<th>TRANSITION DATE FOR OPENING IND AS BS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary Compliance (Optional)</td>
<td>FY 15-16 i.e. year ending 31st March 2016</td>
<td>FY 14-15 i.e. year ending 31st March 2015</td>
<td>01/04/2014</td>
</tr>
<tr>
<td>Mandatory Compliance</td>
<td>FY 16-17 i.e. year ending 31st March 2017</td>
<td>FY 15-16 i.e. year ending 31st March 2016</td>
<td>01/04/2015</td>
</tr>
</tbody>
</table>

**Phase- II: Mandatory Compliance of Ind AS from 1st April, 2017**

Clause (iii) of sub-rule (1) of Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015 states that the following companies shall comply with Ind AS for the accounting periods beginning on or after 1st April, 2017:

(a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth of less than Rs. 500 crore;

(b) Unlisted companies having net worth ≥ Rs.250 crore but < Rs.500 crore;
(c) Holding, Subsidiary, Associate and J.V. of Above.

Thus, from April 2017 Ind AS shall apply to all listed companies irrespective of their net whereas the unlisted companies shall be required to comply with Ind AS only if their net worth is equal to or exceeding Rs. 250 crore. In other words, the companies meeting the above threshold for the first time as on 31st March, 2018 shall apply Ind AS for the financial year 2018-19 onwards.

<table>
<thead>
<tr>
<th>COMPLIANCE</th>
<th>IND AS CURRENT FY</th>
<th>IND AS COMPARATIVE PERIOD</th>
<th>TRANSITION DATE FOR OPENING IND AS BS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voluntary Compliance</td>
<td>FY 16-17 i.e. year ending 31st March 2017</td>
<td>FY 15-16 i.e. year ending 31st March 2016</td>
<td>01/04/2015</td>
</tr>
<tr>
<td>(Optional)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mandatory Compliance</td>
<td>FY 17-18 i.e. year ending 31st March 2018</td>
<td>FY 16-17 i.e. year ending 31st March 2017</td>
<td>01/04/2016</td>
</tr>
</tbody>
</table>

Note that the comparative information i.e. comparative figure for the preceding accounting period is required in both phases for the period ending 31st March 2016/2017 or thereafter. You should also note that the Rule do not mention the net worth criteria for holding, subsidiary, joint venture or associate companies and therefore even smaller companies in this category will be covered for the purpose of applicability of Ind AS.

**What will be the Net Worth for the above purpose?**

**Net worth of Companies for the purpose of Ind AS**

The term *Net Worth* shall have the meaning assigned to it in clause (57) of Section 2 of the Companies Act, 2013. For the purposes of calculation of net worth of companies, the following principles shall apply, namely:

(a) The net worth shall be calculated in accordance with
   i) the stand-alone financial statements of the company as on 31st March, 2014; or
   ii) The first audited financial statements for accounting period which ends after 31st March, 2014;

(b) for companies which are not in existence on 31st March, 2014 or an existing company falling under any of thresholds specified in sub-rule (1) for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in respect of which it meets the thresholds specified in sub-rule (1).

\[
\text{Net Worth} = \text{Total Paidup Share Capital} + \text{Free Reserves (Excluding Revaluation Res.)} + \ldots
\]
Sec. Prem A/c - Accumulated Losses - Deferred Expenditures & Misc Exp. (excluding written back of depreciation)

**Other Points:**

- Ind As once required to be complied with in accordance with Companies (Indian Accounting Standards) Rules, 2015, shall apply to both standalone financial statements and consolidated financial statements.

- For companies which are not in existence on 31st March, 2014 or an existing company falling under any of thresholds specified for the first time after 31st March, 2014, the net worth shall be calculated on the basis of the first audited financial statements ending after that date in respect of which it meets the thresholds specified.

- Overseas subsidiary, associate, joint venture and other similar entities of an Indian company may prepare its standalone financial statements in accordance with the requirements of the specific jurisdiction, provided that such Indian company shall prepare its consolidated financial statements in accordance with Ind AS either voluntarily or mandatorily if it meets the criteria.

- Indian company which is a subsidiary, associate, joint venture and other similar entities of a foreign company shall prepare its financial statements in accordance with the Ind AS either voluntarily or mandatorily if it meets the criteria.

**IND AS FOR BANK, INSURANCE COMPANIES AND NBFCS (Notification Date 18th Jan 2016)**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Entities</th>
<th>For Accounting Period Beg. Frm 1st April 2018 onwards</th>
<th>For Accounting Period Beg. Frm 1st April 2019 onwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(a) Scheduled Commercial Banks (excluding RRBs) (b) All India Term lending refinancing Institutions (EXIM, NABARD, SIDBI) And (c) Insurance Companies</td>
<td>Mandatory</td>
<td>NA</td>
</tr>
<tr>
<td>2</td>
<td>Non Banking Financial Institutions (NBFCs)</td>
<td>Having Net Worth of Rs. 500 Cr. or More Holding, Subsidiary, JV or Associates of the above</td>
<td>NBFCs whose equity/debt instruments are listed or in process of listing and having Net Worth Less than Rs. 500 Cr. Unlisted NBFCs, Having Net worth of Rs. 250 Cr. or more but less than Rs. 500 Cr. Holding, Subsidiary, JV or Associates of the above</td>
</tr>
</tbody>
</table>
Other Points:
1. Voluntary adoption is not permitted for BANKs/NBFCs/INSURERS
2. Entities not covered in the roadmap shall continue to apply Accounting Standards at present.
IND AS - 1 PRESENTATION OF FINANCIAL STATEMENTS

1. Applicable for preparing and presenting General purpose financial statements (not for any specific industry).
2. General purpose FS means - which intends to fulfill the need of those users who cannot require an entity to prepare tailored reports for their particular needs.
3. Not applicable to the Structure and Content of condensed Interim FS (where Ind AS 34 is applicable) except provisions relating to Fair presentation, compliance with IND AS and Fundamental accounting assumptions.
   (i) It uses terminology suitable for Profit Oriented entities. (Entities having non-profit activities have to amend description used for particular line item)
4. Material omissions or misstatements of items - are those which can influence the economic decisions that users make on the basis of FS. (Size or nature is to be considered for materiality)
5. Notes - Additional information, Narrative descriptions or disaggregation of items.
6. OCI (Other Comprehensive Income)- Items which are not recognized in the statement of Profit or loss as per any other IND ASs. Components of OCI (examples):
   (i) Revaluation Reserve (IND AS 16 & IND AS38)
   (ii) Re Measurements of defined benefit Plans (IND AS19)
   (iii) FCTR on conversion of Foreign Operations (IND AS21)
   (iv) Change in fair value of Equity Instruments if not HFT and designated as FVTOCI (IND AS 9)
   (v) Change in fair value of Hedged Instrument in case of CASH FLOW HEDGE (IND AS -9)
7. Reclassification adjustments - amounts reclassified to Profit or Loss in current period that were recognized in OCI.
8. Total Comprehensive income = Components of P/L +OCI (Change in equity resulting from transactions/events other than the changes from transaction with owners)
10. Complete Set of Financial Statements
    (a) A Balance Sheet as at the end of the Period
    (b) A Statement of Profit and Loss for the period (two sections - P&L and OCI)
    (c) A Statement of Changes in Equity for the period ( all owner changes in equity)
    (d) A Statement of Cash Flows for the period
    (e) Notes, significant a/c policies and explanatory information
    (f) Comparative information in respect of preceding period
    (g) A Balance Sheet as at the beginning of preceding period if entity applies accounting policy retrospectively or makes retrospective restatement of items or on reclassification of items and they are material. (Notes of this
11. Entity shall make an **EXPLICIT & UNRESERVED STATEMENT** of compliance if its FS are complied with in accordance with IND ASs. However Ind AS 1 allows deviation from a requirement of an Accounting Standard in case:
   - The Management concludes that compliance with Ind ASs will be misleading; &
   - If the regulatory framework requires such a departure OR if the regulatory framework does not prohibit such a departure.
   
   Else, Disclosure of non compliance is required to be given.

12. Inappropriate Accounting policies can—not be rectified only by Disclosure, or Notes or Explanatory statements.

13. FS shall be prepared on the basis of **GOING CONCERN** unless there is intention to liquidate or to cease trading or has no realistic alternative but to do so.
   
   If on the basis of **material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern** the entity shall disclose such uncertainties.
   
   If FS are not prepared on Going Concern Basis then it shall disclose such fact along with the basis on which it is prepared and reasons.
   
   Assessment of Going Concern assumption should be based on all available future information which is **at least 12 months** from the end of reporting period.

14. FS shall be prepared on **ACCRUAL** basis.

15. No offsetting of Assets and Liabilities or Incomes and Expenses unless requires by IND AS.

16. Frequency of Reporting: **at least Annual.**

17. Change in Presentation or Change in Classification of items in FS - **reclassify comparative amounts** unless it is impracticable.

18. **Consistency:** Presentation and Classification of items shall be consistent from one period to next unless:
   
   (a) It is apparent that such change would be more appropriate; or
   
   (b) An IND AS requires such Change.

19. **Structure and Content of FS:** Clearly identify each financial statements and notes and distinguished from other information in published documents. Disclose following information prominently and repeat it as necessary:
   
   (a) Name of reporting entity and any change in the name
   
   (b) Whether FS are of Individual entity of Group of Entity
   
   (c) Date of end of reporting period or the period covered by FS
   
   (d) Presentation currency used
   
   (e) Level of rounding used.

20. Separate classification for Current and Non-Current items except when presentation on liquidity basis provides reliable and more relevant information. (Even mixed basis is allowed in diverse operations)

21. **IND AS 1** does not prescribe format of FS rather prescribed minimum lineitems.

22. **Current Assets as per** (Schedule III of Comp Act, 2013):
(a) It expects to realise the asset, or intends to sell or consume it, in its normal operating cycle (receivables and inventories);
(b) It holds the asset primarily for the purpose of trading (Financial Instr. HFT);
(c) It expects to be realised within 12 months after the reporting period.
(d) Cash and Cash equivalents, unless it is restricted for being exchanged or used to settle liability for at least 12 months after the reporting period.

23. Normal operating cycle is the Time between the acquisition of assets for processing and their realisation in cash or cash equivalents. If not clearly identifiable it is assumed to have a period of 12 months.

24. Current liabilities are those:
   • expected to be settled within the entity’s normal operating cycle
   • held for purpose of trading
   • due to be settled within 12 months
   • for which the entity does not have an unconditional right to defer settlement beyond 12 months (settlement by the issue of equity instruments does not impact classification).

25. REFINANCING:

<table>
<thead>
<tr>
<th>Refinancing Agreement on a long term basis is completed after the reporting period but before the approval of FS</th>
<th>At the Reporting date, if Entity Expects and has discretion to refinance/roll over the Obligation for at least 12 months - Treat FL as Non-Current even it is due to be settled within 12 months.</th>
</tr>
</thead>
</table>

26. BREACH OF PROVISION OF LONG TERM LOAN ARRANGEMENT ON OR BEFORE REPORTING DATE:

<table>
<thead>
<tr>
<th>Non - Current</th>
<th>Non-Current</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>If Liability become repayable on demand and if lender agreed after reporting period but before approval of FS for not demanding the payment.</td>
<td>If lender agreed to provide grace period before end of reporting period for at least 12 months from the end of reporting date and during which lender cannot demand immediate payments.</td>
<td>If Liability becomes repayable on demand and if the lender does not agreed for not demanding the payment.</td>
</tr>
</tbody>
</table>

27. Statement of Profit or loss and Other Comprehensive income: No Choice of: (a) Signal Statement with two sections or (b) two statements

28. Allocation of Profit or loss and OCI attributable to
   (a) Non -controlling Interest and
   (b) Owners of the parent

29. OCI will be grouped into the items:
   (a) Which will not be reclassified subsequently to Profit or loss and
   (b) This will be reclassified subsequently to Profit or Loss when conditions met.

30. EXTRAORDINARY ITEM: PROHIBITED
31. **Presentation of Expense:** NATURE wise only not on FUNCTION wise.

32. **Presentation of Notes normally in following order:**
   (a) Statement of compliance with IND ASs
   (b) Summary of Significant Acc. Policies applied
   (c) Supporting information for items shown in BS, P&L, Cash Flows (i.e. schedules)
   (d) Other disclosures such as Contingent liabilities and Non-financial disclosures.

33. Disclosure of **Critical Judgements** made by management in applying accounting policies in summary of significant accounting policies.
   
   Eg. of Critical judgment: whether substantially all the significant risks and rewards of ownership of FA and Leased Assets are transferred to other entities.

34. Disclose key source of **Estimation Uncertainty** at the end of reporting period that have a significant risk of causing material adjustment to the carrying amounts of A/L within the next financial year. (Jo assumptions or estimations liye gaye hai year-end pe unke karan next f.y. me A/L ki book value par agar koi material impact aa sakta hai to vo assumptions or estimations disclosekaro)

### CARVE OUT

<table>
<thead>
<tr>
<th>IAS 1</th>
<th>IND AS 1 (CARVE OUT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>It requires that in case of a loan liability, if any condition of the agreement which was classified as Non Current is breached on the reporting date, such loan liability should be classified as <strong>Current</strong>. Even if the breach is rectified after the reporting date, IAS 1 requires loans to be classified as <strong>Current</strong>.</td>
<td>It clarifies that when there is breach of a material provision of a long term loan liability on or before the end of reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as <strong>Current</strong>, if the lender agreed not to demand payment as a consequence of breach after the reporting period and before the approval of financial statements for issue.</td>
</tr>
</tbody>
</table>

### DIFFERENCE BETWEEN IND AS 1 & IAS 1

<table>
<thead>
<tr>
<th>BASIS</th>
<th>IAS 1</th>
<th>IND AS 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single or Two Statements</td>
<td>It permits companies to present all items of income and expenses recognised either in a single or in two statements</td>
<td>It does not permit the two statement approach. All items of incomes and expenses to be presented in a single statement of Profit and Loss.</td>
</tr>
<tr>
<td>Analysis of Expenses</td>
<td>Expenses will be presented using the classification based on either their</td>
<td>Ind AS 1 mandates only <strong>nature</strong> wise classification of expenses.</td>
</tr>
<tr>
<td>Statement of Changes in Equity</td>
<td>nature or their function within the company.</td>
<td>Requires the statement to be presented as a separate statement.</td>
</tr>
</tbody>
</table>
**AS -2 (IND AS - 2)**

**INVENTORIES**

**Definition of Inventory AS 2 & Ind AS 2 (Same definition)**

Inventories are Assets:
(a) Held for sale in the ordinary course of business (Finished Goods)
(b) In the process of Production for Such Sale (WIP) or
(c) In the form of materials or supplies to be consumed in the production process or in the rendering of services (Raw Material).

As per the definition of inventory or closing stock it includes following things:
- Items which are held for sale in the normal course of business that is finished stock of goods.
- Work-in-progress (WIP) for such sale. Goods which are not yet finished or ready to sale.
- Raw material which is not even issued for production while valuation of closing stock or inventory. It also includes consumable stores item.

**Applicability AS 2**

AS-2 is not applicable to following cases.

Work in process in the construction contract business including, directly related to service contract.

Any financial instruments held as stock in trade which includes shares, debentures, bonds etc.

Other inventories like livestock, agricultural product and forest product, natural gases and mineral oils etc.

Work in progress in the business of banking, consulting and service business. That means it includes incomplete consulting service, merchant banking service and medical service in process.

All of above are not cover under the definition of inventory/ closing stock that’s why this accounting standard if not become applicable to above cases or in the course of business.
Cost of inventory

Valuation of inventory is made at cost or market/net realisable value whichever is lower. So that for the purpose of valuation cost of inventory is required to obtain. There can be three types of cost are included in the inventory which are as follow.

Purchase cost:
- Invoice price at which goods are purchased
- Duties and taxes paid
- Freight inward
- Any other expenditure directly relating to acquiring goods

Above cost should be reduced by following
- Duties and taxes received or receivable back from the tax authority
- Trade discount
- Rebate
- Duty drawback

Cost of Conversion

As per AS 2 After purchasing the raw material or goods during the production time whatever cost is paid or payable will be considered as conversion cost. It includes direct labour, material and other direct expense plus allocation of fixed and variable production overhead incurred for conversion or raw material into finished goods.

Following things should be considered for conversion cost of the inventory.

1. Fixed production overhead - it includes indirect cost for production which remains constant without relating to numbers of units produced. For example - depreciation and maintenance of factory building.
2. Variable overhead - indirect cost of production which depends on the number of units are produced such as packing material and other supporting material to finished product.
3. Allocation of fixed expense should be made on the bases of normal capacity and allocation of variable cost will be done on the basis of actual numbers of units are produced.

Other cost

It includes any other expenditure incurred to bring inventory or stock in the present location and condition. All three are the major part of the cost which required to be considered for valuation of the inventory. But it should not include abnormal wastage relating to material and labour, storage cost, administrative expenses & selling and distribution expenses.
Methods of valuation of inventory as per AS 2

There are numbers of methods for valuation of the inventory in the normal course of business which includes FIFO, LIFO, weighted average cost, standard cost and retail method. But practically following two methods only used as per AS 2.

- FIFO (first in first out)
- Weighted average

Net realisable value

As per AS 2 Net realisable value means normal selling price of the goods less estimated expenditure to sale such goods. It is estimated value on the basis of reliable evidence at time of valuation. Estimation of net realisable value can be done on the following basis.

If the finished goods in which raw material and supply is used is sold at cost or above the cost, then the estimated realisable value of raw material and supplies is considered more than cost.

If the finished goods in which raw material and supply are used is sold at below cost then the estimated realisable value of raw material or supply is equal to replacement price of raw material or supply.

Disclosure in financial statement

AS 2 Valuation of inventory is made on comparison of cost and net realisable value whichever is lower. This value should be disclosed in the financial statements. Other things relating to inventory to be disclosed in accordance with Accounting Standard-1 are accounting policies adopted in measuring inventory, cost formula and classification of inventory such as finished goods, raw material & WIP and stores and spares etc.
## MAJOR DIFFERENCES BETWEEN AS 2 & IND AS 2

<table>
<thead>
<tr>
<th>BASIS OF DIFFERENCE</th>
<th>AS - 2</th>
<th>IND - 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory of Service Providers</td>
<td>AS 2 does not contain any specific provision regarding cost of inventory of service provider.</td>
<td>Cost of Inventory of service providers shall be measured at the cost of their production which consist of Labour and Other cost of personnel directly engaged in providing the services, including supervisory personnel, and attributable overheads.</td>
</tr>
<tr>
<td>Subsequent Recognition</td>
<td>AS - 2 does not have specific provision regarding this.</td>
<td>When inventories are sold, the carrying amount of those inventories are recognised as an expense in the period in which related revenue is recognised. The amount of any written down of inventories to NRV and all losses of inventories shall be recognised as an expense in the period the written down or loss occur.</td>
</tr>
<tr>
<td>Inventory held by Commodity Broker</td>
<td>This aspect is not there in the existing standard.</td>
<td>Ind AS 2 does not apply to measurement of inventories held by commodity broker-traders who measure their inventories at Fair Value less Costs to Sell.</td>
</tr>
<tr>
<td>Inventories acquired on deferred settlement Terms.</td>
<td>AS - 2 does not considers finance element in a transaction of acquisition of inventory.</td>
<td>When inventories are acquired on deferred settlement basis and if it contain finance element then such element (difference between purchase price for normal credit terms and the amount paid) is recognised as an expense over the period of the financing.</td>
</tr>
<tr>
<td>Subsequent Assessment of NRV</td>
<td>AS - 2 does not cover reversal of inventories.</td>
<td>When the circumstances that previously caused inventories to be written</td>
</tr>
<tr>
<td>Machinery Spares</td>
<td>Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of PPE as per AS 10</td>
<td>Ind AS 2 does not contain specific explanation in respect of such spares.</td>
</tr>
</tbody>
</table>
**AS-4**  
Contingencies & Events occurring after the Balance Sheet Date

**IND AS - 10**  
Events after the Reporting Period

---

**NOTE:** After the issuance of AS - 29 "Provisions, Contingent Liabilities and Contingent Assets" the scope of AS - 4 in respect of 'Contingencies' has no relevance. AS - 4 now deals with 'Events occurring after the Balance Sheet date.'

**AS 4 does not apply in following cases:**
- Liabilities of Life Assurance and general Insurance companies.
- Obligations under Retirement Benefit Plans.
- Commitments arising from Long Term Lease Contracts.

**EVENTS Occurring after the Balance Sheet Date are:**
- those significant events, both favorable and unfavorable
- that occur between the balance sheet date and the date on which FS are approved by competent authority.

*(Same definition under IND AS - 10)*

*Example: Balance Sheet date is 31st March, 2011 and Board of Directors approved the accounts on 30th July, 2011. Any event that occurs between 31st March and 30th July is termed as 'Events occurring after the BS date'. Suppose there was fire in company on 13th May, 2011 which destroyed the assets worth Rs. 10 Crores.*

**Classification of Events as per AS - 4 & IND AS - 10: (No Change)**
For accounting treatment Events are classified into two categories:

- **Those that provide Evidence of Conditions that Existed at the end of the Reporting Period.**

  The events related to circumstances/conditions existed on Balance sheet date (known as Adjusting Events).

**Examples:**
- Settlement of litigation against the entity after the reporting date, in respect of events that occurred before the end of reporting period, may provide evidence of existence and amount of liability at the reporting date. (However the provision shall be created by considering AS 29/Ind AS 37)
- Declaration of bankruptcy by a long outstanding receivable after the reporting date may provide evidence that receivable was impaired at the reporting date.
- Detection of Fraud or Errors after reporting period may indicate that the financial statements are misstated.
• Those that are Indicative of conditions that arose after the reporting period.

The events not related to circumstances/conditions existed on Balance sheet date; in other words entirely new events after the BS date (Non Adjusting Events). For e.g. decline in the market values of investments.

Examples:
➢ Destruction of Assets of the entity by floods occurring after the reporting period does not indicate that the assets of the entity were impaired at the end of reporting period.
➢ Initiation of litigation against the company arising out of events that occurred after the reporting period does not indicate the existence of liability at the reporting date.
➢ Decline in the market value of investments after the reporting period does not provide evidence that the investments were impaired at the end of reporting period.

Accounting Treatment:
(a) Adjusting Events:
AS – 4/Ind AS – 10: (1) To adjust the amounts recognised in the financial statement; or (2) to recognize items that were not previously recognised.
Example: Loss should be accounted, Provision should be made.

(b) Non Adjusting Events:
AS – 4: Disclosure in the report of approving authority**, no adjustment in accounts is required.

**EXPOSURE DRAFT**: The ICAI had issued the exposure draft of the limited revision to AS – 4 wherein the “Contingencies“ have been deleted from AS – 4 and name of the AS – 4 will be “Events occurring after the Balance Sheet date“ and requirement of AS – 4 has also been harmonized with Revised Schedule VI. The amended AS provides that “these events should be disclosed in the Financial Statements (by way of Notes to Accounts) instead of in the report of approving authority.” The limited revision will be applicable only after the notification by the Central Government.

Declaration of Dividend after the Reporting Period:

<table>
<thead>
<tr>
<th>AS – 4</th>
<th>IND AS – 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed Dividend should be Accounted for in the same reporting period in which it belongs.</td>
<td>If Dividends are declared after the reporting period but before the approval of financial statements, the dividends are not</td>
</tr>
</tbody>
</table>
Although ICAI has issued Exposure draft on Revised AS 4 according to which Proposed dividend shall not be recognised as liability at the end of reporting period. **recognised as liability** at the end of reporting period.

Such dividends are disclosed in the Notes in accordance with Ind AS 1. **Companies Act, 2013** also confirms the same.

**Going Concern Exception:**

<table>
<thead>
<tr>
<th>AS – 4</th>
<th>IND AS – 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>If after the Balance Sheet date, entity's going concern assumption is no longer appropriate then it should adjust Assets and Liabilities.</td>
<td>If after the reporting date, it is determined that the fundamental accounting assumption of going concern is no longer appropriate, Ind AS 10 requires a fundamental change in the basis of accounting.</td>
</tr>
<tr>
<td>AS 4 does not require any disclosure. However AS 1 requires the disclosure of the fact in case of going concern assumption is not followed.</td>
<td>Also it requires to disclose the FACT that the FS are not prepared on a going concern basis and state the reasons why the entity is not regarded as going concern.</td>
</tr>
</tbody>
</table>
ACCOUNTING STANDARD - 5

“NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGE IN ACCOUNTING POLICIES”

(A) Net Profit Or Loss For The Period:
(a) As per AS-5, all the items of Incomes & Expenses which are recognized in a period should be included in the determination of "Net Profit/Loss for the period" unless other AS requires/permits otherwise.

Examples:
- AS-10: on upward revaluation of FAs, the difference should be transferred to Revaluation reserve a/c
- AS-12: Grant received for Depreciable FA should be deducted from the gross book value of concerned asset.
- AS-16: Borrowing Cost should be added to the cost of FA.

(b) Net Profit/Loss for the period consist of:
(i) Profit/Loss from ordinary activities and
(ii) Extraordinary Items.

Ordinary activities are any activities which are:-
- Undertaken by the enterprise
- as a part of its business

As per AS - 5, when items of incomes and expenses from ordinary activities are of such SIZE or NATURE that their disclosure is relevant to explain the performance of enterprises, then the NATURE and AMOUNT of such item should be separately disclosed in the statement of Profit and Loss.

Extraordinary items are:-
- Incomes and expenses
- arise from events or transactions
- which are clearly distinct from ordinary activities
- and are not expected to recur frequently or regularly.

As per AS - 5, Nature and Amount of extraordinary items should be separately disclosed in the statement of profit and loss.

Examples of Extraordinary items:-Loss due to Earthquake/Fire, Refund of Govt. Grant, VRS expenditure.

(B) Prior Period Items are:
- Incomes and Expenses
- which arise in Current period
- as a result of Error or Omission in the preparation of F/s of one or more prior periods.

As per AS - 5, the Nature & Amount of Prior period items should be separately disclosed in the P&L a/c so that their impact on current year's profit/loss can be seen.

Examples of Prior Period Items:
(a) Omission to account for Incomes or Expenses
(b) Non provision for salary already due in earlier years.
(c) Applying incorrect rate of Depreciation.
(d) Treating Operating lease as Finance lease.

(C) **Changes in Accounting Policies:**
Accounting policies can be changed by complying the conditions of Accounting Standard 1 - Disclosure of Accounting Policies.

**Requirements as per AS - 5:**
- Material effect of changes in accounting policies should be disclosed in financial statements in the year in which such changes occur.
- Such material effect should be ascertained (i.e. quantified).
- If it is not ascertainable, the fact should be disclosed.
- If the effect of such change is not material for the current period, but is material for the later periods, then the fact should be disclosed in the period of change.

(D) **Change in Accounting Estimates:**
- As a result of uncertainties inherent in business activities, many financial statement items can not be measured with accuracy, but can only be estimated.
- The estimation process involves judgments based on the latest information available and circumstances.
- Estimates may have to be revised, if changes occur regarding the circumstances on which estimate was based, or as a result of new information.
- As per AS - 5, effects of changes in accounting estimates should be classified using the same classification in the statement of profit and loss as was used previously for the estimate.
- If an estimate pertains to ordinary activity, then change in accounting estimate should be classified as an ordinary activity.
- If an estimate pertains to extraordinary activity, then change in accounting estimate should be classified as extraordinary.
- Changes in a/c estimates shall not be treated as 'Extraordinary item' or 'Prior period item'.
- Sometimes it is difficult to distinguish between a change in an accounting policy and a change in an accounting estimate. In such cases, the change is treated as a change in an accounting estimate, with appropriate disclosure.(AS - 5)

**Note:**

1. Change in A/c policy ----- Retrospective effect.
   Change in A/c estimates ----- Prospective effect.
2. Examples of accounting estimates are estimating the residual value of fixed assets, estimating the useful life of fixed assets, provision for doubtful debts and income tax.
## MAJOR DIFFERENCES BETWEEN AS 5 & IND AS 8

<table>
<thead>
<tr>
<th>BASIS OF DIFFERENCE</th>
<th>AS - 5</th>
<th>IND - AS 8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extra ordinary Items</td>
<td>AS - 5 defines extraordinary items as incomes and expenses which are not expected to recur frequently or regularly and which are clearly distinct from ordinary activities. Ex. Refund of GG VRS payment.</td>
<td>Since Ind AS 1 prohibits the presentation of any income or expense as Extraordinary item therefore Ind AS 8 not not deal with this issue.</td>
</tr>
<tr>
<td>Change in Accounting Policy</td>
<td>Change in accounting policy is permissible when such change is required by Statue.</td>
<td>Ind AS 8 does not allow to change accounting policy if change is required by Statue.</td>
</tr>
<tr>
<td>Prior Period Items</td>
<td>AS 5 defines PPI as Income or Expenses which arise in current period as a result of Errors or Omissions in the preparation of Financial statements of one or more prior periods.</td>
<td>Ind AS 8 uses the term &quot;Errors&quot; and relates it to errors or omissions arising from a failure to use or misuse of reliable information and error includes frauds.</td>
</tr>
<tr>
<td>Rectification of Material Prior period Items</td>
<td>Prospective Effect</td>
<td>Retrospective effect subject to limited exceptions where it is impracticable to determine the period specific effects.</td>
</tr>
<tr>
<td>Definitions of Accounting Policies</td>
<td>It means the specific accounting principles and the methods of applying those principles.</td>
<td>It broadens the definition to include bases, conventions, rules and practices applied by an entity in the preparation and presentation of financial statements.</td>
</tr>
<tr>
<td>Exceptions in Retrospective Accounting of Changes in Accounting Policies</td>
<td>AS 5 does not specify how change in accounting policy should be accounted for.</td>
<td>Ind AS 8 requires that change in Accounting policies should be accounted for with &quot;Retrospective effect subject to limited exceptions viz., where it is impracticable to determine the period specific effects or the cumulative effect of applying a new accounting policy.</td>
</tr>
</tbody>
</table>
AS - 7 CONSTRUCTION CONTRACTS

A. Types of Construction Contract: Construction contracts are of two types:
   a. **Fixed price contracts**: In this case of contract, contractor agrees for fixed price of the contract or fixed rate/unit. However, in some cases the contract price is subject to escalation.
   b. **Cost–plus contract**: In these contracts, contractor is reimbursed the cost fixed percentage of profit.

B. Calculating the profit or loss of a construction contract: Profit or loss on construction contract is Contract revenue - Contract Cost.

C. Contract revenue: Contract revenue includes/excludes the following:
   Add/Includes:
   a. Revenue/price agreed as per Contract.
   b. Revenue arising due to escalation clause.
   c. When a fixed price contract involves a fixed price per unit of output, contract revenue increases as the number of units is increased.
   d. Variations, Claims & Incentive payments.

   Less/Excludes:
   a. Penalties arising from delays caused by the contractor in the completion of the contract.
   b. Variations.

E. A variation is an instruction by the customer for a change in the work to be performed. It may lead to an increase/decrease in contract revenue. Variations are considered only when:
   a. There is a certainty of collection (it is probable that the customer will accept) the variation &
   b. There is a certainty of measurement.

F. A claim is an amount that the contractor seeks to collect from the customer as reimbursement for costs not included in the contract price. Examples are customer caused delays. Claims are considered only when:
   a. There is a certainty of collection &
   b. There is a certainty of measurement.

G. Incentive payments are additional amounts payable to the contractor if specified performance standards are met or exceeded. Ex. an incentive payment to the contractor for early completion of the contract. These are considered only when:
   a. There is a certainty of collection&
   b. There is a certainty of measurement.

H. Percentage of completion method (PCM): As per AS 7, the contract revenue will be recognised with reference to **STAGE OF COMPLETION** at the reporting date. This is called PCM.

I. Determination of stage of completion:
   a. **Cost to Cost method**: The percentage of completion would be estimated by
comparing total cost incurred to date with total cost expected for the entire contract:

\[
\text{Percentage of Completion} = \frac{\text{Cost to date}}{\text{Cost incurred} + \text{Estimated cost to complete}} \times 100\%
\]

Current period revenue from Contract = Contract price \times \text{Percentage of completion} - \text{Revenue previously recognised}.

b. Technical survey method:
E.g.: A construction contract of a two floor building for Rs. 15 lakhs (with a 50% margin)

<table>
<thead>
<tr>
<th>Divisions of contract</th>
<th>Technical Completion</th>
<th>Cost to complete</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foundation</td>
<td>35%</td>
<td>5</td>
</tr>
<tr>
<td>1st Floor</td>
<td>10%</td>
<td>1</td>
</tr>
<tr>
<td>2nd Floor</td>
<td>15%</td>
<td>1</td>
</tr>
<tr>
<td>Tiling, painting, fitting etc.,</td>
<td>40%</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>100%</td>
<td>10</td>
</tr>
</tbody>
</table>

Foundation work was completed.
Under the cost to cost method, revenue of Rs.7.5 lakhs (15 Lakhs \times 5/10 Lakhs) would be recognised & cost of Rs.5 lakhs would be recognised and profit of Rs. 2.5 lakhs would be recognised. Under the technical survey method, revenue of Rs. 5.25 lakhs (35% of Rs. 15 lakhs) would be recognised, cost of Rs.3.5 lakhs (35% of Rs. 10 lakhs) would be recognised and a profit of Rs. 1.75 lakhs would be recognised.

J. Conditions for recognising the contract revenue:
   a. No significant uncertainty exists regarding the amount of consideration.
   b. No significant uncertainty exists regarding the collection of consideration.

K. When outcome of contract cannot be estimated reliably: In those circumstances the revenue should be recognised only to the extent of contract costs incurred of which recovery is probable, \textit{thus no profit is recognised}.

L. Subsequent uncertainty in collection: When uncertainty of collection of revenue arises subsequently after the revenue recognition, it is better to make provision for the uncertainty in collection rather than adjustment in already recognised revenue.

M. Contract costs consist of the following:
   a. Specific costs: Labour cost, Cost of material used in construction, Depreciation of plant and equipments used on the contract, Cost of hiring plant, Cost of design and technical assistance & Claim from third parties. These costs should be reduced by incidental income, for example, sale of scrap material.
   b. Cost attributable to contract: Insurance, Cost of design and technical assistance that is not directly related to a specific contract & Construction overheads.
   c. Pre contract cost: Contract costs include the costs incurred in securing the contract.
Cost excluded: General administration cost, Selling cost, Research and development.

N. Provision for expected losses: When it is certain that total contract cost will exceed total contract revenue, the expected losses should be immediately provided for.

Guidance Note on Turnover in case of Contractor

Whether the revenue recognized in the financial statements of contractors as per the requirements of Accounting Standard (AS) 7, Construction Contracts (revised 2002), can be considered as ‘turnover’?

Recommendation of G Note on Turnover in case of construction. The amount of contract revenue recognized as revenue in the statement of profit and loss as per the requirements of AS 7 (revised 2002) should be considered as ‘turnover’.

**MAJOR CHANGES in IND AS 11 wrt AS 7**

<table>
<thead>
<tr>
<th>BASIS OF DIFFERENCE</th>
<th>AS - 7</th>
<th>IND AS - 11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusion of Borrowing Cost</td>
<td>AS 7 includes borrowing costs as per AS 16, Borrowing Costs, in the costs that may be attributable to contract activity in general and can be allocated to specific contracts</td>
<td>Ind AS 11 does not specifically make reference to Ind AS23.</td>
</tr>
<tr>
<td>Fair Value</td>
<td>AS 7 does not recognise fair value concept as contract revenue is measured at consideration received/receivable</td>
<td>Ind AS 11 requires that contract revenue shall be measured at fair value of consideration received/receivable.</td>
</tr>
<tr>
<td>Service Concession Arrangements</td>
<td>AS 7 does not deal with accounting for Service Concession Arrangements</td>
<td>Appendix A of Ind AS 11 deals with accounting aspects involved in such arrangements</td>
</tr>
</tbody>
</table>
GUIDANCE NOTE ON ACCOUNTING FOR REAL ESTATE TRANSACTIONS

1. OBJECTIVE AND SCOPE

- The term ‘real estate’ refers to land as well as buildings and rights in relation thereto. Entities who undertake such activity are generally referred to by different terms such as ‘real estate developers’, ‘builders’ or ‘property developers’.
- The Accounting treatment of Real Estate prescribed herein is as enunciated in AS 7 Construction Contracts, which provides for Application of percentage of Completion Method.
- The Accounting treatment of transaction which are in the nature of sale of goods is in accordance with the principles enunciated in AS 9 Revenue Recognition.
- An illustrative list of transactions which are covered by this Guidance Note is as under:
  - Sale of plots of land (including lease of land on finance lease under AS 19, Leases) without any development or with development which includes common facilities like laying of roads, drainage lines and water pipelines, electrical lines, sewage tanks, water storage tanks, sports facilities, gymnasium, club house, landscaping etc.
  - Development and sale of residential and commercial complex, row houses, independent houses, with or without undivided share in land
  - Acquisition, utilisation and transfer of development rights.
  - Redevelopment of existing buildings and structures.
  - Joint development agreements for any of the above activities.

2. DEFINITIONS

(a) PROJECT: Project is the smallest group of units/plots/saleable spaces which are linked with a common set of amenities. A larger venture can be split into smaller projects, if the basic conditions as set out above are fulfilled.

Example
A project may comprise a cluster of towers or each tower can also be designated as a project. Similarly, a complete township can be a project or it can be broken down into smaller projects.

(b) PROJECT COSTS : Project costs in relation to a project ordinarily comprise:
(i) Cost of land and cost of development rights : It includes all the costs related to acquisition of land.
(ii) Borrowing costs : It includes costs incurred directly in relation to a project or which are apportioned to a project. Ind AS 23 is to be applied in respect to it.
(iii) Construction and development costs: It includes costs incurred directly in relation to the specific project and costs that may be attributable to project activity in general and can be allocated to the project.

Construction costs and development costs that relate directly to a specific project include:
(a) land conversion costs, betterment charges, municipal sanction fee and other charges for obtaining building permissions;
(b) site labour costs, including site supervision;
(c) costs of materials used in construction or development of property;
(d) depreciation of plant and equipment used for the project;
(e) costs of moving plant, equipment and materials to and from the project site;
(f) Costs of hiring plant and equipment;
(g) costs of design and technical assistance that is directly related to the project;
(h) Estimated costs of rectification and guarantee work, including expected warranty costs; and
(i) Claims from third parties.

The below costs should not form part of the Construction Costs if they are material:
(a) General administration
(b) Selling costs;
(c) research and development costs;
(d) Depreciation of idle plant and equipment;
(e) Cost of unconsumed or uninstalled material delivered at site; and
(f) Payments made to sub-contractors in advance of work performed.

The below costs are incurred on specific or general basis to the project. These are allocated to the project on rational and consistent basis.
(a) Insurance;
(b) Costs of design and technical assistance that is not directly related to a specific project;
(c) Construction or development overheads; and
(d) Borrowing costs

(c) PROJECT REVENUES: Project revenues include revenue on sale of plots, undivided share in land, sale of finished and semi-finished structures, consideration for construction, consideration for amenities and interiors, consideration for parking spaces and sale of development rights.

3. ACCOUNTING FOR REAL ESTATE TRANSACTIONS

3.1 CONTRACT FOR SALE OF LAND (WITHOUT ANY DEVELOPMENT)
All the principles of AS 9 Revenue are to be applied to completed sale
All the conditions of Ind AS 18 Revenue are to be satisfied:
• The point in time where all the risk and rewards are transferred from buyer to seller
• The entity does not retain managerial involvement usually associated with ownership.
• the amount of revenue can be measured reliably;
• it is probable that the economic benefits associated with the transaction will flow to the entity;
• The costs incurred or to be incurred in respect of the transaction can be measured reliably.

3.2 CONTRACT FOR CONSTRUCTION, DEVELOPMENT OR SALE OF UNITS

• Contract for construction, development or sale of units that are not complete at the time of entering into agreements for construction, development or sale and also for sale of plot with development
• In case of construction sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction.
• This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer.
• *Revenue in such cases is recognised by applying the percentage of completion method on the basis of the methodology explained in AS 7, Construction Contracts.

• Where many contracts are entered for a single construction, when a component is completed, but significant performance in respect of remaining components of the project is pending, revenue in respect of such an individual contract should not be recognised until the performance in respect of remaining components of the project is pending

3.3 APPLICATION OF PERCENTAGE COMPLETION METHOD

✓ The percentage completion method should be applied in the accounting of all real estate transactions/activities in the situations described i.e., where the economic substance is similar to construction contracts and also for the sale of developed plots.
✓ This method is applied when the duration of the project is beyond 12 months i.e. commencement and completion fall in different accounting period.
✓ This method is applied when the outcome of a real estate project can be estimated reliably and when all the following conditions are satisfied:
  o total project revenues can be estimated reliably;
  o it is probable that the economic benefits associated with the project will flow to the entity;
  o the project costs to complete the project and the stage of project completion at the reporting date can be measured reliably; and
The project costs attributable to the project can be clearly identified and measured reliably so that actual project costs incurred can be compared with prior estimates.

Further there is a rebuttable presumption that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in (a) to (d) below are completed.

(a) All the critical approvals necessary for commencement of the project have been obtained.
(b) If the expenditure incurred on the construction and development costs is less than 25%, nothing is recognised as in the profit and loss A/C of the contract.
(c) At least 25% of the saleable project area is secured by contracts or agreements with buyers.
(d) At least 10% of the contract consideration as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts.

Example:

If there are 10 Agreements of sale and 10% of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements only.

- The recognition of project revenue by reference to the stage of completion of the project activity should not at any point exceed the estimated total revenues from 'eligible contracts'/other legally enforceable agreements for sale.
- When it is probable that total project costs will exceed total eligible project revenues, the expected loss should be recognised as an expense immediately. The amount of such a loss is determined irrespective of: Commencement of project work; or The stage of completion of project activity.

### 3.4 TRANSFERABLE DEVELOPMENT RIGHTS

When development rights are sold or transferred, revenue should be recognised when the following conditions are fulfilled:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of development rights;
(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the development rights sold;
(c) the amount of revenue can be measured reliably;
(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and
(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably

4. DISCLOSURE

An entity should disclose:
(a) the amount of project revenue recognised as revenue in the reporting period;
(b) The methods used to determine the project revenue recognised in the reporting period; and
(c) The method used to determine the stage of completion of the project.

An entity should also disclose each of the following for projects in progress at the end of the reporting period:
(a) the aggregate amount of costs incurred and profits recognised (less recognised losses) to date;
(b) the amount of advances received;
(c) the amount of work in progress and the value of inventories; and
(d) Excess of revenue recognised over actual bills raised (unbilled revenue)
Important Notes:
The world today is packed with different kinds of products, services, transactions and many other activities that people and business do. Logically, it is sometimes very tough issue for accountants to determine WHEN and even WHETHER to recognize revenue in the financial statements.
That’s exactly the main aim of this standard to give guidance on the revenue recognition and help in the application of the revenue recognition criteria.

**What is Revenue?**

**AS – 9**
Revenue is gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from:
- the sale of goods,
- from the rendering of services, and
- from the use by others of enterprise resources yielding interest, royalties and dividends.

**IND AS – 18**
Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

**Agency relationship = revenue?**
Here I would like to stress that the revenue includes only the economic benefits received or receivable on the entity’s own account. However, entities often collect the
amounts on behalf of the third parties, such as taxes payable to the state budget—these amounts are NOT revenue and CANNOT be recognized as such.

Also, agency transactions are very common in today’s business and sometimes it’s not easy to determine the agency relationship. In agency relationship, the agent just collects the amounts on behalf of the principal and thus cannot recognize the revenue.

For example, mobile operators often sell some additional content with their monthly prepaid calling plans, such as music or application. The relationship between 3 parties is illustrated in the following scheme:

However, it is difficult to determine the existence of agency relationship and therefore IND AS 18 sets criteria that, individually or in combination, indicate that an entity is acting as principal:

- The entity has the primary responsibility for providing the goods or services to customer or for fulfilling the order.
- The entity has the inventory risk before or after the customer order, during shipping or on return.
- The entity has latitude in establishing prices, either directly or indirectly.
- The entity bears the customer’s credit risk on the receivable due from the customer of the service.

So each transaction must be carefully assessed and if only 1 criterion is met then the entity probably acts as a principal and recognizes revenue from the transaction.

**Measurement of Revenue:**

**AS – 9:** Revenue is recognised at the nominal amount of consideration receivable.

**IND AS – 18:** The revenue shall be measured at fair value of consideration received or receivable.
IND AS 18 specifies the following:

**Measurement of Revenue**

= fair value of consideration received or receivable

- Cash
- Discounted future receipts
- Fair value of goods/services received

- Any trade discounts or rebates shall be deducted and revenue is measured net of these items.
- When the cash inflow is *deferred* or postponed to future, then the fair value of consideration received might be less than its nominal amount. In this case, the fair value of consideration received is determined by *discounting future cash flows* to their present value using the *imputed rate of interest*.
- With regard to exchanges of goods or services (barter transactions):
  - When goods or services are of a *similar nature*, then the exchange is not regarded as a transaction revenue generating and the revenue cannot be recognized.
  - When goods or services are of a *dissimilar nature*, then the exchange is regarded as a transaction revenue generating and the revenue is recognized in amount of fair value of goods/services received (adjusted by the amount of any cash transferred).

**Recognition of Revenue**

IND AS 18 specifies revenue recognition criteria for 3 basic revenue generating scenarios:
- Sale of goods
- Rendering of services
- Interest, Royalties and Dividends

**Sale of Goods (AS & Ind AS same)**

Revenue from sale of goods is recognized when all of the following conditions are satisfied:
- the entity has transferred to the buyer the significant risks and rewards of ownership of the goods
- the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold
• the amount of revenue can be measured reliably
• it is probable that the economic benefits associated with the transaction will flow to the entity
• The costs incurred or to be incurred in respect of the transaction can be measured reliably.

IND AS 18 sets the practical guidance on recognition of revenue from various situations when selling goods. The summarized list is as follows:

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Revenue Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bill and Hold Sales</td>
<td>When the buyer takes title.</td>
</tr>
<tr>
<td>Goods Shipped Subject to Conditions</td>
<td></td>
</tr>
<tr>
<td>- installation &amp; inspection</td>
<td>When the buyer accepts delivery and installation &amp; inspection is completed.</td>
</tr>
<tr>
<td>- on approval</td>
<td>When the buyer formally accepts the shipment</td>
</tr>
<tr>
<td>- with limited right of return</td>
<td>When the goods were delivered and time for return lapsed.</td>
</tr>
<tr>
<td>- consignment sales</td>
<td>After the buyer sells goods to the final customer.</td>
</tr>
<tr>
<td>- cash on delivery sales</td>
<td>When delivery is made and cash is received by the seller.</td>
</tr>
<tr>
<td>Lay Away Sales (a system of paying a deposit to secure an article for later purchase.)</td>
<td>When the delivery is made.</td>
</tr>
<tr>
<td>Sale and Repurchase Agreements</td>
<td>Look out for financing arrangement - not revenue.</td>
</tr>
<tr>
<td>Subscriptions to Publications</td>
<td>In line with the period over which the items are dispatched.</td>
</tr>
</tbody>
</table>

**Rendering of Services**

Here, can the outcome of the transaction be estimated reliably?
• If yes, then the revenue can be recognized by the reference to the stage of completion of the transaction at the end of the reporting period.
• If not, then the revenue can be recognized only to the extent of the expenses recognized that are recoverable.

When can the outcome of the transaction be estimated reliably? It is when all the following conditions are satisfied:
• the amount of revenue can be measured reliably
• It is probable that the economic benefits associated with the transaction will flow to the entity.
• the stage of completion of the transaction at the end of the reporting period can be measured reliably and
The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

**Standard also permits recognition as per Completed Service Contract Method.**

IND AS 18 sets the practical guidance on recognition of revenue from various situations when rendering services:

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Revenue Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Installation Fees</td>
<td>With reference to the stage of completion.</td>
</tr>
<tr>
<td>Servicing Fees</td>
<td>If subsequent services are included, then defer the revenue for the subsequent services.</td>
</tr>
<tr>
<td>Advertising Commissions</td>
<td></td>
</tr>
<tr>
<td>- Media Commissions</td>
<td>When the related advertisement appears before the public.</td>
</tr>
<tr>
<td>- Production Commissions</td>
<td>With reference to the stage of completion.</td>
</tr>
<tr>
<td>Insurance Agency Commissions</td>
<td></td>
</tr>
<tr>
<td>- Agent Renders Further Services</td>
<td>Defer over the period during which the policy is in force.</td>
</tr>
<tr>
<td>- Agent Does Not Render Further Services</td>
<td>At the date of policy commencement or renewal.</td>
</tr>
<tr>
<td>Financial Services</td>
<td></td>
</tr>
<tr>
<td>- Integral Part of Effective Interest Rate</td>
<td>Based on the classification of the related financial instrument</td>
</tr>
<tr>
<td>- Earned As Services Are Provided</td>
<td>When related service is provided.</td>
</tr>
<tr>
<td>- Earned On Execution of Significant Act</td>
<td>When related significant act has been completed.</td>
</tr>
<tr>
<td>Admission Fees</td>
<td>When the event takes place or allocate proportionally to individual events.</td>
</tr>
<tr>
<td>Tuition Fees</td>
<td>Over the period of instruction.</td>
</tr>
<tr>
<td>Initiation, Entrance, Membership Fees</td>
<td></td>
</tr>
<tr>
<td>- No additional services provided</td>
<td>Immediately when membership starts.</td>
</tr>
<tr>
<td>- Additional services provided</td>
<td>Defer over the membership period on some reasonable basis.</td>
</tr>
<tr>
<td>Franchise Fees</td>
<td>On the basis reflecting the purpose for which the fees are charged.</td>
</tr>
<tr>
<td>Fees from Development of Customized Software</td>
<td>With reference to the stage of completion, including the post-delivery service support stage.</td>
</tr>
</tbody>
</table>
**Interest, Royalties and Dividends**
Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognized when:
- it is probable that the economic benefits associated with the transaction will flow to the entity and
- the amount of the revenue can be measured reliably.

Revenue shall be recognized on the following bases:
- **INTEREST**
  - **AS - 9**: The recognition of revenue from interest on **TIME PROPORTION BASIS**.
  - **IND AS - 18**: Interest shall be recognized using the **EFFECTIVE INTEREST METHOD** as set out in IND AS 109 & 32
  
  **Example:**
  A company provides loan facility to one of its employee of Rs. 100000 @ concessional interest of 6% pa. repayable after 4 years. Same loan could have been taken at 10% from SBI without any concession.
  
  **AS - 9** = Interest is recognised at 6% (Agreed/Contractual Rate)
  **Ind AS -18** = Interest is recognised using effective interest rate (i.e. 10%)

- **ROYALTIES** shall be recognized on an accrual basis in accordance with the substance of the relevant agreement.
- **DIVIDENDS** shall be recognized when the shareholder’s right to receive payment is established.

**Postponement of Revenue Recognition**
Revenue recognition shall be postponed when:
- The Consideration is not determinable or
- The amount of consideration is not certain to be collected

When uncertainties get over, Revenue should be recognised.

*If uncertainty about the ultimate collectability of revenue arise after the initial recognition then enterprises should not reverse the revenue already recognised, it should create a proper Provision.*

**Presentation of Turnover:**

**AS - 9**
Turnover should be presented in the following manner:
- Turnover (Gross) XX
- Less: Exice Duty XX
- Turnover (Net) XX

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IND AS - 18

Does not specifically deal with the above presentation basis.

CARVE OUT: (Major Change in Ind AS 18 wrt IFRS)

As per IFRS: On the basis of principles of the IAS 18, IFRIC 15, Agreement for Construction of Real Estate, prescribes that construction of real estate should be treated as sale of goods and revenue should be recognised when the entity has transferred significant risks and rewards of ownership and retained neither continuing managerial involvement nor effective control.

Carve out: IFRIC 15 has not been included in Ind AS 18 to scope out such agreements from Ind AS 18. A separate guidance note on accounting for real estate developers (for Ind AS compliant entities) has been issued by the ICAI to address thematter.

Reason: It was observed that requirement will lead to recognition of revenue in the financial statements by real estate developers based on the completion method, i.e., only in the last year of the completion of project. It was felt that in case the revenue for the whole project is recognised in the last year of completion of project, it will not reflect the true performance of the business of the real estate developer. Further, it was felt that since Ind AS 11 requires recognition of revenue of all construction contracts by reference to stage of completion, it may lead to inappropriate accounting in case of certain real estate development projects in case this Ind AS is applied for all real estate development projects. Therefore, it was considered appropriate that rather than making changes in Ind AS 11 or Ind AS 18, a separate Guidance note (for Ind AS-compliant entities) should be issued in line with the Guidance note on Accounting for Real Estate Transactions issued by the Institute of Chartered Accountants of India(for entities on which AS are applicable).
**AS - 10 (R)
PROPERTY, PLANT & EQUIPMENT (PPE)**

**IND AS - 16
PROPERTY, PLANT & EQUIPMENT**

**NON APPLICABILITY OF AS 10 (REVISED)**
1. When any other Standard specifically applied to a particular item or transaction such as AS 19 on Leases of Fixed Assets.
2. Biological Assets related to Agricultural activity (IND AS 41 is applicable on such assets)
   *However AS 10 - PPE is applicable on Bearer Plants.*

**DEFINITIONS:**
1. **Biological Assets:** It means Living Plants and Animals. AS 10 applies on Bearer Plants only.

2. **Bearer Plant:** A plant that satisfies all the 3 conditions:

<table>
<thead>
<tr>
<th>Condition</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Is used in the production or supply of Agricultural produce</td>
<td></td>
</tr>
<tr>
<td>2. Is expected to bear produce for more than a period of 12 months</td>
<td></td>
</tr>
<tr>
<td>3. Has a remote likelihood of being sold as Agricultural produce except for incidental scrap sales</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** When bearer plants are no longer used to bear produce they might be cut down and sold as scrap. For example - use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a Bearer Plant.

**Example of bearer plant is Mango Tree, Coconut Tree etc**

3. **Property Plant and Equipment:**
   Any Tangible item will be called as PPE if it satisfies the following Conditions:

<table>
<thead>
<tr>
<th>Condition - 1</th>
<th>Condition - 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Held for Use in Production or Supply of goods and services For Rental to Others For Administrative Purposes</td>
<td>Expected to be Used for more than 12 Months.</td>
</tr>
</tbody>
</table>

**Items of PPE may also be acquired for safety or environmental reasons:** Although not directly increasing the future economic benefits, Such items of PPE qualify for recognition as assets because they enable an enterprise to derive future economic
benefits from related assets in excess of what could be derived had those items not been acquired.

**RECOGNITION CRITERIA FOR PPE**

The *cost of an item of PPE* should be recognised as an asset *if, and only if*:
(a) It is probable that future economic benefits associated with the item will flow to the enterprise, and
(b) The cost of the item can be measured reliably.

**Notes:**

1. It may be *appropriate to aggregate individually insignificant items*, such as moulds, tools and dies and to apply the criteria to the aggregate value.
2. An enterprise may *decide to expense an item* which could otherwise have been included as PPE, because the amount of the expenditure is not material.

**Treatment of Spare Parts, Stand by Equipment and Servicing Equipment**

- **Case I:** If they meet the definition of PPE as per AS 10: Recognised as PPE as per AS 10
- **Case II:** If they do not meet the definition of PPE as per AS 10: Such items are classified as Inventory as per AS 2.

**Treatment of different subsequent expenditure on PPE:**

1. *Cost of day to day servicing:* This cost is directly recognised in the Statement of Profit and Loss.
2. *Placement of parts of PPE:* Capitalise in the carrying amount of PPE if the recognition criteria are met.
   - Example: 1) Aircraft interiors such as seats and galleys may require replacement several times during the life of the air frame.
   - 2) Replacing the interior walls of a building, or to make a non-recurring replacement.
3. *Regular Major Inspection:* When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement, if the recognition criteria are satisfied.
   - Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognized.

**MEASUREMENT OF PPE**

<table>
<thead>
<tr>
<th>At Initial Recognition</th>
<th>After Initial Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COST MODEL</strong></td>
<td><strong>COST MODEL</strong> or <strong>REVALUATION MODEL</strong></td>
</tr>
</tbody>
</table>

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**Cost of an item of PPE comprises:**

<table>
<thead>
<tr>
<th>COST Includes</th>
<th>COST Excludes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price including Import duties and Non refundable Taxes</td>
<td>Cost of Opening new business such as inauguration cost</td>
</tr>
<tr>
<td>Any Directly attributable Costs bringing the inventory to its 'location and condition'</td>
<td>Cost of introducing a new product including advertising</td>
</tr>
<tr>
<td>Eg. Cost of Employee benefits on construction or acquisition of PPE</td>
<td>Initial operating losses</td>
</tr>
<tr>
<td>Installation Cost</td>
<td>Cost of relocating or reorganizing part or all the operations of an enterprises.</td>
</tr>
<tr>
<td>Cost of Testing the PPE</td>
<td>Administrative and other general overheads</td>
</tr>
<tr>
<td>Professional Fees</td>
<td></td>
</tr>
</tbody>
</table>

**Decommissioning Restoration and Similar Liabilities**

*Initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as ‘Decommissioning, Restoration and similar Liabilities’*

**INITIAL RECOGNITION AT - COST:**

Cost of an item of PPE is the **CASH PRICE EQUIVALENT** at the recognition date.

**(a)** If payment is deferred beyond normal credit terms:
- Total payment - Cash price equivalent
  - Is recognised as Interest over the period of credit
  - unless such interest is capitalised in accordance with AS 16

**(b)** PPE acquired in Exchange for a Non-monetary Asset or Assets or a combination of Monetary and Non-monetary Assets:

Cost of such an item of PPE is measured at fair value unless:

(i) Exchange transaction lacks commercial substance; Or
(ii) Fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

If the PPE acquired is not measured at Fair Value, its cost is measured at the **carrying amount of the asset given up.**
(c) PPE purchased for a Consolidated Price:
Where several items of PPE are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition.

**Note:** In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent values.

(d) PPE held by a lessee under a Finance Lease:
The cost of an item of PPE held by a lessee under a finance lease is determined in accordance with AS 19 (Leases).

(e) Government Grant related to PPE:
The carrying amount of an item of PPE may be reduced by government grants in accordance with AS 12 (Accounting for Government Grants).

**MEASUREMENT AFTER RECOGNITION**
An enterprise should choose

- Either Cost model,
- Or Revaluation model as its accounting policy and should apply that policy to an entire class of PPE.

**Class of PPE:** A class of PPE is a grouping of assets of a similar nature and use in operations of an enterprise.

Examples of separate classes:
(a) Land
(b) Land and Buildings
(c) Machinery
(d) Ships
(e) Aircraft
(f) Motor Vehicles
(g) Furniture and Fixtures
(h) Office Equipment
(i) Bearer plants

**Cost Model**
After recognition as an asset, an item of PPE should be carried at:
Cost - Any Accumulated Depreciation - Any Accumulated Impairment losses

**Revaluation Model**
After recognition as an asset, an item of PPE whose fair value can be measured reliably should be carried at a revalued amount.
Fair value at the date of the revaluation -
Less: Any subsequent accumulated depreciation (-)
Less: Any subsequent accumulated impairment losses (-)
Carrying value =

Revaluation for entire class of PPE

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If an item of PPE is revalued, the entire class of PPE to which that asset belongs should be revalued.

**ACCOUNTING TREATMENT OF REVALUATIONS**

**Frequency of Revaluations**

(Sufficient Regularity)

**Items of PPE experience significant and volatile changes in Fairvalue**

**ANNUAL REVALUATION**

**Items of PPE with only insignificant changes in Fair value**

**Revalue the item only every 3 or 5 years**

When an item of PPE is revalued, the carrying amount of that asset is adjusted to the revalued amount.

At the date of the revaluation, the asset is treated in one of the following ways:

**Technique 1:** Gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset.

- *Gross carrying amount*
  - May be restated by reference to observable market data, or
  - May be restated proportionately to the change in the carrying amount.

**Accumulated depreciation at the date of the revaluation is** - Adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses

**Case Study on Technique I**

PPE is revalued to Rs. 1,500 consisting of Rs. 2,500 Gross cost and Rs. 1,000 Depreciation based on observable market data.

Details of the PPE before and after revaluation are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cost/Revalued Cost</th>
<th>Accumulated depreciation</th>
<th>Net book value</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPE before revaluation</td>
<td>1,000</td>
<td>400</td>
<td>600</td>
</tr>
<tr>
<td>Fair Value</td>
<td></td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Revaluation Gain</td>
<td></td>
<td></td>
<td>900</td>
</tr>
<tr>
<td>Gain allocated proportionately to cost</td>
<td>1,500</td>
<td>600</td>
<td>900</td>
</tr>
<tr>
<td>PPE after revaluation</td>
<td>2,500</td>
<td>1,000</td>
<td>1,500</td>
</tr>
</tbody>
</table>
The increase on revaluation is Rs. 900 (i.e., Rs. 1,500 - Rs. 600).

**Technique 2:** Accumulated depreciation is eliminated against the Gross Carrying amount of the asset

**Revaluation - Increase or Decrease**

- **Increase:**
  - Credited directly to owners’ interests under the heading of Revaluation surplus
  - Recognised in the Statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in the Statement of profit and loss

- **Decrease:**
  - Charged to the Statement of profit and loss
  - Exception: When it is subsequent Decrease (Initially Increase)
  - Decrease should be debited directly to owners’ interests under the heading of Revaluation surplus to the extent of any credit balance existing in the Revaluation surplus in respect of that asset

**Treatment of Revaluation Surplus**

The revaluation surplus included in owners’ interests in respect of an item of PPE may be transferred to the **Revenue Reserves when the asset is derecognized**.

**Case I:** When whole surplus is transferred: When the asset is:
- Retired; Or
- Disposed of

**Case II:** Some of the surplus may be transferred as the asset is used by an enterprise: In such a case, the amount of the surplus transferred would be:

Depreciation (based on Revalued Carrying amount) - Depreciation (based on Original Cost)

**Transfers from Revaluation Surplus to the Revenue Reserves are not made through the Statement of Profit and Loss.**
DEPRECIATION

Component Method of Depreciation:
Each part of an item of PPE with a cost that is significant in relation to the total cost of the item should be depreciated separately.

Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
Is Grouping of Components possible?
Yes.

A significant part of an item of PPE may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

Accounting Treatment:
Depreciation charge for each period should be recognised in the Statement of Profit and Loss unless it is included in the carrying amount of another asset.

Examples on Exception:

<table>
<thead>
<tr>
<th>AS 2</th>
<th>Depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories as per AS 2.</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS 26</td>
<td>Depreciation of PPE used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26 on Intangible Assets.</td>
</tr>
</tbody>
</table>

Depreciable Amount and Depreciation Period

What is “Depreciable Amount”?

Depreciable amount is:
Cost of an asset (or other amount substituted for cost i.e. revalued amount) - Residual value
The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

Review of Residual Value and Useful Life of an Asset:
Residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5 ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’.

Note: Depreciation is recognised even if the Fair value of the Asset exceeds its
Carrying Amount. Repair and maintenance of an asset do not negate the need to depreciate it.

**Commencement of period for charging Depreciation**
Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

**Land and Buildings**
Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

A. **Land**: Land has an unlimited useful life and therefore is not depreciated.
   - **Exceptions**: Quarries and sites used for landfill.
   - **Depreciation on Land**:
     I. **If land itself has a limited useful life**: It is depreciated in a manner that reflects the benefits to be derived from it.
     II. **If the cost of land includes the costs of site dismantlement, removal and restoration**: That portion of the land asset is depreciated over the period of benefits obtained by incurring those costs.

B. **Buildings**: Buildings have a limited useful life and therefore are depreciable assets.
   - An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

**DEPRECIATION METHOD**

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

The method selected is applied consistently from period to period unless:
- There is a change in the expected pattern of consumption of those future economic benefits; or
- That the method is changed in accordance with the statute to best reflect the way the asset is consumed.

**REVIEW OF DEPRECIATION METHOD**

The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern.

Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.
**RETIREMENTS**

Items of PPE retired from active use and held for disposal should be stated at the lower of:

- Carrying Amount, and
- Net Realisable Value

**Note:** Any write-down in this regard should be recognised immediately in the Statement of Profit and Loss.

**DE-RECOGNITION**

The carrying amount of an item of PPE should be derecognised:

- On disposal
  - By sale
  - By entering into a finance lease, or
  - By donation, Or
- When no future economic benefits are expected from its use or disposal

**Accounting Treatment:**

Gain or loss arising from de-recognition of an item of PPE should be included in the Statement of Profit and Loss when the item is derecognized unless AS 19 on Leases, requires otherwise on a sale and leaseback (AS 19 on Leases, applies to disposal by a sale and lease back.)

Where,

\[
\text{Gain or loss arising from de-recognition of an item of PPE} = \text{Net disposal proceeds (if any)} - \text{Carrying Amount of the item}
\]

**Note:** Gains should not be classified as revenue, as defined in AS 9 'Revenue Recognition'.
ACCOUNTING STANDARD – 11(Revised)

“EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES”

1. This AS deals with:-
   • Foreign Exchange Transactions
   • Foreign Operations
   • Forward Exchange Contracts.

2. This AS is applicable on all Entities. Para 46 of this AS is applicable only for Companies.

3. Translation of Cash Flows of a Foreign operation and Presentation of Cash Flow Statements from Foreign currency transactions both have been kept outside the scope of AS 11 coverage.

FOREIGN EXCHANGE TRANSACTIONS

(A) Initial Recognition: All foreign exchange transactions are converted into reporting currency using Spot exchange rate or approximate rates (i.e. the exchange rate prevailing on the date of Transaction). (As per IAS – 21, Functional currency is used for reporting currency).

Examples of Foreign Currency Transactions:
   • Buying or selling of Goods and Services in Foreign Currency;
   • Borrowing or Lending Money in Foreign Currency;
   • Acquisition or Disposal of Assets in Foreign Currency;
   • Incurring or Settling any Liability in Foreign Currency

(B) Subsequent Recognition:
   • This recognition is applied on Foreign currency Monetary Items (FCMI).
   • FCMIs should be reported using closing exchange rate.
   • Subsequent recognition is applied for preparing financial statements.
   • Any exchange difference arising on conversion of FCMI into reporting currency shall be transferred to Profit & Loss a/c.

Note: Meaning of Foreign Currency Monetary Items (FCMI): FCMI are those Assets/Liabilities whose amount is Fixed under contract and they are to be settled in foreign currency. For example Receivable, Payables, Cash Balances.

(C) Amendments to AS – 11 (NACAS): Para 46 has been introduced in AS 11 with retrospective effect from 7th December 2006 amended on 31st March, 2009.
   (a) This Para is applicable only to companies.
(b) Companies/Non Companies can opt for the application of this Para & option is irrevocable till 31st March, 2020.

(c) FCMI of Long Term in nature (whose realization/payment is beyond 12 months from the date of original transaction) will be converted using closing rate in subsequent recognition.

(D) Exchange difference arising from above point will be recognized as follows:
- Transfer Exchange difference to value of Depreciable Fixed Assets if long term monetary item was taken to finance such Dep F.A. (i.e. to be capitalized if debit difference and subtracted if credit difference)
- Transfer Exchange difference to Foreign Currency Monetary Items
  Translation Diff a/c (FC MIT Diff a/c) long term monetary item has no relation with Depreciable Fixed Assets.

(E) FC MIT Diff a/c will be written off in periods equally by 31st March 2020 or till the life of LTFCMI whichever is earlier.

(F) The balance in FC MIT Diff "a/c (debit or credit) should be shown on the "Equity and Liabilities" side of the balance sheet under the head "Reserves and Surplus" as a separate line item. (as decided by the council of ICAI)

FOREIGN OPERATIONS

AS 11 (Effect of Changes in Foreign Exchange Rates), classifies the foreign branches as:
- Integral Foreign Operation: The activities of which are an integral part of those of the reporting enterprise (i.e. Head Office).
- Non Integral Foreign Operation: The business of such branch is carried on in a substantially independent way.

Examples of Foreign Operations are Branch, Associate, Joint Venture, Subsidiary.

TECHNIQUES FOR TRANSLATION OF FOREIGN BRANCH TRAIL BALANCE:

(A) Integral foreign branch:

<table>
<thead>
<tr>
<th>Items to be Translated</th>
<th>Translation at</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary Items (such as Debtors/creditors, Cash/Bank, Prepaid/Outstanding expense)</td>
<td>At Closing exchange rate</td>
</tr>
<tr>
<td>Non-Monetary items (such FA, Accum. depreciation on FA, Investment set c)</td>
<td>At Cost i.e. at the exchange rate on the date of purchase</td>
</tr>
<tr>
<td>Opening Stock</td>
<td>Opening exchange rate</td>
</tr>
<tr>
<td>Closing Stock</td>
<td>Closing exchange rate</td>
</tr>
<tr>
<td>Revenue nature items (Incomes and expenses)</td>
<td>Average rate</td>
</tr>
</tbody>
</table>
Any Exchange difference arising on the translation of the Branch Trial Balance should be transferred to Profit & Loss a/c of HO.

(B) Non-integral foreign branch:
(i) Balance Sheet items i.e. Assets and Liabilities both Monetary and Non monetary apply Closing exchange rate.
(ii) Items of Income and Expenses - At the actual exchange rates on the date of transactions. However, AS 11 allows average rate subject to materiality.
(iii) Any Exchange rate difference should be accumulated in a “foreign currency translation reserve”.

DIFFERENCES BETWEEN AS 11 and IND AS 21

<table>
<thead>
<tr>
<th>BASIS</th>
<th>AS 11</th>
<th>IND AS 21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange diff. arising on translation of LTFCMI</td>
<td>AS 11, Gives an option to recognize exchange diff. arising on translation of certain LTFCMI from foreign currency to reporting currency directly to equity (FCMIT Diff A/c) or if it is related to acquisition of FA then exchange diff. can be recognized as a part of the cost of the asset.</td>
<td>Ind AS 21 does not apply to LTFCMI recognized in the Financial Statements before beginning of first Ind AS financial reporting period as per the previous GAAP i.e. AS 11. Such an entity may continue to apply the accounting policy so opted for such LTFCMI as per AS 11</td>
</tr>
<tr>
<td>Approach for translation of Foreign Operation</td>
<td>AS 11 is based on Integral and Non Integral Foreign operations approach for accounting of Foreign Operation.</td>
<td>Ind AS 21 is based on the Functional Currency approach. However, factors to be considered in determining an entity’s functional currency are similar to the indicators in existing AS 11 to determine foreign operations as non-integral operation.</td>
</tr>
<tr>
<td>Presentation Currency</td>
<td>There is no such term defined here.</td>
<td>Ind AS 21 - Presentation currency can be different from local currency and it gives detailed guidance in this regard.</td>
</tr>
</tbody>
</table>
- **Functional currency** is the currency of the primary economic environment in which the entity operates.
- **Presentation currency** is the currency in which the financial statements are presented.

### Primary Economic Environment

<table>
<thead>
<tr>
<th>In Which The Entity Primarily Generates And Expends Cash</th>
<th>Primary Indicators</th>
<th>Other Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency that mainly influence <strong>SALE PRICE</strong> of goods and services and Currency of the country whose competitive forces and regulations determine the sale prices of its goods and services</td>
<td>Currency that mainly influence <strong>COST</strong> - Labour, Material and other Cost.</td>
<td>Currency in which funds from financing activities are generated.</td>
</tr>
</tbody>
</table>

### Choice of Functional Currency

1. An entity does not have a free choice of functional currency.
2. An entity cannot change functional currency unless facts and circumstances relevant to its determination change.
Important Notes:
ACCOUNTING STANDARD - 12
ACCOUNTING FOR GOVERNMENT GRANTS

Example of international body: WHO (World Health Organisation)
Example of National body: ICAI allows grant to institutes for conducting accounting research.

3. Grant means: Any Consideration allowed in cash or non cash, whose value can be determined.
Tax exemptions are not considered as grants.
Some Examples:
(ii) Subsidies Yes
(iii) Tax Holidays No
(iv) Tax Exemptions/Deductions No
(v) Govt. assistance: No

4. This standard is applicable for all entities.

5. According to AS - 12, Govt. Grant can be recognized in the books if following conditions are satisfied:
(i) Conditions relating to grant had been complied with, and
(ii) There is reasonable certainty of collection of grant.

6. Types of Grant and their recognition:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Type</th>
<th>Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bailout Grants</td>
<td>Credit grants in P&amp;L a/c</td>
</tr>
<tr>
<td>2</td>
<td>Income Grants (in the nature of Prize)</td>
<td>Credit grants in P&amp;L a/c</td>
</tr>
<tr>
<td>3</td>
<td>Expense Grants (for meeting specific expense)</td>
<td>Credit as liability until expended. It is transferred to P&amp;L a/c when expended or deducted from related exp.</td>
</tr>
<tr>
<td>4</td>
<td>Non-Monetary Grants</td>
<td>At nominal value and credited to capital reserve, depreciation not charged. At acquisition cost</td>
</tr>
<tr>
<td></td>
<td>(i) Free of Cost</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) At concessional price</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Grants as promoter contribution (for working in backward areas)</td>
<td>Credit grant to Capital Reserve.</td>
</tr>
<tr>
<td>6</td>
<td>Grants for Non-Depreciable Assets (Land, Stock)</td>
<td>Credit grant to Capital Reserve.</td>
</tr>
<tr>
<td>7</td>
<td>Grants for Depreciable Fixed Assets (IMP)</td>
<td>See Point No. 6</td>
</tr>
</tbody>
</table>

   (B) Method- I: Net Method: Such Grants are credited to concerned Fixed Assets i.e. deducted from the gross book value of the F.A. Depreciation is applied on Net Value thereafter.

   Journal Entries:
   (i) Bank a/c Dr. To Grant a/c
   (ii) Fixed Asset a/c Dr. to Bank a/c
   (iii) Grant a/c Dr. To Fixed Asset a/c

   (C) Method- II: Gross Method: Such Grants are shown as Differed grants and amortized in ratio of depreciation over useful life of Assets.

   Journal Entries:
   (i) Bank a/c Dr. (at every year end) To Differed Grant a/c
   (ii) Differed Grant a/c Dr. To P&L a/c

8. Refund of Govt. Grants: According to AS - 12, refund of grant should always be treated as ‘Extraordinary Item as per AS - 5’. Whenever grants are to be refunded debit will be given to that account which had been credited earlier at the time of receipt.

9. Disclosure Requirements:
   (i) Govt. grant recognition policy should be disclosed.
   (ii) If the grants have been refunded then reasons of refund should be disclosed.

DIFFERENCES BETWEEN IFRS and IND AS

<table>
<thead>
<tr>
<th>BASIS OF DIFFERENCE</th>
<th>IAS 20 Accounting for GG &amp; Disclosure of Govt. Assistance</th>
<th>IND AS 20 Accounting for GG &amp; Disclosure of Govt. Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non Monetary Grant</td>
<td>It gives an option to measure the grants either at their FV or at Nominal value.</td>
<td>This standard requires measurement of such grants only at their Fair Value. (Nominal Value option is not available)</td>
</tr>
<tr>
<td>Grants related to Assets</td>
<td>Standard gives an option to present the grant either by setting up the grant as deferred income or by deducting the grant from the carrying amount of Asset.</td>
<td>Under this standard grant shall be presented only by setting up the grant as deferred income. (Deduction option is not available)</td>
</tr>
</tbody>
</table>
## DIFFERENCES BETWEEN AS and IND AS

<table>
<thead>
<tr>
<th>BASIS OF DIFFERENCE</th>
<th>AS 20 Accounting for GG</th>
<th>IND AS 20 Accounting for GG &amp; Disclosure of Govt. Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Govt Assistance</td>
<td>It does not deal with govt. assistance</td>
<td>Ind AS 20 deals with govt. assistance which does not fall within the definition of govt. grants.</td>
</tr>
<tr>
<td>Grant for Non Depreciable Assets</td>
<td>The amount of grant should be shown as Capital reserve which is a part of shareholders fund. It further requires that if a grant requires fulfillment of certain obligations the grant should be credited to income over the same period over which cost of meeting such obligations is charged to income.</td>
<td>Ind AS 20 is based on the principle that all govt. grants would normally have certain obligations attached to it. Therefore this grant is required to be deferred over the period over which obligations are required to be fulfilled.</td>
</tr>
<tr>
<td>Non Monetary Grant</td>
<td>If acquired at concessional rate then Actual Acquisition cost. If acquired free of cost then Nominal Value.</td>
<td>This standard requires measurement of such grants only at their Fair Value. (Nominal Value option is not available)</td>
</tr>
<tr>
<td>Grants related to Assets</td>
<td>Standard gives an option to present the grant either by setting up the grant as deferred income or by deducting the grant from the carrying amount of asset.</td>
<td>Under this standard grant shall be presented only by setting up the grant as deferred income. (Deduction option is not available)</td>
</tr>
<tr>
<td>Loans at concessional rate</td>
<td>AS 12 does not deal with this issue.</td>
<td>Ind AS 20 requires that loans received from a govt. that have a below market rate of interest should be recognised and measured in accordance with Ind AS 109 (i.e. by considering effective interest rate approach)</td>
</tr>
</tbody>
</table>
ACCOUNTING STANDARD – 15 (REVISED)
EMPLOYEE BENEFITS

1. Objective:
The objective of this AS is to prescribe the accounting and disclosure for employee benefits. It requires an enterprise to recognise:
(a) a liability when an employee has provided service; and
(b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee.

2. Applicability:
This AS should be applied by an employer in accounting for all employee benefits, except employee share-based payments.

3. Employee benefits include:
(a) formal plans or other formal agreements between an enterprise and employees;
(b) under legislative requirements, or through industry arrangements; or
(c) By those informal practices that give rise to an obligation.

4. Types of Employee benefits:
(a) Short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit-sharing and bonuses (if payable within twelve months nonmonetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
(b) Post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;
(c) Other Long-Term Employee Benefits, including long-service leave or sabbatical leave, long-term disability benefits and, profit-sharing bonuses and deferred compensation; and
(d) Termination benefits (VRS Payments)

Employee benefits include benefits provided to employees or their spouses, children or other dependants:

Note: An employee may provide services on a full-time, part-time, permanent, casual or temporary basis. Employees include whole-time directors and other management personnel.

5. Short-term Employee Benefits
(i) Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.
(ii) Accounting for short-term employee benefits is generally straightforward short-term employee benefit obligations are measured on an undiscounted basis.

D-Fortune Classes & Vsmart Academy – CA. Jai Chawla
(iii) When an employee has rendered service the enterprise should recognise the undiscounted amount of short-term employee benefits.

6. **Short-term Compensated Absences**
   An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

7. **Profit-sharing and Bonus Plans**
   An enterprise should recognise cost of profit-sharing and bonus payments when:
   
   (a) the enterprise has a present obligation to make such payments as a result of past events; and
   
   (b) a reliable estimate of the obligation can be made. A present obligation exists when, and only when, the enterprise has no realistic alternative but to make the payments.

8. **Post-employment Benefits: Defined Contribution Plans and Defined Benefit Plans**
   
   (i) Arrangements whereby an enterprise provides post-employment benefits are post-employment benefit plans.
   
   (ii) Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, Under defined contribution plans:
       
       (a) the enterprise’s obligation is limited to the amount that it agrees to contribute to the fund; and
       
       (b) in consequence, actuarial risk fall on the employee.
   
   (iii) Under defined benefit plans:
       
       (a) the enterprise’s obligation is to provide the agreed benefits to current and former employees; and
       
       (b) Actuarial risk (that benefits will cost more than expected) and investment risk fall, on the enterprise.

### DIFFERENCE BETWEEN DEFINED BENEFIT PLANS AND DEFINED CONTRIBUTION PLANS

<table>
<thead>
<tr>
<th>Defined Contribution Plans (DCP)</th>
<th>Basis of Difference</th>
<th>Defined Benefit Plans (DBP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligation is limited to the amount that it agrees to contribute</td>
<td>Entity’s Legal or Constructive Obligation</td>
<td>Obligation is to provide agreed benefits to current and former employees (Obligation is not limited)</td>
</tr>
<tr>
<td>Contributions and Investment Returns</td>
<td>How Much Post Employment Benefit is to be received by employee</td>
<td>Agreed Benefits</td>
</tr>
<tr>
<td>Risk in substance on the Employee</td>
<td>Actuarial Risk (Benefits will be more/less than expected)</td>
<td>Risk in substance on the entity.</td>
</tr>
</tbody>
</table>
10. **Recognition of DCP:**
   When an employee has rendered service the enterprise should recognise the contribution payable to a defined contribution plan.

11. **Recognition of DBP**
   Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation. Moreover, the obligations are measured on a discounted basis.
   While the Standard requires that it is the responsibility of the reporting enterprise to measure the obligations under the defined benefit plans, it is recognised that for doing so the enterprise would normally use the services of a qualified actuary.

12. **Accounting by an enterprise for defined benefit plans involves the following steps:**
   (a) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned;
   (b) Discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost;
   (c) Determining the fair value of any plan assets;
   (d) Determining the total amount of actuarial gains and losses;
   (e) Where a plan has been introduced or changed, determining the resulting past service cost; and
   (f) Where a plan has been curtailed or settled, determining the resulting gain or loss.

**Note:** Where an enterprise has more than one defined benefit plan, the enterprise applies these procedures for each material plan separately.

13. **Presentation in Balance Sheet**
   The amount recognised as a defined benefit liability should be the net total of the following amounts:
   (a) The present value of the defined benefit obligation;
   (b) Minus any past service cost not yet recognised;
   (c) Minus the fair value of plan assets.

**Note:** An enterprise should offset an asset relating to one plan against a liability relating to another plan when, when, the enterprise:
(a) Has a legally enforceable right; and
(b) Intends to settle the obligations on a net basis.

**Note:** The amount determined above may be negative (an asset). An enterprise should measure the resulting asset at the lower of:
(a) The amount determined above; and
(b) The present value of refunds from the plan.
14. **Presentation in Statement of Profit and Loss**

Enterprise should recognise the net total of the following amounts in the statement of profit and loss:

- (a) current service cost;
- (b) interest cost;
- (c) the expected return on any plan assets;
- (d) actuarial gains and losses;
- (e) past service cost;
- (f) the effect of any curtailments.

**Recognition and Measurement: Present Value of Defined Benefit Obligations and Current Service Cost**

(i) An enterprise should use the Projected Unit Credit Method to determine the present value of its defined benefit obligations. Sometimes known as the accrued benefit method prorated on service.

(ii) Actuarial assumptions comprising demographic assumptions and financial assumptions should be unbiased and mutually compatible.

(a) Demographic assumptions deal with:
   - (i) mortality;
   - (ii) rates of employee turnover, disability and early retirement;
   - (iii) claim rates;

(b) financial assumptions, such as:
   - (i) the discount rate;
   - (ii) future salary and benefit levels;
   - (iii) future medical costs; and
   - (iv) the expected rate of return on plan assets.

**Note: Actuarial Assumptions: Discount Rate**

The rate used to discount post-employment benefit obligations should be determined by reference to market yields at the balance sheet date on government bonds.

(iv) Actuarial Gains and Losses

Actuarial gains and losses should be recognised immediately in the statement of profit and loss as income or expense. Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets.

15. **Past Service Cost/Modification**

An enterprise should recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately.


- Multi-employer Plans
• Group administration plans.
• State Plans
• Insured Benefits

**Curtailments and Settlements**

If Defined Benefit Obligation plan is modified in such a way that employees are not getting benefit, rather benefit originally planned is being reduced, it is called curtailment.

An enterprise should recognize gains or losses on the curtailment when the curtailment occurs.

**Journal Entry:**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>PV DBO Payable A/c</td>
<td>Dr. (Curtailment Amt.)</td>
</tr>
<tr>
<td></td>
<td>To USC A/c (Unamortised Amt. if any)</td>
</tr>
<tr>
<td></td>
<td>To Gain on Curtailment A/c (Balancing Fig)</td>
</tr>
</tbody>
</table>

Gain on curtailment shall be transfer to Statement of P&L.

17. **For long-term employee benefits, an enterprise should recognise the net total of the following amounts as expense:**

   (a) current service cost;
   (b) interest cost,
   (c) the expected return on any plan assets:
   (d) actuarial gains and losses;
   (e) past service cost, which should all be recognised immediately; and
   (f) the effect of any curtailments or settlements.

18. **Termination Benefits**

An enterprise should recognise termination benefits as a liability and an expense when

   (a) the enterprise has a present obligation;
   (b) it is probable that an outflow of resources; and
   (c) a reliable estimate can be made of the amount of the obligation.

**Note** Where an enterprise incurs expenditure on termination benefits on or before 31st March, 2009, the enterprise may choose to follow the accounting policy of deferring such expenditure for amortisation over its pay-back period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April, 2010.
### MAJOR DIFFERENCES BETWEEN AS 15 & IND AS 19

<table>
<thead>
<tr>
<th>Basis Of Differences</th>
<th>AS 15</th>
<th>IND AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CONSTRUCTIVE OBLIGATION</strong></td>
<td>AS 15 does not deal with Constructive Obligation</td>
<td>Employee benefits arising from Constructive obligations are also covered.</td>
</tr>
<tr>
<td><strong>RECOGNITION OF ACTUARIAL GAINS OR LOSSES</strong></td>
<td>Actuarial Gains or Losses are recognised immediately in the P&amp;L A/c</td>
<td>This standard requires to recognize Actuarial Gain or Loss in OCI</td>
</tr>
<tr>
<td><strong>DISCOUNTING RATE</strong></td>
<td>Discount rate should be based on Market Yields on High Quality Corporate Bonds. If there is no deep market in such bonds, Market Yields on Govt. Bonds can be taken for Discount Rate.</td>
<td>Discount rate shall always be calculated by reference to the Market Yields on Government Bonds.</td>
</tr>
</tbody>
</table>

**Constructive Obligation:** An Obligation to pay that arises out of entity's actions rather than a contract. It may typically occur from past conduct.

**Example:** Established Pattern of Past Practice, published policies, or specific statement by which entity has indicated to other parties that it will accept certain responsibilities and as a result of which entity has created a valid expectation on the part of those parties that it will discharge their responsibilities.
ACCOUNTING STANDARD - 16
BORROWING COSTS

MEANING OF BORROWING COST
Borrowing Cost is the:
(a) Interest and
(b) Other cost

Which is incurred by an enterprise in relation to borrowing of funds.
The following points should be considered for the purpose of borrowing cost:-

- Interest on short term loans or long term debts should be included as a part of borrowing cost.
- If any enterprise has incurred ancillary cost (related) for the arrangement of funds than amortized part of such cost should also be included as a part of borrowing cost. (V. Imp)
  o For example: - Brokerage, commission, stamp duty charges and any other related cost.
  o CA fees for Quarterly information reports.
  o Commission given for arrangement of funds.

- Discounts / Premiums which are incurred by an enterprise in relation to arrangement of fund, than the amortized part of such amount should be included as a part of borrowing cost.
- Amount of Interest (finance charges) should also be included as a part of borrowing cost which is paid or payable for finance lease agreement (AS - 19).
- Exchange Diff related to Foreign Currency Loans to the extent of difference in Interest cost (AS - 11)

Note: This standard does not deal with actual or imputed cost of equity including preferred capital not classified as liability. (Dividend on Equity or Preference shares is not Borrowing Cost)

MEANING OF QUALIFYING ASSETS
Qualifying Asset means:
- An ASSET
- that takes Substantial period of time
- To get ready for intended use or sale.

Normally a period of 12 months is considered to be the substantial period of time. But longer period or short term period than 12 month period may also be considerable as substantial period based on reasonable facts and judgments.
Qualifying Asset may be:
- **Fixed Assets:** If these assets are taking substantial period to get ready for the purpose of use.
- **Investments:** For e.g. Investment properties during construction period can be included under the heading of qualifying assets because condition of substantial period can be satisfied only in these investments.
  
  Investment in shares or debentures cannot be recognized as Qualifying assets because conditions of substantial period is not applicable on securities.
- **Stocks:** Inventories can also be qualifying assets only if a condition of substantial is satisfied.

**RECOGNITION**

As per AS – 16, amount of borrowing cost which is Directly Attributable for:
- **Acquisition;**
- **Construction; or**
- **Production of**

Any Qualifying Asset is Capitalized.
Therefore such borrowing cost that would have been avoided if the expenditure on the qualifying asset had not been made.

If any borrowing cost is not having any connection with Q.A. than such amount should be transfer to P/L a/c as an exp.

**COMMENCEMENT OF CAPITALIZATION OF BORROWING COSTS:**

As per the provision of accounting standard, any enterprise can capitalize its borrowing cost only if the following three conditions are satisfied.

(1) Expenditure for the
- **Acquisition;**
- **Construction; or**
- **Production**
  Of a qualifying asset is being incurred.

  **Note:** If any amount is still pending for expenditure purpose out of borrowing funds than the pending amount will not be considered for capitalization purposes.

(2) **Borrowing Costs (interest) are being incurred**

(3) **Necessary Activities for preparation of qualifying assets are in progress.**

**SUSPENSION OF CAPITALIZATION OF BORROWING COSTS:**

Capitalization of Borrowing Costs to be suspended during the extended periods in which Active Development is interrupted.
Exception: Suspension not to taken place in case temporary delays necessary for preparation of qualifying assets (e.g. Seasonal Rains).

Note: Borrowing costs which are related to the suspension period should be transferred to P/L a/c as an exp.

CESSATION OF CAPITALIZATION OF BORROWING COSTS:
- Capitalization should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- Cessation to take place in part if construction of qualifying asset is completed in parts and a part is capable of being used separately.

IMPORTANT POINT:
As per AS 16, if any enterprise has earned temporary income by investment of unused borrowed funds that amount of temporary income should be adjusted against total borrowing cost and only thereafter principals of recognition should be applied.

Types of Borrowing (Imp for Practical Ques.)
Two types of borrowing are specified in the statement as follows:
A. Specific Borrowing
B. General Borrowing

Major Changes in Ind AS 23 as compare to existing AS 16

<table>
<thead>
<tr>
<th>Basis of Difference</th>
<th>Ind AS 23</th>
<th>AS 16</th>
</tr>
</thead>
<tbody>
<tr>
<td>QA measured at Fair Value</td>
<td>Ind AS 23 does not applies to such assets. (such as Biological Assets under Ind AS 41)</td>
<td>This standard is applicable to such assets also.</td>
</tr>
<tr>
<td>Inventories</td>
<td>Ind AS 23 is not applicable to Borrowing costs directly attributable to acquisition, construction or production of those inventories that are manufactured, or otherwise produced in large quantities on a repetitive basis that takes substantial period of time to get ready for its intended sale.</td>
<td>AS 16 is applicable to borrowing costs related to all inventories that requires substantial period of time to bring them in sealable condition.</td>
</tr>
<tr>
<td>Application of Effective interest method</td>
<td>Ind AS 23 specifically requires to calculate</td>
<td>Effective interest rate method is not applicable</td>
</tr>
<tr>
<td>Topic</td>
<td>Description</td>
<td>Notes</td>
</tr>
<tr>
<td>------------------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>interest expenses using effective interest rate method as described in Ind AS 109 by considering ancillary costs and discounts/premiums relating to borrowings as a component of interest expense.</td>
<td></td>
<td>under this standard.</td>
</tr>
<tr>
<td>Hyperinflationary Economies</td>
<td>That part of borrowing cost which compensates for inflation should be expensed (not capitalized in respect of qualifying asset) (Ind AS 29)</td>
<td>Here this point is not considered since there is no standard for hyperinflationary economies.</td>
</tr>
<tr>
<td>Weighted Avg Rate for Parent and Subsidiary</td>
<td>This standard allows to include all borrowings of parent and subsidiary while calculating WA Capitalization rate in some cases. In some cases only borrowings of subsidiary are considered for WA rate of its own borrowings.</td>
<td>This provision is not covered in AS 16</td>
</tr>
<tr>
<td>Disclosure of Capitalization Rate</td>
<td>Ind AS 23 required to disclose the capitalization rate used to determine the amount of capitalization.</td>
<td>AS 16 does not have this requirement.</td>
</tr>
<tr>
<td>Explanation of Substantial period of Time</td>
<td>Not Covered</td>
<td>Covered.</td>
</tr>
</tbody>
</table>
Important Notes:
1. **Purpose**
   The objective of this AS is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates.

2. **Application**
   If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements.

3. **Meaning of Business Segment**
   A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered are:
   (a) the nature of the products or services;
   (b) the nature of the production processes;
   (c) class of customers;
   (d) the methods used to distribute the products; and
   (e) Regulatory environment.

4. **Meaning of Geographical Segment**
   A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors include:
   (a) similarity of economic and political conditions;
   (b) relationships between different geographical areas;
   (c) proximity of operations;
   (d) special risks in a particular area;
   (e) exchange control regulations; and
   (f) The underlying currency risks.

**Note:** The definition allows geographical segments to be based on either: (a) the location of production or (b) the location of its customers.

5. **Primary and Secondary Segment Reporting Formats**
   The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments.

**Note:** Internal organisation and management structure of an enterprise and its system of internal financial reporting to the board of directors and the chief executive officer...
should normally be the basis for identifying the predominant source and nature of risks and differing

6. **Reportable Segments**
   
   **Method I Limits (Para 27)**
   A business segment or geographical segment should be identified as a reportable segment if:
   
   (a) Its revenue from sales **to external customers and from transactions with other segments** is 10% or more of the total revenue; or
   
   (b) Its segment result, 10% or more of -
      
      (i) the combined result of all segments in profit, or
      
      (ii) the combined result of all segments in loss,
      
      Whichever is greater; or
   
   (c) Its segment assets are 10% or more of the total assets of all segments.

   **Method II Choice of management**
   A business segment or a geographical segment which is not a reportable segment as per paragraph 27 may be designated as a reportable segment at the discretion of the management.

   **Method III Comparative Method**
   A segment identified as a reportable segment in the immediately preceding period because it satisfied the relevant 10% thresholds limit should continue to be a reportable segment for the current period.

   **Minimum Benchmark Limit**
   If total **external revenue** attributable to reportable segments constitutes less than 75% of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10% thresholds in paragraph 27, until at least 75 per cent of total enterprise revenue is included in reportable segments.

7. **Primary Reporting Format**
   An enterprise should disclose the following for each reportable segment:
   
   (a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;
   
   (b) segment result;
   
   (c) total carrying amount of segment assets;
   
   (d) total amount of segment liabilities;
   
   (e) total cost incurred during the period to acquire segment assets (tangible and intangible fixed assets);
   
   (f) total amount of expense included in the segment result for depreciation and amortisation;
   
   (g) total amount of significant non-cash expenses, other than depreciation.

   An enterprise should present reconciliation between the reportable segments and financial statements.
   
   • Segment revenue reconciled to enterprise revenue;
   
   • segment result should enterprise net profit or loss;
   
   • segment assets should be reconciled to enterprise assets; and
   
   • segment liabilities should be reconciled to enterprise liabilities.
8. **Other Disclosures**

The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.

**Major Changes in Ind AS 108 as compare to existing AS 17**

<table>
<thead>
<tr>
<th>Basis of Difference</th>
<th>IND AS 108</th>
<th>AS 17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Determination of segments</strong></td>
<td>Segments are identified based on how the financial information is regularly reviewed by the CODM.</td>
<td>AS 17 requires an entity to identify two types of segments—business and geographical, using a risk and rewards approach.</td>
</tr>
<tr>
<td><strong>Measurement</strong></td>
<td>Same measurement basis as used by CODM—reconciliation to financial statements needed. Terms such as segment assets, Segment revenue, and segment asset and segment liability are not defined.</td>
<td>Measurement basis in conformity with financial statements. Segment revenue, segment expense, segment result, segment asset and segment liability have been defined.</td>
</tr>
</tbody>
</table>
ACCOUNTING STANDARD – 19

LEASES

<table>
<thead>
<tr>
<th>Basis of Differences</th>
<th>Ind AS - 17</th>
<th>AS - 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>LAND</td>
<td>Ind AS 17 does not have such scope exclusion. It has specific provisions dealing with leases of land and building applicable.</td>
<td>AS 19 excludes leases of land from its scope.</td>
</tr>
</tbody>
</table>

Treatment of initial direct costs under Ind AS 17 differs from the treatment prescribed under the existing standard.

- **Finance Lease Non-manufacturer/ Non-dealer Lessor**
  - Interest rate implicit in the lease is defined in such a way that the initial direct costs included automatically in the finance lease receivable; there is no need to add them separately.
  - Either recognised as expense immediately or allocated against the finance income over the lease term.

- **Operating lease- Lessor accounting**
  - Added to the carrying amount of the leased asset and recognized as expense over the lease term on the same basis as lease income.
  - Either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or recognized as expense in the period in which incurred.

- **Sale and Lease Back transactions**
  - Ind AS 17 retains the deferral and amortisation principle, it does not specify any method of amortisation.
  - Deferred and amortised in the proportion of Depreciation of the leased asset.

**LEASE OF LAND AND BUILDING: (IND AS 17)**

- When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with the general criteria discussed above. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.
- Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments (including any lump-sum upfront payments)
are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease.

- If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

- For a lease of land and buildings under which the present value of the minimum lease payments allocated to the land at the inception of the lease is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with the general criteria discussed above. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.
ACCOUNTING STANDARD – 20

EARNINGS PER SHARE

BASIC EARNINGS PER SHARE
Basic earnings per share should be calculated by dividing the net profit or loss for the period attributable to equity shareholders by the weighted average number of equity shares outstanding during the period.

EARNINGS – BASIC
The net profit or loss for the period attributable to equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period.

Note 1: All items of income and expense which are recognised in a period, including tax expense and extraordinary items are included in the determination of the net profit or loss.

Note 2: The amount of preference dividends that is deducted is:
(a) any preference dividends on non-cumulative preference shares provided; and
(b) The full amount of preference dividends for cumulative preference shares, whether or not the dividends have been provided for.

PER SHARE – BASIC
The number of equity shares should be the weighted average number of equity shares outstanding during the period.

PARTLY PAID SHARE
Partly paid equity shares are treated as a fraction of an equity share to the extent that they were entitled to participate in dividends.

BONUS SHARES
In case of a bonus issue or a share split or consolidation of shares, equity shares are issued to existing shareholders for no additional consideration. The number of equity shares is adjusted as if the event had occurred at the beginning of the earliest period reported.

RIGHT SHARES
A rights issue usually includes a bonus element.

Treatment of Right Shares:
Following steps are applied

Step 1: Calculate TMP[ER] if not available. Such price is IV of shares
Formula
For Doubts – 7887 7887 05 (Whatsapp)

\[
\text{Total shares post right} = \left( \frac{\text{Fair Value (before right) \times No. of share (pre-right)}}{\text{Profit Proceeds}} \right) + \text{Right issue proceeds}
\]

**Step 2:** Calculate paid-up part in Right issue

\[
\text{Paid - up Part} = \frac{\text{Profit Proceeds}}{\text{Market Price as per Step 1}}
\]

**Step 3:** Calculate Bonus part in Right

Bonus * Right Share - paid part as per Step 2

**Step 4:**
- Paid part should be adjusted from the date of receipts of amount.
- Bonus part should be considered price beginning
- Previous Year EPS will be readjusted because of Bonus elements.

**AMALGAMATION IN NATURE OF PURCHASE**

Equity shares issued as part of the consideration in an amalgamation in the nature of purchase are included as of the date of the acquisition.

**AMALGAMATION IN NATURE OF MERGER**

Equity shares issued during the reporting period as part of the consideration in an amalgamation in the nature of merger are included from the beginning of the reporting period and earnings of transferor co. for the period before amalgamation shall also be considered.

**ABSOLUTE DIFFERENTIAL DIVIDEND RIGHTS**

An enterprise should present basic and diluted earnings per share on the face of the statement of profit and loss for each class of equity shares.

**DILUTED EARNINGS PER SHARE**

For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to shareholders and the weighted average number of shares outstanding during period should adjusted for the effect of all dilutive potential equity shares.

A potential equity share is financial instrument of other contract that entitles, or may entitle, its holder to convert its holding in to equity shares.

Examples of potential equity shares are:

(a) debt instruments or preference shares, that are convertible into equity shares,
(b) share warrants;
(c) Options including employee stock option plans under which employees of an enterprise are entitled to receive equity shares as part of their remuneration and other similar plans.
(d) Share application money pending allotment if used in the business.
(e) Partly paid shares not entitled to Dividend.
Dilutive or Non Dilutive

Potential equity shares should be treated as dilutive when, and only when their conversion to equity shares would decrease net profit per share from continuing ordinary operations. (Para 39)

Note 1: An enterprise uses net profit from continuing ordinary activities as "the control figure" that is used to establish whether potential equity shares are dilutive or anti-dilutive.

The net profit from continuing ordinary activities is the net profit from ordinary activities after deducting preference dividends and any attributable tax thereto and after excluding items relating to discontinued operations.

Note 2: Potential equity shares are anti-dilutive when their conversion to equity shares would increase earnings per share from continuing ordinary activities or decrease loss per share from continuing ordinary activities.

### How to Calculate DEPS - Following calculation is required:

9. Identify Potential Equity Shares first. (Whether any security which is pending for conversion is outstanding and resources thereof have been used in the business)

10. In case of Vested ESOPs, potential equity shares will be calculated as under:
    - Total ESOP - \( \text{Exer. Price} \times \text{No. of Option} / \text{Avg. Fair Value} \)
    - In case of Unvested ESOPs - Potential equity shares will be Zero

11. Identify Dilutive potential equity shares by applying following steps:
    - (d) Calculate Incremental EPS for every single potential equity share
    - (e) Arrange IEPS in Increasing Order
    - (f) Apply Test for Dilution. Test each potential equity share on BEPS from continuing ordinary operations. If ratio EPS declines from preceding calculation then it is called Diluted EPS and if ratio increases from previous calculation then it is called Anti - Diluted EPS

- Note: Anti Diluted EPS shall not be presented in the Statement of P&L, in that case Diluted EPS shall be equal to BEPS

### SEBI Rules Regarding Bonus on Convertible Instruments

- If the company has outstanding Convertible Instruments (eg. Debentures convertible into Eq. Shares), and the company declares Bonus Eq Shares then Holders of such Convertible Instruments will also be entitled for Bonus Eq. Shares after the conversion of instruments.
- While Calculating DEPS, Potential Eq. Shares should be increased with the Bonus Entitlement without any Time Weight.
• **While Calculating BEPS**, such Bonus entitlement for convertible instruments are not be considered. However, if such instruments get converted in the current year, Bonus shares issued on the convertible instruments will be taken into account in the calculation of BEPS without Time Adjustment.

**DISCLOSURES**

An enterprise should disclose the following:

(1) The enterprise should disclose basic and diluted earnings per share computed on the basis of earnings excluding extraordinary items also and

(2)

(a) The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation.

(b) The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation; and

(c) The nominal value of shares along with the earnings per share figures.
ACCOUNTING STANDARD - 22
ACCOUNTING FOR TAXES ON INCOME

DEFINITIONS

1. **Accounting income** is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

2. **Taxable income (tax loss)** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

3. **Tax expense (tax saving)** is the aggregate of Current tax and Deferred tax charged or credited to the statement of profit and loss for the period.

4. **Current tax** is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

5. **Deferred tax** is the tax effect of timing differences.

6. **Timing differences** are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

7. **Permanent differences** are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. Permanent differences do not result in deferred tax assets or deferred tax liabilities,

UNABSORBED DEPRECIATION AND CARRY FORWARD OF LOSSES

Unabsorbed depreciation and carry forward of losses which can be set off against future taxable income are also considered as timing difference and result in deferred tax assets, subject to consideration of prudence.

PRUDENCE LIMITS: VIRTUAL CERTAINTY

Deferred tax should be recognized for all timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.

Expect in the situations stated in paragraph 17, deferred tax assets should be recognized and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realized. (Para 15)

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realized. (Para 17)
**CAPITAL LOSS**
Explanation as per NACAS 7-12-2006

(a) As per the relevant provisions of the Income-tax Act, 1961 (herein referred to as the 'Act'), the 'loss' arising under the head 'Capital gains' can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Act.

(b) Where an enterprise's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Act, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years. In respect of such 'loss', deferred tax asset is recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset is recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act.

**Re-assessment of Unrecognised Deferred Tax Assets**
At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets.

**Measurement**
Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

**Application of MAT**
Explanation as per NACAS 7-12-2006

(a) The payment of tax under section 115JB of the Income-tax Act, 1961 (hereinafter referred to as the Act) is a current tax for the period.

(b) In a period in which a company pays tax under section 115JB of the Act, the deferred tax assets and liabilities in respect of timing differences arising during the period, tax effect of which is required to be recognized under this Standard, is measured using the regular tax rates and not the tax rate under section 115JB of the Act.

(c) In case an enterprise expects that the timing differences arising in the current period would reverse in a period in which it may pay tax under section 115JB of the Act, the deferred tax assets and liabilities in respect of timing differences arising during the current period, tax effect of which is required to be recognised under AS 22, is measured using the regular tax rates and not the tax rate under section 115JB of the Act.
**DISCOUNTING**

Deferred tax assets and liabilities should not be discounted to their present value.

**Review of Deferred Tax Assets**

The carrying amount of deferred tax assets should be reviewed at each balance sheet date.

**presentation and Disclosure**

An enterprise should offset assets and liabilities representing tax if the enterprise:

(a) has a legally enforceable right; and

(b) Intends to settle the asset and the liability on a net basis.

**TAX HOLIDAY**

Explanation as per NACAs 7-12-2006

(a) The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised.

(b) Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences originate. However, recognition of deferred tax assets is subject to the consideration of prudence as laid down in paragraphs 15 to 18.

(c) For the above purposes, the timing differences which originate first are considered to reverse first.
Some Important Terms:
1. **Temporary Differences**: is a difference between the carrying amount of an Asset or Liability and its Tax Base Balance sheet Method.

2. **Tax Base**: is the amount that will be deductible for Tax purpose. If the economic benefits will not be taxable the tax base of the asset is equal to its carrying amount.

3. **Taxable Temporary Differences**: are temporary differences that will result in taxable amounts in determining taxable profits of future periods. It arises DTL.

4. **Deductible Temporary Differences**: are temporary differences that will result in amounts that are deductible in determining taxable profits of future periods. It results in DTA subject to probability.

   **Example**: Machine Costing Rs. 100 lakhs. Useful life = 10 years, depreciation = 10%. Tax depreciation = 20%.
   At year 1 end: Book value of Machine = Rs. 90 lakhs
   Tax Base of Machine = Rs. 80 lakhs therefore its Taxable Temporary difference of Rs. 10 lakhs. DTL is to be recognized.

   **Other Examples**: Calculate Tax Base
   - Interest receivable = 100 (taxed on cash basis)
   - Trade receivable = 100 (related revenue taxed)
   - Penalties payable = 100 (not allowable as an expense)

5. **Deferred tax on Revaluation of Assets**: IND AS permit or require certain assets to be carried at fair value or to be revalued (for example, IND AS 16 Property, Plant and Equipment, IND 38 Intangible Assets, IND 109 Financial Instruments and IND AS 40 Investment Property).

   However, as per the tax laws, revaluation of asset are not considered while computing the taxable income. Consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount (on sale or otherwise) will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:
   (a) The entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or
   (b) Tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets.

   **For example**, Company A buys an asset worth Rs.100 on 1st April, 2010. The useful life of the asset is five years and the tax laws allow it to be depreciated over four years. One year later, on 31st March, 2011, the Company revalue the asset to Rs.120. Tax Rate is 30%. In such a case the temporary difference will be as shown in the following Table.
Table:

<table>
<thead>
<tr>
<th>Year ending March 31</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net book value</td>
<td>120</td>
<td>90</td>
<td>60</td>
<td>30</td>
<td>0</td>
</tr>
<tr>
<td>Tax base</td>
<td>75</td>
<td>50</td>
<td>25</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Temporary difference</td>
<td>45</td>
<td>40</td>
<td>35</td>
<td>30</td>
<td>0</td>
</tr>
</tbody>
</table>

In the above case, the deferred tax liability created on revaluation on 31st March, 2011, of Rs.45 reverses in the subsequent periods. The accounting entry for the year 2011 would be:

Revaluation reserve A/c Dr. 45x30%
To Deferred tax liability A/c 45x30%

Suppose on 31st March, 2013, the Company decides to sell the asset at Rs.70. In this case, there would be a gain of Rs.10 as per the books of accounts. However, the tax books will show a gain of Rs.45, thus offsetting the temporary difference of Rs.35.

6. Business Combination:

- Company A buys Company B for Rs. 1,500
- Book value of assets of B = 1 000
- Fair value of assets of B = 1,200
- Goodwill = 1,500 - 1,200 = 300
- Tax Rate = 30%
- Taxable temporary difference = 1,200 - 1,000 = 200
- DTL = 200x30% = 60
- Goodwill = 300 + 60 = 360

ACCOUNTING ENTRY:

Goodwill A/c Dr. 60 (200 * 30%)
To DTL A/c 60

7. Unrealized Gain on Consolidation:

- Company X (Holding) sold goods costing ₹ 60 to Company Y (Subsidiary)
- In the Standalone Balance Sheet of Y stock is shown at ₹ 100
- In the Consolidated Balance Sheet Stock will be shown at ₹ 60
- Tax base for Y is ₹ 100 and Y’s Tax rate is 30%, X’s Tax rate is 25%
- Deductible Temporary Difference = 100-60 = ₹ 40
- DTA = Rs.40 x 30% = ₹12

ACCOUNTING ENTRY:

Deferred Tax Asset A/c Dr. 12
To Profit and Loss A/c 12

Revaluation of Assets:

Difference between carrying amount of revalued asset and its tax base is a temporary difference which will result in DTL or DTA through OCI/Revaluation surplus.

Financial Instrument:

If the instrument is classified on initial recognition in two components viz. Equity and Liability then Taxable temporary difference will arise since in books liability will have lower amount and in tax base the entire amount is liability. Therefore DTL is recognized through Equity.
Research Cost:
Carrying amount is nil (because entire amount is treated as an expense to determine accounting profit) and tax base is the amount which will be deductible in future. Difference is deductible temporary difference that results in a DTA through P&L.

### Comparison of AS 22 and IND AS 12

<table>
<thead>
<tr>
<th>BASIS</th>
<th>AS 22 - Accounting for Taxes on Income</th>
<th>IND. AS 12 - Income Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calculation base</td>
<td>Deferred tax is computed on Timing differences.</td>
<td>Deferred Tax is computed for Temporary differences.</td>
</tr>
<tr>
<td>Approach</td>
<td>It Follows Profit and Loss A/c Approach - Compares Revenue items as per Accounting Books and Income Tax.</td>
<td>It Follows Balance Sheet Approach - Compares Carrying amount of Assets and Liabilities as per Accounting Books and Tax base.</td>
</tr>
<tr>
<td>Recognition of DT in OCI</td>
<td>No specific guidance in AS 22.</td>
<td>Current Tax and DT is to be recognized in OCI or directly in equity if the items on which CT and DT is calculated is recognized in OCI or in Equity.</td>
</tr>
<tr>
<td>Recognition of DTA</td>
<td>DTA is recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against such deferred tax assets can be realised. For all other unused tax credits/timing differences - DTA is recognized if there is reasonable certainty.</td>
<td>DTA is recognized if it is probable that future taxable profit will be available against which the unused tax losses and tax credits can be utilized.</td>
</tr>
</tbody>
</table>
| DT on Investment in subsidiary, Associates, Joint Ventures | No Deferred Tax Liability is recognized | DTL for all Temporary differences are recognized except to the extent:
  (a) The Parent, Investor or the Venturer is able to control timing of the reversal of the temporary difference, and
  (b) It is probable that the temporary difference will not reverse in the foreseeable future. |

DT is recognized as per
GUIDANCE NOTE ON ACCOUNTING FOR CREDIT AVAILABLE IN RESPECT OF MINIMUM ALTERNATIVE TAX UNDER THE INCOME TAX ACT, 1961

Q1. Whether MAT credit is a deferred tax asset?

Payment of MAT does not by itself, and result in any timing difference since it does not give rise to any difference between the accounting income and the taxable income which are arrived at before adjusting the tax expense, namely, MAT. In other words, under AS 22, deferred tax asset and deferred tax liability arise on account of difference in the item of income and expenses credited or charged in the profit and loss account as compared to the items of income that are taxed or items of expense that are allowed as deduction, for the purpose of the Act. Thus, deferred tax assets and deferred tax liabilities do not arise on account of the amount of tax expense itself. In view of this, it is not appropriate to consider MAT credit as a deferred tax asset for the purposes of AS 22.

Q2. Whether MAT credit can be considered as an 'asset'

"An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise".

MAT paid in a year in respect of which the credit is allowed during the specified period under the Act is a resource controlled by the company as a result of past event, namely, the payment of MAT. MAT credit has expected future economic benefits in the form of its adjustment against the discharge of the normal tax liability if the same arises during the specified period. Accordingly, MAT credit is an 'asset'. Where MAT credit is recognized as an asset the same should be reviewed at each balance sheet date. A company should write down the carrying amount of the MAT credit asset to the extent there is no longer convincing evidence to the effect that the company will pay normal income tax during the specified period.

Q3. Show Presentation of MAT credit in the financial statements.

Where a company recognizes MAT credit as an asset, the same should be presented under the head 'Loans and Advances' since; it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

Revaluation of Assets | considered as permanent difference. | Balance Sheet approach through Equity.
---|---|---
DT on unrealized intra group gains/losses | No recognition | DT is recognized at buyer's Tax Rate.
In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Provision for Taxation' on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head 'Loans and Advance'.

The tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognized as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as separate line item therein.

**GUIDANCE NOTE ON ACCOUNTING TREATMENT OF EXCISE DUTY**

(i) Excise duty should be considered as a manufacturing expense and like other manufacturing expenses be considered as an element of cost for inventory valuation.

(ii) Where excise duty is paid on excisable goods and such goods are subsequently utilised in the manufacturing process, the duty paid on such goods, if the same is not recoverable from taxing authorities, becomes a manufacturing cost and must be included in the valuation of work-in-progress or finished goods arising from the subsequent processing of such goods.

(iii) Where the liability for excise duty has been incurred but its collection is deferred, provision for the unpaid liability should be made.

(iv) Excise duty cannot be treated as a period cost.

(v) If the method of accounting for excise duty is not in accordance with the principles explained in this Guidance Note, the auditor should qualify his report.

**Accounting entries:**

1) **Accounting entry at the time of purchase of raw material:**

   Purchases A/c \( \text{Dr} \ 100 \)
   
   CENVAT Input credit A/c \( \text{Dr} \ 12 \)
   
   To Creditors A/c \( \text{Dr} \ 112 \)

2) **Provision for Unpaid Excise Duty:**

   The liability for excise duty arises when the manufacture of the goods is completed, it is necessary to create a provision for liability of unpaid excise duty on stocks lying in the factory or bonded warehouse. Failure to provide for the liability will result in the balance sheet not showing a true and fair view of the state of affairs of the enterprise.

   a) **Accounting entry for Unpaid Excise Duty on the closing stock of finished goods remaining on the date of balance sheet:**
Excise duty (P&L A/c) Dr 50
To Provision for Unpaid ED (Current Liability) 0

Calculation of Provision for Unpaid Liabilities at the yearend:
Value of closing stock X Excise duty rate in force on the balance sheet date

Calculation of value of closing stock
Excise duty is payable not on the point of sale but on the point of production

Accounting Standard-2: Valuation of Inventory
According to Accounting Standard-2, Stock should be valued at cost or market value, whichever is lower, as it is a prudent business practice. Inventory cost should comprise of all cost of purchases, cost of conversion and other costs incurred in bringing the inventories to the present location and condition. Cost of purchases should be exclusive of duties which are recoverable from the taxing authorities. (e.g. Cenvat). Inventory should be valued at lower of cost or net realisable value.

b) For inclusion in Closing Stock as at 31st March
No separate entry. The usual closing stock entry value is increased by estimated ED of ₹ 50/-

Net Result in P&L A/c
Closing Stock stand increased (by 50/-), and an Excise Duty expense also stand increased (by 50/-).

Net result in Balance Sheet:
Value of closing stock increased (by 50/-). Current Liabilities includes Provision for unpaid ED (of 50/-)

Accounting entries in next financial year:
By bringing in Opening Stock, automatically, excise is debited to your trading account.

(i) Reversal Entry for
Provision:
Provision for Unpaid ED A/c Dr 50 (Current Liability)
To Excise Duty 50 (To knock of the excess expense booked in opening stock)

(ii) Accounting entry when the finished goods is sold:
Debtors A/c
To Sales A/c 1000
To Excise Duty Payable A/c 120
(iii) **Accounting entry for payment of Excise Duty:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise Duty Payable A/c</td>
<td>Dr 120</td>
<td></td>
</tr>
<tr>
<td>To CENVAT Credit A/c</td>
<td></td>
<td>60</td>
</tr>
<tr>
<td>To PLA (Bank/cash)</td>
<td>60</td>
<td></td>
</tr>
</tbody>
</table>

**Net Result In P&L A/c**

Opening Stock stand increased (by 50/-), and an Excise Duty expense stand decreased (by 50/-).

**Net result in Balance Sheet:**

Provision for unpaid ED (of 50/-) become Nil.

**Auditor responsibility:**

If the method of accounting for excise duty is not in accordance with the principles explained in this Guidance Note, the auditor should qualify his report.

Though there is no impact in P&L account but management/auditor can’t escape their responsibility in case of non-compliance as, the financial position of the company is getting affected since results in understatement of value of inventory as well as liabilities of the company by the same amount.
ACCOUNTING STANDARD – 25

INTERIM FINANCIAL REPORTING

Meaning

1. Interim period is a financial reporting period shorter than a full financial year.
2. Interim financial report means a financial report containing either a complete set of financial statements or a set of condensed financial statements (as described in this standard) for an interim period.

Note: During the first year of operations of an enterprise its annual financial reporting period may be shorter than a financial year. In such case that shorter period is not considered as an interim period.

Contents of an Interim Financial Report
(a) Balance sheet;
(b) Statement of profit and loss,
(c) Cash flow statement; and
(d) Notes to Accounts.

3. In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an enterprise may be required to or may elect to present less information at interim dates as compared with its annual financial statements.

4. Form and Content of Interim Financial Statements
   If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements.

5. If an enterprise prepares a set of condensed financial statements those condensed statements should include, at a minimum, each of the headings and sub-headings that were included in its most recent annual financial statements.

6. Basic and diluted earnings per share should be presented in accordance with AS 20 on the face of the statement of profit and loss, complete or condensed, for an interim period.

7. An enterprise should include the following information, as a minimum, in the notes:
   (i) a statement that the same accounting policies are followed in the interim financial statements as those followed in the most recent annual financial statements;
   (ii) explanatory comments about the seasonality;
   (iii) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence;
   (iv) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year if those changes have a material effect in the current interim period;
(v) issuances, buy-backs, repayments and restructuring of debt, equity and potential equity shares;

(vi) dividends, aggregate or per share, separately for equity shares and other shares;

(vii) segment revenue, segment capital employed and segment result for business segments or geographical segments;

(viii) material events that have not been reflected in the financial statements for the interim period;

(ix) the effect of changes during the interim period, such as amalgamations, acquisition or disposal of subsidiaries; and

(x) Material changes in contingent liabilities.

8. **Periods for which Interim Financial Statements are required to be presented**

Interim reports should include interim financial statements for periods as follows:

(a) balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year;

(b) statements of profit and loss for the current interim period and cumulatively for the current financial year to date, with comparative statements of profit and loss for the comparable interim periods (current and year-to-date) of the immediately preceding financial year;

(c) Cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

9. **Materiality**

In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality should be assessed.

10. **Revenues Received Seasonally or Occasionally**

Revenues that are received seasonally or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of the enterprise’s financial year.

**GUIDANCE NOTE ON APPLICABILITY OF AS - 25 TO INTERIM FINANCIAL RESULTS**

Whether Accounting Standard (AS) 25, Interim Financial Reporting, is applicable to interim financial results presented by an enterprise pursuant to the requirements of a statute/regular, for example, quarterly financial results presented under Clause 41 of the Listing Agreement entered into between Stock Exchange and the listed enterprises?

Recommendation as applicability of AS 25 to Financial Results. The presentation and disclosure requirements contained in AS 25 should be applied only if an enterprise prepares and presents an 'interim financial report' as defined in AS 25. Accordingly, presentation and disclosure requirements contained in AS 25 are not required to be applied in respect of interim financial results (which do not meet the definition of 'interim financial report' as per AS 25) presented by an enterprise. Listed enterprises do not meet the definition of 'interim financial report' as per AS 25. However, the
recognition and measurement principles laid down in AS 25 should be applied for recognition and measurement of items contained in such interim financial results.

GUIDANCE NOTE ON MEASUREMENT OF INCOME TAX FOR INTERIM FINANCIAL REPORTING

1. Calculate Actual Income up to current IFR and estimated Income for remaining interim period of CY along with bifurcation of Regular Income and Special Income (such as Capital gain).
2. Calculate Tax Expenses (Special Tax, Deferred Tax, and Normal Tax) on above actual/estimated Taxable Income for the entire year wise.
3. Calculate weighted avg tax rate for different taxes separately.
   - Regular W. Avg. Tax Rate = Regular Tax / Regular Income x 100
   - Special W. Avg Tax Rate = Special Tax / Total Special Income x 100
   (or we don’t need to calculate Weighted avg. special tax, it is to be applied on specific basis)
   - Deferred Tax W. Avg Rate = Def. Tax / Regular Income x 100
4. Calculate tax expense for IFR based on actual income and WA tax rates.
5. Distribute Special Tax in the ratio of Special Income Ratio; distribute deferred tax and Normal Tax in the ratio of Normal Income Ratio.
ACCOUNTING STANDARD - 26
“INTANGIBLE ASSETS”

APPLICABILITY:
- Financial assets like Cash, Ownership interest in another enterprise.
- Intangible assets covered by AS 14, AS 21, AS 22
- Intangible assets arising in the insurance enterprises
- Expenditure incurred to obtain any right in respect of exploration or extraction of Oil, Gas and any other mineral or natural resources
  However this standard specifically applies to:
  - Goodwill
  - Expenditure on Advertising
  - Expenditure on Training
  - Research and Development activities
  - Patents, Copyrights and Trademarks
  - Rights under licensing agreements such as video recordings, plays, picture films.

ASSET:
- Controlled by the enterprise as a result of past events and,
- From which Future Economic Benefits are expected to flow to the enterprise.
  (Road sidings are not controlled but Rail sidings are controlled.)

INTANGIBLE ASSETS: An Intangible asset is:
- An identifiable
- Non - Monetary asset
- Without physical substance
- Held for use in the production or supply of goods or services, for rental to others, or for administrative purpose.

Examples:
- Identifiable means capable of Sale/Rental to others.
- An intangible asset is identifiable if the future economic benefits are flow to the enterprise from that intangible asset.
- Employees loyalty, staff training etc cannot be identifiable though they are beneficial for entity but can not be sold/rental to others.
- However purchased goodwill, patents, trademarks, licenses are identifiable
- Non - monetary asset means the value to be received against the asset is not fixed.
- Computer software/Websites/Films-License/Trademarks are intangible asset since it has no physical substance, however the software is contained in CDs or DVDs being physical substance but the cost of physical substance is insignificant as compared to intangible non physical substance.
- Ringtones of telecom companies (Airtel, Idea, Reliance etc) are Intangible Assets since it satisfy all the conditions of being an Intangible Asset.
  - If the cost/ value of physical substance is more, than asset should be treated as per AS- 10 i.e. Fixed asset.
NOTE: For clarification, following are not Intangible Assets as per AS - 26, hence they should be written off in P&L immediately:
(a) Preliminary expenses (non-identifiable)
(b) Pre-Operating expenses (non-identifiable)
(c) Staff Training
(d) Heavy Advertisement expenses

RECOGNITION OF INTANGIBLE ASSETS:

If the following conditions are satisfied then, an intangible asset should be recognized/recorded in the books of accounts, otherwise treated as an expense:
- It is probable that future economic benefits from the intangible asset will flow to the enterprise; and
- The COST of intangible can be measured reliably.

INITIAL MEASUREMENT:

As per AS 26, Intangible assets should be recognized only at COST.

COST MEANS WHAT?:

Separate Acquisition – Cost will be purchase price including non refundable duties and taxes and any other directly attributable expenses.

Exchange of Assets – Cost will be the fair value of assets given up.

By Issue of Shares/Securities – Cost will be the fair value of intangible asset acquired or fair value of shares/securities issued, whichever is more evident.

Acquisition as a part of Amalgamation – If Intangible assets are obtained in scheme of amalgamation, they would be recorded at Fair values as per AS -26. In case of amalgamation in the nature of purchase, difference between PC and acquired assets is regarded as Goodwill under AS - 14.

Acquisition by way of Govt. Grants – Should be recognized as per AS - 12 (Govt. Grants). As per AS - 12, such assets are recorded at nominal value. For example import quota given to exporters as free are to be recorded as nominal value.

Self Generated Goodwill – Cost cannot be measured reliably hence, not recognized.

Internally generated Intangible assets like Brands, Customer Lists; Good and Trained employees should not be recognized as intangible assets. Publishing Titles such as “India Today”, “Champak” cannot be recorded as IA.
RESEARCH AND DEVELOPMENT:

Research Phase: Gaining of scientific or technical knowledge. Cost of Research activity should not be capitalized as an intangible asset, it should be treated as expense and transfer to P&L a/c as per AS 26.

Development Phase: It is the activity which converts the result of the research to a marketable product (Gained knowledge is applied). Cost of Development activity should be capitalized only if it meets the recognition criteria i.e. the future economic benefits will flow to the enterprise by such activity otherwise treat it as expense.

If all of the following conditions are satisfied then it is considered as Development phase:
- Technical feasibility has been established.
- Intention of entity to develop assets should exist.
- Marketability of asset should be proved as per survey report.
- Resources for development should be available.

SUBSEQUENT EXPENDITURE:

Subsequent Expenditure on already recognized Intangible Asset should be Capitalized if the following two conditions are fulfilled:
- Subsequent Expense increases the future economic benefits of Intangible Assets.
- Such expense can be measured reliably.

If the above two conditions are not fulfilled than the subsequent expense should be transferred to P&L A/c.

AMORTIZATION (Depreciation) OF INTANGIBLE ASSETS:

1. Amortization Period: Depreciable amount of Intangibles should be allocated on a systematic basis over the best estimate of its useful life. There is presumption that the useful life of an intangible asset will not exceed the Ten Years from the date when the asset is available for use unless there is significant evidence that the useful life is more than 10 years.

2. Amortization Method:
- The amortization method used should reflect the pattern in which the asset’s economic benefits are consumed by the enterprise.
- If that pattern cannot be determined reliably the Straight Line Method (SLM) should be used.
  a. Residual Value: The residual value of intangibles should be assumed to be Zero unless:
     (a) There is a commitment by the third party to purchase the asset at the end of its useful life; or
     (b) There is a active market for the asset and:
        (i) Residual value can be determined by reference to that marked; and
(ii) It is probable that such a market will exist at the end of the asset’s useful life.

3. Review of Amortization period and method:
   • The amortization period and method should be reviewed at least at each financial year end.
   • If the expected useful life is significantly different from the previous estimates, the amortization period should be changed accordingly.
   • If there has been change in expected pattern of economic benefits from the asset, the amortization method should be changed to reflect such changed pattern.

IMPAIRMENT OF INTANGIBLE ASSETS:
   • Intangible Asset should be impaired if its Recoverable amount is less than the Carrying amount (i.e. book value).
   • In such case, impairment loss equal to recoverable amount minus carrying amount should be recognized in the P&L a/c.

RETIREMENT AND DISPOSAL OF INTANGIBLE ASSETS:

An intangible asset should be derecognized (eliminated from the Balance sheet) if:
   • It is disposed; or
   • No future economic benefits are expected from its use.
   Gain/Loss arising on retirement or disposal of intangibles should be recognized as income or expense in P&L A/c.

DISCLOSURE:
The financial statements should disclose the following in respect of intangibles:
   • Useful life
   • Amortization method
   • Gross carrying amount, accumulated amortization and net carrying amount after accumulated amortization.
   • If amortization period is more than 10 years, the reason why the useful life is estimated for more than 10 years.
   • Research and Development expenses recognized as expenses during the period.
## Difference Between AS 26 and Ind AS 38

<table>
<thead>
<tr>
<th>Basis</th>
<th>Ind AS 38</th>
<th>AS 26</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Payment deferred beyond normal credit term</strong></td>
<td>On acquisition of Intangible Assets, if payment is deferred beyond normal credit terms, the difference between the amount paid and the amount recognised is Interest expense to be amortised over the period of credit unless it is capitalized as per Ind AS 23 (AS 16)</td>
<td>There is no such provision in the existing standard.</td>
</tr>
<tr>
<td><strong>Useful Life</strong></td>
<td>The rebuttable presumption of 10 years is not in this standard. Here the useful life can even be indefinite and in such case it should not be amortised but should be tested for Impairment.</td>
<td>There is an assumption that useful life of an Intangible Asset is always finite, and includes a rebuttable presumption that useful life cannot exceed 10 years.</td>
</tr>
<tr>
<td><strong>Change in method of amortization</strong></td>
<td>This change would be treated as Change in Accounting Estimate.</td>
<td>The change will be treated as change in Accounting Policy.</td>
</tr>
<tr>
<td><strong>Valuation Model</strong></td>
<td>This standard permits the entity to choose either Cost model or revaluation model.</td>
<td>Revaluation Model is not permitted.</td>
</tr>
</tbody>
</table>
ACCOUNTING STANDARD - 28

IMPAIRMENT OF ASSETS

1. **Applicability**
   This Standard should be applied in accounting for the impairment of all assets, other than:
   (a) Inventories;
   (b) Assets arising from construction contracts;
   (c) Financial Assets;
   (d) Deferred tax assets.

2. **Meaning**
   
   **Impairment Loss:** is the amount by which the carrying amount of an asset exceeds its recoverable amount.
   
   **Recoverable amount:** is the higher of an asset’s net selling price and its value.
   
   Note: It is not always necessary to determine both an asset’s net selling price and its value.
   
   Note: Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs.

   **Value in use:** is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

   **Partial Exemption**
   The definition of the term ‘value in use’ in the proviso implies that instead of using the present value technique, a reasonable estimate of the ‘value in use’ can be made. Consequently, if an SMC chooses to measure the ‘value in use’ by not using the present value technique, the relevant provisions of AS 28, such as discount rate, etc., would not be applicable to such an SMC.

   **Net Selling price:** is the amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal.

   **Carrying amount:** is the amount at which an asset is recognized in the Balance sheet after deducting any accumulated depreciation and accumulated impairment losses thereon.

3. **Formal Estimate of Impairment Loss**
   An enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset.
   An enterprise should consider, as a minimum, the following indications:

   **External sources of Information**
   (a) Asset’s market value has declined significantly;
(b) Significant changes with an adverse effect on the enterprise have taken place in the technological, market, economic or legal environment.
(c) Market interest rates or other market rates of return have increased during the period;
(d) The carrying amount of the net assets of the reporting enterprise is more than its market capitalization;

**Internal sources of information**
(a) Evidence is available of obsolescence or physical damage of an asset;
(b) Significant changes expected or taken place in the near future including plans to discontinue or restructure the operation; and
(c) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

4. **How to Calculate Net Selling Price**
   (i) The best evidence of an asset's net selling price is a price in a binding sale agreement.
   (ii) If there is no binding sale, net selling price is the asset's market price less the cost of disposal. The appropriate market price is usually the current bid price.
   (iii) If there is no binding sale agreement or active market for an Asset then selling price is based on the best information available.

5. **How to Calculate Value in Use**
   **Meaning of Cash Flows**
   (a) Cash flow projections should be based on reasonable and supportable assumptions that represent management’s best estimate;
   (b) Cash flow projections should cover a maximum period of five years, unless a longer period can be justified; and
   (c) Growth rate should not exceed the long term average growth rate for the products.
   **Composition of Estimates of Future Cash Flows**
   Estimate include
   (a) Projections of cash inflows from the continuing use of the asset;
   (b) Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset.
   (c) Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.

**Foreign Currency Future Cash Flows**
Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency.

**Discount Rate**
The discount rate(s) should be pre-tax rate(s) that reflect(s) current market assessments of the time value of money and the risks specific to the asset.
6. **When to Recognise Liability**
   When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognize a liability.

7. **Impairment Loss for a Goodwill (Also applies to corporate assets)**
   In testing a cash generating unit for impairment, an enterprise should identify whether goodwill is recognized in the financial statements. An enterprise should:
   
   (a) Perform a ‘bottom-up’ test, that is, the enterprise should:
   1. Identify whether the carrying amount of goodwill can be allocated on a reasonable and consistent basis; and Then, compare the recoverable amount of the cash generating unit under review to its carrying amount recognize any impairment loss.
   2. The enterprise should perform the step at (ii) above even if none of the carrying amount of goodwill can be allotted on a reasonable and consistent basis.
   
   (b) If the enterprise could not allocate the goodwill enterprise should also perform a ‘top-down’ test, that is, the enterprise should:
   1. Identify the smallest cash generating unit that includes the cash-generating unit under review to which the carrying amount of goodwill can be allocated on a reasonable and consistent basis (the ‘larger’ cash generating unit); and
   2. Then, compare the recoverable amount of the larger cash generating unit to its carrying amount and recognize any impairment loss.

8. **Allocation**
   The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
   
   (a) First, to goodwill allocated to the cash generating unit; and
   (b) Then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

9. **Reversal of an Impairment Loss**
   An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognized for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

   Impairment loss recognized for goodwill should not be reversed.

10. **Indicators of Reversal**
    Enterprise should consider, as a minimum, the following indications:
    
    **External sources of information**
    (a) The asset’s market value has increased significantly;
    (b) Significant changes with a favorable effect;
    (c) Market interest rates or other market rates of return on investments have decreased;
Internal sources of information
(d) Significant changes with include capital expenditure that has been incurred during the period to improve or enhance an asset in excess of its originally assessed standard; and
(e) Evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.

11. Reversal of an Impairment Loss—upper limit
The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

12. Disclosure
For each class of assets financial statements should disclose:
(a) the amount of impairment losses recognised in the statement of profit and loss during, the amount of reversals of impairment losses recognised in the statement of profit and loss during;
(b) the amount of impairment losses recognised directly against revaluation surplus; and
(c) the amount of reversals of impairment losses recognised directly in revaluation surplus.

Note 1: An enterprise should disclose the following for each reportable segment based:
(a) the amount of impairment losses recognised; and
(b) The amount of reversals of impairment losses.

Note 2: The events and circumstances that led to the recognition or reversal of the impairment loss.

Note 3: If recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.
# Difference Between AS 28 and IND AS 36

<table>
<thead>
<tr>
<th>AS – 28</th>
<th>Basis of Difference</th>
<th>IND AS 36</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher of Value in Use &amp; Net Selling Price</td>
<td>Recoverable Amount</td>
<td>Higher of Value in Use &amp; Fair Value less cost of disposal</td>
</tr>
<tr>
<td>There are no such Intangibles therefore no specific requirement</td>
<td>Intangible Assets having Indefinite useful life</td>
<td>Irrespective of whether there is an indication of impairment, an entity shall test an intangible asset with indefinite useful life annually.</td>
</tr>
<tr>
<td>It follows Bottom up &amp; Top down approach for allocation of Goodwill</td>
<td>Impairment of Goodwill</td>
<td>The Goodwill is allocated to CGU’s or group of CGU’s that are expected to benefit from the synergies of the business combination from which it arose i.e. there is no bottom up and top down approach</td>
</tr>
<tr>
<td>It can be reversed in subsequent period if it is caused by specific external event of an exceptional nature.</td>
<td>Reversal of Impairment Loss on Goodwill</td>
<td>Prohibited</td>
</tr>
<tr>
<td>AS 28 does not specifically exclude Biological Assets</td>
<td>Biological Assets eg. Live stocks, cattle, and living plants.</td>
<td>IND AS 36 specifically excludes Biological Assets relating to Agricultural Activities because there is a separate IND AS 41</td>
</tr>
</tbody>
</table>
ACCOUNTING STANDARD – 29

“PROVISIONS, CONTINGENT LIABILITIES AND
CONTINGENT ASSETS”

1. AS 29 IS NOT APPLICABLE IN FOLLOWING CASES:
   • Financial Instruments, since these are covered under AS 30
   • Excutory Contracts- Contracts under which neither party has performed any of
     its obligations or both parties have partially performed their obligations to an
     equal extent. It means pending performances under a contract does not come as a
     Liability or Contingent liability. (however AS-29 applies to ‘Onerous Contracts’)
   • Insurance enterprises - Liabilities arising out of insurance contracts with policy
     holders.
   • Liabilities, provisions and contingent liabilities covered under other Accounting
     standards such as AS -7, 15, 19 etc.
   • The provisions which are adjusted against Assets in the balance sheet such as
     Provision for doubtful debts, Provision for depreciation are not covered under this
     standard.

Note: Onerous Contract: means a contract where unavoidable cost of meeting the
obligation (simply call it as Cost) exceed the economic benefits (Revenue) expected to be
recovered. Provision should be made on such contracts at lower of (i) Net cost of
meeting the obligation or (ii) compensation payable on cancellation of contract.

2. DEFINITIONS:
   • Obligating Event: an event that creates an obligation that results in an
     enterprise having no realistic alternative to settling that obligation.
   • Present Obligation: if based on evidences available, its existence on the balance
     sheet date is considered probable i.e. more likely than not.
   • Possible Obligation: if based on evidences available, its existence on the balance
     sheet date is considered not probable.
   • Liability: Liability is a
     ▪ Present obligation of enterprise
     ▪ arising from past events,
     ▪ The settlement of which is expected to result in an outflow from the
       enterprises of resources embodying economic benefits.
   • Provision: Provision is a
     ▪ Liability
     ▪ Which can be measured only by using a substantial degree of estimation.
   • Contingent Liability is :
     (a) Possible obligation: that arises from past events and existence of which will
        be confirmed only by the occurrence or non-occurrence of one or more
        uncertain future events not wholly within the control of enterprise; or
     (b) Present obligation: that arises from past events but is not recognised as
        ‘Liability’ or ‘Provision’ because:
(i) Probability of outflow of resources is very low; Or
(ii) Reliable estimate of the amount of that obligation cannot be made.

- **Contingent Asset**: is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of enterprise.

### 3. RECOGNITION:

**a) Liability:** to recognize a liability there must be satisfaction of following conditions:
- Past obligating event (not pertains to the event to happen in future)
- Present obligation (if possible than treat it as contingent liability not as liability)
- Outflow of economic resources will be required to settle such obligation.
- Amount is almost ascertainable and does not require significant estimation

**b) Provision:** Provision should be made when these conditions are satisfied:
- Past obligating event (not pertains to the event to happen in future)
- Present obligation (if possible than treat it as contingent liability not as liability)
- Outflow of economic resources will be required to settle such obligation.
- Amount is not easily ascertainable; a reliable degree of estimation is required.

If these conditions are not met, no provision should be recognized.

**Note:** The following points should be kept in mind while making a provision:

1. Provisions are totally based on estimates and such estimates can be made on the basis of evidences available at the balance sheet date or even after the balance sheet date.
2. Obligating event that exist on the balance sheet date only lead to provisions and such obligating event should pertains to the things that have already been happened for e.g. penalty for infraction of law that has happened.
3. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimates. If no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.
4. When provision is needed to be made because of change in law, Provision should be made only when the legislation is virtually certain to be enacted.
5. If any amount is expected to be reimbursed from another party, then the provision should be made net of the reimbursement, if such reimbursement if virtually certain to be received.
6. Provision should not be recognized for Future operating losses.

**c) Contingent Liability:**
- An enterprise should not recognize a contingent liability i.e. no provision should be created in the books for a contingent liability.
Contingent liability should only be disclosed as a part of notes to accounts in preparation of financial statements.

If possibility of an outflow of resources embodying economic benefits is remote then even disclosure is not required.

**Note:** Contingent liabilities should be reviewed at each balance sheet date, if it becomes probable that an outflow of resources embodying economic benefits will be required for an item which is previously treated as Contingent liability, a provision is recognized.

4. **OBLIGATIONS FOR WHICH ENTITY IS JOINTLY & SEVERALLY LIABLE:**
   - A part of the obligation that is expected to be met by other parties is treated as a contingent liability.
   - The balance is recognized as provision except where no reliable estimates can be made.

5. **RESTRUCTURING:**
   **Meaning:** Restructuring means a programme which is planned and controlled by the management and which materially changes either:
   - the scope of business undertaken; or
   - the manner in which that business is conducted.

   **Examples:** Sale or termination of business; Closure of business locations in a country or region; Relocation of business activities from one country or region to another; Change in management structure.

Restructuring does not mean to launch a new system it does not include:
- Retraining or relocating the continuing staff
- Marketing
- Investment in a new system

**Whether provision is needed?** : Provision for restructuring cost should be recognized only when recognition criteria for provision is met.

**Restructuring Cost:** should include only the direct expenditures arising from restructuring programme. It does not include:
- Cost of retraining or relocating the continuing staff
- Marketing cost
- Expected losses on sale of assets due to restructuring.

6. **RECOGNITION PRINCIPLES OF CONTINGENT ASSETS:**
   - An enterprise should not recognize a contingent asset because it may result in the recognition of income that may never be realized.
   - However, if realization is virtually certain then the related asset is not contingent asset and it can be recognised as an asset.
Contingent assets are not required to be disclosed in the financial statements. It is usually recorded in the books of approving authorities (BOD in case of companies).

Contingent assets are assessed periodically and if it has become virtually certain that an inflow of economic benefits will arise, the asset and related income are recognized in that period.

**DIFFERENCE BETWEEN AS 29 AND INS AS 37**

<table>
<thead>
<tr>
<th>IND AS 37</th>
<th>BASIS OF DIFFERENCE</th>
<th>AS 29</th>
</tr>
</thead>
<tbody>
<tr>
<td>This standard requires creation of provision in respect of Constructive obligation also.</td>
<td>Constructive Obligation</td>
<td>Provision is created from normal business practices and customs.</td>
</tr>
<tr>
<td>It allows Discounting of amount of provisions if effect of time value of money is material</td>
<td>Discounting Provisions</td>
<td>AS 29 prohibits discounting the amounts of provisions.</td>
</tr>
<tr>
<td>It requires disclosure of Contingent Assets when the inflow of economic benefit is probable.</td>
<td>Disclosure of Contingent Assets</td>
<td>Disclosure of Contingent Asset is allowed only in the report of approving authority but prohibits disclosure of the same in the Financial Statements.</td>
</tr>
</tbody>
</table>
AS 18 - RELATED PARTY DISCLOSURES

Introduction
AS 18 is applicable for Separate Financial Statements as well as Consolidated Financial Statements.
In this standard we will discuss:
1. The types of Relationships (between Reporting Entity and different parties known as related parties).

DEFINITIONS
The following definitions are relevant for understanding the Standard:
1. A related party is (i) a person or (ii) entity that is related to the reporting entity.
2. A reporting entity in this Standard is an entity that is preparing its financial statements.
3. Control:
   (a) ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or
   (b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
   (c) a substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

For the purpose of AS 18, an enterprise is considered to control the composition of the board of directors of a company or governing body of an enterprise, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors/members of the governing body of that company/enterprise.

An enterprise/individual is considered to have a substantial interest in another enterprise if that enterprise or individual owns, directly or indirectly, 20% or more interest in the voting power of the other enterprise.

4. Significant influence
   It means Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.
   Significant influence may be gained by
   (i) Share ownership : owing directly/indirectly through subsidiaries 20% or more voting power of the enterprise.
   (ii) Statute or
   (iii) Agreement with other Shareholders.
Example of significant influence
By representation on the board of directors,
Participation in the policy making process,

5. **An Associate**: An enterprise in which an investing reporting party has significant influence and which is neither a subsidiary nor a joint venture of that party.

6. **Key management personnel** are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

   A non-executive director of a company should not be considered as a key management person, unless he falls in any of the categories of 'related party relationships' discussed above.

7. **Relative**: In relation to an individual, means the *spouse, son, daughter, brother, sister, father and mother* who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

   **Note:**
   If there is separation agreement between two brothers or husband wife then it cannot be said that they both can influence or be influenced with each other in dealings with reporting enterprise.

8. **Joint Venture** - a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control.

9. **Joint Control** - the contractually agreed sharing of power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

10. **Related party transaction**: A transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

11. **Fellow subsidiary** - a company is considered to be a fellow subsidiary of another company if both are subsidiaries of the same holding company.

**Related Party Relationships**
Related party - parties are considered to be related if at any time during the reporting period one party has the ability

   (a) To **Control** the other party or
   (b) To **Exercise significant influence** over the other party

   In making financial and/or operating decisions.

**TYPES OF RELATED PARTY RELATIONSHIPS**

- One relationship is between the reporting entity and a person or persons.
- The other relationship is between the reporting entity and another entity or entities.
**Type 1 – In relation to a Person**

(A) A person or his relative or both is related to a reporting entity if that person:
   (a) has control over the reporting entity;
   (b) has significant influence over the reporting entity;
   (c) or

**Examples:**

1. Mr. A holds 51% in equity share capital of A Limited. A Limited has no other form of share capital. As Mr. A controls A Limited, he is a related party.
2. Mrs. A is wife of Mr. A. Mr. A holds 51% of equity shares of A Limited. A Limited has no other form of share capital. Mr. A controls A Limited. Since Mr. A is a related party, Mrs. A is also a related party of A Limited.
3. Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he is related to A Limited.

(B) A person or his relative - is a member of the key management personnel of the reporting entity

**Examples:**

Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he along with his relatives is related to A Limited.

**Type 2 – In relation to another entity**

An entity is related to a reporting entity if any of the following conditions applies:

(A) Enterprises that directly, or indirectly through one or more intermediaries,
   - Control, or
   - are controlled by, or
   - are under common control
   With, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries).

In simple language, Members of the same group are related parties to each other.
(Members of Same group here only mean Parent and all subsidiaries. Associate and Joint Ventures shall not become part of members of same group).

**Example:**

SA Limited and SB Limited are subsidiaries of H Limited. SA Limited, SB Limited and H Limited are related to each other.

**Note:** An entity (First party) has control in other entity (second party) and another entity (third party) has significant influence or Joint Control over the same entity (second party), i.e. one entity is common over which first party has control and third party has significant influence/joint control then First Party and Third party cannot become Related Parties under the above point.
(B) One entity is an associate or joint venture of the other entity.

**Note:** Co-venturers and Co-Investors cannot become related parties to each other

**Example:**
Parent Ltd. has a joint venture in J Ltd. with co-venturer X Ltd. and Parent Ltd. has 35% investment (significant influence) in A Ltd.

Here, Parent Ltd. and J Ltd. are related to each other.
Parent Ltd. and A Ltd. are related to each other.
But Parent Ltd. and X Ltd. (Co-Venturers) are not related to each other.

(C) Enterprises over which any person (who is KMP or Individual having control) described in type 1 above is able to exercise significant influence.

This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.

**Example:** The Managing Director (KMP) of Lion Ltd. own 100% of Tiger Ltd.

**Example:** Mr. Jai having 51% share in D-Fortune Ltd. is a partner in JCA & Associates, a partnership firm of Chartered Accountants.

**Relationships not covered under AS 18**
In the context of AS 18, the following are deemed not to be related parties:
(1) Two companies simply because they have a director in common (unless the director is able to affect the policies of both companies in their mutual dealings).
(2) A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence and

(3) The parties listed below, in the course of their normal dealings with an enterprise by virtue only of those dealings:
   (i) Providers of finance
   (ii) Trade unions
   (iii) Public utilities
   (iv) Government departments and government agencies including government sponsored bodies

Related party disclosure requirements as laid down in AS 18 do not apply in circumstances where providing such disclosures would conflict with the reporting enterprise’s duties of confidentiality as specifically required in terms of a statute or by any regulator or similar competent authority.
**For example:**
Banks are obliged by law to maintain confidentiality in respect of their customers' transactions and this Standard would not override the obligation to preserve the confidentiality of customers' dealings.

No disclosure is required in consolidated financial statements in respect of intra group transactions.

No disclosure is required in the financial statements of state-controlled enterprises as regards related party relationships with other state-controlled enterprises and transactions with such enterprises.

### RELATED PARTY TRANSACTIONS

A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

**Examples**
- (a) purchases or sales of goods (finished or unfinished);
- (b) purchases or sales of property and other assets;
- (c) rendering or receiving of services;
- (d) leases;
- (e) transfers of research and development;
- (f) transfers under licence agreements;
- (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- (h) provision of guarantees or collateral;
- (i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognised and unrecognised);
- (j) Settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

**Note:** It is _not necessary for any consideration to be passed_ for related party transactions.

### DISCLOSURES IN RESPECT OF RELATED PARTIES

The disclosure requirements can be broadly classified into two categories.

(a) **Category 1** requires disclosures of relationships even though there are no related party transactions between the disclosed related parties.

Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

This is to enable users of financial statements to form a view about the effects of related party relationships on the enterprise.
(b) **Category 2** requires disclosures of relationships and items only when there are related party transactions.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) The name of the transacting related party;
(ii) A description of the relationship between the parties;
(iii) A description of the nature of transactions;
(iv) Volume of the transactions either as an amount or as an appropriate proportion;
(v) Any other elements of the related party transactions necessary for an understanding of the financial statements;
(vi) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;
(vii) Amounts written off or written back in the period in respect of debts due from or to related parties.

**Note:**
Remuneration paid to key management personnel should be considered as a related party transaction requiring disclosures. In case non-executive directors on the Board of Directors are not related parties, remuneration paid to them should not be considered a related party transaction.
**AS 24**  
**DISCONTINUING OPERATION**

AS 24 is applicable to all discontinuing operations.

**Discontinuing Operation:**

A discontinuing operation is a component of an enterprise:

a. That the enterprise, pursuant to a **single plan**, is:
   - (i) **Disposing of substantially** in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
   - (ii) **Disposing of piecemeal**, such as by selling off the component’s assets and settling its liabilities individually or
   - (iii) Terminating through **abandonment** (giving up completely) and

b. That represents a separate major line of business or geographical area of operations. (for example Business Segments or geographical Segments as defined in AS 17)

c. That can be distinguished operationally and for financial reporting purposes.

**DISCONTINUED OPERATION DOES NOT INCLUDE DISCONTINUATION OF A SINGLE PRODUCT ONLY OR DISCONTINUING A BUSINESS IN A PARTICULAR AREA.**

To qualify as a discontinuing operation, the disposal must be pursuant to a **single coordinated plan**.

However, changing the scope of an operation or the manner in which it is conducted is not abandonment because that operation, although changed, is continuing.

Examples:

a. Gradual or evolutionary phasing out of a product line or class of service.

b. Discontinuing, even if relatively abruptly, several products within an ongoing line of business.

c. Shifting of some production or marketing activities for a particular line of business from one location to another and

d. Closing of a facility to achieve productivity improvements or other cost savings.

**(V.V.I.MP)**

A component can be distinguished operationally and for financial reporting purposes -
criterion (c) of the definition of a discontinuing operation - if all the following conditions are met:

a. The operating assets and liabilities of the component can be directly attributed to it.
b. Its revenue can be directly attributed to it.
c. At least a majority of its operating expenses can be directly attributed to it.

(Assets, liabilities, Revenues and Expenses can be directly attributable)

The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 does not, in itself, bring into question the enterprise’s ability to continue as a going concern.

(V.V.IMP)

Initial Disclosure event

With respect to a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

a. The enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation or
b. The enterprise’s board of directors or similar governing body has both
   (i) approved a detailed, formal plan for the discontinuance and
   (ii) Made an announcement of the plan.

Note:
A detailed, formal plan for the discontinuance normally includes:

- Identification of the major assets to be disposed of;
- The expected method of disposal; (i.e. how we are going to dispose the business or assets)
- The period expected to be required for completion of the disposal;
- The principal locations affected;
- Approximate number of employees who will be compensated for terminating their services; and
- The estimated proceeds or salvage to be realised by disposal.

An enterprise’s board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.
Presentation and Disclosure

1. Initial Disclosure (in the first financial statements subsequent to announcement)

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:

a. A description of the discontinuing operation(s)

b. The business or geographical segment(s) in which it is reported as per AS 17

c. The date and nature of the initial disclosure event.

d. The date or period in which the discontinuance is expected to be completed if known or determinable

e. The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled

f. The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period

g. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto

h. The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period

Where to disclose above items?

All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last bullet above) which should be shown on the face of the statement of profit and loss.

2. Further disclosures (in the next financial statements)

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:

a. For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation,
   (i) the amount of the pre-tax gain or loss and
   (ii) income tax expense relating to the gain or loss and
b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.

3. **Updating the disclosures**
   In addition to these disclosures, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.

**Till which period the disclosures should be given? (Important)**

The disclosures should continue in financial statements for periods upto and including the period in which the discontinuance is completed.

Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.

If an enterprise abandons or withdraws from a plan that was previously reported as a discontinuing operation, that fact, reasons therefore and its effect should be disclosed.

**Separate disclosure for each discontinuing operation**

Any disclosures required by AS 24 should be presented separately for each discontinuing operation.

**V.V.IMP**

### Presentation of the required disclosures

The above disclosures should be presented in the notes to the financial statements except the following which should be shown on the face of the statement of profit and loss:

a. The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto and

b. The amount of the pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.
**Restatement of prior periods**

Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that mentioned above.

**Disclosure in interim financial reports**

Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial is reporting', including:

a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and

b. Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.
**IND AS 101**

**FIRST TIME ADOPTION OF IND AS**

### Summary

- For the purpose of Ind AS adoption, an entity shall select a date of transition which is first day of the comparative period.
- It is required to prepare an opening Ind AS Balance Sheet as on the date of transition, Ind AS compliant financial statements for the comparative period and current period.
- It shall prepare reconciliation statement explaining differences in equity, total comprehensive income and cash flows arising of Ind AS adoption.
- These reconciliations are presented by way of an explanatory statement in the first Ind AS compliant financial statements.
- An entity’s first Ind AS financial statements shall include at least three Balance Sheets, two Statements of profit and loss, two Statements of cash flows and two Statements of changes in equity and related notes, including comparative information for all statements presented.
- Ind AS 101 provides mandatory and optional transitional exemptions.
- Important optional exemptions are:
  - Existing carrying amount of property, plant and equipment, intangible assets and investment property can be included in the opening Ind AS Balance Sheet without adjustment;
  - Deferred exchange fluctuation loss/gain on long term foreign currency monetary items can be carried forward;
  - Lease classification of land and building can be given prospective effect.

### DEFINITIONS:

**Date of transition to Ind AS**: The beginning of the earliest period for which an entity presents full comparative information under Ind AS in *first Ind AS financial statements*.

**First Ind AS financial statements**: The first annual financial statements in which an entity adopts *Indian Accounting Standards* (Ind AS), by an explicit and unreserved statement of compliance with Ind AS.

**First Ind AS reporting period**: The latest reporting period covered by an entity’s first Ind AS financial statements.

**First-time adopter**: An entity that presents its first Ind AS financial statements.

**Opening Ind AS balance sheet**: An entity’s balance sheet at the date of transition to Ind AS.
Previous GAAP: The basis of accounting that a first-time adopter used for its statutory reporting requirements in India immediately before adopting Ind ASs. For instance, companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements.

Objective

The objective of Ind AS 101 is to ensure that an entity's first Ind AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

- is transparent for users and comparable over all periods presented;
- provides a suitable starting point for accounting in accordance with Ind ASs; and
- can be generated at a cost that does not exceed the benefits.

HOW AN ENTITY ADOPTS IND AS?

- Ind-AS 101 applies when an entity adopts Ind-AS for the first time by an explicit and unreserved statement of compliance with Ind-ASs.
- This means compliance with ALL Ind-ASs.
- Partial Compliance is not enough to make an entity Ind-AS Compliant.

SCOPE OF IND AS 101

An entity shall apply this standard:

- in its first Ind-AS compliant financial statements, and
- In each interim financial report, if any, presented in accordance with Ind AS 34, Interim Financial Reporting, for part of the period covered by its first Ind AS financial statements.

For example:

If a company adopts Ind ASs for the financial year 2016-17, the following are the relevant Ind AS adoption date/period:

- The date of transition is 1.4.2015;
- Comparative period to the first Ind AS financial statements period is 2015-16; and
First Ind AS financial statements period is 2016-17.

An entity would apply Ind ASs consistently. It is required to apply Ind Ass effective for the period ending on 31 March, 2016 the purposes of:
- Preparation and presentation of opening Ind AS Balance Sheet as on 1.4.2015;
- Preparation and presentation of comparative financial statements for the period 2015-16;
- Preparation and presentation of first Ind AS financial statements for the period 2016-17; and
- This standard will not be applied on and from the second financial year of Ind AS adoption i.e. for the financial year 2017-18.

An entity shall not apply different versions of Ind ASs that were effective at earlier dates. It may apply a new Ind AS that is not yet mandatory if that Ind AS permits early application.

PROCESS OF FIRST TIME ADOPTION OF IND AS

First time adoption of Ind ASs requires selection/mandatory adoption of the accounting period in which Ind AS based financial statements shall be prepared for the first time. Based on the Ind AS adoption period, the date of transition is determined.

Date of transition is the first day of the earliest comparative period. If an entity adopts Ind ASs in 2015-16 voluntarily, then its date of transition is 1.4.2014, the comparative period is 2014-15.

It is required to explain how the transition from previous GAAP to Ind Ass affected its reported Balance Sheet, financial performance and cash flows.

These explanations are provided by way of reconciliations of equity and profit or loss. Steps to be followed in first time adoption of Ind ASs are presented in following Table:

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
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</thead>
<tbody>
<tr>
<td>Date of Transition</td>
<td>Comparative Period</td>
<td>First-time Ind AS adoption period</td>
</tr>
<tr>
<td>(a) Prepare a Balance</td>
<td>(a) Prepare Ind AS compliant financial</td>
<td>(a) Prepare Ind AS compliant financial</td>
</tr>
<tr>
<td>Sheet as on 1.4.2014 as</td>
<td>statements for 2014-15 which shall be</td>
<td>statements for 2015-16 and use</td>
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<tr>
<td>per Ind AS which is</td>
<td>used as the basis for comparatives of</td>
<td>information of 2014-15 Ind AS</td>
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<td>termed as opening</td>
<td>the first Ind AS compliant financial</td>
<td>compliant financial statements as</td>
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<tr>
<td>Ind AS Balance</td>
<td>statements. These financial statements</td>
<td>comparatives. For Balance Sheet as on</td>
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<td>Sheet.</td>
<td>are released only as comparatives.</td>
<td>31.3.2016, comparatives shall be</td>
</tr>
<tr>
<td>(b) Prepare explanatory</td>
<td></td>
<td>Balance Sheets as on 1.4.2014 &amp;31.3.2015</td>
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<tr>
<td>statement reconciling</td>
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</table>
previous GAAP as on 31.3.2014.
(c) Distinguish difference Arising out of correction Of errors made in the previous GAAP and difference arising out of Ind ASs adoption.
(d) Disclosures in accordance with Ind AS 36 when any previously recognised impairment loss is reversed while Preparing opening Ind AS Balance Sheet.

(b) Prepare explanatory Statement reconciling equity as on 31.3.2015 as per Ind ASs and as per previous GAAP as on 31.3.2015.
(c) Prepare explanatory statement reconciling total comprehensive income for the period 2014-15 as per Ind ASs and as per previous GAAP.
(d) Provide details of material Adjustments to cash flows statement.

(b) Present in the Notes an explanatory statement showing reconciliation stated in 1(b), (c) & (d), and 2 (b), (c) & (d).

The resulting adjustments arise from events and transactions before the date of transition to Ind AS shall be recognised directly in retained earnings.

### Ind-AS 101 : First Time Adoption of Ind-AS

#### Requirements

- **General**
  - To comply with each Ind-AS effective at the end of its first Ind-AS reporting period.

- **Specific**
  - To recognise, De-recognise, measure & re-classify in the opening Ind-AS statement of financial position that it prepares.
IND AS 101 – SPECIFIC REQUIREMENTS:

(a) **Recognise** All Assets and Liabilities whose recognition is required by IND AS
(b) **Not recognize** items as Assets or Liabilities if Ind AS do not permit such recognition
(c) **Reclassify** items that it recognised under previous GAAP as one type of Asset, Liability or component of equity, but a different type of asset, liability or component of equity under Ind AS and
(d) Apply Ind AS in **measuring** all Recognised Assets and Liabilities.

<table>
<thead>
<tr>
<th>Recognition</th>
<th>De-recognition</th>
<th>Reclassification</th>
<th>Measurement</th>
</tr>
</thead>
</table>

**RECOGNISE (Examples)**

- Defined benefit pension plans (Ind-AS 19)
- Deferred taxation (Ind-AS 12)
- Assets and liabilities under Appendix C Decommissioning Liability commissioning
- Provisions where there is a legal or construction obligation (Ind-AS 37)
- Derivative financial instruments (Ind-AS 39)
- Share-based payments (Ind-AS 2)

**DE-RECOGNISE (Examples)**

- Internally generated intangible assets (Ind-AS 38)
- Deferred tax assets where recovery is not probable (Ind-AS 12)
- Provision for Dividend (Ind-AS 10)
- Preliminary & Pre-Operative expenses.

**CLASSIFY (Examples)**

- Investments accounted for in accordance with Ind-AS 39
- Certain financial instruments previously classified as equity
- Any assets and liabilities that have been offset where the criteria for offsetting in Ind-AS are not met—for example, the offset of an insurance recovery against a provision.
- Noncurrent assets held-for-sale (Ind-AS 5)
- Non-controlling interest (Ind-AS 27)

**MEASURE OR REMEAURE (Examples)**

- Receivables (Ind-AS 18)
- Inventory (Ind-AS 2)
- Employee benefit obligations (Ind-AS 19)
Deferred taxation (Ind-AS 12)
Financial instruments (IndAS 39)
Investment Property (Ind-AS 40)
Property Plant & Equipment (Ind-AS 16)

IND AS 101 – EXEMPTIONS & EXCEPTIONS

General Rule - Retrospective Application

Exceptions to the Retrospective application of other Ind AS - This Ind -AS prohibits retrospective application of some aspects of other Ind-ASs. These exceptions are set out in paragraphs 14-17 - (Estimates) and Appendix B

MANDATORY EXCEPTIONS

1. Estimates: An entity's estimates in accordance with Ind AS at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

In other words, estimates made by the entity in accordance with local GAAP shall not be changed in view of the developments after the transition date.

For example, an entity made provision on 31st March,2015, for Rs. 1 lakh. By the time the entity prepares 1st Ind-AS Financial Statements - the said liability was settled for Rs. 80,000.

How much should the provision be measured at when an entity make in the 1st Ind-As Financial Statement prepared on 1st April, 2011 ?

A.Rs. 80,000 or B. 1,00,000

The Answer is B,

2. Non-controlling Interests: A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind AS:
   (a) Total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
   (b) Accounting for changes in the parent’s ownership interest in a subsidiary that do not result in a loss of control; and
   (c) Accounting for a loss of control over a subsidiary,
3. **Government Loans:** A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32.

**Exception: below market rate Loan**

The requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

Still the entity is not precluded from restating Government Loan retrospectively provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

**VOLUNTARY EXEMPTIONS**

**Exemptions for Business Combinations:** A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS).

However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

**Share-based Payment Transactions:** A first-time adopter is encouraged, but not required, to apply Ind AS 102 ‘Share-based Payment’ to equity instruments that vested before date of transition to Ind AS.

**Deemed Cost:** An entity may elect to measure an item of property, plant and equipment or an intangible asset at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost at that date.

A first-time adopter may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition measured as per the previous GAAP and use that as its deemed cost. This exemption is also applicable to intangible assets and investment property.

**Be careful – This exemption is not available on asset by asset basis – its for all assets.**

**Long-term Foreign Currency Monetary Items:** A first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the
period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

**Investments in Subsidiaries, Joint Ventures and Associates:** When an entity prepares separate financial statements, Ind AS 27 requires it to account for its investments in subsidiaries, joint ventures and associates either:
(a) at cost; or
(b) In accordance with Ind AS 109.

If a first-time adopter measures such an investment at cost in accordance with Ind AS 27, it shall measure that investment at one of the following amounts in its separate opening Ind AS Balance Sheet:
(a) cost determined in accordance with Ind AS 27; or
(b) Deemed cost. The deemed cost of such an investment shall be its:
(i) fair value at the entity's date of transition to Ind AS in its separate financial statements; or
(ii) Previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, joint venture or associate that it elects to measure using a deemed cost.

**Carve Outs in Ind AS 101 from IFRS 1**

(i) **Allowing the use of Carrying Cost of Property, Plant and Equipment (PPE) on the Date of Transition of Ind AS 101.**

*As per IFRS:* IFRS 1 First time adoption of International Accounting Standards provides that on the date of transition either the items of Property, Plant and Equipment shall be determined by applying IAS 16 ‘Property, Plant and Equipment’ retrospectively or the same should be recorded at fair value.

*Carve out:* Ind AS 101 provides an additional option to use carrying values of all items of property, plant and equipment on the date of transition in accordance with previous GAAP as an acceptable starting point under Ind AS.

*Reason:* In case of old companies, retrospective application of Ind AS 16 or fair values at the date of transition to determine deemed cost may not be possible for old assets. Accordingly, Ind AS 101 provides relief to an entity to use carrying values of all items of property, plant and equipment on the date of transition in accordance with previous GAAP as an acceptable starting point under Ind AS.

(ii) **Long-term Foreign Currency Monetary Items**

*As per IFRS:* No provision in IFRS 1.
Carve out: Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Consequently, Ind AS 21 also provides that it does not apply to long-term foreign currency monetary items for which an entity has opted for the exemption given in paragraph D13AA of Appendix D to Ind AS 101. Such an entity may continue to apply the accounting policy so opted for such long-term foreign currency monetary items.

Reason: AS 11 provides an option to recognise long term foreign currency monetary items in the statement of profit and loss as a part of the cost of property, plant and equipment or to defer its recognition in the statement of profit and loss over the period of loan in case the loan is not related to acquisition of fixed assets. To provide transitional relief, such entities have been given an option to continue the capitalisation or deferment of exchange differences, as the case may be, on foreign currency borrowings obtained before the beginning of First IFRS reporting period.
FINANCIAL INSTRUMENTS

IND AS 109, 32 & 107

UNIT - 1

BASIC KNOWLEDGE ABOUT FINANCIAL INSTRUMENTS

Before we proceed for in depth discussion we should understand the basic knowledge of some of the terms, which are as under:

**What is Financial Instrument?**

FI is any contract that gives rise to Financial Assets for One Entity and Financial Liability or Equity for Another Entity.

There can be two types of FI:

- **Primary FI**: such as receivables, payables, loans

- **Derivatives FI**: such as futures, options, forwards, swaps

**What is a Financial Asset?**

A Financial Asset is any asset i.e.

- (a) cash, includes deposits of cash with banks or financial institution
- (b) any equity instrument of another entity (such as investment in equity shares of another entity i.e. BHEL, RIL)
- (c) a contractual right to receive cash or another financial asset from another entity (such as trade receivables, loan receivables, bonds receivables)
- (d) a contractual right to exchange the financial assets or financial liability with another entity under the conditions that are favorable to the entity.
- (e) A contract that will or may be settled in entity's own equity instruments and is - A non-derivative for which the entity is or may be obliged to receive a variable number of entity's own equity instruments; (where shares are used as currency)
- (f) Derivative Contracts

<table>
<thead>
<tr>
<th>ITEMS of ASSETS</th>
<th>FA - Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td></td>
</tr>
</tbody>
</table>
What is Financial Liability?

Financial liability is any liability i.e.
(a) A contractual obligation to deliver cash (such as trade payables, loan liabilities) or to deliver another financial asset to another entity.
(b) A contractual obligation to exchange the financial asset or financial liability with another entity under the conditions which are potentially unfavorable to the entity.
(c) A contract that will or may be settled in entity's own equity instruments and is:
A non-derivative for which the entity is or may be obliged to deliver a variable number of entity's own equity instruments; (a liability which is to be settled in variable no. of own equity shares, which are used as currency)
(d) Derivative Instruments

<table>
<thead>
<tr>
<th>ITEMS of LIABILITIES</th>
<th>FL - Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan Taken</td>
<td></td>
</tr>
<tr>
<td>Creditors/Payables</td>
<td></td>
</tr>
<tr>
<td>Salary Payable</td>
<td></td>
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<tr>
<td>Credit balance of debtors</td>
<td></td>
</tr>
</tbody>
</table>
Illustration 1 (ICAI New Syllabus Module)
A Ltd. (the ‘Company’) makes a borrowing for INR 10 lacs from RBC Bank, with bullet repayment of INR 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay INR 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.
(a) Does the above instrument meet definition of financial liability? Please explain.
(b) Analyse the differential amount to be exchanged for one-time settlement.

Solution:
(a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of financial liability.
(b) Let’s compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year -
- Loan principal amount = Rs. 10,00,000
- Amount payable at the end of 6th year = Rs. 12,54,400 \([10,00,000 \times 1.12 \times 1.12]\) (Interest for 5th & 6th year in default plus principal amount)
- One time settlement = Rs. 13,00,000
- Additional amount payable = Rs. 45,600

The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavorable to A Ltd. (owing to additional amount payable in comparison to amount that would have been paid without one time settlement). Hence, the rescheduled arrangement meets definition of ‘financial liability’.

Illustration 2 (ICAI New Syllabus Module)
Target Ltd. took a borrowing from Z Ltd. for Rs. 10,00,000. Z Ltd. enters into an arrangement with Target Ltd. for settlement of the loan against issue of a certain number of equity shares of Target Ltd. whose value equals Rs. 10,00,000. For this purpose, fair value per share (to determine total number of equity shares to be issued) shall be determined based on the market price of the shares of Target Ltd. at a future date, upon settlement of the contract. Evaluate this under definition of financial instrument.
Solution:
In the above scenario, Target Ltd. is under an obligation to issue variable number of equity shares equal to a total consideration of Rs. 10,00,000. Hence, equity shares are used as currency for purpose of settlement of an amount payable by Target Ltd. Since this is variable number of shares to be issued in a non-derivative contract for fixed amount of cash, it tantamounts to use of equity shares as 'currency' and hence, this contract meets definition of financial liability in books of Target Ltd.

What is Equity? (Fix Payment ki koi obligation nai hoti)
An equity instrument is any contract that evidences a residual interest in the net assets of an entity after deducting all of its liabilities. Equity Holder can-not claim on the company, if he/she can claim he is not equity he is someone else.

The most important characteristic of equity instrument is it does not have contractual obligation.

<table>
<thead>
<tr>
<th>ITEMS</th>
<th>Equity - Yes/No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Share Capital</td>
<td></td>
</tr>
<tr>
<td>Reserves and Surplus</td>
<td></td>
</tr>
<tr>
<td>Redeemable Pref Share Capital</td>
<td></td>
</tr>
<tr>
<td>Irredeemable Pref. Shares</td>
<td></td>
</tr>
<tr>
<td>Perpetual Debt Instruments (Irredeemable)</td>
<td></td>
</tr>
<tr>
<td>100% Compulsorily Convertible Debentures</td>
<td></td>
</tr>
<tr>
<td>Convertible Debentures at the option of Holder</td>
<td></td>
</tr>
<tr>
<td>Share Warrants</td>
<td></td>
</tr>
<tr>
<td>Convertible Debentures at the option of Issuer</td>
<td></td>
</tr>
</tbody>
</table>
Equity comprises of:
(a) Non-puttable equity shares issued by entity (No obligation to redeem)
(b) Instruments which are convertible in fixed no. of equity shares (Fixed for Fixed)
(c) Puttable instruments subject to fulfillment of certain conditions.

Exclusion from scope of IndAS 109 although following items may be in the nature of financial assets and financial liabilities:
1. Share based payments (IndAS 102)
2. Employee Benefits payable (IndAS 19)
3. Rights/Obligations arising under construction contracts (IndAS 11/18/115)
4. Contracts of Insurance (IndAS 104)
5. Contracts under Business Combinations (IndAS 103)
6. Contingent Liabilities and Contingent Assets (IndAS 37)
## Settlement in own equity shares of entity:

<table>
<thead>
<tr>
<th>Consideration for financial instrument</th>
<th>No. of own equity shares to be issue in settlement</th>
<th>Classification with reason</th>
</tr>
</thead>
</table>
| Fixed                                  | Fixed                                             | **Equity** - Neither issuer has any obligation to pay cash nor holder is exposed to any variability.  
                                |                                                   | **It is called Fixed for Fixed Test.** |
| Fixed                                  | Variable (equity shares will be issue at the fair value prevailing at the time of redemption) | **Financial Liability** - Issuer has obligation to provide variable equity shares i.e. equity instruments are being used as currency for settlement |
| Variable                               | Fixed                                             | **Financial Liability** - issuer does not have any obligation to pay cash but holder is exposed to variability. |
| Variable                               | Variable                                          | **Financial Liability** - both parties are exposed to variability and equity shares are being used as currency. |

### Illustration: 3 (ICAI)

DF Ltd. issues convertible debentures to JL Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into 15 crore equity shares of Rs. 10 each.

*Examine the nature of the financial instrument.*

**Answer:** This contract is an equity instrument because changes in the fair value of equity shares arising from market related factors do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered.

### Illustration: 4 (ICAI)

CBA Ltd. issues convertible debentures to RQP Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into equity shares of CBA Ltd at a fair value at the time of redemption.
Examine the nature of the financial instrument.

**Answer:** Such a contract is a financial liability of the entity even though the entity can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. The underlying thought behind this conclusion is that the entity is using its own equity instruments 'as currency'.

**PUTTABLE INSTRUMENTS:**
In a simple term - puttable instrument means redeemable equity shares.

Puttable instrument is a financial instrument that gives the holder:

- the right to put the instrument back to the issuer for cash or another financial asset, or
- is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder

Put back means redemption. Therefore, puttable instruments are 'financial liabilities'.

**Exception** - Puttable Instruments are not financial liability but equity instruments if they fulfill all the following conditions:

1. It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. Providing pro rata share means providing residual interest in the net assets of any entity. It should be exact pro rata neither lower nor higher.

   **Example:** 1
   
   *ABC Ltd. has two classes of puttable shares - Class A shares and Class B shares. On liquidation, Class B shareholders are entitled to a pro rata share of the entity's residual assets up to a maximum of Rs. 10,000,000.*
   
   *There is no limit to the rights of the Class A shareholders to share in the residual assets on liquidation. Examine the nature of the financial instrument.*
   
   The cap of Rs. 10,000,000 means that Class B shares do not have entitlement to a pro rata share of the residual assets of the entity on liquidation. They cannot therefore be classified as equity.

2. If it is sub-ordinate to all other classes of instruments. That means it has no priority over other claims to the net assets. These instruments are rank last for the repayment in the event of liquidation.

3. They should have **Identical features** in the entire class of puttable instruments

4. Holders of puttable instruments should have **no other contractual right** to receive cash or entity's own equity in **variable numbers** that could satisfy the
5. **Return** on puttable instruments (Expected cash flows attributable to the instruments) should only be based on - *Profit/Loss, change in Net assets and change in the fair value of net assets* and not any other factor other than these three. For example if return is based on index price then such instrument is not equity.

**Executory Contracts are outside the scope of IndAS 109:**

- Contracts to buy or sell non-financial assets/items for **self-consumption** are not Financial Instruments.
- Contracts to buy or sell non-financial assets/items and to be settled **net in cash** are financial instruments (Derivative contracts), i.e. contracts without any physical delivery of Non-Financial items/assets.
- Contracts between the parties where objective it to **take quick delivery and quickly resell it** may also be derivative contracts hence they may be financial instruments.

**Example:**

ABC Ltd. enters into a contract to buy 100 tonnes of cocoa beans at 1,000 per tonne for delivery in 12 months. On the settlement date, the market price for cocoa beans is 1,500 per tonne. If the contract cannot be settled net in cash and this contract is entered for delivery of cocoa beans in line with ABC Ltd.’s expected purchase/usage requirements, then own-use exemption applies. In such case, the contract is considered to be an executory contract outside the scope of Ind AS 109 and hence, shall not be accounted as a derivative.

*If the contract can be settled in net cash then it will become Derivative contract and treated as Financial Asset or Liability.*
### PRESENTATION IN BALANCE SHEET

**Division –II (IndAS Based Entities)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Note no.</th>
<th>CY</th>
<th>PY</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Assets</td>
<td></td>
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<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Property, plant and equipment</td>
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<tr>
<td>(b) Capital work-in-progress</td>
<td></td>
<td></td>
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<tr>
<td>(c) Investment property</td>
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<tr>
<td>(d) Goodwill</td>
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<tr>
<td>(e) Other intangible assets</td>
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<tr>
<td>(f) Intangible assets under development</td>
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<tr>
<td>(g) Biological assets other than bearer plant</td>
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<td></td>
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<tr>
<td>(h) Financial assets</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(i) Investment</td>
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<tr>
<td>(ii) Trade receivable</td>
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<td></td>
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<tr>
<td>(iii) Loan</td>
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<td></td>
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<tr>
<td>(i) Deferred tax assets (net)</td>
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<tr>
<td>(j) Other non-current assets</td>
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<tr>
<td>(2) Current assets:</td>
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<td></td>
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<tr>
<td>(a) Investment</td>
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<tr>
<td>(b) Financial assets</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>i. Investments</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>ii. Trade receivable</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>iii. Cash and cash equivalents</td>
<td></td>
<td></td>
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<tr>
<td>iv. Bank balance other than (iii) above</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>v. Loans</td>
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<td></td>
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<tr>
<td>vi. Others (to be specified)</td>
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<tr>
<td>(c) Current Tax Assets (Net)</td>
<td></td>
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<tr>
<td>(d) Other current assets</td>
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<td></td>
<td></td>
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<tr>
<td>Total Assets</td>
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<td></td>
<td></td>
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<tr>
<td>Equity and Liabilities</td>
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<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>(a) Equity share capital</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>(b) Other equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For Doubts – 7887 7887 05 (Whatsapp)
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
</table>
| (a) Financial liabilities | i. Borrowings  
| | ii. Trade payables  
| | iii. Other financial liabilities (other than those specified in item (b) to be specified) |
| (b) Provisions | (c) Deferred tax liabilities (net)  
| | (d) Other non-current liabilities |
| Current liabilities | (a) Financial liabilities  
| | i. Borrowings  
| | ii. Trade payables  
| | iii. Other financial liabilities (other than those specified in item (c), to be specified) |
| (b) Other current liabilities | (c) Provisions |
| | (d) Current tax liabilities (Net) |

Total Equity and liabilities
UNIT - 2

RECOGNITION & MEASUREMENT OF FINANCIAL INSTRUMENTS

INITIAL RECOGNITION

Initial Recognition means - First Time Recording in the books of accounts.

Financial Assets – Initial Recognition at Fair Value

(a) Amortised Cost - at Fair Value +/- Transaction Cost
(b) Fair Value through OCI (FVTOCI) - at Fair Value +/- Transaction Cost
(c) Fair Value through P&L (FVTPL) - at Fair value (transaction cost is to be charged to P&L a/c directly)

Financial Liabilities – Initial Recognition at Fair Value

(a) Amortised Cost - at Fair Value +/- Transaction Cost
(b) Fair Value through P&L (FVTPL) - at Fair value (transaction cost is to be charged to P&L a/c directly)

Equity –
Since it is a residual interest in the net assets of the company therefore it is recognised at Residual Value not fair value.

SUBSEQUENT RECOGNITION

Subsequent Recognition means - Measurement at Balance Sheet date (reporting date)

Financial Assets

Financial Assets are classified into 3 categories for the accounting purpose:

(i) Amortised cost
(ii) Fair value through Other Comprehensive Income (FVTOCI)
(iii) Fair value through Profit & Loss (FVTPL)

The above classification will be based on entity’s "Business Model" for managing the
financial assets.

The classification will be made as under:

(a) **Financial assets measured at Amortised Cost -**
   - If the business model is such that the objective is to hold such asset till maturity date and earn contractual cash flows entirely.
   - Such asset can generate INTEREST INCOME only on the instruments. (i.e. not able to sell and earn other income like capital gain)
   - And the instrument generates cash flows only from INTEREST & PRINCIPAL on SPECIFIED DATES
     eg. FD, LIC, Debentures redeemable in cash, staff advances, Govt. Securities and Bonds.

   **Initial Recognition:** If the above three conditions are satisfied then financial asset will be measured at fair value i.e. amortised cost (PV of future cash flows at ERI) after considering any initial transaction cost.

   **Subsequent Recognition:**
   1. Income shall be recorded in the profit and loss statement always.
   2. At Balance sheet date such Financial Asset is required to be measured at Present value of agreed contractual cash flows calculated using "Effective Rate of Interest" (IRR)

(b) **Financial assets measured at Fair Value Through OCI (FVTOCI)-**
   - If the business model of an entity is such that the objective is **not to hold till maturity date** but to sell such instruments in the market or having no maturity;
   - Such Asset can generate INTEREST as well as OTHER INCOME (such as capital gain) from the sale of instrument;
   - And the instrument generates PRINCIPAL & INTEREST on SPECIFIED DATES.
     Then the financial asset will be measured at FVTOCI eg. Listed company's debentures, irredeemable instruments etc

   **Initial Recognition:** Financial asset under FVTOCI will be measured at fair value after considering any initial transaction cost. (FV +/- Transaction Cost)

   **Subsequent Recognition:**
   1. Regular (specified) Income shall be recorded in the profit and loss statement
always.

2. At Balance sheet date such Financial Asset is required to be measured at Fair Value (market value) and \textit{any changes in carrying amount due to fair valuation will be accumulated in OCI}. (since it is unrealized gain or loss)

3. On derecognition of FA under this category, accumulated balance in OCI in respect of such FA shall be recycle (transfer) to P&L a/c. (it means it becomes realised gain/loss)

\textbf{(c) Financial assets measured at Fair Value through P&L (FVTPL)-}

This is a residual category and the financial assets falls under this category are generally those assets whose contractual cash flows are not fixed and they does not generate cash flows on specified dates such as \textit{Investments in equity shares of other companies}.

eg. Equity shares (except not held for trading), derivatives.

\textbf{Initial Recognition:} Financial asset under FVTPL will be measured at fair value only. Transaction cost shall always be transfer to Profit and loss a/c immediately.

\textbf{Subsequent Recognition:}

1. Regular Income shall be recorded in the profit and loss statement always.

2. At Balance sheet date such Financial Asset is required to be measured at Fair Value (market value) and \textit{any changes in carrying amount due to fair valuation will be recognised in P&L A/c}.

\textbf{Example:} We bought share of Infosys Ltd. at Rs.2100. Transaction cost is Rs.2. On quarter end FV of shares is Rs.2250. These shares are designated as FVTPL (held for trading)

\textbf{Answer:} Day-1 Investment in shares Dr. 2100

\begin{align*}
\text{Transaction cost (P&L) Dr.} & \quad 2 \\
\text{To Bank A/c} & \quad 2102 \\
\end{align*}

Quarter end -

\begin{align*}
\text{Investment in shares Dr.} & \quad 150 \\
\text{To Fair value gain (P&L)} & \quad 150 \\
\end{align*}

Now suppose if we sell these shares at Rs.2500 and transaction cost is Rs.3

\begin{align*}
\text{Bank Dr.} & \quad 2500 \\
\end{align*}
To investment in shares A/c 2250
To P&L (Gain) A/c 250

Transaction cost (P&L) A/c 3
To Bank A/c 3

**Exception:**

Equity Instruments are generally *Held for Trading*. However if equity instruments are not held for Trading then there is an option that Equity instruments (not held for trading) may be designated as FVTOCI.

Is equity instrument (FA) held for trading? If Yes :-then FVTPL always.

If No:- there is an option to designate it to FVTOCI instead of FVTPL (it means holder may opt to categorize under FVTOCI)

**NOTE:** If the option of FVTOCI is selected for equity shares not held for trading, then any resulting gain/loss on REVALUATION (subsequent recognition) will be transferred to OCI and NO RECYCLING to P&L is permissible and this option is IRREVOCABLE. On sale of such option, it will also be reflected in OCI and not P&L.

**Example:** We bought shares of Infosys at Rs.2100. Transaction cost is Rs.2. On quarter end FV of shares is Rs.2250. These shares are designated as FVTOCI, not held for trading.

**Answer:** Day-1 Investment in shares Dr. 2102
    To Bank A/c 2102

Quarter end -

Investment in shares Dr. 148
    To OCI 148

Now suppose if we sell these shares at Rs.2500 and transaction cost is Rs.3
Bank Dr. 2497

To investment in shares A/c 2250
    To OCI A/c 247
Q1: A Ltd. has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit. Assume market interest rate for a deposit for similar period to be 12% per annum.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Security Deposit (Starting date)</td>
<td>1/4/X1</td>
</tr>
<tr>
<td>Date of Security deposit (finishing date)</td>
<td>31/03/X6</td>
</tr>
<tr>
<td>Description</td>
<td>Leases</td>
</tr>
<tr>
<td>Total Lease Period</td>
<td>5</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>12%</td>
</tr>
<tr>
<td>Security Deposit (A)</td>
<td>10,00,000</td>
</tr>
<tr>
<td>PV of the deposit at beginning (B)</td>
<td>5,67,427</td>
</tr>
<tr>
<td>Prepaid lease payment at beginning (A-B)</td>
<td>4,32,573</td>
</tr>
</tbody>
</table>

Solution: The above security deposit is an interest free deposit redeemable at the end of lease term for Rs. 1000000. Hence this involves collection of contractual cash flows at specified date and not able to sale in the market hence will be categorized under “Amortised Cost”.

Journal Entry:
At beg.

Security Deposit a/c Dr. 5,67,427
Prepaid Lease Exp A/c Dr. 4,32,573
To Bank A/c 10,00,000

At the end of 1st Year:

Security deposit a/c Dr. 68,091
To Interest income a/c 68,091

Prepaid lease expense shall be amortised over the life of lease term on SLM basis unless any other approach is reasonable.

Rent Expense a/c Dr. 86,515
To Prepaid Expense a/c 86,515

Q2: (Staff Welfare)
XYZ Ltd. Grants loans to its employees at 4% amounting to Rs. 10,00,000 at the beginning of 2015-2016. The principal amount is repaid over a period of 5 years whereas the accounted interest computed on reducing balance at simple interest is collected in 2 equal annual instalments after collection of the principal amount.
Assume the benchmark interest rate is 8%.
Show the accounting entries on 1.4.2015 and 31.3.2016.
Solution:
<table>
<thead>
<tr>
<th>Year</th>
<th>CCF</th>
<th>PV @ 8%</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>15-16</td>
<td>2,00,000</td>
<td>185185</td>
<td>Principle</td>
</tr>
<tr>
<td>16-17</td>
<td>2,00,000</td>
<td>171467</td>
<td>Principle</td>
</tr>
<tr>
<td>17-18</td>
<td>2,00,000</td>
<td>158766</td>
<td>Principle</td>
</tr>
<tr>
<td>18-19</td>
<td>2,00,000</td>
<td>147006</td>
<td>Principle</td>
</tr>
<tr>
<td>19-20</td>
<td>2,00,000</td>
<td>136118</td>
<td>Principle</td>
</tr>
<tr>
<td>20-21</td>
<td>60,000</td>
<td>37810</td>
<td>Interest</td>
</tr>
<tr>
<td>21-22</td>
<td>60,000</td>
<td>35010</td>
<td>Interest</td>
</tr>
<tr>
<td>Financial Asset (at the beginning)</td>
<td></td>
<td><strong>8,71,362</strong></td>
<td></td>
</tr>
</tbody>
</table>

Employee Expenses = 10,00,000 - 8,71,362 = 1,28,638/

Finance charges for 1st Year = 871362 x 8% = 69,709/

U can calculate subsequent finance charges (income) on the balance outstanding balance accordingly.
### SUBSEQUENT RECOGNITION

**FINANCIAL LIABILITY**

Under IND-AS 109, Financial Liabilities are classified into 2 categories i.e.

1. Amortised cost (Default category)
2. FVTPL (Fair value to P&L)

(a) **Amortised Cost:**

Accounting treatment of financial liability which can be measured at amortised cost:

- For the purpose of accounting, we need EFFECTIVE INTEREST RATE (i.e. IRR) for the financial liability measured at amortised cost.
- The effective interest rate will be given in the question or we need to calculate interest by interpolation technique.

**TYPES OF FINANCIAL LIABILITY UNDER AMORTISED COST:**

- Compound FI
- Non compound FI

**Amortised Cost - COMPOUND FINANCIAL INSTRUMENT**

Compound Financial Instruments are those instruments which are having features of both equity as well as financial liability.

**Modification in Financial Instruments (Early settlement/late settlement):**

Modification may rise to - Change in ERI, Change in Service Period, Change in repayment terms like contractual interest rate or principle repayment or change in Fair value of instruments. Following steps are to be followed:

**Step 1** - Determine the carrying values of Financial Assets/Liability and Equity as on Modification date.

**Step 2** - Calculate Revised values of FA/FL and Equity on modification as per revised terms such as revised ERI, revised period, revised CCF and revised Fair Values etc.

Note: If revised ERI is not given but as per question's information it shows that ERI should be revised then we have to calculate IRR

**Step 3** - Difference between Revised values of FA/FL/Equity and Carrying values of the same shall be treated as under -

Difference in FA/FL shall be transferred to Profit and Loss a/c (Gain or Loss)
Difference in Equity shall be transferred to Other Equity (SOCE)

Step 4 - Settle the amount of FA/FL or Equity as per the question's requirement

(b)Fair Value through Profit and Loss (FVTPL):
Financial liability are measured at FVTPL when they are held for trading. A financial liability is held for trading when it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or when it is a derivative. (except a derivative of hedging in the nature of Cash Flow)

Q3: (Non-Compound Instruments)
B Ltd issued on 1-4-2008 9% Debentures whose face value is Rs. 20,00,000 at discount of 5%. Company is to redeem 50% Debentures on 31-3-2011 at 7% premium and balance will be redeemed on 31-3-2013 at 10% premium. On 31-3-2012 Rs. 20,000 will be distributed as cash bonus to debenture holders. Prepare Debentures. A/c
Ans. 12.66%

Q4: (Compound Instruments)
B Ltd issued 9% Compulsory Convertible Debentures of Rs.7,00,000 at 10% discount on 1-4-2008 convertible on 31-3-2011. These are to be redeemed at 10% Premium. Interest Rate on Non-Convertible Debentures is 13%. Calculate Debt and Equity.
(Answer: Fin. Liab.: Rs. 148743; Equity: Rs. 481257)

Q5: (Compound Instruments)
Mega Ltd. issued Rs. 100,00,000 worth of 8% Debentures of face value Rs100/- each on par value basis on 1st Jan, 2011. These debentures are redeemable at 12% premium at the end of 2014 or exchangeable for Ordinary shares of Mega Ltd. on 1:1 basis. The interest rate for similar debentures that do not carry conversion entitlement is 12%. You are required to calculate the value of the debt position of the above compound financial instrument. The Present value of the rupee at the end of years 1 to 4 at 8% and 12% are supplied to you as:

<table>
<thead>
<tr>
<th></th>
<th>8%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of year 1</td>
<td>0.926</td>
<td>0.893</td>
</tr>
<tr>
<td>End of year 2</td>
<td>0.857</td>
<td>0.797</td>
</tr>
</tbody>
</table>

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Q6: (Compound Instrument)
On 1st April, 2008 Sigma Ltd. issued 6% Convertible debentures of face value of Rs.100 per debenture at par. The debentures are redeemable at a premium of 10% on 31-03-2012 or these may be converted into ordinary shares at the option of the holder, the interest rate for equivalent debentures without conversion rights would have been 10%, Being a compound financial instrument you are required to separate equity and debt portion (Debenture amount). The present value is Rs.1,85,400 for equity portion. Find out the debt portion (Debenture amount). The present value of Rs. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

<table>
<thead>
<tr>
<th>End of Year</th>
<th>6%</th>
<th>10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.94</td>
<td>0.91</td>
</tr>
<tr>
<td>2</td>
<td>0.89</td>
<td>0.83</td>
</tr>
<tr>
<td>3</td>
<td>0.84</td>
<td>0.75</td>
</tr>
<tr>
<td>4</td>
<td>0.79</td>
<td>0.68</td>
</tr>
</tbody>
</table>

(Answer: FL – 2814600; No. of Debentures = 30,000)

Q7: (RTP – May 18) (Compound Instruments – Modification)
On 1st April, 20X4, Shelter Ltd. issued 5,000, 8% convertible debentures with a face value of Rs 100 each maturing on 31st March, 20X9. The debentures are convertible into equity shares of Shelter Ltd. at a conversion price of Rs 105 per share. Interest is payable annually in cash. At the date of issue, Shelter Ltd. could have issued non-convertible debt with a 5 year term bearing a coupon interest rate of 12%. On 1st April, 20X7, the convertible debentures have a fair value of Rs 5,25,000. Shelter Ltd. makes a tender offer to debenture holders to repurchase the debentures for Rs 5,25,000, which the holders accepted. At the date of repurchase, Shelter Ltd. could have issued non-convertible debt with a 2 year term bearing a coupon interest rate of 9%.

Show accounting entries in the books of Shelter Ltd. for recording of equity and liability component:
(i) At the time of initial recognition and
(ii) At the time of repurchase of the convertible debentures.

The following present values of Rs. 1 at 8%, 9% & 12% are supplied to you:

<table>
<thead>
<tr>
<th>Interest Rate</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>8%</td>
<td>0.926</td>
<td>0.857</td>
<td>0.794</td>
<td>0.735</td>
<td>0.681</td>
</tr>
<tr>
<td>9%</td>
<td>0.917</td>
<td>0.842</td>
<td>0.772</td>
<td>0.708</td>
<td>0.650</td>
</tr>
</tbody>
</table>
SOLUTION:

(i) At the time of initial recognition

<table>
<thead>
<tr>
<th>Liability component</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value of 5 yearly interest payments of Rs 40,000, discounted at 12% annuity (40,000 x 3.605)</td>
<td>1,44,200</td>
</tr>
<tr>
<td>Present value of Rs 5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)</td>
<td>4,27,700</td>
</tr>
</tbody>
</table>

| Equity component | 72,300 |
| (Rs 5,00,000 - Rs 4,27,700) |         |
| **Total proceed** | 5,00,000 |

**Note:** Since Rs 105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs 100 each only.

<table>
<thead>
<tr>
<th>Journal Entry</th>
<th>Rs</th>
<th>Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Dr.</td>
<td>5,00,000</td>
<td>4,27,700</td>
</tr>
<tr>
<td>To 8% Debentures (Liability component)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>To 8% Debentures (Equity component)</td>
<td>72,300</td>
<td></td>
</tr>
<tr>
<td>(Being Debentures are initially recorded a fair value)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(ii) At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

<table>
<thead>
<tr>
<th>Carrying Value @ 12%</th>
<th>Fair Value @ 9%</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs</td>
<td>Rs</td>
</tr>
<tr>
<td>Liability component</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of 2 remaining yearly interest payments of ` 40,000, discounted at 12% and 9%, respectively</td>
<td>67,600</td>
<td>70,360</td>
</tr>
<tr>
<td>Present value of Rs 5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively</td>
<td>3,98,500</td>
<td>4,21,000</td>
</tr>
<tr>
<td><strong>Liability component</strong></td>
<td>4,66,100</td>
<td>4,91,360</td>
</tr>
<tr>
<td><strong>Equity component</strong></td>
<td>72,300</td>
<td>33,640*</td>
</tr>
</tbody>
</table>
(5,25,000 - 4,91,360) = 33,640
*(5,25,000 - 4,91,360) = 33,640

### Journal Entries

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>8% Debentures (Liability component) Dr. Profit and loss A/c (Debt settlement expense) Dr. To Bank A/c (Being the repurchase of the liability component recognised)</td>
<td>4,66,100</td>
<td>25,260</td>
</tr>
<tr>
<td>To Bank A/c (Being the repurchase of the liability component recognised)</td>
<td>4,91,360</td>
<td></td>
</tr>
<tr>
<td>8% Debentures (Equity component) Dr. To Bank A/c To Reserves and Surplus A/c (Being the cash paid for the equity component recognised)</td>
<td>72,300</td>
<td>33,640</td>
</tr>
<tr>
<td>To Reserves and Surplus A/c (Being the cash paid for the equity component recognised)</td>
<td>38,660</td>
<td></td>
</tr>
</tbody>
</table>

Q8: (Exam - May 18 - 8 Marks) (Loan by Holding to its Subsidiary at concessional rate)

S Limited issued redeemable preference share to its Holding Company - H Limited. The terms of the instruments have been summarized below. Analyse the given situation supplying the guidance in Ind AS 109 ‘Financial Instruments’, and account for this in the books of H Limited.

<table>
<thead>
<tr>
<th>Nature</th>
<th>Non-cumulative redeemable preference shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Re</td>
<td>Redeemable after 3 years</td>
</tr>
<tr>
<td>D</td>
<td>1st April 2015</td>
</tr>
<tr>
<td>Date of Allotment</td>
<td>31st March 2018</td>
</tr>
<tr>
<td>Total Period</td>
<td>3 Years</td>
</tr>
<tr>
<td>Value of Preference Shares issued</td>
<td>5,00,00,000</td>
</tr>
<tr>
<td>Dividend Rate</td>
<td>0.0001% Per Annum</td>
</tr>
<tr>
<td>Market rate of interest</td>
<td>12% per Annum</td>
</tr>
<tr>
<td>Present value factor</td>
<td>0.7118</td>
</tr>
</tbody>
</table>

Solution:

1. **Analysis of the financial instrument issued by S Ltd. to its holding company H Ltd.**

Applying the guidance in Ind AS 109, a ‘financial asset’ shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (i.e., different from market terms for a similar instrument if exchanged between market participants).
For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since S Ltd has issued preference shares to its Holding Company– H Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by H Ltd. in its subsidiary. This can further be substantiated by the nominal rate of dividend i.e. 0.0001% mentioned in the terms of the instrument issued.

**Computation on Initial Recognition:**

<table>
<thead>
<tr>
<th>Transaction Value of redeemable Pref Shares</th>
<th>5,00,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Present value of loan component @ 12% (5,00,00,000 x 0.7118)</td>
<td>(3,55,90,000)</td>
</tr>
<tr>
<td><strong>Investment in Subsidiary</strong></td>
<td>1,44,10,000</td>
</tr>
</tbody>
</table>

Subsequently, such preference shares shall be carried at amortised cost at each reporting date as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Date</th>
<th>Opening Bal.</th>
<th>Interest</th>
<th>Closing Bal.</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/04/2015</td>
<td>3,55,90,000</td>
<td>-</td>
<td>3,55,90,000</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>31/03/2016</td>
<td>3,55,90,000</td>
<td>42,70,800</td>
<td>3,98,60,800</td>
</tr>
<tr>
<td>2</td>
<td>31/03/2017</td>
<td>3,98,60,800</td>
<td>47,83,296</td>
<td>4,46,44,096</td>
</tr>
<tr>
<td>3</td>
<td>31/03/2018</td>
<td>4,46,44,096</td>
<td>53,55,904**</td>
<td>5,00,00,000</td>
</tr>
</tbody>
</table>

** Last year's Interest is taken balancing figure due to rounding off error.

Q9: (Modification) (ICAI New Syllabus Module)

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs 1,00,000, bearing interest at 10% (payable on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs 1,000,000. No costs or fees are incurred. The effective interest rate is therefore 10%. On 1 January 20X5 (i.e. after 5 years) XYZ Ltd. and the bondholders agree to a modification in accordance with which: no further interest payments are made.

The bonds are redeemed on the original due date (31 December 20X9) for Rs 1,600,000; LEGAL fees will be 50,000 on the date of modification.
Q10: (Modification) (ICAI New Syllabus Module)
JK Ltd. has an outstanding unsecured loan of Rs 90 crores to a bank. The effective interest rate (EIR) of this loan is 10% Owing to financial difficulties; JK Ltd. is unable to service the debt and approaches the bank for a settlement.

The bank offers the following terms which are accepted by JK Ltd.

- 2/3rd of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is Rs 80 crores.
- 1/3rd of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is Rs 25 crores. The fair value of the cash flows as per these revised terms is Rs 28 crores.

(Answer: 6 Cr. Gain on modification charged to Profit and Loss a/c)

Q11: (Conversion into Equity) (ICAI New Syllabus Module)
ABC Ltd. issued convertible debentures (at the option of holder) amounting to Rs. 100 Lacs. As per the terms of the issue it has been agreed to issue equity shares amounting to Rs. 150 lacs to redeem the debentures at the end of 3rd year. Assume the companies market yield is 10% for Initial year and year 1 end, and 10.5% for year 2 end. Show accounting entries.

Solution:
Value of Debentures (Financial Liability) to be recorded initially:
PV of Rs. 150 lacs at 10% (at the end of 3rd year) = \(150 \times 0.7513\) = Rs. 1,12,69,500
Difference between current initial inflow and value of FL is = 1,269,500 to be transfer to profit and loss a/c

Q12: FVTOCI (ICAI New Syllabus Module)
A Ltd. invested in equity shares of C Ltd. on 15th March for Rs 10,000. Transaction costs were Rs 500 in addition to the basic cost of Rs 10,000. On 31 March, the fair value of the equity shares was Rs 11,200 and market rate of interest is 10% per annum for a 10 year loan. Pass necessary journal entries. Analyse the measurement principle and pass necessary journal entries.
Solution:
The above investment is in equity shares of C Ltd and hence, does not involve any contractual cash flows that are solely payments of principal and interest. Hence, these equity shares shall be measured at fair value through profit or loss. Also, an irrecoverable option exists to designate such investment as fair value through other comprehensive income.

<table>
<thead>
<tr>
<th>Journal Entries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Particulars</strong></td>
</tr>
<tr>
<td>Upon initial recognition -</td>
</tr>
<tr>
<td>Investment in equity shares of C Ltd. Dr.</td>
</tr>
<tr>
<td>To Bank a/c</td>
</tr>
<tr>
<td>(Being investment recognized at fair value plus transaction costs upon initial recognition)</td>
</tr>
<tr>
<td>Subsequently -</td>
</tr>
<tr>
<td>Investment in equity shares of C Ltd. Dr.</td>
</tr>
<tr>
<td>To Fair value gain on financial instruments</td>
</tr>
<tr>
<td>(Being fair value gain recognized at year end in P&amp;L)</td>
</tr>
</tbody>
</table>
MISCELLANEOUS PROVISIONS OF INDAS 109/32

(A)

TRADE DATE ACCOUNTING VS. SETTLEMENT DATE ACCOUNTING

1. Entity may choose either Trade date accounting or Settlement date accounting for Financial Instruments.
2. Trade date accounting - FA/FL shall be recorded on agreement date itself although the transaction is yet to be settled in future.
3. Settlement date accounting - FA/FL shall be recorded on final settlement date only and ignoring trade date.
4. On Balance sheet date, while measuring asset/liability at fair value -
   • Trade date accounting - FA/FL shall be increased/decreased accordingly
   • Settlement date accounting - Changes in Fair value of FA/FL shall be recorded only without recording any FA/FL
5. The most important thing to understand is whether we are following Trade date accounting or settlement date accounting, FA/FL shall be shown at Fair Value on Settlement date.

Refer Q17

(B)

TREASURY SHARES - (BUYBACK OF EQUITY SHARES)

If an entity reacquires its own equity instruments:
- Consideration paid for those instruments ('treasury shares') shall be deducted from equity. An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired.
- Consideration received shall be recognised directly in equity.
- No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments

(C)

BUYBACK OPTION OR WRITTEN PUT OPTION OR OBLIGATION TO PURCHASE OWN EQUITY:

- Such contracts are puttable instruments and are treated as Financial Liability.
- If an entity announces written put option for such instrument which was earlier classified under equity, then this will rise to reclassification from equity to financial liability at PV of redemption amount.
- Any option premium collected by entity on written put option shall be directly recognised in equity not in P&L a/c
- At the time of exercise of option by holder the financial liability is paid off if the option is exercised otherwise it is again reclassified to equity if option is not exercised.

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Following journal entries may be passed:

(a) On receipt of option premium:
   Bank a/c   Dr.
   To Option premium (Equity) a/c

(b) On transfer of equity to financial liability on the date of option agreement
   Equity a/c   Dr.
   To Financial Liability a/c  (Re-measurement)

(c) On recognition of Interest/Finance charges every year on above financial liability
   Interest (P&L) a/c   Dr.
   To Financial Liability a/c

(d) On Settlement date:
   If option is exercised —
   Financial Liability a/c   Dr.
   To Bank a/c

   If option is not exercised —
   Financial Liability a/c   Dr.
   To Equity a/c

(D) RECLASSIFICATION FROM EQUITY TO FL OR FL TO EQUITY
Example, if an entity redeems all its issued non-puttable instruments and any puttable instrument that remain outstanding have all the features and meet all the conditions mentioned above, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

<table>
<thead>
<tr>
<th>Reclassification From</th>
<th>Reclassification to</th>
<th>Measurement</th>
<th>Recognition of Diff. in CA &amp; Measurement of instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Liability</td>
<td>Equity</td>
<td>Same amount (i.e. Carrying value on the date of reclassification)</td>
<td>NA (holder avails the option of conversion into equity)</td>
</tr>
<tr>
<td>Equity</td>
<td>Financial liability</td>
<td>Fair Value at the date of reclassification (eg. PV of CCF at</td>
<td>In Equity (not in Profit and Loss account)</td>
</tr>
</tbody>
</table>

For Doubts – 7887 7887 05 (Whatsapp)
(E) RECLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Reclassification of Financial Liability is not allowed. Reclassification of Financial Assets is possible only when entity changes its Business Model:

Case 1: Amortised cost to FVTPL - It is measured at fair value on reclassification date.
   - Any gain or loss arising from difference between the previous amortised cost of the financial asset and fair value is recognised in profit or loss.

Example 1:
Bonds for Rs 1,00,000 reclassified as FVTPL. Fair value on reclassification is Rs 90,000. Pass the required journal entry.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds at FVTPL Dr.</td>
<td>90,000</td>
<td></td>
</tr>
<tr>
<td>Loss on reclassification Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Bonds at amortised cost</td>
<td>1,00,000</td>
<td></td>
</tr>
</tbody>
</table>

Case 2: Amortised cost to FVOCI - It is measured at fair value on reclassification date.
   - Any gain or loss arising from difference between the previous amortised cost of the financial asset and fair value is recognised in other comprehensive income.
   - Effective interest rate and measurement of expected credit losses are not adjusted as a result of reclassification.

Example 2:
Bonds for Rs 1,00,000 reclassified as FVOCI. Fair value on reclassification is Rs 90,000. Pass the required journal entry.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds at FVOCI Dr.</td>
<td>90,000</td>
<td></td>
</tr>
<tr>
<td>OCI (Loss on reclassification) Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Bonds at amortised cost</td>
<td>1,00,000</td>
<td></td>
</tr>
</tbody>
</table>

Case 3: FVTPL to Amortised cost
   - It is measured at fair value on reclassification date and this fair value becomes the new gross carrying amount. Effective interest rate is computed based on this new gross carrying amount.
Any gain or loss arising from difference between the previous amortised cost of the financial asset and fair value is recognised in profit or loss.

Example 3:
Bonds for Rs 100,000 reclassified as Amortised cost. Fair value on reclassification is Rs 90,000. Pass the required journal entry.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds at Amortised cost Dr.</td>
<td>90,000</td>
<td></td>
</tr>
<tr>
<td>Loss on reclassification Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Bonds at FVTPL</td>
<td></td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

Case 4: FVTPL to FVOCI
- The financial asset continues to be measured at fair value.
- The effective interest rate is determined on the basis of fair value of asset at reclassification date.

Example 4:
Bonds for Rs 100,000 reclassified as FVOCI. Fair value on reclassification is Rs 90,000. Pass the required journal entry.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds at FVOCI</td>
<td>90,000</td>
<td></td>
</tr>
<tr>
<td>Loss on reclassification Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Bonds at FVTPL</td>
<td></td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

Case 5: FVOCI to Amortised cost
- The financial asset is measured at fair value on reclassification date.
- However, cumulative gain or loss previously recognised in other comprehensive income (OCI) is removed from equity and adjusted against fair value of financial asset at reclassification date.
- As a result, the financial asset is measured at reclassification date as if it had always been measured at amortised cost. This adjustment affects OCI but does not affect profit or loss and therefore, is not a reclassification adjustment.
- Effective interest rate and measurement of expected credit losses are not adjusted as a result of reclassification.

Example 5:
Bonds for Rs 100,000 reclassified as Amortised cost. Fair value on reclassification is Rs 90,000 and Rs 10,000 loss was recognised in OCI till date of reclassification. Pass required journal entry.
Solution

<table>
<thead>
<tr>
<th>ACCOUNTING AND REPORTING OF FINANCIAL INSTRUMENT SSolution</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Particulars</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds at FVOCI Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To OCI-Loss on reclassification</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>[Being loss recognized in OCI now reversed prior to reclassification]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds(Amortised cost)Dr.</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>To Bonds at FVOCI</td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td>[Being bonds reclassified from FVOCI to Amortised cost]</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Case 6: FVOCI to FVTPL
- The financial asset continues to be measured at fair value.
- The cumulative gain or loss previously recognised in other comprehensive income (OCI) is reclassified from equity to profit or loss as a reclassification adjustment at the reclassification date.

Example 6:
Bonds for Rs 100,000 reclassified as FVTPL. Fair value on reclassification is Rs 90,000. Pass the required journal entry.

Solution

<table>
<thead>
<tr>
<th>Particular</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>P&amp;L-Loss on reclassification</td>
<td>Dr.</td>
<td>10,000</td>
</tr>
<tr>
<td>To OCI-Loss on reclassification</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Bonds at FVTPL</td>
<td>Dr.</td>
<td>90,000</td>
</tr>
<tr>
<td>To bonds at FVOCI</td>
<td></td>
<td>90,000</td>
</tr>
</tbody>
</table>

(F)

LOAN GRANTED BY PARENT CO. TO SUBSIDIARY AT CONCESSIONAL RATE:

Step 1:
Calculate fair value of loan using Effective rate of interest (Amortised Cost Method).

Step 2:
Any difference between loan amount paid and fair value of step 1 will be considered as Cost of Investment in subsidiary and capitalised accordingly.
Step 3:
Under consolidated financial statements, while comparing Cost of investment with the equity of subsidiary (Net Assets), such capitalised amount will be offset since it is included in cost of parent and equity of subsidiary.

Refer Q19

(6)
**CARVE OUT FROM IFRS: EQUITY CONVERSION OPTION EMBEDDED IN A FOREIGN CURRENCY CONVERTIBLE BOND**

IndAS 32 considers the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of entity's own equity instruments as an equity instrument if the exercise price is fixed in any currency.

Example:
Entity A issues a bond with face value of USD 100 and carrying a fixed coupon rate of 6% p.a. Each bond is convertible into 1,000 equity shares of the issuer. Examine the nature of the financial instrument.

**Solution**
While the number of equity shares is fixed, the amount of cash is not. The variability in cash arises on account of fluctuation in exchange rate of INR-USD. Such a foreign currency convertible bond (FCCB) will qualify the definition of “financial liability”. However, Ind AS 32 provides, "the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency.” Accordingly, FCCB will be treated as an “equity instrument”.

(H)
**TRANSACTION COSTS:**

- Transaction costs includes fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.
- Any transaction costs incurred for acquisition of the financial asset are adjusted upon initial recognition while determining fair value.
- If an entity originates a loan that bears an off-market interest rate (eg 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity recognises the loan at its fair value, ie net of the fee it receives.

**Transaction cost under Financial Assets**
**Transaction Cost under Financial Liabilities**

**FL under AMC** - Included as part of Financial Liabilities (+/- in the initial inflow)

But in case of compound financial instrument - *allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds*.

**FL under FVTPL** - Directly charged to Profit and Loss a/c.

**Transaction cost under Equity:**

Deduction from equity to the extent they are incremental costs *directly attributable to the equity transaction* that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

(I)

**IMPAIRMENT OF FINANCIAL ASSETS/LOSS ALLOWANCE:**

Loss allowance is not required in case of Investment in Equity Instruments and FA under FVTPL

Loss allowance can be provided for following assets -

(a) FA under AMC & FVTPL

(b) A lease receivable

(c) Loan commitment

(d) Financial guarantee contract

Loss allowance is to be provided using “Expected Credit Loss method”

Expected credit loss is equal to the sum of present values of expected cash flows that may not be realised in future as per the current circumstances. (discount rate shall be original ERI)
- Life time expected credit losses means Probability of default for total life of FA
- 12 month expected credit losses means Probability of default over next 12 months
- If the Financial Asset is Credit impaired then always use Lifetime expected credit loss approach. (Credit impaired means High risk of default or credit risk has been increased significantly like breach of loan terms and conditions, IBC proceedings are initiated etc)
- If the amount of FA remains overdue for more than 30 days period there is rebuttable presumption that Financial Asset is Credit Impaired.
- An entity may use practical expedients when measuring expected credit losses.

An example of a practical expedient is the calculation of the expected credit losses on trade receivables using a provision matrix. The entity would use its historical credit loss experience for trade receivables to estimate the 12-month expected credit losses or the lifetime expected credit losses on the financial assets as relevant. A provision matrix might, for example, specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1 per cent if not past due, 2 per cent if less than 30 days past due, 3 per cent if more than 30 days but less than 90 days past due, 20 per cent if 90-180 days past due etc).

Loss Allowance under ECL = Amount of FA x Probability of Unrealised cash flows (%) x Probability of default (%)

(J) OFFSETTING A FINANCIAL ASSET AND A FINANCIAL LIABILITY
A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position (Balance Sheet) when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts
(b) intends either to settle on a net basis, or to realise the asset and settle the
(K)

DERECOGNITION OF FINANCIAL ASSETS

(a) Derecognition refers to the timing of removing a financial asset from the balance sheet.

(b) FA under FVTOCI category - any gain or loss previously recognised in OCI shall be recycled to Profit and Loss a/c (except for Equity instruments not held for trading designated under FVTOCI)

(c) Financial Asset is derecognised when any of the following conditions are satisfied:
   • Right to receive cash flows has been expired; or
   • The entity has transferred its right to receive cash flows and transferred substantially all the risks and rewards.

(d) Financial Assets can be transferred with Risks (means without recourse) and without risks (means with recourse).

(e) Transfer of Financial Assets without Risk (with recourse) - This FA shall not be derecognised, entity shall continue to recognise the transferred asset.

   Also a separate Financial liability shall be booked for the consideration received at fair value using Effective rate of interest.

   (1)  Bank A/c Dr.
        To Loan (FL) a/c

   (2)  Interest a/c Dr.
        To Loan a/c

(f) Accounting Treatment for de-recognition of FA (Risks and Rewards transferred):

   Full transfer of FA -
   Bank a/c Dr. (proceeds)
   To FA a/c (BV)
   (difference in above transfer to profit and loss a/c)

   Partial transfer of FA - FA shall be divided into two parts - Strip transferred and strip unsold. We have to first separate the strip transferred and strip unsold from the total book value of FA in proportion of Fair Value (considering ERI of Future Cash flows)

   To separate the entire FA into two parts:
   Strip Transferred A/c Dr.
   Strip Unsold A/c Dr.

   To Financial Assets a/c (BV)
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Q13: Written put option over non-controlling interests
Parent P holds a 70% controlling interest in Subsidiary S. The remaining 30% is held by Entity Z. On 1 January 20X1, P writes an option to Z which grants Z the right to sell its shares to Parent P on 31 December 20X2 for Rs 1,000. Parent P receives a payment of Rs 100 for the option. The applicable discount rate for the put liability is determined to be 12%. State by which amount the financial instrument will be recognised and under which category.

Solution
On 1 January 20X1, the present value of the (estimated) exercise price is Rs 797 (Rs 1,000 discounted over 2 years at 12%).

Accordingly, P will recognise a financial liability of Rs 797 and the difference between cash received i.e. Rs 1000 and the financial liability of Rs 797 will be debited to equity.

Q14: (Concessional Loan to Subsidiary)
P Ltd. has subscribed 5% Preference Share of its subsidiary S Ltd. having face value of Rs. 25 lacs on 01/04/17. Market rate being 11% pa. Discuss the treatment as per IndAS 109 in the separate financial statement as well as Consolidated Financial statement of P Ltd. Also in the separate financial statement of S Ltd. Term - 5 years.

Solution:
Q15: 12 month expected credit loss - Probability of default approach
Entity A originates a single 10 year amortising loan for Rs. 1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PoD) of 0.5 per cent over the next 12 months. Entity A also determines that changes in the 12-month PoD are a reasonable approximation of the changes in the lifetime PoD for determining whether there has been a significant increase in credit risk since initial recognition. Loss given default (LGD) is estimated as 25% of the balance outstanding. Calculate loss allowance.

Solution
At reporting date, no change in 12-month PoD and entity assesses that there is no significant increase in credit risk since initial recognition - therefore lifetime ECL is not required to be recognised.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan</td>
<td>Rs 1,000,000 (A)</td>
</tr>
<tr>
<td>LGD</td>
<td>25% (B)</td>
</tr>
<tr>
<td>PoD - 12 months</td>
<td>0.5% (C)</td>
</tr>
<tr>
<td>Loss allowance (for 12-months ECL)</td>
<td>Rs 1,250 (A<em>B</em>C)</td>
</tr>
</tbody>
</table>

Q16: Life time expected credit losses (provision matrix for short term receivables)
Company M, a manufacturer, has a portfolio of trade receivables of Rs. 30 million in 20X1 and operates only in one geographical region. The customer base consists of a large number of small clients and the trade receivables are categorised by common risk characteristics that are representative of the customers' abilities to pay all amounts due in accordance with the contractual terms. The trade receivables do not have a significant financing component in accordance with IndAS 18. In accordance with paragraph 5.5.15 of Ind AS 109 the loss allowance for such trade receivables is always measured at an amount equal to lifetime time expected credit losses.

Please use the following information of debtors outstanding:

<table>
<thead>
<tr>
<th></th>
<th>Gross carrying amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>Rs. 15,000,000</td>
</tr>
<tr>
<td>1-30 days past due</td>
<td>Rs. 7,500,000</td>
</tr>
<tr>
<td>31-60 days past due</td>
<td>Rs. 4,000,000</td>
</tr>
<tr>
<td>61-90 days past due</td>
<td>Rs. 2,500,000</td>
</tr>
<tr>
<td>More than 90 days past due</td>
<td>Rs. 1,000,000</td>
</tr>
<tr>
<td></td>
<td>Rs. 30,000,000</td>
</tr>
</tbody>
</table>

Company M uses following default rates for making provisions:

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>1-30 days past due</th>
<th>31-60 days past due</th>
<th>61-90 days past due</th>
<th>More than 90 days past due</th>
</tr>
</thead>
</table>

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Determine the expected credit losses for the portfolio

**Solution**

To determine the expected credit losses for the portfolio, Company M uses a provision matrix. The provision matrix is based on its historical observed default rates over the expected life of the trade receivables and is adjusted for forward-looking estimates. At every reporting date the historical observed default rates are updated and changes in the forward-looking estimates are analysed. In this case it is forecast that economic conditions will deteriorate over the next year.

On that basis, Company M estimates the following provision matrix:

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>1-30 days past due</th>
<th>31-60 days past due</th>
<th>61-90 days past due</th>
<th>More than 90 days past due</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default rate</td>
<td>0.3%</td>
<td>1.6%</td>
<td>3.6%</td>
<td>6.6%</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

The trade receivables from the large number of small customer’s amount to CU 30 million and are measured using the provision matrix.

<table>
<thead>
<tr>
<th></th>
<th>Gross carrying amount</th>
<th>Lifetime expected credit loss allowance (Gross carrying amount x lifetime expected credit loss rate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>Rs. 15,000,000</td>
<td>Rs. 45,000</td>
</tr>
<tr>
<td>1-30 days past due</td>
<td>Rs. 7,500,000</td>
<td>Rs. 120,000</td>
</tr>
<tr>
<td>31-60 days past due</td>
<td>Rs. 4,000,000</td>
<td>Rs. 144,000</td>
</tr>
<tr>
<td>61-90 days past due</td>
<td>Rs. 2,500,000</td>
<td>Rs. 165,000</td>
</tr>
<tr>
<td>More than 90 days past due</td>
<td>Rs. 1,000,000</td>
<td>Rs. 106,000</td>
</tr>
<tr>
<td></td>
<td>Rs. 30,000,000</td>
<td>Rs. 580,000</td>
</tr>
</tbody>
</table>


On 1st April 2017, A Ltd. lent Rs. 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company Rs. 10 lakhs. The company has agreed not to charge interest on this loan to help the supplier’s short-term cash flow but expected the supplier to repay Rs. 2.40 crores on 31st March 2019. As calculated by the finance team of the company, the effective annual rate of interest on
this loan is 6.9%. On 28th February 2018, the company received the information that poor economic climate has caused the supplier significant problems and in order to help them, the company agreed to reduce the amount repayable by them on 31st March 2019 to Rs. 2.20 crores. Suggest the accounting entries as per applicable Ind AS.

Solution:

The loan to the supplier would be regarded as a financial asset. The relevant accounting standard Ind AS 109 provides that financial assets are normally measured at fair value. If the financial asset in which the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these inflows rather than dispose of the asset to a third party, then Ind AS 109 allows the asset to be measured at amortised cost using the effective interest method.

If this method is adopted, the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value ` 2,10,00,000.

Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due. The income recognised in the current period is ` 14,49,000 ( ` 2,10,00,000 x 6.9%)

In the absence of information regarding the financial difficulties of the supplier the financial asset at 31st March, 2018 would have been measured at ` 2,24,49,000 ( ` 2,10,00,000 + 14,49,000). The information regarding financial difficulty of the supplier is objective evidence that the financial asset suffered impairment at 31st March 2018.

The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be ` 2,05,79,981 ( ` 2,20,00,000 / 1.069). The reduction in carrying value of ` 18,69,019 ( ` 2,24,49,000 - 2,05,79,981) would be charged to profit or loss in the current period as an impairment of a financial asset.

Therefore, the net charge to profit or loss in respect of the current period would be Rs. 4,20,019 (18,69,019 - 14,49,000).

Q18: (De-recognition of partial Financial Asset)

Sea Ltd. has lent a sum of Rs. 10 lakhs @ 18% pa for 10 years. The loan had a fair value of Rs. 12,23,960 at the effective interest rate of 13%. To mitigate prepayment risks but at the same time retaining control over the loan, Sea Ltd. transferred its right to receive the principal amount of the loan on its maturity with interest, after retaining rights over 10% of principal and 4% interest that carries Fair Value of Rs. 29000, and 184620 respectively. The consideration for the transaction was Rs. 990000. The interest
component retained included a 2% fee towards collection of principal and interest that has a fair value of 65160. Defaults, if any are deductible to a maximum extent of the company's claim on principal portion. You are required to show the journal entries to the record the derecognition of Loan.

(Answer: Stirp Sold – 825468 & Gain on Transfer – 164352/-)

**Additional Questions for Practice:**

**Illustration 1 (ICAI New Syllabus Module) (Home Work)**

A Ltd issued redeemable preference shares to a Holding Company - Z Ltd. The terms of the instrument have been summarized below. Account for this in the books of Z Ltd.

<table>
<thead>
<tr>
<th>Nature</th>
<th>Non-cumulative redeemable preference shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repayment:</td>
<td>Redeemable after 5 years</td>
</tr>
<tr>
<td>Date of Allotment:</td>
<td>1-Apr-20X1</td>
</tr>
<tr>
<td>Date of repayment:</td>
<td>31-Mar-20X6</td>
</tr>
<tr>
<td>Total period:</td>
<td>5.00 years</td>
</tr>
<tr>
<td>Value of preference shares issued:</td>
<td>100,000,000</td>
</tr>
<tr>
<td>Dividend rate</td>
<td>0.0001%</td>
</tr>
<tr>
<td>Market rate of interest</td>
<td>12.00% per annum</td>
</tr>
<tr>
<td>Present value factor</td>
<td>0.56743</td>
</tr>
</tbody>
</table>

**Solution**

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since A Ltd has issued preference shares to its Holding Company - Z Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by Z Ltd. in its subsidiary.
Following is the table summarising the computations on initial recognition:

<table>
<thead>
<tr>
<th>Market rate of interest</th>
<th>12.00%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present value factor</td>
<td>0.56743</td>
</tr>
<tr>
<td>Present value</td>
<td>56,742,686</td>
</tr>
<tr>
<td>Loan component</td>
<td>56,742,686</td>
</tr>
<tr>
<td>Investment in subsidiary</td>
<td>43,257,314</td>
</tr>
</tbody>
</table>

Subsequently, such preference shares shall be carried at amortised cost at each reporting date. The computation of amortised cost at each reporting date has been done as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Date</th>
<th>Opening Asset</th>
<th>Days</th>
<th>Interest @ 12%</th>
<th>Closing balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>31-Mar-20X1</td>
<td>56,742,686</td>
<td>364</td>
<td>6,790,467</td>
<td>63,533,153</td>
</tr>
<tr>
<td>2</td>
<td>31-Mar-20X2</td>
<td>63,533,153</td>
<td>365</td>
<td>7,623,978</td>
<td>71,157,131</td>
</tr>
<tr>
<td>3</td>
<td>31-Mar-20X3</td>
<td>71,157,131</td>
<td>365</td>
<td>8,538,856</td>
<td>79,695,987</td>
</tr>
<tr>
<td>4</td>
<td>31-Mar-20X4</td>
<td>79,695,987</td>
<td>366</td>
<td>9,589,720</td>
<td>89,285,707</td>
</tr>
<tr>
<td>5</td>
<td>31-Mar-20X5</td>
<td>89,285,707</td>
<td>365</td>
<td>10,714,285</td>
<td>100,000,000</td>
</tr>
</tbody>
</table>

Journal Entries to be done at every reporting date

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Date of transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment - Equity portion</td>
<td>Dr.</td>
<td>43,257,314</td>
</tr>
<tr>
<td>Loan receivable</td>
<td>Dr.</td>
<td>56,742,686</td>
</tr>
<tr>
<td>To Bank</td>
<td></td>
<td>(100,000,000)</td>
</tr>
<tr>
<td>Interest income - March 31, 20X2</td>
<td></td>
<td>6,790,467</td>
</tr>
<tr>
<td>Loan receivable</td>
<td>Dr.</td>
<td>7,623,978</td>
</tr>
<tr>
<td>To Interest income</td>
<td></td>
<td>(7,623,978 )</td>
</tr>
<tr>
<td>Interest income - March 31, 20X4</td>
<td></td>
<td>8,538,856</td>
</tr>
<tr>
<td>Loan receivable</td>
<td>Dr.</td>
<td>9,589,720</td>
</tr>
<tr>
<td>To Interest income</td>
<td></td>
<td>(9,589,720)</td>
</tr>
</tbody>
</table>
Illustration 2 (ICAI New Syllabus Module) **(Home Work)**

A Limited issues INR 1 crore convertible bonds on 1 July 20X1. The bonds have a life of eight years and a face value of INR 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited at any time in the next eight years. Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8 per cent per annum.

Required:

(a) Identify the present value of the bonds, and, allocating the difference between the present value and the issue price to the equity component, provide the appropriate accounting entries.

(b) Calculate the stream of interest expenses across the eight years of the life of the bonds.

(c) Provide the accounting entries if the holders of the option elect to convert the options to ordinary shares at the end of the third year.

**Solution**

(a) Applying the guidance for compound instruments, the present value of the bond is computed to identify the liability component and then difference between the present value of these bonds & the issue price of INR 1 crore shall be allocated to the equity component. In determining the present value, the rate of 8 per cent will be used, which is the interest rate paid on debt of a similar nature and risk that does not provide an option to convert the liability to ordinary shares.

Present value of bonds at the market rate of debt

- Present value of principal to be received in eight years discounted at 8%
  \[(10,000,000 \times 0.5403) = 5,403,000\]

- Present value of interest stream discounted at 8% for 8 years
  \[(6,00,000 \times 5.7466) = 3,447,960\]

- Total present value = 8,850,960

- Equity component = 1,149,040

- Total face value of convertible bonds = 10,000,000
The accounting entries will be as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Dr. Amount (INR)</th>
<th>Cr. Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 20X1</td>
<td>10,000,000</td>
<td>8,850,960</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1,149,040</td>
</tr>
</tbody>
</table>

1 July 20X1
Cash Dr.
To Convertible bonds (liability)
To Convertible bonds (equity component)
(Being entry to record the convertible bonds and the recognition of the liability and equity components)

30 June 20X2
Interest expense Dr.
To Cash
To Convertible bonds (liability)
(Being entry to record the interest expense, where the expense equals the present value of the opening liability multiplied by the market rate of interest).

(b) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 8 per cent.

<table>
<thead>
<tr>
<th>Date</th>
<th>Payment</th>
<th>Interest expense at 8%</th>
<th>Increase in bond liability</th>
<th>Total bond liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>01 July 20X1</td>
<td>600,000</td>
<td>708,077</td>
<td>108,077</td>
<td>8,850,960</td>
</tr>
<tr>
<td>30 June 20X2</td>
<td>600,000</td>
<td>716,723</td>
<td>116,723</td>
<td>8,959,037</td>
</tr>
<tr>
<td>30 June 20X3</td>
<td>600,000</td>
<td>726,061</td>
<td>126,061</td>
<td>9,075,760</td>
</tr>
<tr>
<td>30 June 20X4</td>
<td>600,000</td>
<td>736,146</td>
<td>136,146</td>
<td>9,201,821</td>
</tr>
<tr>
<td>30 June 20X5</td>
<td>600,000</td>
<td>747,037</td>
<td>147,037</td>
<td>9,337,967</td>
</tr>
<tr>
<td>30 June 20X6</td>
<td>600,000</td>
<td>758,800</td>
<td>158,800</td>
<td>9,485,004</td>
</tr>
<tr>
<td>30 June 20X7</td>
<td>600,000</td>
<td>771,504</td>
<td>171,504</td>
<td>9,643,804</td>
</tr>
<tr>
<td>30 June 20X8</td>
<td>600,000</td>
<td>784,692*</td>
<td>184,692</td>
<td>10,000,000</td>
</tr>
</tbody>
</table>

*for rounding off

(c) if the holders of the options elect to convert the options to ordinary shares at the end of the third year of the debentures (after receiving their interest payments), the entries in the third would be:
<table>
<thead>
<tr>
<th>Date</th>
<th>Dr. Amount (INR)</th>
<th>Cr. Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 20X4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense Dr. To Cash To Convertible bonds (liability) (Being entry to record interest expense for the period)</td>
<td>726,061</td>
<td>600,000 126,061</td>
</tr>
<tr>
<td>30 June 20X4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Convertible bonds (liability) Dr. Convertible bonds (equity component) Dr. To Contributed equity (Being entry to record the conversion of bonds into shares of A Limited).</td>
<td>9,201,821 1,149,040</td>
<td>10,350,861</td>
</tr>
</tbody>
</table>

**Illustration 3 (ICAI New Syllabus Module) (Allocation of Transaction Cost)**

*ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ Rs 150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.*

**Key terms:**

<table>
<thead>
<tr>
<th>Date of Allotment</th>
<th>01-Apr-20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Conversion</td>
<td>01-Apr-20X6</td>
</tr>
<tr>
<td>Number of Preference Shares</td>
<td>10,000</td>
</tr>
<tr>
<td>Face Value of Preference Shares</td>
<td>150</td>
</tr>
<tr>
<td>Total Proceeds</td>
<td>15,00,000</td>
</tr>
<tr>
<td>Rate Of dividend</td>
<td>10%</td>
</tr>
<tr>
<td>Market Rate for Similar Instrument</td>
<td>15%</td>
</tr>
<tr>
<td>Transaction Cost</td>
<td>30,000</td>
</tr>
<tr>
<td>Face value of equity share after conversion</td>
<td>10</td>
</tr>
<tr>
<td>Number of equity shares to be issued</td>
<td>5,000</td>
</tr>
</tbody>
</table>

**Solution:**

This is a compound financial instrument with two components - liability representing present value of future cash outflows and balance represents equity component.
a. Computation of Liability & Equity Component

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Cash Flow</th>
<th>Discount Factor</th>
<th>Net present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-Apr-20X1</td>
<td></td>
<td>0</td>
<td>1</td>
<td>0.00</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>Dividend</td>
<td>150,000</td>
<td>0.869565</td>
<td>130,434.75</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>Dividend</td>
<td>150,000</td>
<td>0.756144</td>
<td>113,421.6</td>
</tr>
<tr>
<td>31-Mar-20X4</td>
<td>Dividend</td>
<td>150,000</td>
<td>0.657516</td>
<td>98,627.4</td>
</tr>
<tr>
<td>31-Mar-20X5</td>
<td>Dividend</td>
<td>150,000</td>
<td>0.571753</td>
<td>85,762.95</td>
</tr>
<tr>
<td>31-Mar-20X6</td>
<td>Dividend</td>
<td>150,000</td>
<td>0.497177</td>
<td>74,576.55</td>
</tr>
<tr>
<td>Total Liability Component</td>
<td></td>
<td></td>
<td></td>
<td>502,823.25</td>
</tr>
<tr>
<td>Total Proceeds</td>
<td></td>
<td></td>
<td></td>
<td>1,500,000.00</td>
</tr>
<tr>
<td>Total Equity Component (Bal fig)</td>
<td></td>
<td></td>
<td></td>
<td>997,176.75</td>
</tr>
</tbody>
</table>

b. Allocation of transaction costs

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Allocation</th>
<th>Net Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability Component</td>
<td>502,823</td>
<td>10,056</td>
<td>492,767</td>
</tr>
<tr>
<td>Equity Component</td>
<td>997,177</td>
<td>19,944</td>
<td>977,233</td>
</tr>
<tr>
<td>Total Proceeds</td>
<td>1,500,000</td>
<td>30,000</td>
<td>1,470,000</td>
</tr>
</tbody>
</table>

c. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs
- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability

Assume the effective interest rate is 15.86%

<table>
<thead>
<tr>
<th>Date</th>
<th>Opening Financial Liability A</th>
<th>Interest B</th>
<th>Cash Flow C</th>
<th>Closing Financial Liability A+B-C</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-Apr-20X1</td>
<td>492,767</td>
<td>-</td>
<td>-</td>
<td>4,92,767</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>492,767</td>
<td>78,153</td>
<td>150,000</td>
<td>4,20,920</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>420,920</td>
<td>66,758</td>
<td>150,000</td>
<td>3,37,678</td>
</tr>
<tr>
<td>31-Mar-20X4</td>
<td>337,678</td>
<td>53,556</td>
<td>150,000</td>
<td>2,41,234</td>
</tr>
<tr>
<td>31-Mar-20X5</td>
<td>241,234</td>
<td>38,260</td>
<td>150,000</td>
<td>1,29,494</td>
</tr>
<tr>
<td>31-Mar-20X6</td>
<td>129,494</td>
<td>20,506</td>
<td>150,000</td>
<td>-</td>
</tr>
</tbody>
</table>

d. Journal Entries to be recorded for entire term of arrangement are as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-Apr-20X1</td>
<td>Bank A/c Dr.</td>
<td>1,470,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td></td>
<td>492,767</td>
</tr>
<tr>
<td></td>
<td>To Equity Component of Preference shares A/c</td>
<td></td>
<td>977,233</td>
</tr>
</tbody>
</table>
Being compulsorily convertible preference shares issued. The same are divided into equity component and liability component as per the calculation.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Mar-20X2</td>
<td>Preference shares A/c Dr.</td>
<td>150,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td>150,000</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>Finance cost A/c Dr.</td>
<td>78,153</td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td>78,153</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>Preference shares A/c Dr.</td>
<td>150,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td>150,000</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>Finance cost A/c Dr.</td>
<td>66,758</td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td>66,758</td>
</tr>
<tr>
<td>31-Mar-20X4</td>
<td>Preference shares A/c Dr.</td>
<td>150,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td>150,000</td>
</tr>
<tr>
<td>31-Mar-20X4</td>
<td>Finance cost A/c Dr.</td>
<td>53,556</td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td>53,556</td>
</tr>
<tr>
<td>31-Mar-20X5</td>
<td>Preference shares A/c Dr.</td>
<td>150,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td>150,000</td>
</tr>
<tr>
<td>31-Mar-20X5</td>
<td>Finance cost A/c Dr.</td>
<td>38,260</td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td>38,260</td>
</tr>
<tr>
<td>31-Mar-20X6</td>
<td>Preference shares A/c Dr.</td>
<td>150,000</td>
</tr>
<tr>
<td></td>
<td>To Bank A/c</td>
<td>150,000</td>
</tr>
<tr>
<td>31-Mar-20X6</td>
<td>Finance cost A/c Dr.</td>
<td>20,506</td>
</tr>
<tr>
<td></td>
<td>To Preference Shares A/c</td>
<td>20,506</td>
</tr>
<tr>
<td>31-Mar-20X6</td>
<td>Equity Component of Preference shares A/c Dr.</td>
<td>977,233</td>
</tr>
<tr>
<td></td>
<td>To Equity Share Capital A/c</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>To Securities Premium A/c</td>
<td>927,233</td>
</tr>
</tbody>
</table>

(Being Preference shares converted in equity shares and remaining equity component is recognised as securities premium)
Illustration 4: Accounting for assets at FVTOCI *(Homework)*
Metallics Ltd. has made an investment in equity instrument of a company - Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for Rs 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is Rs 45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

**Solution**
The Company has made an irrevocable option to carry its investment at fair value through other comprehensive income. Accordingly, the investment shall be initially recognised at fair value and all subsequent fair value gains/losses shall be recognised in other comprehensive income (OCI).

### Journal Entries

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upon initial recognition -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in equity shares of C Ltd. Dr.</td>
<td>5,00,000</td>
<td></td>
</tr>
<tr>
<td>To Bank a/c</td>
<td></td>
<td>5,00,000</td>
</tr>
<tr>
<td>(Being investment recognized at fair value plus</td>
<td></td>
<td></td>
</tr>
<tr>
<td>transaction costs upon initial recognition)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsequently -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value loss on financial instruments Dr.</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>To Investment in equity shares of C Ltd.</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>(Being fair value loss recognised)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair value reserve in OCI Dr.</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>To Fair value loss on financial instruments</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>(Being fair value loss recognized in other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>comprehensive income)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
UNIT - 3

DERIVATIVES, EMBEDDED DERIVATIVES & HEDGE ACCOUNTING

(Here we will cover IndAS portion as well as Guidance Note on Accounting for Derivative contracts portion)

(GN on Derivative contracts is applicable for Non IndAS based entities.)

DERIVATIVES

Koi bhi contract jiska price koi dusre financial/non-financial item (underlying) se derive ho.
Ek party k liye favorable position create hoti hai aur dusri party k liye unfavorable position banti hai i.e. FA for one party and FL/Equity for another.

There can be two types of derivatives -

1. Standalone derivative contracts (Options, Futures, Forwards etc); and
2. Embedded derivative contracts - which are part of or included in a hybrid contract, in which some non-derivative host is included.

It should have the following characteristics:

a. Its value changes in response to change in an underlying. (Underlying can be equity share, stock index, Foreign Exchange rates, interest rates, any financial instrument, commodity index, commodity price i.e gold, or any other variable item that has some value or even a non-financial asset)

b. It requires no investment or very little initial investment.

c. It is settled at a future date

Note: It may settle on net to net basis (i.e in cash without any delivery) in case of non-financial item or it may settle with delivery also for Financial Items.

Illustration 1: Prepaid forward (ICAI New Syllabus Module)
Entity XYZ enters into a forward contract to purchase 1 million ordinary shares of Entity T in one year
The current market price of T is Rs 50 per share.

The one-year forward price of T is Rs 55 per share
XYZ is required to prepay the forward contract at inception with a Rs 50 million payment. Analyse whether this is a derivative contract.

Solution
Purchase of 1 million shares for current market price is likely to have the same response to changes in market factors as the contract mentioned above. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

Illustration 2:
PQR Ltd. issues a call option (i.e. an option to buy) to ABC Ltd. to subscribe to PQR Ltd.’s equity shares at a price of `100 per share. The call option is to be settled on a ‘net’ basis i.e. without physical delivery of shares. If at the balance sheet date, market value of equity share of PQR Ltd. is `110 per share, PQR Ltd. will be obliged to pay `10 to settle the option. Such a condition is potentially unfavourable to PQR Ltd. and hence `10 represents a financial liability for PQR Ltd.

Illustration 3: (Nov. 2011, 4 marks)
BEE Ltd. has entered into a contract by which it has the option to sell its identified property, plant and equipment (PPE) to AXE Ltd. for Rs. 100 lakhs after 3 years whereas its current market price is Rs.150 lakhs. Is the put option of BEE Ltd. a financial instrument? Explain.
Hint: If settlement will be on net to net then this contract (put option) is Financial Instrument If settlement by way of physical delivery then this is not a financial instrument.

Illustration 4: (Nov. 2015, 4 marks)
Company owns an office building. Company enters into a put option with an investor that permits the company to put the building to the investor for Rs. 150 million. The current value of the building is Rs. 175 million. The option expires in 5 years. The option if exercised may be settled through physical delivery or net cash, at company”s option. How do the company and the investor account for the option?
Hint: If settlement will be on net to net then this contract (put option) is Financial Instrument If settlement by way of physical delivery then this is not a financial instrument.

Illustration 5: (Nov. 2015, 4 marks)
A Company enters into fixed price forward contract to purchase one million kilograms of copper in accordance with its expected usage requirements. The contract permits the company to take physical delivery of the copper at the end of 12 months or to pay or
receive a net settlement in cash, based on change in fair value of copper. Is the contract accounted for as a derivative? Explain.

(Answer:}

<table>
<thead>
<tr>
<th>BASIC RULE OF ACCOUNTING FOR DERIVATIVES:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivatives are always accounted under FVTPL category (do not conduct business model test or contractual cash flows test)</td>
</tr>
<tr>
<td>Basic Principle: All derivative contracts should be recognised on balance sheet at Fair Value whether there is a favorable position or unfavorable position.</td>
</tr>
<tr>
<td>This means that on Balance Sheet date, if there are any unsettled derivative contracts then we have to create Financial Asset (Favourable position) or Financial Liability (Unfavourable Position) at Fair values through P&amp;L a/c.</td>
</tr>
<tr>
<td>Fair value means “EXIT PRICE” i.e. the price that would be paid to transfer a liability or the price that would be received when transferring an asset in an orderly transaction between market participants.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ACCOUNTING FOR VARIOUS DERIVATIVES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eg. of Derivatives: Futures, Options, Hedging, Forwards, Swaps</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FUTURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entered into with the help of Exchange. It has Defined Underlying, Defined Tenor, Defined Size.</td>
</tr>
<tr>
<td>Long Position: Price will go up</td>
</tr>
<tr>
<td>Short Position: Price will go down</td>
</tr>
<tr>
<td>Follow the three steps accounting as under:</td>
</tr>
<tr>
<td>- On the date of contract: No Accounting (except for margin payment), only a proper disclosure can be given.</td>
</tr>
<tr>
<td>- At each reporting dates: Derivative Future Asset or Liability shall be recognized through Profit and Loss a/c (FVTPL) (difference amount only)</td>
</tr>
<tr>
<td>- On settlement Date: Gain or Loss transfer to Profit and Loss A/c</td>
</tr>
</tbody>
</table>
 Accounting Entries:

1. For Initial Margin: (this can be treated as Security deposit)
   
   Initial Margin (Futures) A/c
   
   Dr.
   
   To Bank A/c

2. For Mark to Market
   
   Margin:
   
   Bank A/c Dr.                                MTMDM A/c Dr.
   
   To MTMDM A/c                                To Bank A/c
   
   (in some cases this margin may not require to be paid every time)

3. Recognition on BS Date: (Ind AS application) - at Fair Value
   
   Futures A/c (Asset) Dr.                    P&L A/c Dr.
   
   To P&L A/c                                  To Futures A/c
   
   (Liability)

4. Settlement of Future Contract (if margin is received/paid earlier)
   
   MTMDM A/c Dr.                                Futures (Liability) A/c Dr.
   
   To Futures (Assets) A/c                     To MTMDM A/c

5. Settlement of Future Contract (if no margin is received/paid earlier)
   
   Bank A/c Dr.                                    Futures (Liability) A/c Dr.
   
   To Futures (Assets) A/c                       To Bank A/c
**FORWARDS**

- Same as Futures but without the help of Stock Exchange or any intermediary.
- Customized contract between two parties.
- Any Underlying, any size, any term.

*Accounting is same as accounting for Future Contracts as above.*

**OPTIONS**

Entered into with the help of Exchange. Defined Underlying, Defined Term, Defined Size.

Option contracts are Right without obligation for Holder and obligation without right for Issuer/writer.

Here the holder needs to pay a premium to get the option (i.e. Right).

Option is for Non-Financial Asset without physical delivery (net cash settlement), this will be covered under IndAS 109.

Option is for Non-Financial Asset with physical delivery, this will not be covered under IndAS 109.

**Buyer of Options**
- Call position (Right to Buy)
- Put Position (Right to Sell)
  - (In both cases he has to pay premium)

**Seller of Option**
- Call position (Obligation to Sell)
- Put Position (Obligation to Buy)
  - (In both cases he gets premium)

**When to Exercise the Option?**
- Call Option - When market price is higher
- Put Option - When market price is lower

**Accounting Entries:**

<table>
<thead>
<tr>
<th></th>
<th>Option Holder</th>
<th>Option Writer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>On payment of option premium</td>
<td>On receipt of option premium</td>
</tr>
<tr>
<td></td>
<td>Derivative Option (Asset) a/c Dr.</td>
<td>Bank A/c Dr.</td>
</tr>
<tr>
<td></td>
<td>To Bank a/c</td>
<td>To Derivative option (Liability) a/c</td>
</tr>
<tr>
<td>2.</td>
<td>On measurement at Balance Sheet date for unsettled Derivative</td>
<td>On measurement at Balance Sheet date for unsettled Derivative</td>
</tr>
<tr>
<td></td>
<td>Derivative Option (Asset) a/c Dr.</td>
<td>Fair Value loss (P&amp;L) a/c Dr.</td>
</tr>
<tr>
<td></td>
<td>To Fair Value Gain (P&amp;L) a/c</td>
<td>To Derivative Option (Liability) a/c</td>
</tr>
</tbody>
</table>
Fair Value loss (P&L) a/c Dr.  
To Derivative Option (Asset) a/c

Derivative Option (Liability) a/c Dr.  
To Fair Value Gain (P&L) a/c

3. On Settlement date
If contract is settled in Net Cash without  
physical delivery-  
Only in favourable position
Bank A/c Dr.  
To Derivative Asset a/c

If contract is settled with physical  
delivery -  
Financial Asset a/c Dr. (FV)  
To Bank a/c (Payment)  
To Derivative Asset a/c (BV)

3. On Settlement date
If contract is settled in Net Cash without  
physical delivery  
Only in Un-favourable position
Derivative Liability A/c Dr.  
To Bank a/c

If contract is settled with physical  
delivery -  
Derivative Liability a/c Dr. (BV)  
Bank a/c Dr. (Payment)  
To Financial Asset a/c

Buyer: To get Call/Put option I need to pay option premium. This premium is non-refundable. Amount of premium will be booked as Financial Asset until the expiry of Contract.

Suppose, I bought NIFTY 1 month call option on 1000 lots at strike price of Rs. 11050 at the premium of Rs. 25/- per unit.

Day 1 Accounting –  
Option Premium (Asset) A/c Dr.  25000  
To Bank a/c  25000

After 1 Month - Nifty is as follows:

<table>
<thead>
<tr>
<th>Cases</th>
<th>Nifty Index</th>
<th>Exercise/Not Exercise</th>
<th>Accounting Entry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10900</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>11000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>11075</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Now Suppose, before the end of 1 month, there is a BS date and NIFTY on that date becomes 11090. What should I do?

IND AS 109 requires that the derivative instruments needs to be fair valued through P&L. Since this is a call option, Strike price is increased there is a favorable position (Gain of Rs. 15000)

**Accounting at BS date:**

Suppose on settlement date the Nifty becomes 11040 -

**Accounting on settlement date:**

**Illustration 6: (Equity Index Futures) (Homework)**

Mr. A Purchases the following units of equity Index Futures (EIF).

<table>
<thead>
<tr>
<th>Date of Purchase</th>
<th>Name of Future</th>
<th>Expiry Date</th>
<th>Contract Price Per Unit</th>
<th>Contract Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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For Doubts – 7887 7887 05 (Whatsapp)

Daily Settlement Prices of the above units of Equity Index Futures were as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>EF1 – May Series</th>
<th>EF2 – June Series</th>
</tr>
</thead>
<tbody>
<tr>
<td>28/03/2003</td>
<td>1410</td>
<td></td>
</tr>
<tr>
<td>29/03/2003</td>
<td>1428</td>
<td>4300</td>
</tr>
<tr>
<td>30/03/2003</td>
<td>1435</td>
<td>4270</td>
</tr>
<tr>
<td>31/03/2003</td>
<td>1407</td>
<td>4290</td>
</tr>
<tr>
<td>01/04/2003</td>
<td>1415</td>
<td>4250</td>
</tr>
<tr>
<td>02/04/2003</td>
<td>1430</td>
<td>-</td>
</tr>
<tr>
<td>03/04/2003</td>
<td>1442</td>
<td>-</td>
</tr>
</tbody>
</table>

For the sake of convenience, it has been assumed that the above contracts were settled on the following dates:

- EF-2 June Series on 1st April, 2003
- A contract of 200 units of EF-1 May Series on 2nd April, 2003.
- The other contract of EF-1 May series on 3rd April, 2003.

Prepare necessary accounts.

Solve Here:

Illustration 7: (Equity Index Futures)

Mr. A purchases the following units of Equity Stock Futures (ESF):

<table>
<thead>
<tr>
<th>Date of Purchase</th>
<th>ESF (Name of Company)</th>
<th>Expiry Date/ Series</th>
<th>Contract price per Unit</th>
<th>Contract Multiplier (No.)</th>
</tr>
</thead>
</table>

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<table>
<thead>
<tr>
<th>Date of Contract</th>
<th>Company</th>
<th>Date of Settlement</th>
<th>Units</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>28th March, 18</td>
<td>XYZ Ltd.</td>
<td>May 18</td>
<td>1420</td>
<td>200</td>
</tr>
<tr>
<td>29th March, 18</td>
<td>PQR Ltd.</td>
<td>June 18</td>
<td>4280</td>
<td>50</td>
</tr>
<tr>
<td>29th March, 18</td>
<td>XYZ Ltd.</td>
<td>May 18</td>
<td>1416</td>
<td>200</td>
</tr>
</tbody>
</table>

The contracts are settled through net cash on the Settlement Date, i.e., May 29, 2018 and June 26, 2018 respectively.

Suppose 30th April is year ending date. On 30th April, XYZ Ltd’s future sells at 1425 and PQR Ltd.’s future sells at 4240.

On settlement date XYZ contract settles at 1423 and PQR settles at 4210. Journalise settlement entry.

**Solve Here:**

**Illustration 8: (Forwards on Currency Rates) (ICAI New Syllabus Module)**

On 1st January 20X1, Sam Co. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 20X1 for a rate equal to Rs 68 per USD. Sam Co. Ltd. did not pay any amount upon entering into the contract. Sam Co Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.
For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March 20X1 - Rs (25,000)
As at 30th June 20X1 - Rs (15,000)
As at 30th September 20X1 - Rs12,000

Spot rate of USD on 31st December 20X1 - Rs66 per USD

Solution:

(i) **Assessment of the arrangement using the definition of derivative included under Ind AS 109.**

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

a) its value changes in response to the change in 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 (sometimes called the ‘underlying’).

b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c) it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

b) the initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 20,000 on inception.

c) the contract is settled in future

The derivative is a forward exchange contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

(ii) **Accounting on 1st January 20X1:**

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.
(iii) **Accounting on 31st March 20X1:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and loss A/c Dr.</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>To derivative financial liability</td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>(Being mark to market loss on forward contract recorded)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(iv) **Accounting on 30th June 20X1:**

The change in value of the derivative forward contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative financial liability A/c Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Profit and loss A/c</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>(Being partial reversal of mark to market loss on forward contract recorded)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(v) **Accounting on 30th September 20X1:**

The value of the derivative forward contract shall be recorded as a derivative financial asset in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative financial liability A/c Dr.</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Derivative financial asset A/c Dr</td>
<td>12,000</td>
<td>27,000</td>
</tr>
<tr>
<td>To Profit and loss A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(vi) **Accounting on 31st December 20X1:**

The settlement of the derivative forward contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (USD Account) @ 20,000 * 66 Dr.</td>
<td>13,20,000</td>
<td></td>
</tr>
<tr>
<td>Profit and loss A/c Dr.</td>
<td>52,000</td>
<td>13,60,000</td>
</tr>
<tr>
<td>To Cash @ 20,000 x 68</td>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td>To Derivative financial asset A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Illustration 9: (Forwards on Currency Rates) (ICAI New Syllabus Module)

(Homework)

On 1st January 20X1, SamCo. Ltd. entered into a written put option for USD ($) 20,000 with JT Corp to be settled in future on 31st December 20X1 for a rate equal to ` 68 per USD at the option of JT Corp. SamCo. Ltd. did not receive any amount upon entering into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the classification principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of put option contracts at each reporting date:

- As at 31st March 20X1 - Rs (25,000)
- As at 30th June 20X1 - Rs (15,000)
- As at 30th September 20X1 - Rs NIL
- Spot rate of USD on 31st December 20X1 - Rs 66 per USD

Solution

i. Assessment of the arrangement using the definition of derivative included under Ind AS 109.

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

a. its value changes in response to the change in 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 (sometimes called the ‘underlying’).

b. it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c. it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

b) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

d) the initial amount received to enter into the contract is zero. A contract which would
give the holder a similar response to foreign exchange rate changes would have required an investment of USD 20,000 on inception.

e) the contract is settled in future

The derivative liability is a written put option contract.
As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

ii. **Accounting on 1st January 20X1**
As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

iii. **Accounting on 31st March 20X1**

The value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and loss A/c Dr.</td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>To derivative financial liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Being mark to market loss on the put option contract recorded)</td>
<td></td>
<td>25,000</td>
</tr>
</tbody>
</table>

iv. **Accounting on 30th June 20X1**
The change in value of the derivative put option contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative financial liability A/c Dr.</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>To Profit and loss A/c</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>(Being partial reversal of mark to market loss on the put option contract recorded)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

v. **Accounting on 30th September 20X1**
The change in value of the derivative option contract shall be recorded as a zero in the books of SamCo Ltd. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
</table>
Derivative financial liability A/c Dr.
To Profit and loss A/c
(Being gain on mark to market of put
option contract booked to make the
value the derivative liability as zero)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (USD Account) @ 20,000 x 66 Dr. Profit and loss A/c Dr. To Cash @ 20,000 x 68 (being loss on settlement of put option contract booked on actual purchase of USD)</td>
<td>13,20,000</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>13,60,000</td>
</tr>
</tbody>
</table>

vi. **Accounting on 31st December 20X1**
The settlement of the derivative put option contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. upon exercise by JT Corp. by recording the following journal entry:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (USD Account) @ 20,000 x 66 Dr. Profit and loss A/c Dr. To Cash @ 20,000 x 68 (being loss on settlement of put option contract booked on actual purchase of USD)</td>
<td>13,20,000</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>13,60,000</td>
</tr>
</tbody>
</table>

**Illustration 10: (Equity Options)**

Mr. A buys the following Equity Stock Options and the seller/writer of the options is Mr. B.

<table>
<thead>
<tr>
<th>Date of Purchase</th>
<th>Type of Options</th>
<th>Expiry Date</th>
<th>Market Lot</th>
<th>Premium per Unit</th>
<th>Strike Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>29 June, 01</td>
<td>XYZ Co. Ltd. Call</td>
<td>Aug, 30 2001</td>
<td>100</td>
<td>30</td>
<td>450</td>
</tr>
<tr>
<td>30 June, 01</td>
<td>ABC Co. Ltd. Put</td>
<td>Aug, 30 2001</td>
<td>100</td>
<td>40</td>
<td>550</td>
</tr>
</tbody>
</table>

Journalize assuming price of XYZ Co. Ltd. and ABC Co. Ltd. on 30th August, 2001 is Rs. 470 and Rs. 500 respectively.

**Solve Here:**
**INTEREST RATE SWAPS**

These contracts are undertaken to cover the risk of Interest rates on variable or fixed rate of interest.

**Accounting Treatment**

**Step 1 - on contract date** Do nothing

**Step 2 - on balance sheet date** check whether the entity is in favourable position or unfavourable position and create Financial Asset Receivable a/c or Financial Liability Payable a/c accordingly by the net gain in interest swaps.

**Step 3 - on settlement date**, re-measure the Financial Asset or Liability based on position on settlement date and then realise the Financial Asset or settle the financial liability in Cash.

**Prepaid Interest Rate Swaps:**
If interest rate swaps (Pay variable, get fixed rate) is prepaid, then these are not derivative contracts, since the initial investment on these are not nil or very less.

**Illustration 11: Prepaid pay-variable, receive-fixed interest rate swap (ICAI)**

Entity S enters into a Rs 100 crores notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C.
The variable leg of the swap is reset on a quarterly basis to three-month MIBOR.
The fixed interest payments under the swap are calculated as 10% of the swap’s notional amount, i.e. Rs 10 crores p.a.
Entity S prepays its obligation under the variable leg of the swap at inception at current market rates. Say, that amount is Rs 36 crores.
It retains the right to receive fixed interest payments of 10% on Rs 100 crores every year. Analyse whether this a derivative contract.

**Solution**
In effect, this contract results in an initial net investment of Rs 36 crores which yields a cash inflow of Rs 10 crores every year, for five years. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.
Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions.

For this reason, the instrument fails the condition 'no initial net investment or an initial net investment' that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’. Therefore, the contract is not accounted for as a derivative contract.

**EMBEDDED DERIVATIVES**

Any contract which has Two Elements, one is Host Contract (i.e. main contract) which is non-derivative part of the contract and the other one is derivative part (it is embedded with the host contract).

So what to do with this embedded derivative? Do we need to separate this from host contract or not?

So the answer is - if the host contract and embedded derivative are closely related with each other, then no need to separate them.

If they are not closely related then derivative element is required to be accounted separately.

**Case – 1**

**No separation is required** - Entire contract shall be accounted as one single contract as per the relevant IndAS.

**Case – 2**

**Separation is required** -

(a) Contract of Sell/purchase in future-
   - Record the sale/purchase at pre-determined forward rate (forward rate on the date of contract)
   - Consider changes in forward rate as Derivative Contract (FVTPL)

(b) Prepayment option in Loan-
   Calculate value of Loan as per Amortised Cost Method
   Calculate value of Loan as per ACM if prepayment option is exercised
   If difference in above two values is significant then record separately the Derivative Asset/Liability.
Illustration 12: Debt instrument with prepayment option (ICAI New Syllabus Module)
Entity PQR borrows Rs 100 crores from CFDH Bank on 1 April 20X1.
Interest is payable at 12% p.a. and there is a bullet repayment of principal at the end of the term.
Term of the loan is 6 years.
The loan includes an option to prepay the loan at 1st April each year with a prepayment penalty of 3%.
There are no transaction costs.
Without the prepayment option, the interest rate quoted by bank is 11% p.a.

Analyse

Solution

Step 1: Identify the host contract and embedded derivative, if any
In the given case,
- Host is a debt instrument comprising annual interest payment at 12% p.a. and bullet principal repayment at the end of 6 years.
- Option to prepay the debt at Rs 103 crores is an embedded derivative

Step 2: Determine the amortised cost of the host debt instrument
Whether the prepayment option is likely to be exercised or not, the amortised cost of the host debt instrument should be calculated as present value (PV) of expected cash flows using a fair market interest rate for a debt without the prepayment option (11% p.a. in this case). This is calculated below as Rs 104.23 crores:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash outflow</th>
<th>PV @ 11% p.a.</th>
<th>Finance cost</th>
<th>Amortised cost</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs crores</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>12.00</td>
<td>10.81</td>
<td>11.46</td>
<td>103.68</td>
</tr>
<tr>
<td>2</td>
<td>12.00</td>
<td>9.74</td>
<td>11.41</td>
<td>103.09</td>
</tr>
<tr>
<td>3</td>
<td>12.00</td>
<td>8.77</td>
<td>11.34</td>
<td>102.43</td>
</tr>
<tr>
<td>4</td>
<td>12.00</td>
<td>7.90</td>
<td>11.27</td>
<td>101.70</td>
</tr>
<tr>
<td>5</td>
<td>12.00</td>
<td>7.12</td>
<td>11.20</td>
<td>100.90</td>
</tr>
<tr>
<td>6</td>
<td>112.00</td>
<td>59.88</td>
<td>11.10</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>104.22</td>
<td>67.78</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Step 3: Compare the exercise price of the prepayment option with the amortised cost of the host debt instrument

<table>
<thead>
<tr>
<th>Year</th>
<th>Amortised cost</th>
<th>Exercise price of prepayment option</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs Crores</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>103.68</td>
<td>103.00</td>
<td>0.7%</td>
</tr>
<tr>
<td>2</td>
<td>103.09</td>
<td>103.00</td>
<td>0.1%</td>
</tr>
<tr>
<td>3</td>
<td>102.43</td>
<td>103.00</td>
<td>-0.6%</td>
</tr>
<tr>
<td>4</td>
<td>101.70</td>
<td>103.00</td>
<td>-1.3%</td>
</tr>
<tr>
<td>5</td>
<td>100.90</td>
<td>103.00</td>
<td>-2.1%</td>
</tr>
</tbody>
</table>
The management of Entity PQR may formulate an appropriate accounting policy to determine what constitutes "approximately equal". In this case, if the management determines that a difference of more than 2% will indicate that the option’s exercise price is not approximately equal to the amortised cost of the host debt instrument, it will need to separate the embedded derivative and account for it as per principles given in the subsequent sub-section.

**Illustration 13:**
Entity A (an INR functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an INR functional currency entity) to sell equipment on 30 June 20X1.

| Spot rate on 1 January 20X1: INR/USD | 45 |
| Spot rate on 31 March 20X1: INR/USD | 57 |
| Three month forward rate on 31 March 20X1: INR/USD | 45 |
| Six month forward rate on 1 January 20X1: INR/USD | 55 |
| Spot rate on 30 June 20X1: INR/USD | 60 |

Let’s assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.

**Solution**
The contract should be separated using the 6 month USD/INR forward exchange rate, as at the date of the contract (INR/USD = 55). The two components of the contract are therefore:
- A sale contract for INR 55 Million
- A six-month currency forward to purchase USD 1 Million at 55
- This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

**On delivery**
1. Entity A records the sales at the amount of the host contract = INR 55 Million
2. The embedded derivative is considered to expire.
3. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial asset on delivery.
4. In this case the carrying value of the currency forward at 30 June 20X1 on maturity is = INR (1,000,000*60-55*1,000,000)=Rs 5,000,000 (profit/asset)

The table summarising the computation of gain/ loss to be recorded at every period end

<table>
<thead>
<tr>
<th>Date</th>
<th>Transaction</th>
<th>Sales</th>
<th>Debtors</th>
<th>Derivative Asset (Liability)</th>
<th>(Profit) Loss</th>
</tr>
</thead>
</table>

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<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Dr. Amount (INR)</th>
<th>Cr. Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-Jan-20X1</td>
<td>Embedded Derivative</td>
<td></td>
<td>Nil Value</td>
</tr>
<tr>
<td>31-Mar-20X1</td>
<td>Change in Fair Value of Embedded Derivatives MTM (55-45)*1Million</td>
<td>(10,000,000)</td>
<td>10,000,000</td>
</tr>
<tr>
<td>30-Jun-20X1</td>
<td>Change in Fair Value of Embedded Derivatives (60-45)*1Million</td>
<td>15,000,000</td>
<td>(15,000,000)</td>
</tr>
<tr>
<td>30-Jun-20X1</td>
<td>Recording sales at forward rate</td>
<td>(55,000,000)</td>
<td>55,000,000</td>
</tr>
<tr>
<td>30-Jun-20X1</td>
<td>Embedded derivative-settled against debtors</td>
<td>5,000,000</td>
<td>(5,000,000)</td>
</tr>
</tbody>
</table>

Journal Entries to be recorded at every period end

a. 01 January 20X1 – No entry to be made

b. 31 March 20X1 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit and loss A/c Dr.</td>
<td>10,000,000</td>
<td>10,000,000</td>
</tr>
<tr>
<td>To Derivative financial liability A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(being loss on mark to market of embedded derivative booked)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

c. 30 June 20X1 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative financial asset A/c Dr.</td>
<td>5,000,000</td>
<td></td>
</tr>
<tr>
<td>Derivative financial liability A/c Dr.</td>
<td>10,000,000</td>
<td></td>
</tr>
<tr>
<td>To Profit and loss A/c</td>
<td>15,000,000</td>
<td></td>
</tr>
<tr>
<td>(being gain on embedded derivative based on spot rate at the date of settlement booked)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

d. 30 June 20X1 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivable A/c Dr.</td>
<td>55,000,000</td>
<td></td>
</tr>
<tr>
<td>To Sales A/c</td>
<td></td>
<td>55,000,000</td>
</tr>
<tr>
<td>(being sale booked at forward rate on the date of transaction)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

e. 30 June 20X1 –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr. Amount (Rs)</th>
<th>Cr. Amount (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivable A/c Dr</td>
<td>5,000,000</td>
<td></td>
</tr>
<tr>
<td>To Derivative financial asset A/c</td>
<td></td>
<td>5,000,000</td>
</tr>
</tbody>
</table>
(being derivative asset re-classified as a part of trade receivables, bringing it to spot rate on the date of sale)

HEDGE ACCOUNTING

Hedging means - Managing Risk or reducing risk in a Recognised Asset/Liability or Firm commitment to buy an Asset or Highly forecast cash flow transaction by making a derivative or non-derivative contract in a Financial Instruments in such a way that change in Fair value of Hedging Instrument wholly or partially offset change in Fair value of Hedged Item.

Some Important Terms:
(a) Hedged item - It may be a recognised Asset or Liability (Financial or Non-Financial such as Foreign Currency Debtors/Creditors, Inventory etc), a firm commitment to buy asset or a Highly probable Forecast Transaction which involves cash flows.
(b) Hedging instrument - It may be investment in Derivative instrument or non-derivative instrument such as (Futures, Forwards, Options, Swaps).
(c) Firm Commitment: A firm commitment is a binding agreement for the exchange of specified quantity of resources at specified future date or dates.
(d) Highly Forecast Cash Flow Transaction: A forecast transaction is an uncommitted but anticipated future transaction which involves cash inflow or outflow.

Conditions for Hedge Accounting:
1. There must be eligible hedging instrument and eligible hedged items
2. At the inception of the hedging relationship, there must be a formal designation and documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge.
3. Hedge effectiveness should exist. It means economic relations between hedged items and Hedging instruments should exist.

If the above conditions are not fulfilled, then Hedging accounting will not be permissible. In that situation, we will follow normal derivative accounting separately for Hedged Item and separate accounting for Hedging Instruments.
CASH FLOW HEDGE

If the entity is having risk of change in future cash flows (inflow or outflow) from:
Sale or purchase of stock in future;
- Sale or purchase of shares in future; or
- From collection or payment to debtors or creditors; or
- From highly forecast cash flow transaction.

Accounting Treatment

Step 1 - Fair value the Hedged Item (Recognised Asset/Liability) through OCI (Cash Flow hedge reserve)

Step 2 - Fair value the hedging instruments (derivative contract) through OCI (Cash Flow hedge reserve)

Step 3 - Amortise the actual loss over the life of contract by debiting Profit and Loss a/c and crediting Cash Flow Hedge Reserve (OCI)

Step 4 - On settlement date, realise or settle the contract in cash. CFHR (OCI) account will be nil.

Illustration 14:
On 1 January 20X1, Company D issues a three-year 5.5% fixed rate bond of USD 15 million at par. D's functional currency is sterling. As part of its risk management policy, D
decides to eliminate the exposure arising from movements in the US dollar/GBP exchange rates on the principal amount of the bond for three years. D enters into a foreign currency forward contract to buy USD 15 million and sell GBP 9,835,389 at 31 December 20X3.

D designates and documents the forward contract as the hedging instrument in a cash flow hedge of the variability in cash flows arising from the repayment of the principal amount of the bond due to movements in forward US dollar/sterling exchange rates.

D states in its hedge documentation that it will use the hypothetical derivative method to assess hedge effectiveness. D identifies the hypothetical derivative as a forward contract under which it sells USD 15 million and purchases GBP 9,835,389 at 31 December 20X3 (the repayment date of the bond). The hypothetical foreign currency forward contract has a fair value of zero at 1 January 20X1. The spot and the forward exchange rates and the fair value of the foreign currency forward contract are as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Spot rate</th>
<th>FWD rate</th>
<th>FV of forward</th>
<th>FWD points</th>
<th>FWD points</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-Jan-20X1</td>
<td>0.6213</td>
<td>0.6557</td>
<td>-</td>
<td>0.0344</td>
<td>USD 15,000,000</td>
</tr>
<tr>
<td>31-Dec-20X1</td>
<td>0.5585</td>
<td>0.5858</td>
<td>(957,205)</td>
<td>0.0273</td>
<td>Forward points 516,000</td>
</tr>
<tr>
<td>31-Dec-20X2</td>
<td>0.5209</td>
<td>0.528</td>
<td>(1,833,346)</td>
<td>0.0071</td>
<td>-</td>
</tr>
<tr>
<td>31-Dec-20X3</td>
<td>0.5825</td>
<td>0.5825</td>
<td>(1,097,789)</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Pass necessary journal entries.

**Solution**

The hedge remains effective for the entire period, with changes in the fair value of the forward contract and the hedging instrument being perfectly offset. Because D has designated the variability in cash flows arising from movements in the forward rates as the hedged risk, the entire change in the fair value of the forward contract is recognised in OCI.

At each reporting date, G reclassifies from equity an amount equal to the movement in the spot rate on the principal amount of the bond.

In addition, to ensure that the forward points recognised in OCI are reclassified fully to profit or loss over the life of the hedge, D reclassifies from equity the forward points recognised in OCI amortised over the life of the hedging relationship. Assuming that all criteria for hedge accounting have been met, D records the following journal entries:
<table>
<thead>
<tr>
<th>Particulars</th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Dr.</td>
<td>93,19,500</td>
<td></td>
</tr>
<tr>
<td>To Bond</td>
<td></td>
<td>93,19,500</td>
</tr>
<tr>
<td>(Being bond liability recognized at spot rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31 December 20X1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedging Reserve (OCI) Dr.</td>
<td>9,57,205</td>
<td></td>
</tr>
<tr>
<td>To Derivative</td>
<td></td>
<td>9,57,205</td>
</tr>
<tr>
<td>(Being loss on hedging instrument i.e. forward contract (as per Ind AS 109.6.5.11(b), change in fair value of spot element - loss of 9,42,000 and as per Ind AS 109.6.5.16, change in fair value of forward element - loss of 15,205) recognized in OCI)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bond Dr.</td>
<td>9,42,000</td>
<td></td>
</tr>
<tr>
<td>To Foreign currency (P&amp;L)</td>
<td></td>
<td>9,42,000</td>
</tr>
<tr>
<td>(Being gain on restatement of hedged item i.e. foreign currency bond recognized in P&amp;L as per Ind AS 21)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td>9,42,000</td>
<td></td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td></td>
<td>9,42,000</td>
</tr>
<tr>
<td>(Being cash flow hedge reserve associated with hedged item recognized as per Ind AS 109.6.5.11(a))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td>1,72,000</td>
<td></td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td></td>
<td>1,72,000</td>
</tr>
<tr>
<td>(Being reclassification adjustment in respect of amortization of forward element at the date of designation of the forward contract as hedging instrument over the tenor of forward contract)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense Dr.</td>
<td>4,60,763</td>
<td></td>
</tr>
<tr>
<td>To Cash</td>
<td></td>
<td>4,60,763</td>
</tr>
<tr>
<td>(Being interest expense recognized (for sake of simplicity, the same is recognized at closing spot rate whereas Ind AS 21.21-22 mandates use of exchange rate on the date of transaction or an average rate over the relevant period))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31 December 20X2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedging Reserve (OCI) Dr.</td>
<td>8,76,141</td>
<td></td>
</tr>
<tr>
<td>To Derivative</td>
<td></td>
<td>8,76,141</td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
<td></td>
</tr>
<tr>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>------------</td>
<td></td>
</tr>
<tr>
<td>(Being loss on hedging instrument i.e. forward contract (as per Ind AS 109.6.5.11(b), change in fair value of spot element - loss of 5,64,000 and as per Ind AS 109.6.5.16, change in fair value of forward element - loss of 3,12,141) recognized in OCI)</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>Bond Dr.</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>To Foreign currency (P&amp;L)</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>(Being gain on restatement of hedged item i.e. foreign currency bond recognized in P&amp;L as per Ind AS 21)</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td>5,64,000</td>
<td></td>
</tr>
<tr>
<td>(Being cash flow hedge reserve associated with hedged item recognized as per Ind AS 109.6.5.11(a))</td>
<td>1,72,000</td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td>1,72,000</td>
<td></td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td>1,72,000</td>
<td></td>
</tr>
<tr>
<td>(Being reclassification adjustment in respect of amortization of forward element at the date of designation of the forward contract as hedging instrument over the tenor of forward contract)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense Dr.</td>
<td>4,29,743</td>
<td></td>
</tr>
<tr>
<td>To Cash</td>
<td>4,29,743</td>
<td></td>
</tr>
<tr>
<td>(Being interest expense recognized (for sake of simplicity, the same is recognized at closing spot rate whereas Ind AS 21.21- 22 mandates use of exchange rate on the date of transaction or an average rate over the relevant period))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31 December 20X3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivative Dr.</td>
<td>7,35,346</td>
<td></td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td>7,35,346</td>
<td></td>
</tr>
<tr>
<td>(Being gain on hedging instrument i.e. forward contract (as per Ind AS 109.6.5.11(b), change in fair value of spot element - gain of 9,24,000 and as per Ind AS 109.6.5.16, change in fair value of forward element - loss of 1,88,654) recognized in OCI)</td>
<td>9,24,000</td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td>9,24,000</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Dr. Amount</td>
<td>Cr. Amount</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>------------</td>
<td>------------</td>
</tr>
<tr>
<td>To Bond</td>
<td></td>
<td>9,24,000</td>
</tr>
<tr>
<td>(Being loss on restatement of hedged item i.e. foreign currency bond recognized in P&amp;L as per Ind AS 21)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedging Reserve (OCI) Dr.</td>
<td></td>
<td>9,24,000</td>
</tr>
<tr>
<td>To Foreign currency (P&amp;L)</td>
<td></td>
<td>9,24,000</td>
</tr>
<tr>
<td>(Being cash flow hedge reserve associated with hedged item recognized as per Ind AS 109.6.5.11(a))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency (P&amp;L) Dr.</td>
<td></td>
<td>1,72,000</td>
</tr>
<tr>
<td>To Hedging Reserve (OCI)</td>
<td></td>
<td>1,72,000</td>
</tr>
<tr>
<td>(Being reclassification adjustment in respect of amortization of forward element at the date of designation of the forward contract as hedging instrument over the tenor of forward contract)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest expense Dr.</td>
<td></td>
<td>4,80,563</td>
</tr>
<tr>
<td>To Cash</td>
<td></td>
<td>4,80,563</td>
</tr>
<tr>
<td>(Being interest expense recognized (for sake of simplicity, the same is recognized at closing spot rate whereas Ind AS 21.21- 22 mandates use of exchange rate on the date of transaction or an average rate over the relevant period))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bond Dr.</td>
<td>87,37,500</td>
<td></td>
</tr>
<tr>
<td>To Cash</td>
<td>87,37,500</td>
<td></td>
</tr>
<tr>
<td>(Being financial liability towards spot value of bonds extinguished through repayment)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivative Dr.</td>
<td>10,97,789</td>
<td></td>
</tr>
<tr>
<td>To Cash</td>
<td>10,97,789</td>
<td></td>
</tr>
<tr>
<td>(Being payment for derivative liability on date of settlement i.e. difference between spot rate on the date of issuance of bond and date of settlement)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Movement of hedging reserve is summarised below:

<table>
<thead>
<tr>
<th>Movement</th>
<th>Dr. Amount</th>
<th>Cr. Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening</td>
<td>(1,56,795)</td>
<td>(16,654)</td>
</tr>
<tr>
<td>Derivative</td>
<td>9,57,205</td>
<td>8,76,141</td>
</tr>
<tr>
<td>MTM on loans</td>
<td>(9,42,000)</td>
<td>(5,64,000)</td>
</tr>
<tr>
<td>Forward point</td>
<td>(1,72,000)</td>
<td>(1,72,000)</td>
</tr>
</tbody>
</table>
Illustration 15:
The Company has taken an external commercial borrowing of $1 million. The term of the loan is 3 years. The Company also bought a foreign currency swap to hedge the foreign currency risk. The Company paid premium of Rs. 1 million to purchase the swap with exercise INR/USD price of 53. Other details are given below:

<table>
<thead>
<tr>
<th>Date of Loan</th>
<th>Spot Price</th>
<th>Forward Rate</th>
<th>End of Q1 Spot Price</th>
<th>Forward Rate</th>
<th>End of Q2 Spot Price</th>
<th>Forward Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Dec-20X1</td>
<td>50</td>
<td>53</td>
<td>31-Mar-20X2</td>
<td>52</td>
<td>30-Jun-20X2</td>
<td>55</td>
</tr>
</tbody>
</table>

MTM values of derivative contract

<table>
<thead>
<tr>
<th>Date</th>
<th>MTM Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Dec-20X1</td>
<td>10,00,000</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>25,00,000</td>
</tr>
<tr>
<td>30-Jun-20X2</td>
<td>65,00,000</td>
</tr>
</tbody>
</table>

Record journal entries if Company was to do hedge accounting and if the Company did not opt for hedge accounting. Assume hedge is effective for this purpose.

Solution

<table>
<thead>
<tr>
<th>As on 31 Decembe r 20X1</th>
<th>Balance Sheet</th>
<th>Ind-AS (without hedge accounting)</th>
<th>Ind-AS (with hedge accounting)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Entry required</td>
<td>Carrying value</td>
<td>Entry required</td>
</tr>
<tr>
<td>Bank a/c</td>
<td>49,00,000</td>
<td>49,00,000</td>
<td>49,00,000</td>
</tr>
<tr>
<td>Loan a/c</td>
<td>(50,00,000)</td>
<td>(50,00,000)</td>
<td>(50,00,000)</td>
</tr>
<tr>
<td>Derivative a/c (Ind AS)</td>
<td>1,00,000</td>
<td>1,00,000</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

As on 31 March 20X2

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Ind-AS (without hedge accounting)</th>
<th>Ind-AS (with hedge accounting)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank a/c</td>
<td>-</td>
<td>49,00,000</td>
</tr>
<tr>
<td>Loan a/c</td>
<td>(2,00,000)</td>
<td>(52,00,000)</td>
</tr>
<tr>
<td>Derivative a/c</td>
<td>1,50,000</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

Profit & Loss Account
(Profit)/loss on restatement of loan | 2,000,000 | 2,000,000 | 2,000,000 | 2,000,000
(Profit)/loss on derivative | (1,500,000) | (1,500,000) | (2,000,000) | (2,000,000)
Amortisation of forward element (Ind AS hedge accounting) | - | - | 83,333 | 83,333
\(\text{Being } \frac{1}{12} \text{th of initial premium for option contract representing one quarter's amortization}\)

<table>
<thead>
<tr>
<th>Other Comprehensive Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forward element of hedging instrument</td>
</tr>
</tbody>
</table>

As on 30 June 20X2  | Balance Sheet |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank a/c</td>
<td>49,000,000</td>
</tr>
<tr>
<td>Loan a/c</td>
<td>49,000,000</td>
</tr>
<tr>
<td>Derivative a/c (Ind AS)</td>
<td>4,000,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profit &amp; Loss Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit/loss on restatement of loan</td>
</tr>
<tr>
<td>Profit/loss on derivative</td>
</tr>
<tr>
<td>Amortisation of forward element (Ind AS hedge accounting)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Comprehensive Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forward element of hedging instrument</td>
</tr>
</tbody>
</table>

**FAIR VALUE HEDGE**

When there is a risk on Hedged item being other than Cash such as Inventory, Gold, Shares of another co. held as investments or any other financial or non-financial asset.

Under Fair value hedge, entity covers the risk by entering into hedging derivative contract in Futures, Forwards or Options.

**Accounting Treatment**  - Both the Hedged Items and Hedging Instrument are measured at Fair Value through Profit and Loss a/c.

**Exception**: If equity instruments (not held for trading) are designated as FVTOCI then measurement of Hedged item and Hedging Instrument shall be done through...
OCI. This fair value gain or loss accumulated in OCI is not allowed to be recycled. On sale of Investment in equity, this OCI shall be directly transferred to General reserve.

Illustration 16:
Entity has Investment in Equity shares of Infosys Ltd. On 1/03/18 carrying amount of investments is Rs. 1500. Entity is worried about decrease in market price of equity share. On the same date entity has entered into future contract (to sell) on shares of Infosys Ltd. at Rs. 1400 for 3 months.

On 31/03/2018, Mp of equity shares (Non-derivative market) = Rs. 1425
And MV of 2 months Future contract on Infosys (Derivative market) = Rs. 1370

On Settlement date - MV of equity shares - Rs. 1350/-

Assume that entity has entered into Future contracts to hedge the risk of decrease in price of Shares.
Show the accounting treatment.

Solve here:
HEDGE OF NET INVESTMENT IN FOREIGN OPERATION

Hedge of a net investment in foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, shall be accounted for similarly to cash flow hedges:

- Portion of gain/loss on hedging instrument that is determined to be effective hedge
  - Gain/loss recognized in OCI (Foreign currency translation reserve)
- Ineffective portion
  - Gain/loss recognized in P&L

The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from equity to profit or loss as a reclassification adjustment on the disposal or partial disposal of the foreign operation.
Important Notes:
ITEMS WHICH ARE SPECIFICALLY REQUIRED TO BE TRANSFER TO OTHER COMPREHENSIVE INCOME (OCI) as per INDAS:

Selective List:

<table>
<thead>
<tr>
<th>RELEVANT INDAS</th>
<th>PARTICULARS OF ITEMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>INDAS 16 - PPE</td>
<td>Revaluation Profit of PPE - known as Revaluation Reserve</td>
</tr>
<tr>
<td>INDAS 19 - EMPLOYEE BENEFITS</td>
<td>Actuarial Gains and Losses on DBP and PLAN ASSETS</td>
</tr>
<tr>
<td>INDAS 21 - EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES</td>
<td>Exchange Difference on translation of Functional Currency To Presentation Currency - also called FCTR</td>
</tr>
<tr>
<td>INDAS 109 - FINANCIAL INSTRUMENTS</td>
<td>Financial Assets categorized under FVTOCI</td>
</tr>
<tr>
<td>INDAS 109 - FINANCIAL INSTRUMENTS</td>
<td>FV Gain/Losses under Cash Flow Hedge</td>
</tr>
<tr>
<td>INDAS 109 - FINANCIAL INSTRUMENTS</td>
<td>Equity Shares not Held For Trading - Option to designate as FVTOCI Permanently</td>
</tr>
<tr>
<td>INDAS 109 - FINANCIAL INSTRUMENTS</td>
<td>Fair Value Gain or Loss on Net Investment in Foreign Operation and Derivative Instrument thereof</td>
</tr>
<tr>
<td>INDAS 103 - BUSINESS COMBINATIONS</td>
<td>NET ASSETS acquired less PURCHASE CONSIDERATION = OCI (CR)</td>
</tr>
<tr>
<td>INDAS 12 - INCOME TAXES</td>
<td>Current Tax &amp; Deferred Tax is to be recognized in OCI or directly in Equity if the items on which CT &amp; DT is calculated belongs to OCI</td>
</tr>
</tbody>
</table>