CA Final I Paper 1

New Syllabus

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2nd Edition

# Our Rankers

**AIR 5**


Sarthak Aggarwal
CA Inter May-23

**AIR 19**


Aman Mahajan
CA Inter Dec-21

**AIR 33**


Sundar B
CA Inter Dec-21

**AIR 49**


Ria Gupta
CA Inter May-22

# What Our Students have to Say....

**Aman Mahajan (CA AIR 19)**

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test serieshelped a lot in improving my writing speed and presentation skills.

**Sundar Sri Renganathan B (AIR 33)**

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

**Dwarakesh**

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

**Yug Manoj Kumar Bhattad**

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at Indigolearn.

**Prakash Bhatt**

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

**Naveen Kumar S**

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

**Bhagyasree Chougule**

It was only because of Indigolearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

**Mohd Thayyab**

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

**Lalit Chetan Sanpal**

Indigolearn has been fantastic and brilliant. Helped me alot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at Indigolearn. Really grateful. Will go for CA Finals at Indigolearn For sure. Thank you so much Indigolearn.

# #StudentFirst

### Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

### Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result ) because only in Accounting I got exemption. Thank you IndigoLearn.

### Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

### Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from Indigolearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well.Special thanks to the FM faculty, I studied only 2 chapters in economics,and still managed to score excemption in the 8th paper.

### Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

### Rajalaxmi
### CA Inter

Can't believe I cleared.Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

### Priyanka Udeshi

All the faculties have  excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

### Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the facilities and forum friends who support me a lot.

**Disclaimer**

This book is designed for students pursuing CA Final course, who are appearing for the Financial Reporting exam in **May-24 or afterwards**. The content in the book is not in the order provided by ICAI to ensure logical and comprehensive learning.

Every effort has been made to avoid errors and omissions. Despite this, errors may still occur. Any mistake, error, or discrepancy may be brought to our attention by emailing us at support@indigolearn.com and we shall fix the same in the next edition of the book.



Jan 2024 - 2nd Edition

## *Note from your Faculty*

***Dear Student,***

*We are pleased to present to you a comprehensive and simplified book on Financial Reporting for the CA Final examination. This subject is of utmost importance in the field of accounting and finance and mastering it will significantly enhance your professional competence.*

*Financial Reporting plays a crucial role in providing stakeholders with reliable and relevant information about the financial position, performance, and cash flows of an entity. We will delve into the conceptual framework, which serves as the foundation for accounting standards.*

*We will also cover the applicable Indian Accounting Standards that govern financial reporting. This includes standards related to revenue recognition, lease accounting, financial instruments, and consolidation of financial statements, among others.*

*It is essential to stay updated with the latest developments in financial reporting. Hence, we recommend referring to professional pronouncements, regulatory updates, and amendments to accounting standards issued by the relevant authorities. You should also read annual reports of listed entities to understand the practical application of what you learn in Financial Reporting.*

*Remember, financial reporting is not only a subject for examination but a vital skillset that will serve you throughout your professional career. Embrace this opportunity to strengthen your knowledge and practical application of financial reporting principles.*

*As you prepare for the examination ensure that you understand things conceptually and practice questions instead of just reading or watching the solutions. We wish you the best of luck in your studies and future endeavours.*

*CA Suraj Lakhotia*
*Director & Faculty,*
*1Fin by IndigoLearn*

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# INTRODUCTION TO INDIAN ACCOUNTING STANDARDS

## 1 Introduction

### 1.1 Financial Statement

A set of Financial statements

key tool of communication about

Useful to stakeholders in making economic decisions

| Financial position | Financial performance and | changes in financial position of an entity |
|---|---|---|

### 1.2 Accounting Standard (AS)

- AS provides principles and rules that must be followed to ensure accuracy, consistency, standardize the diverse accounting policies and comparability of financial statements
- ensure that FS should be understandable, relevant, reliable and comparable.
- set of documents that lay down the principles covering various aspects, such as, recognition, measurement, presentation & disclosure of accounting transaction in the FS
- AS enables stakeholders to get the reliable and comparable accounting data and investors to make more informed economic decisions.

### 1.3 Accounting Standard Board (ASB)

ASB of the ICAI:

- Established - 1977
- involved in the formulation of AS and standard setting process of the country.

**ASB** Recommends draft of AS post incorporating the public comments on exposure draft to → National Financial Reporting Authority (**NFRA**) and then → **Government of India, through MCA** notifies AS or Ind-AS for corporate entities under Companies Act and → **ICAI** issues AS for non-corporate entities

## 2 Prior to Introduction of IND AS in India - AS

### 2.1 Accounting Standards

- Ind AS are Accounting Standards converged with IFRS
- Prior to Ind AS, ASB issued AS to deal with reporting matters
- AS are applicable to
  - a) companies other than those following Ind AS,
  - b) SMCs (Small and Medium Sized Companies) and
  - c) non-corporate entities.

Note:
IFRS - International Financial Reporting Standards
AS - Accounting standards
FS – Financial Statement

### 2.2 Limitations of Accounting Standards

With the increase in Globalisation, Cross border transactions, flow of foreign funds and internationalisation of business, Accounting Standards could not deal with increasing complexities.

a. Capital raised in the form of complex financial instruments like optionally convertible / compulsorily convertible shares / debentures etc.

b. Various derivative instruments embedded in the foreign currency bonds / equity instruments , commodity derivatives etc.
c. Group restructuring, business acquisitions, mergers, demergers, slump sale etc.
d. Complex revenue arrangements and business models with innovating emerging digital economy
e. Diverse stock-based compensation with innovative remuneration models for C-suite
f. Complex tax provisions and impact thereof in determination of current and deferred tax
g. Different ways to provide shareholders' return and various modes of shareholder's investments in kind in the event of group reorganisation.

The recognition and disclosure requirements in ASs for Aspects like revenue, related party transactions, segment reporting, business combinations are limited. Further Accounting standards did not have necessary guidance for complex transactions like financial instruments.

## 3 Emergence of Global Accounting standards

- **1973:** The International Accounting Standards Committee (IASC) is formed, consisting of professional accountancy bodies from various countries. Its goal is to harmonize global financial reporting practices.

- Late 1990s: After 25 years, the IASC recognizes the need for a change in structure to converge national accounting standards. The International Accounting Standards Board (IASB) is formed on July 1, 2000, operating under the new International Accounting Standards Committee Foundation (IASCF, now IFRS Foundation).

- Early 2000s: The International Organisation of Securities Commissions (IOSCO) recognizes the importance of internationally accepted standards for cross-border securities offerings. In 2000, IOSCO recommends the use of 30 IASC 2000 standards for multinational issuers.

- July 19, 2002: The European Parliament and the European Council of Ministers pass a regulation requiring the adoption of International Financial Reporting Standards (IFRS) for all EU listed companies from 2005.

- Post-2002: IFRS and US Generally Accepted Accounting Principles (US GAAP) emerge as two prominent and widely adopted accounting standards globally.

- G20 Involvement: The Group of 20 (G20) expresses interest in improving the global financial system and supports the convergence of accounting standards. The G20 includes major economies like the United States, China, India, and the European Union.

- Joint Convergence Project (2002): IASB and US Financial Accounting Standards Board (FASB) launch a joint convergence project to eliminate differences between IFRS and US GAAP. The project begins with the Norwalk Agreement in October 2002.

- Present: IFRS, along with US GAAP, is recognized as one of the two globally accepted financial reporting frameworks. According to IASB research, 167 jurisdictions now require the use of IFRS for all or most publicly listed companies, and an additional 12 jurisdictions permit its use. The goal of a single set of high-quality global accounting standards remains a work in progress.

## 4 Global Accounting Standards in India

- Modern economies rely on global transactions and free international capital flow.
- Investors seek diversification and investment opportunities worldwide.
- Companies engage in cross-border activities, raising capital, conducting transactions, and establishing international operations.
- Challenges for Indian companies in cross-border activities include increased compliance costs due to diverse national accounting standards.
- Adhering to local accounting standards results in significant differences in financial information presentation.

- Variations in national accounting standards add complexity and risk to financial statements preparation and decision-making.
- Detailed examination is required to address minor differences that impact reported financial performance and position.
    - Examples include differing approaches in the valuation of non-current investments under Accounting Standards (AS) and International Financial Reporting Standards (IFRS).
- Need to revamp Indian AS arises due to limitations in dealing with emerging business transactions and structures.
- International investors often prefer financial information produced under IFRS, reflecting concerns about the understanding of the Indian accounting framework.
- India committed to the convergence of its accounting standards with IFRS at the G20 summit in 2009, signaling a proactive move towards aligning with global financial reporting norms.

## 5 Benefits of Global Accounting standards

**Global Accounting Standards**

High-quality, Internationally recognised set of accounting standards to financial markets around the world.

| Transparency | Accountability | Efficiency |
|---|---|---|
| > by enhancing the international comparability and quality of financial information,<br>> enabling investors and other market participants to make informed economic decisions. | > reducing the information gap between the providers of capital and the people to whom they have entrusted their money | > by helping investors to identify opportunities and risks across the world, thus improving capital allocation |

Company which has operations in multiple countries, it became easy for them

- to consolidate their operations,
- track operational key performance indicators, and
- reduce the number of different reporting systems.

## 6 Convergence vs Adoption of IFRS

Adoption of IFRS

- applying IFRS in the same manner and would be 100% compliant with the guidelines issued by IASB.

Convergence with IFRS

- Dictionary definition of Convergence → to move towards each other or meet at the same point from different directions
- The National accounting standards setter would work with IASB to develop high quality AS over the time.
- Adopted IFRS with some exceptions, and work with IASB towards those exceptions to reach at a point wherein there are no differences left.

Countries have choice to fully implement IFRS without any convergence. However, it is impossible for IASB to consider the individual factors of each country. Hence, such countries decide to converge to IFRS with limited exceptions. These exceptions are regularly looked upon and in order to meet at a point where no exceptions are left.

Countries like Canada, Bahrain, Cambodia etc have adopted IFRS while countries like India, China, Hongkong etc have converged with IFRS.

## 7 Process of development and finalization of Ind AS

IASB issues new IFRS or updates the existing one → Deliberation and consideration of draft Ind AS in line with IFRS by ASB → Circulation of Draft Ind AS to the Council members of ICAI and specified outside bodies

→ Meeting with the representative of the specified outside bodies to ascertain their views → Incorporation of Comments from Council and outside bodies → Issue of Exposure Draft for Public Comments

→ Consideration of comments received on the Exposure Draft and finalisation of final draft → Final draft sumbission to NFRA with recommendations → NFRA (MCA) notifies Ind AS under Companies Act

## 8 Transition from AS to IND AS

Convergence of Ind AS with IFRS

↓

at the G20 summit in 2009.

↓

MCA issued a roadmap for implementation beginning April 2011.

↓

However, suspended due to unresolved tax and other issues.

↓

In the presentation of the Union Budget 2014 –15, the Honourable Minister for Finance, Corporate Affairs and Information and Broadcasting proposed the adoption of Ind AS.

↓

The Minister clarified that the respective regulators will separately notify the date of implementation for banks and insurance companies. Also, standards for tax computation would be notified separately.

↓

In accordance with the Budget statement, the MCA has notified the Companies (Ind AS) Rules 2015 vide its G.S.R dated 16th February 2015.

↓

The IASB issues new/revised IFRS on a regular basis.

| Ind AS | IAS/IFRS | Title of Ind AS/ IFRS | AS/GN | AS/GN Title |
|---|---|---|---|---|
| 101 | IFRS 1 | First Time Adoption of Indian Accounting Standards | - | - |
| 102 | IFRS 2 | Share Based Payment | GN | Guidance Note on Accounting for Share- based Payments |
| 103 | IFRS 3 | Business Combinations | AS 14 | Accounting for Amalgamations |
| 104 | IFRS 4 | Insurance Contracts | - | - |
| 105 | IFRS 5 | Non-current Assets Held for Sale and Discontinued Operations | AS 24 | Discontinuing Operations |
| 106 | IFRS 6 | Exploration for and Evaluation of Mineral Resources | GN 15 | Guidance Note on Accounting for Oil and Gas Producing Activities |
| 107 | IFRS 7 | Financial Instruments: Disclosures | - | - |
| 108 | IFRS 8 | Operating Segments | AS 17 | Segment Reporting |

| Ind AS | IAS/IFRS | Title of Ind AS/ IFRS | AS/GN | AS/GN Title |
|---|---|---|---|---|
| 109 | IFRS 9 | Financial Instruments | - | - |
| 110 | IFRS 10 | Consolidated Financial Statements | AS 21 | Consolidated Financial Statements |
| 111 | IFRS 11 | Joint Arrangements | AS 27 | Financial Reporting of Interests in Joint Ventures |
| 112 | IFRS 12 | Disclosure of Interests in Other Entities | - | - |
| 113 | IFRS 13 | Fair Value Measurement | - | - |
| 114 | IFRS 14 | Regulatory Deferral Accounts | GN | Accounting for Rate Regulated Activities |
| 115 | IFRS 15 | Revenue from Contracts with customers | AS 7<br>AS 9 | Construction Contract Revenue Recognition |
| 116 | IFRS 16 | Leases | AS 19 | Leases |
| | IFRS 17 | Insurance Contracts | | |
| 1 | IAS 1 | Presentation of Financial Statements | AS 1 | Disclosure of Accounting Policies |
| 2 | IAS 2 | Inventories | AS 2 | Valuation of Inventories |
| 7 | IAS 7 | Statement of Cash Flows | AS 3 | Cash Flow Statements |
| 8 | IAS 8 | Accounting Policies, Changes in Accounting Estimates and Errors | AS 5 | Net Profit or Loss for the Period, Prior period Items and Changes in Accounting Policies |
| 10 | IAS 10 | Events after the Reporting Period | AS 4 | Contingencies and Events Occurring After the Balance Sheet date |
| 12 | IAS 12 | Income Taxes | AS 22 | Accounting for Taxes on Income |
| 16 | IAS 16 | Property, Plant and Equipment | AS 10 | Property, Plant and Equipment |
| 19 | IAS 19 | Employee Benefits | AS 15 | Employee Benefits |
| 20 | IAS 20 | Accounting for Government Grants and Disclosure of Government Assistance | AS 12 | Accounting for Government Grants |
| 21 | IAS 21 | The Effects of Changes in Foreign Exchange Rates | AS 11 | The Effects of Changes in Foreign Exchange Rates |
| 23 | IAS 23 | Borrowing Costs | AS 16 | Borrowing Costs |
| 24 | IAS 24 | Related Party Disclosures | AS 18 | RelatedParty Disclosures |
| | IAS 26 | Accounting & reporting by Retirement benefit plans | | |
| 27 | IAS 27 | Separate Financial Statements | - | - |
| 28 | IAS 28 | Investment in Associates and Joint Ventures | AS 23 | Accounting for Investment in Associates in Consolidated Financial Statements |
| 29 | IAS 29 | Financial Reporting in Hyperinflationary Economies | - | - |
| 32 | IAS 32 | Financial Instruments: Presentation | - | - |
| 33 | IAS 33 | Earnings per Share | AS 20 | Earnings per Share |
| 34 | IAS 34 | Interim Financial Reporting | AS 25 | Interim Financial Reporting |
| 36 | IAS 36 | Impairment of Assets | AS 28 | Impairment of Assets |
| 37 | IAS 37 | Provisions, Contingent Liabilities and Contingent Assets | AS 29 | Provisions, Contingent Liabilities and Contingent Assets |

| Ind AS | IAS/IFRS | Title of Ind AS/ IFRS | AS/GN | AS/GN Title |
|---|---|---|---|---|
| 38 | IAS 38 | Intangible Assets | AS 26 | Intangible Assets |
| 40 | IAS 40 | Investment Property | AS 13 | Accounting for Investments |
| 41 | IAS 41 | Agriculture | - | - |

Ind AS are numbered in line with IAS/IFRS

IAS 1-41 : Ind AS 1-41 [IAS were issued till 2000]

IFRS 1 onwards – Ind AS 101 onwards [IFRS issued post 1st July 2000]

Ind AS have following components and they are generally structured as follows:

I. Objective – Main purpose of Ind As
II. Scope – What standard intends to cover and not to cover
III. Definitions – Definition of various terms used in the standard
IV. Content of the Standard – Main principle of the standard
    a. Recognition,
    b. Measurement,
    c. Subsequent measurement
    d. along with any other standard specific contents
V. Disclosure
    a. Qualitative / Quantitative information of particular
        i. asset /
        ii. liability /
        iii. income /
        iv. expense should be presented in FS.
VI. Transitional provisions and effective date
VII. Appendices – Integral part of standard, mainly consist of:
    a. Explanation on industry specific issues which require detailed guidance.
    For e.g.: Appendix to Ind AS 16 contains treatment of stripping costs in the production phase of a surface mine
    b. Application Guidance – These are mainly in standards which are converged from International Financial Reporting Standards (Ind AS 101 and onwards). It contains detailed guidance in applying the principles mentioned in the standard
    c. Defined terms – It mentions definition of terms mentioned in the standard
    d. References to matters contained in other Ind AS - It lists the appendix which is a part of another Indian Accounting Standard and makes reference to the particular standard.
    e. Comparison with IFRS – Differences with IFRS are explained in this section
    f. IFRIC and SIC applicable and relevant for the respective Ind AS

# 9 Roadmap for Applicability of Ind AS

MCA has notified the Companies (Ind AS) Rules, 2015 vide its G.S.R dated 16 Feb, 2015.

- 39 Ind AS and has laid down an Ind AS transition roadmap for companies and non- banking finance companies excluding banking companies and insurance companies.
- proposed phase-wise approach for mandatory transition to Ind AS.

## 9.1 Applicability of Ind As for Listed Companies

| Applicability of Ind AS to Listed entities in the following two phases: | | |
|---|---|---|
| | Phase 1 | Phase 2 |
| Applicability: | | |
| (a) Equity or Debt securities | listed or in process - on any stock exchange in India or outside India and NW≥500 Crs | listed or in process - on any stock exchange in India or outside India and NW<500 Crs) |

| Applicability of Ind AS to Listed entities in the following two phases: | | |
|---|---|---|
| | Phase 1 | Phase 2 |
| (b) Net worth | 500crs or more | 250 crs or more, but less than 500 crs |
| (c) Includes | Holding, subsidiary, associate or Joint Venture of Companies already covered under sub clause (a) & (b) above | |
| Accounting period: | | |
| Accounting Period beginning on or after | 1st Apr, 2016 | 1st Apr, 2017 |
| Opening balance sheet as on | 1st Apr, 2015 | 1st Apr, 2016 |
| Comparative for | 31st Mar, 2016 | 31st Mar, 2017 |
| Financial statement for the | FY 2016-17 | FY 2017-18 |

The Companies (Ind AS) Rules, 2015 clarifies,

- Non-applicable of road map
    - companies whose securities are listed or are in the process of being listed
        - on SME (Small and Medium Enterprise) exchange as referred to in Chapter XB or
        - on the Institutional Trading Platform without initial public offering in accordance with the provisions of Chapter XC of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.
- Option for Early adoption of Ind AS
    - for their FS for accounting periods beginning on or after 1st April 2015, with the comparatives for the periods ending on 31st March 2015 or any time thereafter.

Non-applicable of Ind AS → Unlisted companies whose NW<250 Crs

- Follow AS as per its applicability discussed above.
- Can voluntary adopt Ind AS.

## Net worth:

As per clause 57 of section 2 of the Companies Act, 2013

**Net worth means**

- the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account,
- after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet,
- but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation

For calculation of Net worth

- Consider stand-alone financial statements of the company as on 31st Mar 2014 or the first audited FS for accounting period which ends after that date;
- If Company is not in existence on 31st March 2014 or an existing company falling under threshold first time after 31st Mar, 2014
    - Consider audited SFS ending after that date, in respect of which it meets the thresholds.
- If threshold is met at the end of accounting year, Ind AS is applied from next financial year. In other words check the threshold as at the end of previous accounting period.

## 9.2 Key Matters on Transition

| | |
|---|---|
| **Comparative Financial Information** | All companies applying Ind AS are required to present comparative information as per Ind AS for one year. To comply with this requirement, Ind AS will be applicable from the beginning of the previous period |
| **Ind AS Applicability** | Companies shall prepare their first set of financial statements in accordance with the Ind AS effective at the end of its first Ind AS reporting period. |

| | |
|---|---|
| **Consistent application of Ind AS** | A Company shall be required to follow the Indian Accounting Standards (Ind AS) for all the subsequent financial statements even if any of the criteria specified in the Rules does not subsequently apply to it. |
| **Applicability for Group Companies** | If Ind AS is applicable to a company, it would also be applicable to its holding company, subsidiary company, associate company and joint venture. |
| **Overseas group companies** | 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.<br>• provided that such Indian company shall prepare its consolidated financial statements in accordance with the Indian Accounting Standards (Ind AS) |
| **SFS/CFS** | Ind AS once required to be complied with in accordance with these rules, shall apply to both stand-alone financial statements and consolidated financial statements. |

## 9.3 Applicability of Ind As for Non-Banking Financial Company

Non-Banking Financial Company as

- defined in clause (f) of sec 45-I of the RBI Act, 1934 and
- includes Housing Finance Companies, Merchant Banking companies, Micro Finance Companies, Mutual Benefit Companies, Venture Capital Fund Companies, Stock Broker or Sub-Broker Companies, Nidhi Companies, Chit Companies, Securitisation and Reconstruction Companies, Mortgage Guarantee Companies, Pension Fund Companies, Asset Management Companies and Core Investment Companies

Ind AS applicability to NBFC

| NBFCs to apply Ind AS in the following two phases: | | | |
|---|---|---|---|
| | Phase 1 | Phase 2 | |
| Applicability: | | | |
| | | Listed or in process | Unlisted |
| (a) Net worth | 500crs or more | Less than 500 crs | 250 crs or more, but less than 500 crs |
| (b) Includes | Holding, subsidiary, associate or Joint Venture of NBFCs already covered under sub clause (a) above<br>(other than companies already covered under Ind AS roadmap for Non-Financial companies) | | |
| Accounting period: | | | |
| Accounting Period beginning on or after | 1st Apr, 2018 | 1st Apr, 2019 | |
| Opening balance sheet as on | 1st Apr, 2017 | 1st Apr, 2018 | |
| Comparative for | 31st Mar, 2018 | 31st Mar, 2019 | |
| Financial statement for the | FY 2016-17 | FY 2017-18 | |

Clarification on calculation of Net Worth:

- Consider <u>stand-alone financial statements</u> of the NBFCs as on 31st March 2016 or the first audited FS for accounting period which ends after that date;
- not in existence on 31st March 2016 or an existing NBFC falling first time
  - Consider SFS ending after that date, in respect of which it meets the thresholds.

Example:

| NBFC meeting threshold for the first time as on | Ind AS applicable for FY |
|---|---|
| 31st Mar, 2019 | FY 2019-20 onwards |

| | |
|---|---|
| 31st Mar, 2020 | FY 2020-21 onwards |

***Voluntary application of Ind AS is not permitted for NBFCs.***

Application of Ind AS to non-finance companies whose parent / subsidiary or associate or joint venture is a NBFC:

Standalone FS:

companies shall apply AS or Ind AS on the basis of respective standard applicable to them.

Preparation of Consolidated Financial Statements:

| Parent Company | Its subsidiaries, associates and joint ventures (S/A/JV) | Required to provide FS data by S/A/JV (for consolidation purposes) in accordance with |
|---|---|---|
| NBFC → AS | Non-finance company → Ind AS | Accounting policies followed by the parent company i.e in line with AS |
| Non-finance company → Ind AS | NBFC | Accounting policies followed by the parent company i.e in line with Ind AS |

### 9.4 Applicability of Ind As for Banking and Insurance Companies

- As per the Companies (Ind AS) (Amendment) Rules, 2016 → as notified by the RBI and Insurance Regulatory Development Authority (IRDA) respectively.
- As the same are yet to be notified, Ind AS is not applicable to Banking and Insurance Companies presently.
- Shall not be allowed to voluntarily adopt Ind AS.
- Ind AS compliant FS for the purpose of preparation of CFS by its parent/investor, as required by the parent to comply with the existing requirements of law.

### 9.5 Applicability of Ind As for Mutual Funds

- As per regulatory framework for operating and functioning of MFs by SEBI (MF) Regulations, 1996
- On 25 January 2022, SEBI (Mutual Funds) (Amendment) Regulations, 2022 notifies
  - FS and accounts of MF schemes will be prepared in accordance with Ind AS.
- Circular (dated 4 February 2022) provides
  - certain guidelines on accounting with respect to Ind AS for MFs.
  - specific formats of the FS to be prepared for the MF schemes under Ind AS
  - Applicable from 1 April 2023.

## 10 IND AS Relevant Statutory provisions

### 10.1 Relevant sections referring to Ind AS in the Companies Act, 2013 and rules

Ind AS

- initially notified under the Companies (Ind AS) Rules, 2015.
- Post that it includes the amendments / changes in the Ind AS.

| Following are provisions of the Companies Act 2013, which gives reference to Ind AS: | |
|---|---|
| Section | States / suggests |
| Sec 133 | CG may prescribe the standards of accounting or any addendum thereto,<br>➢ as recommended by the ICAI, constituted under section 3 of the CA Act, 1949 (38 of 1949),<br>➢ in consultation with and after examination of the recommendations made by the NFRA.<br>Under the power given to the CG under section 133 → notified the Companies (Ind AS) Rules, 2015. |
| Sec 129 | FS shall give a true and fair view of the state of affairs of the company or companies, comply with the AS notified under sec 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III |

| | |
|---|---|
| Sec 134 (5) | Statement that the applicable AS had been followed with proper explanation relating to material departures shall be given in the Director Responsibility statement<br>- to be issued under sec 134 (3) (c) in the Director's report to be published in AGM |
| Sec 143 | auditor has to opine whether the FS comply with the AS |
| Sec 230 | Power to compromise or make arrangements with creditors and members and Sec 232 – Merger and amalgamation of Companies, the scheme of compromise or arrangement is to be sanctioned by the tribunal<br>- only after obtaining a certificate from the company's auditor that the accounting treatment given proposed in the scheme of compromise or arrangement is in conformity with the AS mentioned in Sec 133. |
| Sec 66 | Reduction of Share Capital, which states that no application for reduction of share capital shall be sanctioned by the Tribunal<br>- unless the accounting treatment, proposed by the company for such reduction is in conformity with the AS specified in sec133 or any other provision of this Act and<br>- a certificate to that effect by the company's auditor has been filed with the Tribunal. |

### 10.2 Relevant SEBI Rules and Regulations

- Circular dated 30th November 2015 provides
  - Format for publishing quarterly FS.
  - Point 5 of the circular clarified that Companies adopting the Ind AS in terms of Companies (Ind AS) Rules, 2015 notified by the MCA on 16th Feb, 2015 while publishing quarterly / annual financial results under Regulation 33 of the Listing Regulations, 2015,
    - shall ensure that the comparatives filed along with such quarterly/annual financial results are also Ind AS compliant.
- Disclosures in offer documents under SEBI (ICDR) Regulations, 2018 → The applicability of Ind AS for financial information (last 3 years financials - year wise)

- Revised formats for financial results and implementation of Ind AS by Listed Entities applicable for period ending on or after 31st Marcy 2017.

## 11 Format of Division II to Schedule III to the companies Act - Structure

### 11.1 Schedule III to the Companies Act, 2013

- notified on 29th August
- Format of FS for every company registered under the Act

**Financial Statements** as defined under Companies Act, 2013 include
- Balance Sheet,
- Statement of Changes in Equity for the period if applicable,
- the Statement of Profit and Loss for the period,
- Cash flow statement for the period and
- Notes.

### 11.2 'Division II' to Schedule III

'Division II' – 'Ind AS Schedule III' → Newly inserted to Schedule III
- gives a format of FS for companies that are required to comply with the Companies (Ind AS Rules, 2015, as amended from time to time.
- would apply while preparing its first and subsequent Ind AS Financial Statements
- Non-applicability
  - any insurance or banking company or to any other class of company for which a form of BS and P&L has been specified in or under any other Act governing such class of company
  - NBFCs that adopt Ind AS of Companies (Ind AS) Rules, 2015 notified in Companies (Ind As) (Amendment) Rules, 2016 as amended from time to time.

| 'Division II' – 'Ind AS Schedule III' is divided into following three parts: | | |
|---|---|---|
| Part I | Part II | Part III |

| | | |
|---|---|---|
| Format of<br>○ Balance Sheet and<br>○ Statement of Changes in Equity and<br>○ notes related to them | Format of<br>○ Statement of Profit and Loss and<br>○ notes related to it | General Instructions for preparation of CFS |

## 12 Guidance note on Division II to Schedule III to the Companies act, 2013

Guidance Note on Division II to Schedule III to the Companies act, 2013

- Latest → issued in January, 2022
- Aims
  - to provide guidance and
  - to deal with practical issues that may arise in implementation of Amended Division-II to Schedule III to the Companies Act, 2013

<u>Following are the some of key guidance stated in guidance note, read in conjunction with Guidance Note issued on the subject:</u>

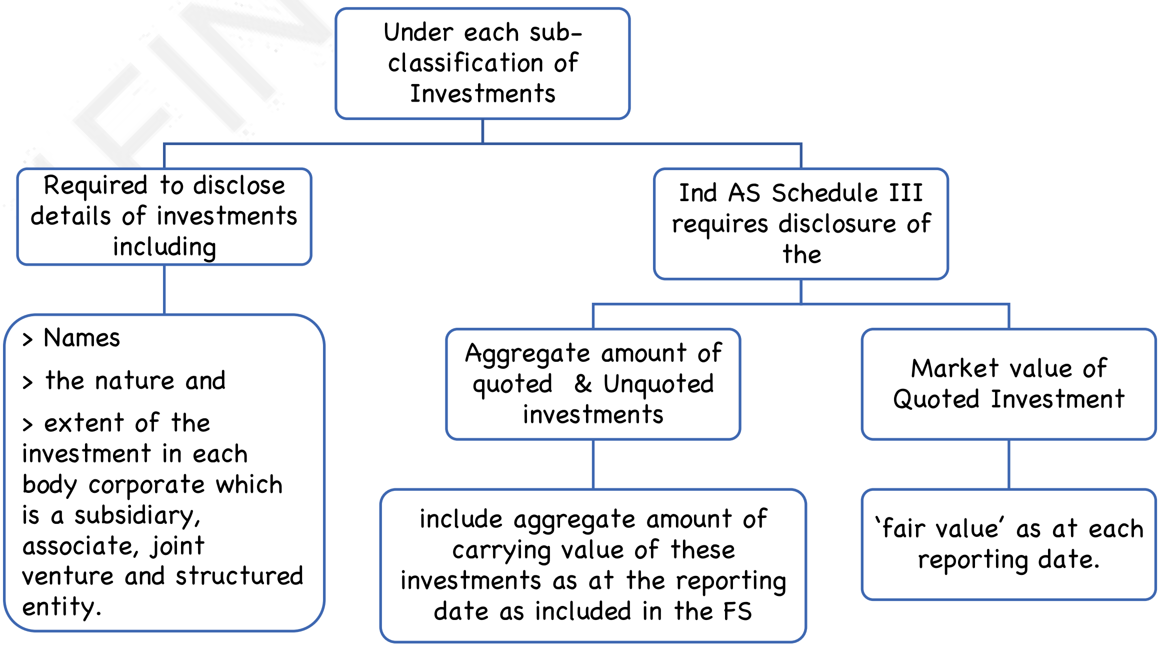
### 12.1 Property, Plant and Equipment:

| Land and Building | | |
|---|---|---|
| Under the Ind AS Schedule III | paragraph 37 of Ind AS 16 | Conclusion |
| presented as two separate classes of PPE | - grouping land and building under same class for revaluation purposes<br>- states that a class of PPE is a grouping of assets of a similar nature and use in an entity's operations | present land and building separately as given in Ind AS Schedule III & such presentation needs to be followed consistently |

<u>Note:</u> As per Ind AS Schedule III,

- capital advances/ advances for purchase of capital assets
  - should be included under other non- current assets
  - Not under capital work-in-progress

### 12.2 Non-current Investment:



In some cases the company may determine that the quoted price may not be fair value (for e.g due to reduction in volume). In such case, quote value would be disclosed as per Sch III even though the same may not be representative of Fair value.

As per Ind AS Schedule III, aggregate amount for impairment in value of investments should be disclosed separately. Investment in partnership firm would be disclosed separately. LLP investments would be clubbed with other investments.

Note: Any application money paid towards securities, where security has not been allotted on the date of the Balance Sheet, shall be disclosed as a separate line item under 'other non-current financial assets'. In case the investment is of current investment in nature, such share application money shall be accordingly, disclosed under other current financial assets

### 12.3 Trade Receivables:

A Receivable

classified as 'Trade Receivable', If it is

| | |
|---|---|
| due on account of goods sold or services rendered in the normal course of business and | company has a right to an amount of consideration that is unconditional (Requires only passage of time) |

Note: Amounts due, other than arising out of sale of goods or rendering of services → cannot be included within Trade Receivables. These are classified as other financial assets. For e.g insurance claims.

Amounts due under contractual rights

↓

classified as "other financial assets" and disclosed nature-wise

↓

Eg: insurance claims, sale of Property, Plant and Equipment, contractually reimbursable expenses, etc

**Ageing of the trade receivables**

needs to be determined from the due date of the invoice.

**Due date**

(Date on which the payment of an invoice falls due)

Agreement between between buyer and supplier (Either orally or in written)

exists - Agreed due date

Not exists - Transaction date

Schedule III:

- Schedule III requires split of trade receivables between 'disputed' and 'undisputed'
- Dispute means disagreement between two parties demonstrated by some positive evidence which supports or corroborates the fact of disagreement
- It should be considered while assessing the credit risk associated with respective party while computing the impairment loss.

### 12.4 Other Non-Current Financial Assets

| Finance lease receivables | |
|---|---|
| Ind AS Schedule III | Guidance note |

| | |
|---|---|
| does not specify about its presentation | Clarifies the presentation finance lease receivable<br>➢ Its Non - current portion under 'Other non - current financial assets'<br>➢ Its Current portion under 'Other current financial assets'. |

## 12.5 Current Assets

As per Ind AS Schedule III

- all items of assets and liabilities are to be bifurcated between current and non-current portions.
- Some items presented under the "non-current, may not have a corresponding "current" head under the format given in Ind AS Schedule III.

<u>Since Ind AS Schedule III permits the use of additional line items</u> → in such cases classified under the "Current" category as a separate line item and other relevant disclosures should be made.

## 12.6 Cash and Cash Equivalents

| Cash and cash equivalents | |
|---|---|
| Ind AS Schedule III | Ind AS 7 |
| not defined | Cash is defined to include cash on hand and demand deposits with banks. |

**Cash Equivalents** are defined as short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

As per para 8 of Ind AS 7

➢ where bank overdrafts which are repayable on demand form an integral part of an entity's cash management

➢ bank overdrafts are included as a component of cash and cash equivalents.

➢ A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

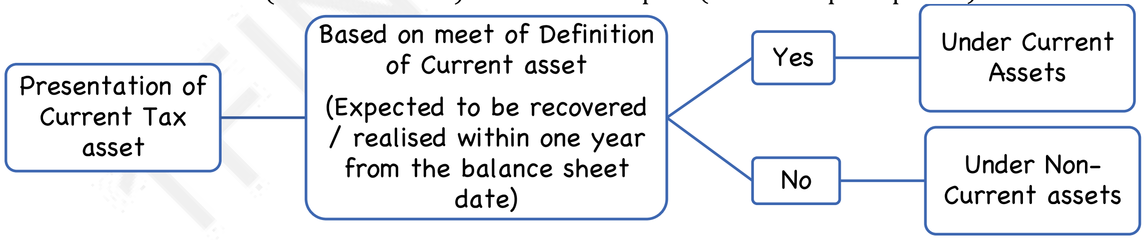
### Bank overdraft

➢ It is not appropriate to include bank overdraft as a component of cash and cash equivalents for the purpose of presentation in the balance sheet, unless the offset conditions as given in paragraph 42 of Ind AS 32 are complied with.

➢ Bank overdraft, in the balance sheet, should be included as 'borrowings' under Financial Liabilities.

## 12.7 Current Tax Assets

$$\text{Current Tax Asset (Excess Tax Paid)} = \text{Tax amount paid (Current \& prior period)} - \text{Taxdue for those periods}$$




## 12.8 Equity Share Capital

**The accounting definition of 'Equity'** is principle based as compared to the legal definition of 'Equity' or 'Share', such that <u>any contract that evidences residual interest in an entity's net asset</u> is termed as 'Equity' irrespective of whether it is legally recognized as a 'Share' or not.

Note:

➢ All instruments (including convertible preference shares and convertible debentures) → considered as 'Equity' for the purpose of Ind AS Schedule III & termed as 'Instruments entirely equity in nature', If that
   - o meet the definition of 'Equity' as per Ind AS 32 in its entirety and

- when they do not have any component of liability

### 12.9 Borrowings

- "Term loan" not defined in the Schedule III, normally have a fixed or pre-determined maturity period or a repayment schedule.
- Terms of repayment of term loans (unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated) and other loans (all categories listed under the heading 'Non – Current borrowings' as per Ind AS Schedule III) shall be disclosed.
- Ind AS Schedule III
  - Long-term debt - borrowing having a period of more than twelve months at the time of origination.
  - Current maturities of long-term debt
    - The portion of non-current borrowings, which is due for payments within twelve months of the reporting date is required to be classified under "current borrowings" while the balance amount should be classified under non-current borrowings.

### 12.10 Trade Payable

- Amount due on account of goods purchased or services received in the normal course of business → 'Trade payable'
- Amount due under contractual obligations or which are statutory payables → Not Trade Payables. (Eg: statutory obligations like contribution to provident fund or contractual obligations like contractually reimbursable expenses, amounts due towards purchase of capital goods, etc)

### 12.11 Current Borrowings

- Loans payable within a period of 12 months from the date of the loan & Loans payable on demand → treated as Current borrowings.
- the period and the amount of defaults of such loans are existing as at the date of the Balance Sheet should be disclosed (item-wise).
- In addition to Ind AS Schedule III requirements for presenting 'current maturities of long-term borrowings' under current borrowings → Companies shall provide the amount of non-current as well as current portion for each of the respective category of non-current borrowings either by way of a note or a schedule or a cross- reference, as appropriate.

### 12.12 Other Current Liabilities

- Trade Deposits and Security Deposits, which do not meet the definition of financial liabilities, should be classified as 'Others' grouped under this head.
- Others may also include liabilities in the nature of statutory dues such as Withholding taxes, Service Tax, VAT, Excise Duty, Goods and Services Tax (GST), etc.

### 12.13 Contingent Liabilities and Commitments

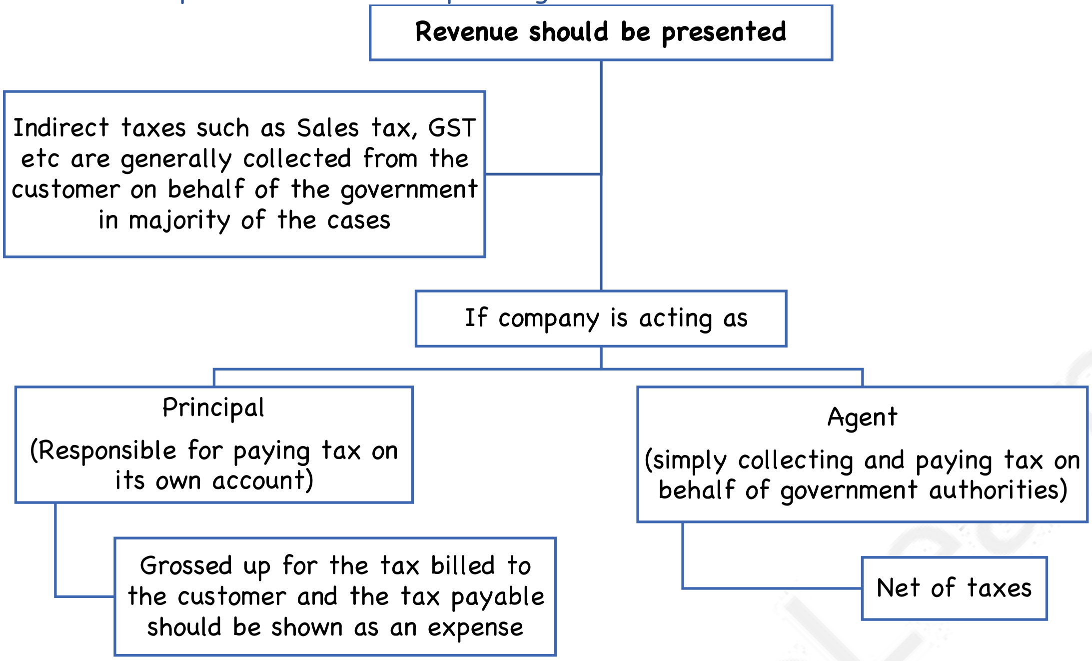
- A contingent liability in respect of guarantees arises when a company issue guarantees to another person on behalf of a third party

  E.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.
- However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance Sheet.
  - For various reasons, it is customary for guarantees to be issued by Bankers

    e.g. for payment of insurance premium, deferred payments to foreign suppliers, letters of credit, etc.
  - For this purpose, the company issues a "counter-guarantee" to its Bankers.
    - Such "counter-guarantee" is not really a guarantee at all
    - but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premium when demanded or to make deferred payments when due.

- Hence, such <u>performance guarantees and counter guarantees should not be disclosed as contingent liabilities</u>.

## 12.14 Revenue from Operations and other operating income




- "<u>Other operating revenue</u>" is not defined, but include
  - Revenue arising from a <u>company's operating activities</u>, i.e., either its principal or ancillary revenue-generating activities,
  - but not revenue arising from sale of products or rendering of services.
- "other operating revenue" or "other income" is to be decided based on
  - the facts of each case and
  - detailed understanding of the company's activities.

## 12.15 Exceptional Items

- The term 'Exceptional items' is neither defined in Ind AS Schedule III nor in Ind AS.
- However, Ind AS 1 has reference to such items.
- An entity considers factors including materiality and the nature and function of the items of income and expense. It indicates circumstances that would give rise to the separate disclosures of items of income and expenses and include:
  - Write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
  - restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
  - disposals of items of property, plant and equipment;
  - disposals of investments;
  - discontinued operations;
  - litigation settlements; and
  - other reversals of provisions.

# AS 2

# INVENTORIES

## 1. Introduction

### 1.1 Objective

- To prescribe accounting treatment of inventories.
- Determination of cost of inventory.
- Subsequent recognition as an expense.
- Provides guidelines on cost formulas.

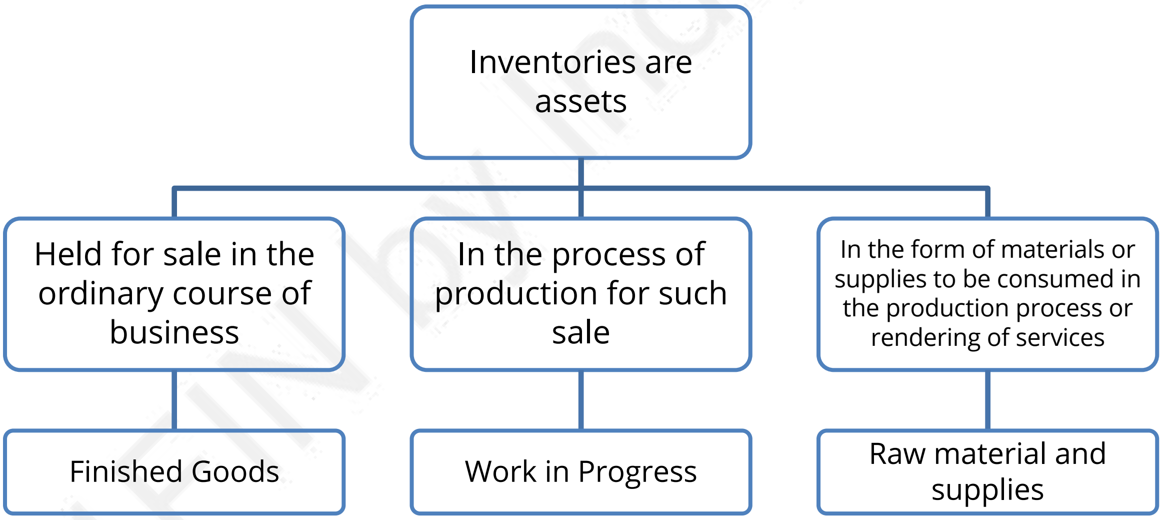
### 1.2 Scope

Standard applies to all inventories except

| | | |
|---|---|---|
| (a) | Financial Instruments | IndAS 109 |
| (b) | Biological Assets related to Agriculture & Agriculture Produce at the point of Harvest. **Note : Produce post harvest will be covered under IndAS-2 and cost will be the value determined as per IndAS-41** | IndAS 41 |
| (c) | Measurement of inventories held by<br>- Producers of agricultural & forest products, minerals etc to the extent meausred at NRV in line with industry practice<br>- Commodity broker-traders who measure inventories at FV less cost to sell | Recognition and disclosures criteria applies |

## 2. Definitions

### 2.1 Inventories




### 2.2 Net Realisable Value (NRV)

NRV is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

### 2.3 Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

## 3. Measurement

**Golden Rule - Inventories are measured at lower of cost and net realisable value.**

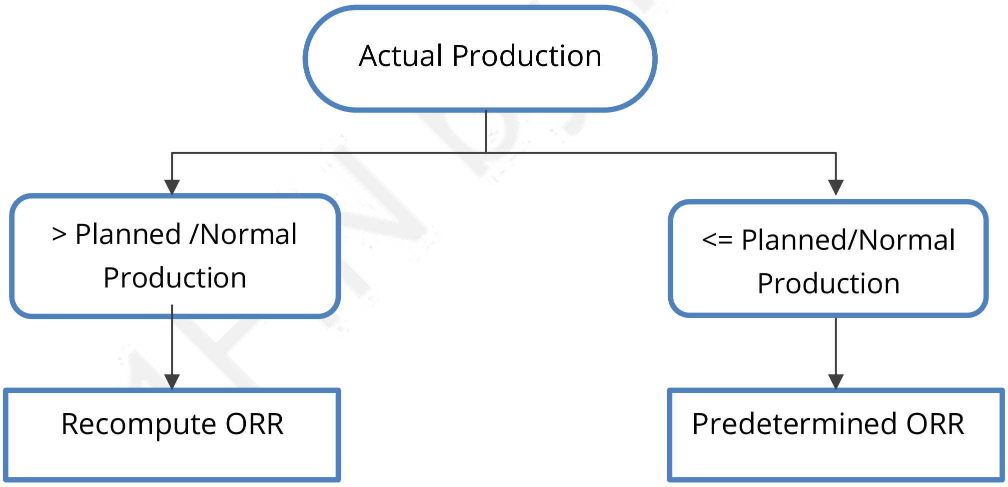
### 3.1 Cost of Inventories

| PARTICULARS | AMOUNT | |
|---|---|---|
| ***Cost of Purchases*** | | |
| *Purchase Price* | XXX | |
| *(+) Import duties & other taxes* | XXX | |
| *(+)Transport & handling charges* | XXX | |
| *(+) Other Costs to bring the inventory to present location* | XXX | |
| *& condition* | XXX | |
| *(-)Trade discounts, rebates & other similar items* | (XXX) | XXX |
| *Cost of Conversion* | | |
| *Direct material* | XXX | |
| *(+) Direct labour* | XXX | |
| *(+) Other direct costs* | XXX | |
| *(+) Overheads (Fixed* as well as variable overheads)* | XXX | XXX |
| *Other Costs* | | |
| *Costs incurred to bring the inventories to their present location & condition* | XXX | |
| *(+) Borrowing Cost under Ind AS 23* | XXX | XXX |
| *Cost of Inventory* | | XXX |

### 3.2 Overhead

Fixed overhead is allocated based on predetermined overhead recovery rate (ORR) computed as below.

$$Pre\ Determined\ ORR = \frac{Budgeted\ Fixed\ OH}{Planned\ or\ Normal\ Production}$$



### 3.3 Net Realisable Value

| | |
|---|---|
| *Estimated Selling Price* | XXX |
| *(-) Estimated costs to complete* | (XXX) |
| *(-) Estimated Costs to Sell* | (XXX) |
| *Net Realisable Value* | XXX |

- Estimates of NRV should be based on most reliable evidence available.
- Events occuring after balance sheet should be considered to the extent they provide additional evidence of events existing on balance sheet date.
- Price reductions in future should not be considered to determine NRV.
- If inventory is held for a firm contract to sell, the contracted price can be an evidence of NRV.

**Write down of inventories should be done on an item to item basis and not on global basis.**

### 3.4 Joint Products & By Products

**Joint Products** – Two or more products produced from a single process using common inputs. Each product has significant value. Example – Petrol, Diesel, Gas produced on refining crude.

Joint costs are allocated on the basis of relative sales value / NRV at split off point.

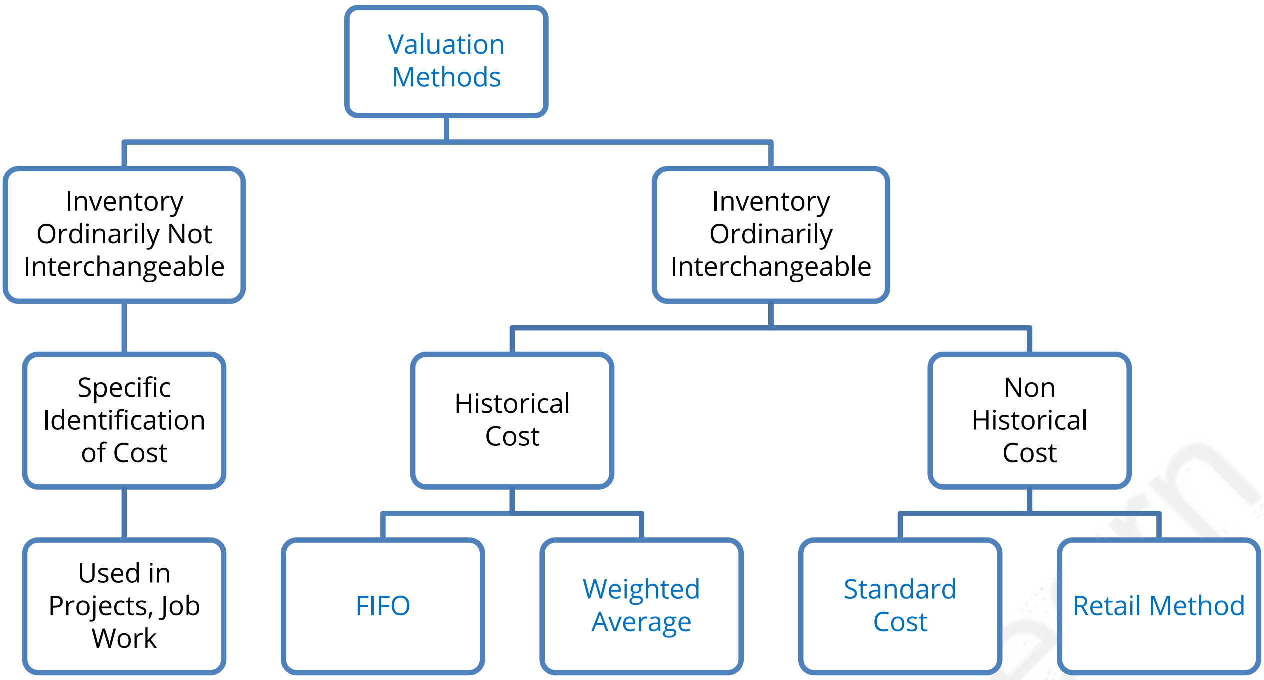
**By Products** – These are low value produces – generally considered as scrap.

NRV of by products is reduced from joint costs if the by products are immaterial. If the by products are material, consider as Joint Products.

### 3.5 Cost measurement techniques

| Retail Method | Standard Cost Method |
|---|---|
| **Cost of Inventory =**<br>Expected Sales Value<br>(-) Normal Gross Profit Margin | Standard cost is set considering standard usage of<br>- Material<br>- Labour<br>- Overhead<br>- Capacity utilisation |

### 3.6 Cost Formula




An entity shall use same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different use , different cost formula can be used.

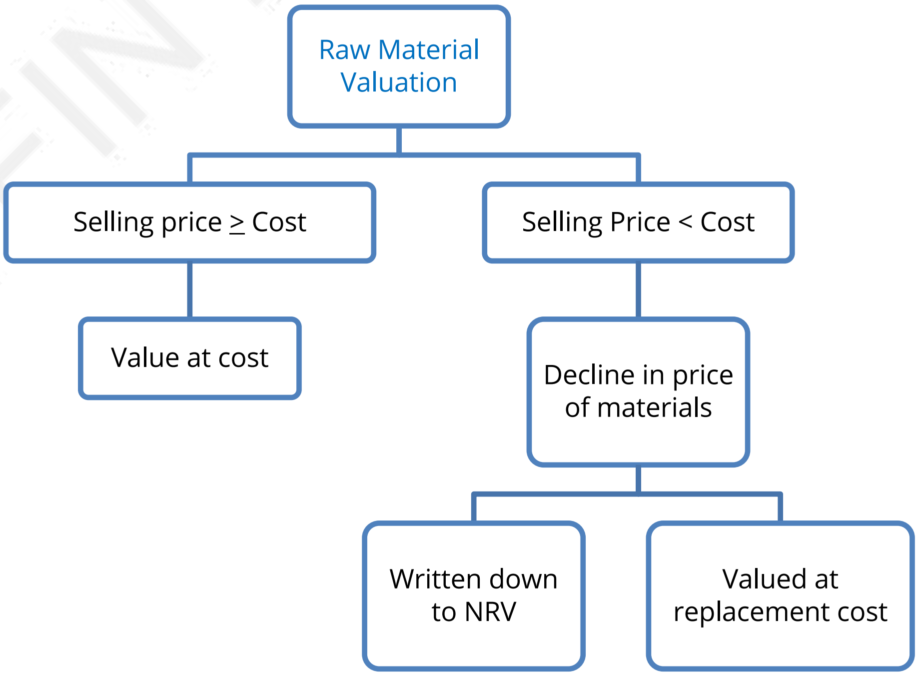
#### 3.6.1 FIFO Method

- Assumption of cost flow : Inventory purchased first is sold first.
- Goods in Inventory are valued using the latest rates

#### 3.6.2 Weighted Average Rate

- Cost is determined using a weighted average rate of goods received.
- The weighted average can be a periodic weighted average or a moving weighted average.

### 3.7 Raw Material Valuation



## 4. Recognition of Expenses

Expense charged to P&L = Carrying amount of inventories sold + write down of inventories – reversals of write down.

The cost of some inventories may be allocated to other asset accounts. For example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset are recognised as an expense during the useful life of that asset through charging of depreciation on that asset (Ind AS 16)

## 5. Disclosures

Accounting policies including cost formula used.

- Analysis of carrying amount of inventory & carrying amount in classifications appropriate to the entity
- Carrying amount of inventories carried at fair value less cost to sell
- Carrying amount of inventories pledged as security
- Amounts recognised in profit or loss
    - Recognised as expense
    - Write down of inventory
    - Reversals of write down

## 6. IndAS 2 vs AS 2

There are no significant differences between the two standards

- IndAS 2 deals with recognition of expenses which is not dealt by AS-2
- IndAS 2 Explains inventories of service providers
- AS 2 deals with treatment of spare parts
- Ind AS 2 is not applicable to inventories of brokers/traders
- IndAS 2 covers concept of Fair value which is not covered by AS-2
- Agricultural produce are excluded from measurement aspects under IndAS-2. Under AS-2 these are fully excluded

# Illustrations

## 1. Illustration (RTP Nov 20)

A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:

- Material = Rs. 200 per unit;
- Labour = Rs. 100 per unit;
- Variable manufacturing overhead = Rs. 100 per unit;
- Fixed factory production overhead =Rs. 1,00,00,000;
- Fixed factory selling overhead = Rs. 50,00,000;
- Variable factory selling overhead = Rs. 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead?

## 2. Illustration

In a manufacturing process of Mars ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

| Item | Unit | Amount | Output | Closing Stock 31-03-X1 |
|---|---|---|---|---|
| Raw material | 14,500 | 1,50,000 | MP 1-5,000 units | 250 |
| Wages | - | 90,000 | MP II - 4,000 units | 100 |
| Fixed overhead | - | 65,000 | BP- 2,000 units | |
| Variable overhead | - | 50,000 | | |

Average market price of MP1 and MP2 is Rs. 60 per unit and Rs. 50 per unit respectively, by- product is sold @ Rs. 20 per unit. There is a profit of Rs. 5,000 on sale of by-product after incurring separate processing charges of Rs. 8,000 and packing charges of Rs. 2,000, Rs. 5,000 was realised from sale of scrap.

**Required:** Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

## 3. Illustration

The following information relates to 20X1-20X2

| Date | Particular | Unit | Cost p.u. | Total Cost |
|---|---|---|---|---|
| April | Inventory | 200 | 10 | 2,000 |
| May | Purchases | 50 | 11 | 550 |
| September | Purchases | 400 | 12 | 4,800 |
| February | Purchases | 350 | 14 | 4,900 |
| | **Total** | **1,000** | | **12,250** |
| June | Sales | 150 | | |
| October | Sales | 300 | | |
| November | Sales | 150 | | |

Physical inventory at 31.03.20X2 400 units. Calculate ending inventory value and cost of sales using:

a. FIFO

b. Weighted Average

Under periodic and perpetual inventory system

## 4. Illustration (RTP May 2018)

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is Rs. 11 million and estimated selling expenses are same Rs. 0.5 million.

What will be the value inventory at the following dates:

- 31$^{st}$ March 20X1
- 31$^{st}$ March 20X2

## 5. Illustration (RTP May 20)

The following is relevant information for an entity:

- Full capacity is 10,000 labour hours in a year.
- Normal capacity is 7,500 labour hours in a year.
- Actual labour hours for current period are 6,500 hours.
- Total fixed production overhead is Rs. 1,500.
- Total variable production overhead is Rs. 2,600.
- Total opening inventory is 2,500 units.
- Total units produced in a year are 6,500 units.
- Total units sold in a year are 6,700 units.
- The cost of inventories is assigned by using FIFO cost formula.

How overhead costs are to be allocated to cost of goods sold and closing inventory?

## 6. Illustration

UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

## 7. Illustration

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-20X3 are as follows:

- Solar power panel (WIP) Rs. 85 lakhs
- Solar power panel (finished products) Rs. 55 lakhs
- Sundry Debtor (solar power panel) Rs. 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

## 8. Illustration

Night Ltd. sells beer to customers; some of the customers consumes the beer in the bars run by Night Limited. While leaving the bars, the consumers leaves the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling tenders.

(i) Decide whether the stock of empty bottle is an asset of the company;

(ii) If so, whether the stock of empty bottles existing as on the date of

Balance Sheet is to be considered as inventories of the company & valued as per Ind AS-2 or to be treated as scrap and shown at realized value with corresponding credit to 'Other Income'?

## 9. Illustration

ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X wasRs.1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.
The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.
Import duties (basic custom duties) ofRs.60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost ofRs.5,000 to have the components taken to its warehouse. Calculate the cost of inventory

## 10. Illustration

ABC Ltd. manufactures control units for air conditioning systems. Each control unit requires the following:

- 1 component X at a cost ofRs.1,205 each
- 1 component Y at a cost ofRs.800 each

- Sundry raw materials at a cost ofRs.150 each

The company faces the following monthly expenses:

- Factory rentRs.16,500
- Energy costRs.7,500
- Selling and administrative costsRs.10,000
- Each unit takes two hours to assemble. Production workers are paid Rs.300 per hour.
- Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.

Determine the cost of inventory.

## 11. Illustration

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost ofRs.50 per pack.

During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, wasRs.40 per pack.

Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total ofRs.15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value

## 12. Illustration

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of Rs.10 per unit. The current market price is Rs.8 per unit at which these units can be sold.

Company P has a firm sales contract with Company Q to sell 60 units at Rs.11 per unit, which cannot be settled net.

Estimated incremental selling cost is Rs. 1 per unit. Determine the Net Realisable Value (NRV) of the inventory of Company P.

## 13. Illustration

In Year 2, A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

| | Cost | Estimated Sales Price | Selling costs |
|---|---|---|---|
| Inventory Item A1 | 8,000 | 7,800 | 500 |
| Inventory Item A2 | 14,000 | 18,000 | 200 |
| Inventory Item B1 | 16,000 | 17,000 | 200 |
| Inventory Item C1 | 6,000 | 7,500 | 150 |

Determine the value of closing inventory in the financial statements of a business.

## 14. Illustration

A dealer has purchased 1,000 cars costing Rs.2,80,000 each on deferred payment basis as 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

## 15. Illustration

| Particulars | | Kg | Rs. |
|---|---|---|---|
| Opening Inventory | Finished Goods | 1,000 | 25,000 |
| | Raw Materials | 1,100 | 11,000 |
| Purchases | | 10,000 | 1,00,000 |
| Labour | | | 76,500 |
| Overheads (Fixed) | | | 75,000 |
| Sales | | 10,000 | 2,80,000 |
| Closing Inventory | Raw Materials | 900 | |
| | Finished Goods | 1,200 | |

The expected production for the year was 15,000 kg of finished product.

Due to fall in the market demand the sales price for the finished goods was Rs.20 per kg and the replacement cost for the raw material was Rs.9.50 per kg on the closing day.

You are required to calculate the closing inventory as on that date.

# PROPERTY, PLANT AND EQUIPMENT

## 1. Introduction

### 1.1 Objective

- To prescribe accounting treatment of property, plant and equipment.
- Recognition of assets.
- Determination of carrying amont and depreciation charges
- Depreciation, retirement and disposal accounting.

### 1.2 Scope

PPE are generally grouped into various classes like land and buildings, machinery, ships, aircrafts, furniture, bearer plants etc.

This standard does NOT deal with the following.

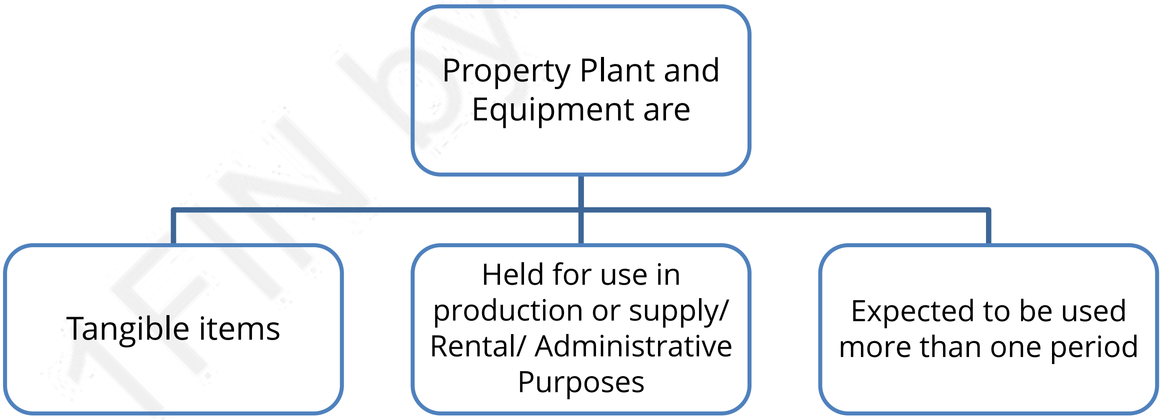
| | | |
|---|---|---|
| (a) | PPE classified as held for sale | Dealt as per Ind AS 105 |
| (b) | Biological assets related to agricultural activity other than bearer plants | Dealt as per Ind AS 41 |
| (c) | Recognition and measurement of exploration and evaluation assets | Dealt as per Ind AS 106 |
| (d) | Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources | No Ind AS exists. Industry rules and regulations are followed. |

This Standard applies to property, plant and equipment used to **develop or maintain** the assets described in (b)–(d).

Investment property under Ind AS 40 shall use the cost model under this standard for owned investment property.

## 2. Definitions

### 2.1 Property, Plant and Equipment




### 2.2 Bearer Plant

Bearer plant is a living plant that

(a) Is used in the production/supply of agricultural produce
(b) Is expected to bear produce for more than a period of twelve months
(c) Has a remote likelihood of being sold as an agricultural produce, except for incidental scrap sales.

## 2.3 Carrying Amount

| | |
|---|---|
| Gross Book Value | xxx |
| (-) Accumulated Depreciation | xxx |
| (-) Accumulated Impairment Loss | xxx |
| **Carrying Amount** | **xxx** |

## 3. Recognition

**General Criteria for recognition of PPE**

- Probable that future economic benefits associated with the item will flow to the entity
- Cost of item can be measured reliably

**Spare parts, stand-by equipment, and servicing equipment:**

Recognised in accordance with this Ind AS when they meet the definition of PPE. Otherwise, such items are classified as inventory (Ind AS 2) and charged to statement of profit or loss when it is issued for usage.

**Aggregation of individually insignificant items:**

It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the recognition criteria to the aggregate value.

**Other important points:**

Items of PPE may be acquired for safety or environmental reasons. These may be necessary for an entity to obtain the future economic benefits from its other assets. (Indirect benefits)

Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets more than what could be derived had those items not been acquired.

## 4. Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should **be initially measured at its cost.** Amount to be capitalised is based on the nature of consideration paid for the asset.

Asset is acquired by

- Payment by cash/ for credit
- Self Construction
- Exchange of Non monetary assets

### 4.1 If asset is purchased by payment of cash or credit.

The cost of an item of PPE comprises

| | |
|---|---|
| Purchase Price | xxx |
| **Add:** | |
| Non-refundable taxes and duties | xxx |
| Initial delivery and handling charges | xxx |
| Cost of site preparation | xxx |
| Installation & Assembly costs | xxx |
| Professional Fees | xxx |
| Borrowing costs (If permitted by Ind AS 23) | xxx |
| Costs of testing – Net Sale Proceeds<br>*If net sale proceeds is greater than cost of testing, the amount is deducted from the cost. | xxx |
| **Present Value** of Decommissioning, restoration costs (In accordance with Ind AS 37) | xxx |
| **Any directly attributable cost** to bring the asset to the location and condition, necessary to **operate for its purpose intended** by the management | xxx |
| **Less:** | |
| Government grant received specific to the asset (Ind AS 20) | xxx |
| Trade discounts and rebates (If included in above costs) | xxx |
| **Cost of PPE to be capitalised** | xxxx |

### 5.1.1 Exclusions from Cost of PPE

(a) Costs of conducting business in a new location or with a new class of customer (including costs of staff training)

(b) Costs incurred in introducing a new product or service.

(c) Cost of opening a new facility

(d) Administrative and other general overhead costs

> The income and related expenses of incidental operations are recognised in profit or loss

## 4.2 Self – Constructed PPE

The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

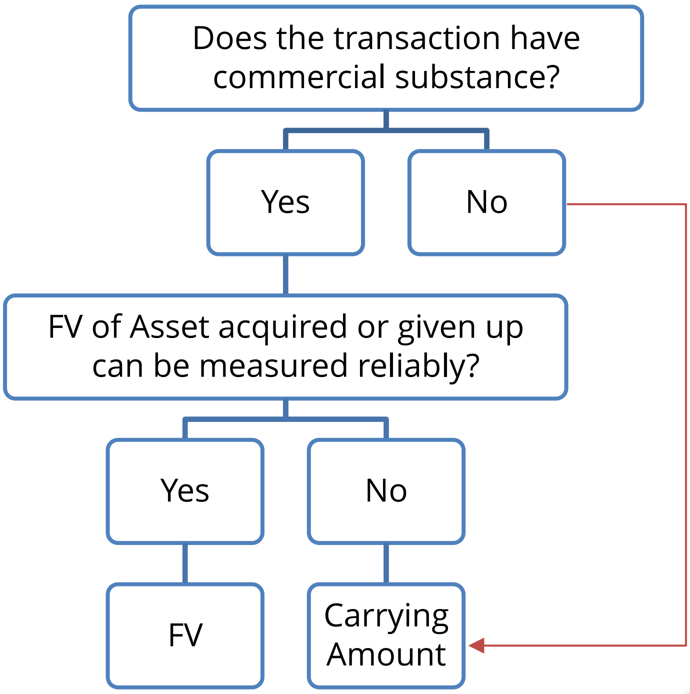
**Inclusions:**

- Costs of construction that directly relate to the specific assets
- Costs that can be attributable or allocated to the construction activity.
- Borrowing costs if PPE is a qualifying asset as per Ind AS 23

**Exclusions:**

- Internal profits (Always take cost of construction and not sale price)
- The cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset.

## 4.3 PPE is acquired by exchange of non-monetary assets




If both the above conditions are satisfied, PPE is measured at

(a) Fair value of asset given up (1st Preference)

(b) Fair value of asset received

If both are available, consider whichever is more clearly evident.

If above conditions are not satisfied, PPE is measured carrying amount of the asset given up.

**Commercial Substance:**

An exchange transaction has commercial substance if:

(a) The risk, timing, and amount of the cash flows of the asset received are significantly different from the cash flows of the asset transferred.

(b) There is a significant effect on the present value of the after tax cash flows that an entity expects to arise from the continuing use and disposal of the asset due to exchange transaction.

**Fair Value of the Asset:**

The fair value of an asset is reliably measurable if:

a) The variability in the range of reasonable fair value measurements is not significant for that asset

b) The probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

> If the PPE is acquired by issuing shares of the entity, it will be dealt separately by Ind AS 102 – Share based payments

### 4.4 Cost of Bearer Plants

All the cost of activities necessary to cultivate the bearer plants before they are in the location and condition necessary to be capable of operating in the manner intended by management.

## 5. Cessation of Capitalisation

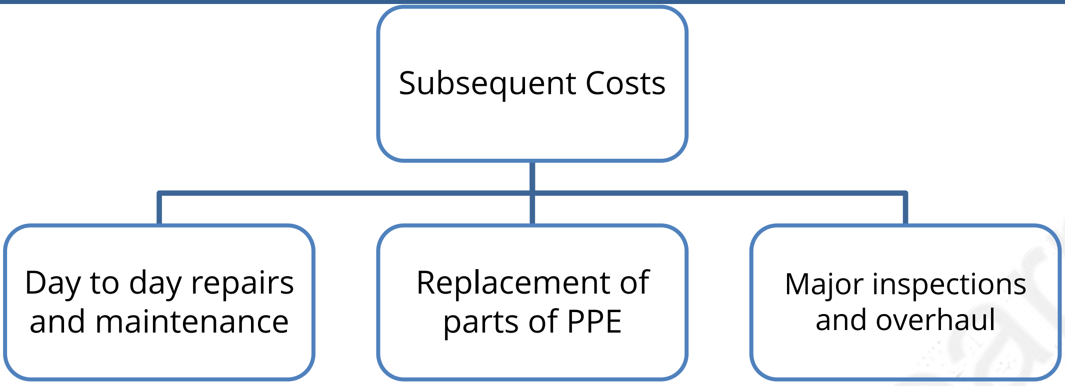
Recognition of costs to carrying amount of PPE ceases when the item is in the

> Costs incurred in using or redeploying an item are not included in the carrying amount of that item

- location and
- condition
- necessary for it to be capable of operating in the manner
- intended by management.

For Example, Initial operating losses, cost of relocating or reorganising entity's operations are not included in the cost of PPE.

## 6. Subsequent Costs




### 6.1 Repair and maintenance

Recognised in profit or loss as incurred.

### 6.2 Replacement of parts of PPE

Parts of some items of PPE may require replacement at regular intervals.

Entity should capitalise the cost of replacement as a component of PPE and depreciate such cost over its useful life.

The carrying amount of those parts that are replaced should be derecognised.

### 6.3 Major Inspections or overhauls

A condition of continuing to operate an item of property, plant, and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced.

When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant, and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection is derecognised.

The inspection costs are recognised irrespective of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed.

If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

## 7. Deferred credit period

The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. The difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with Ind AS 23.

## 8. Depreciation

The depreciable amount of an asset should be allocated on a systematic basis over its useful life.

| | |
|---|---|
| Historical cost/ Revalued Amount | xxx |
| Less: Estimated residual value | xx |
| Depreciable Amount | xxx |

The 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.

| | |
|---|---|
| Commencement of Depreciation | **When the asset is available to 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. |
| Cessation of Depreciation | Ceases at the earliest of<br>(a) The asset is classified as held for sale or included in disposal group that is classified as held for sale (As per Ind AS 105)<br>(b) Date on which the asset is derecognised. |

> Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

### 8.1 Component Accounting for depreciation

An asset may consist of different and significant physical components. If an item of PPE comprises two or more significant components, with substantially different useful lives, usage, or flow of economic benefits, then each component should be recognised and depreciated separately over its individual useful life.

When significant component is replaced or restored, the old component is derecognised, and the cost of new component is capitalised.

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

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.

A combination of more than one depreciation method is sometimes used depending upon type, nature of circumstances for significant parts one PPE.

For Example:

Entity can follow WDV method for aircraft engine whereas SLM for aircraft body.

> In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

## 8.2 Factors Determining Depreciable Amount

Factors determining depreciable amount

- Historical cost/ Revalued Amount
- Expected useful life
- Estimated Residual Value

Depreciable amount is determined based on the following three factors

(a) Historical cost/ Revalued Amount

(b) Expected useful life of the depreciable asset.

(c) Estimated residual value of the depreciable asset.

### 8.2.1 Useful life of an asset -

Useful life is

(a) the period over which an asset is expected to be available for use by an entity

(b) the number of production or similar units expected to be obtained from the asset by an entity.

The following factors are considered in determining the useful life of an asset

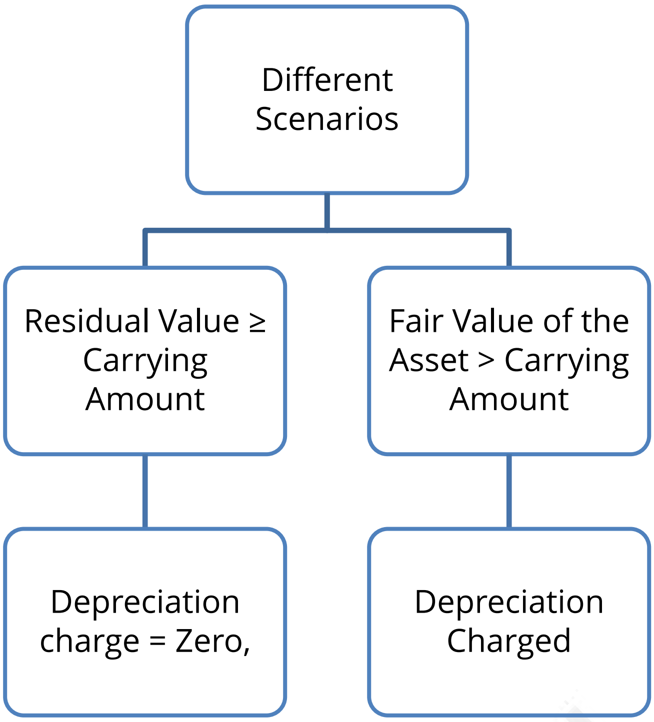
- Expected usage of the asset.
- Expected physical wear and tear (Depends on operational factors)
- Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
- Legal or similar limits on the use of the asset.

> The useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets

### 8.2.2 Residual Value

It is an estimated amount, which can be recovered from the asset at the end of its useful life. Residual value is a current estimat based on similar assets which would have reached the end of their useful life. The estimation is made by the management at the time of acquisition. If the estimated residual value is insignificant, value is considered as NIL.

> The residual value and the useful life should be reviewed at least at the end of financial year. Any change from expectations should be accounted for as a change in an accounting estimate (Ind AS 8)
>
> Remaining depreciable amount should be depreciated over the remaining revised useful life.




### 8.3 Depreciation Method

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

For Example:

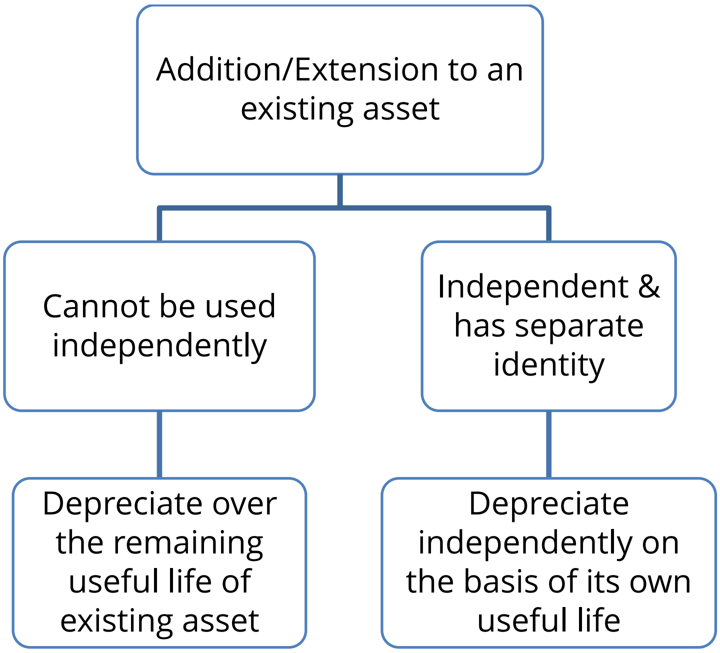
| | |
|---|---|
| Straight line depreciation | Constant charge over the useful life |
| Diminishing Balance Method | Decreasing charge over the useful life |
| Units of Production method | Charged based on expected use or output |

The management should consider **true & fair** view, **prudence**, **substance over form** and **materiality** while selecting depreciation method.

Depreciation charge **can be zero** if the entity follows number of units production basis for depreciation and **if no production happens** in a particular year. (But needs to **test for impairment** as per Ind AS 36)

Depreciation method should **not be based on** ratio of revenue as **revenue** generated depends upon demand, supply, inflation, sales volume, and prices.

### 8.4 Depreciation of an addition/ extension to an existing PPE

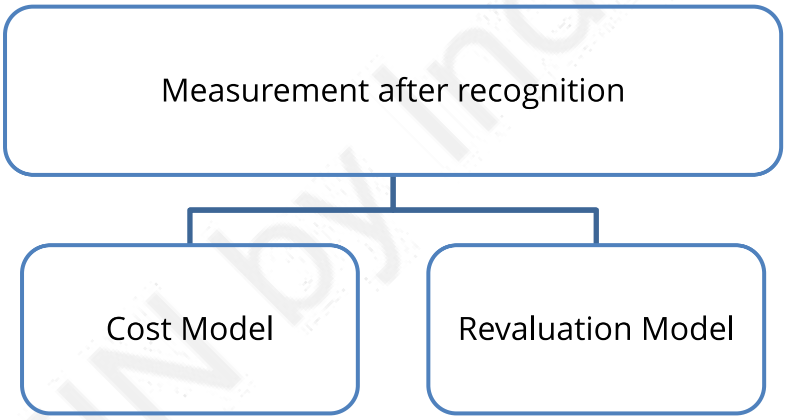



## 9. Impairment

Entity must calculate the recoverable amount in accordance with Ind AS 36.

Compensation from third parties for items of PPE that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

## 10. Measurement After recognition




### 10.1 Cost Model

| Initial Cost | xxx |
|---|---|
| (-) Accumulated Depreciation | xxx |
| (-) Accumulated Impairment Loss | xxx |
| **Carrying Amount** | **xxx** |

### 10.2 Revaluation Model

| Fair Value at the date of revaluation | xxx |
|---|---|
| (-) Subsequent Accumulated Depreciation | xxx |
| (-) Subsequent Accumulated Impairment Loss | xxx |
| **Carrying Amount** | **xxx** |

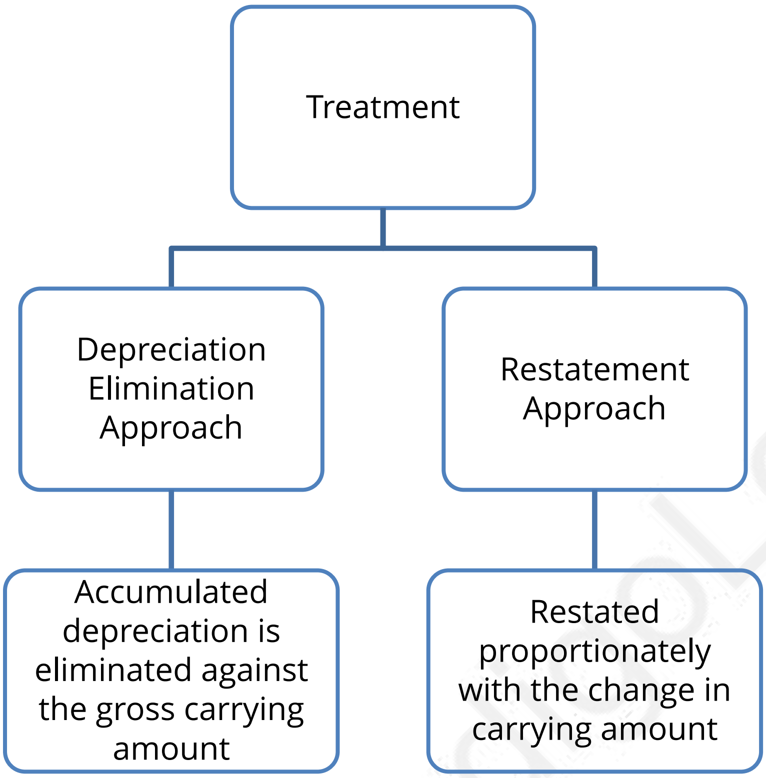
Revaluations are required to be carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

### 8.2.1 Frequency of revaluations

The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued.

If PPE experience significant and volatile changes in fair value, there must be annual revaluation. Otherwise, it may be necessary to revalue the item only every three or five years.

### 8.2.2 Accumulated Depreciation at the date of revaluation




> Restatement approach is used when an asset is revalued by means of applying an index to determine depreciated replacement cost

### 8.2.3 Limit on Revalued Amount -

The revalued amount should not be more than the recoverable amount (As per Ind AS 36)

### 8.2.4 Revaluation to be made for entire class of assets -

**Revaluation** should be performed for an **entire class of PPE**.

For Example: If the entity takes a decision to revalue its buildings, it should revalue all the buildings of the entity. i.e., revaluation of selective assets within a class is not permitted.

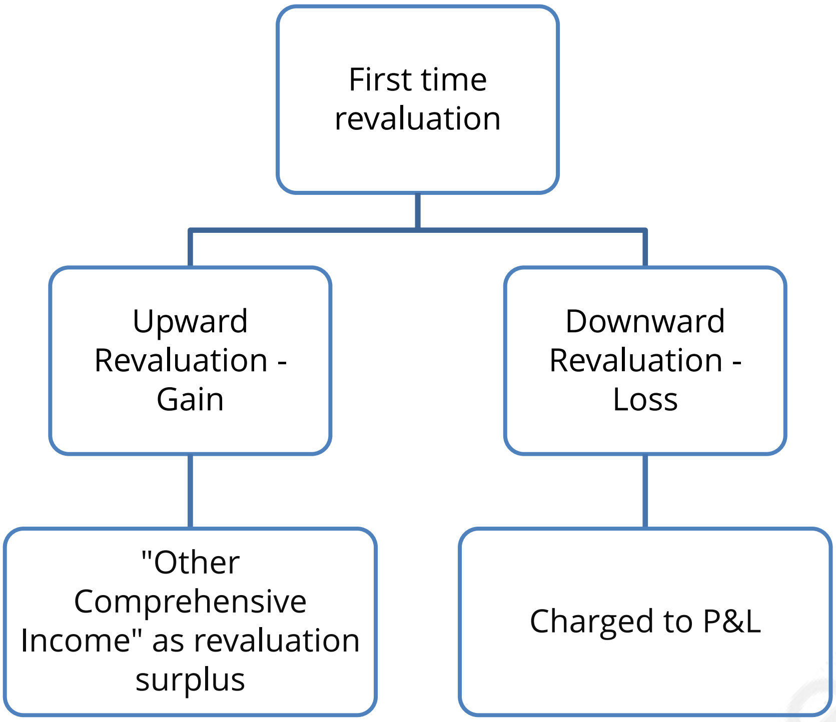
The entity can divide the PPE into classes based on the nature of items such as land, land and buildings, machinery, ships, aircraft, motor vehicles, furniture and fixtures, office equipment, bearer plants.

> The items within a class of PPE are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates.

### 8.2.5 Revaluation Accounting

The entity can do revaluation any number of times and it can be upward or downward revaluation.

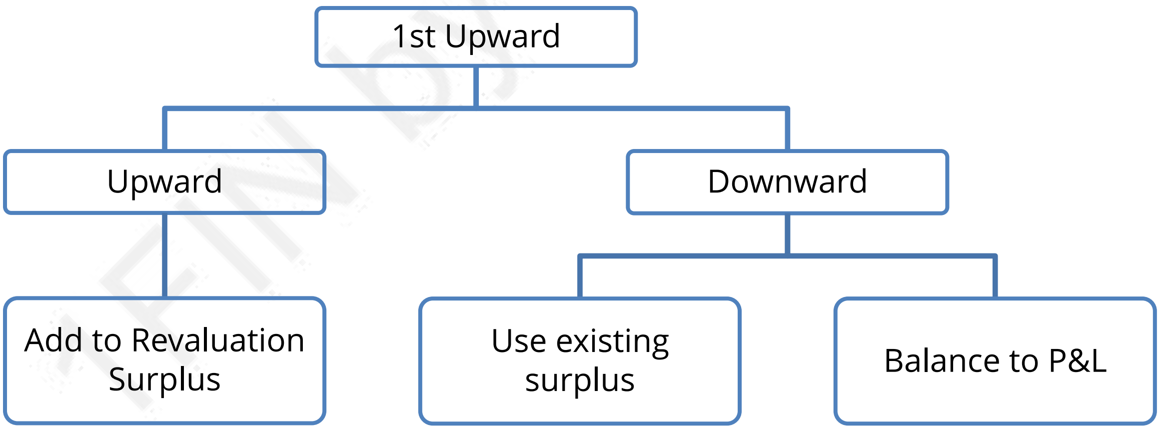
**First Time Revaluation:**




| | |
|---|---|
| **Upward** Revaluation | PPE A/c **Dr**<br>To Revaluation Surplus A/c (OCI) |
| **Downward** Revaluation | Profit & Loss A/c **Dr**<br>To PPE A/c |

**Subsequent Revaluation:**

**(a) If first time is upward revaluation**




**Subsequent upward revaluation** – Further increase should be recognised in "Other Comprehensive Income" (OCI) and accumulated in equity under revaluation surplus.

PPE A/c **Dr**

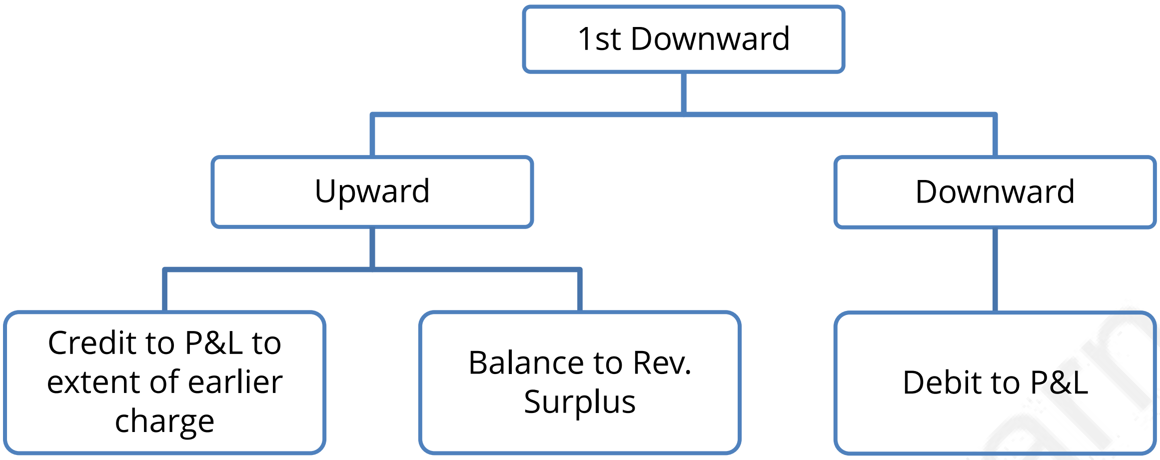
To Revaluation Surplus A/c (OCI)

**Subsequent downward revaluation** – Utilise the available revaluation surplus and remaining balance should be charged to statement of profit and loss.

Revaluation Surplus A/c **Dr** (OCI)

Statement of Profit & Loss A/c **Dr** (Balancing Figure)
To PPE A/c

**(b) If first time is downward revaluation**




**Subsequent downward revaluation –** Further decrease should be transferred to statement of profit and loss.

Profit and Loss A/c **Dr**
To PPE A/c

**Subsequent upward revaluation –** Credit the statement of profit and loss to the extent it was charged in earlier revaluation and remaining balance should be credited to "Other Comprehensive Income" and accumulated in equity under revaluation surplus.

PPE A/c **Dr**
To Profit & Loss A/c (To the extent charged earlier)
To Revaluation surplus (balancing Figure) (OCI)

> The effects of taxes on revaluation are recognised and disclosed as per Ind AS 12 – Income taxes

**Treatment of Revaluation Surplus:**

Treatment of Revaluation Surplus

**Option 1 -**

The revaluation surplus may be transferred directly to retained earnings when the asset is derecognised.

**Option 2 -**

The surplus may be trasnferred as the asset is used by an entity.

Surplus = Depreciation based on the revalued carrying amount of the asset **(-)** Depreciation based on the asset's original cost

Transfers from revaluation surplus to retained earnings are not made through profit or loss.

## 11. Derecognition

The carrying amount of an item of property, plant and equipment should be derecognised

(a) on disposal

(b) When no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition of an item of property, plant and equipment is included in profit or loss when the item is derecognised.

Gain/Loss from derecognition of PPE = Net disposal proceeds – Carrying Amount.

Gains shall not be classified as revenue.

In determining the date of disposal of an item of PPE, an entity applies the criteria in Ind AS 115 (date recipient obtains control over PPE) for recognising revenue. Ind AS 116 applies to disposal by a sale and leaseback.

Transfers from revaluation surplus to general reserve should not be made through statement of profit and loss.

## 12. Disclosure

(i) The financial statements should disclose, **for each class** of property, plant, and equipment:

a. The measurement bases used for determining the gross carrying amount

b. The depreciation methods used
c. The useful lives or the depreciation rates used
d. The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

(ii) Entity is also required to provide a reconciliation of the carrying amount at the beginning and end of the period showing:

a. additions
b. Assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals
c. Acquisitions through business combinations
d. Increases or decreases resulting from revaluations and from impairment losses recognised or reversed in other comprehensive income;
e. Impairment losses recognised in profit or loss in accordance with Ind AS 36;
f. Impairment losses reversed in profit or loss in accordance with Ind AS 36;
g. Depreciation;
h. The net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and
i. Other changes

(iii) The financial statements should also disclose

a. The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities
b. The amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
c. The amount of contractual commitments for the acquisition of property, plant and equipment; and
d. If it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

(iv) If items of property, plant and equipment are **stated at revalued amounts**, the following should be disclosed

a. the effective date of the revaluation;
b. Whether an independent valuer was involved;
c. For each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and
d. The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

(v) **Entities are encouraged but not required**, to disclose the following amounts:

a. The carrying amount of temporarily idle property, plant and equipment
b. The gross carrying amount of any fully depreciated property, plant and equipment that is still in use
c. The carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with Ind AS 105; and
d. When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

## 13. Changes in Existing Decommissioning Restoration & Similar Liabilities (Appendix A)

### 13.1 Applicability of Appendix A to Ind AS 16?

Applicable to changes in measurement of any existing de-commissioning, restoration or similar liability that is both

- Recognised as part of the cost of an item of PPE

  or

  As part of the cost of a right-of-use asset in accordance with Ind AS 116;

- Recognised as a liability in accordance with Ind AS 37

This Appendix addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability should be accounted for:

a. A change in the estimated outflow of resources embodying economic benefits required to settle the obligation
b. A change in the current market-based discount rate
c. An increase that reflects the passage of time (unwinding of the discount)

### 13.2 Accounting Guidance in Appendix A

**If related asset is measured using cost model:**

i. Changes in liability shall be added to or deducted from the cost of the asset in the current period and related provision is adjusted accordingly.
ii. Decrease in liability cannot exceed the carrying amount of the asset.

> If Decrease in Liability > Carrying Amount, excess is recognised as income

iii. If changes in liability results in addition to the cost of PPE, consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, test for impairment as per Ind AS 36 and account for impairment loss.

**If related asset is measured using Revaluation model:**

i. Any increase in liability is adjusted against revaluation surplus ( to the extent of balance available). Any excess is recognised in the statement of profit and loss

ii. Any decrease in liability is recognised in revaluation reserve. If any revaluation deficit is charged to profit and loss in the prior periods, to that extent, it is recognised as income in the statement of profit and loss.

> If Decrease in Liability > Carrying Amount, excess is recognised as income in the statement of profit and loss

iii. Any change in liability would require the asset to be tested for impairment to ascertain if there is any change in fair value.

iv. Change in the revaluation surplus arising from a change in liability shall be presented as a separate line item in the Statement of Other Comprehensive Income

**Common points for both cost and revaluation model:**

The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in profit or loss as they occur.

The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost, as it occurs. Capitalisation under Ind AS 23 is not permitted.

## 14. Ind AS 16 vs AS 10

| Ind AS 16 | AS 10 |
|---|---|
| Does not deal with Assets held for sale as they are governed by Ind AS 105 | Deals with accounting for items retired from active use & held for sale |
| Provides guidance on measuring 'Stripping cost' of a production phase of a surface mine. | Does not have this guidance |

## Ind AS 16 – Property Plant & Equipment
## ILLUSTRATIONS

### 1. Illustration

On 1st April of year 1, XYZ Ltd. acquired a machine under the following terms:

| | Amount (in ₹) |
|---|---|
| List price of machine | 80,00,000 |
| Import duty | 5,00,000 |
| Delivery fees | 1,00,000 |
| Electrical installation costs | 10,00,000 |
| Pre-production testing | 4,00,000 |
| Purchase of a five-year maintenance contract with vendor | 7,00,000 |

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5% if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on 20th April of year 1. At what cost the asset will be recognised?

## 2. Illustration

Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market.

You are required to calculate the amount which can be capitalised as per Ind AS 16

| **Particulars** | **₹ in 000 Cost Incurred** |
|---|---|
| Site preparation costs | 150 |
| Direct Material | 2,000 |
| Direct labour cost, including Rs. 10,000 incurred during an industrial strike | 1160 |
| Testing of various processes in factory | 200 |
| Consultancy fees for installation of equipment | 300 |
| Relocation of staff to new factory | 450 |
| General overheads | 550 |
| Estimated costs to dismantle (at present value) | 200 |

## 3. Illustration

The term of an operating lease allows a tenant, XYZ Ltd. to tailor the property to meet its specific needs by building an additional internal wall, but on condition that the tenant returns the property at the end of the lease in its original state. This will entail dismantling the internal wall. XYZ Ltd. incurs a cost of Rs. 25,00,000 on building the wall and present value of estimated cost to dismantle the wall is Rs. 10,00,000. At what value should the leasehold improvements be capitalised in the books of XYZ Ltd.

## 4. Illustration

X Limited started construction on a building for its own use on 1st April, 20X0. The following costs are incurred

| **Particulars** | **Amount in ₹** |
|---|---|
| Purchase price of land | 30,00,000 |
| Stamp duty & legal fee | 2,00,000 |
| Architect fee | 2,00,000 |
| Site preparation | 50,000 |
| Materials | 10,00,000 |
| Direct labour cost | 4,00,000 |
| General overheads | 1,00,000 |

Other relevant information:

Material costing Rs. 1,00,000 had been spoiled and therefore wasted and a further Rs. 1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November, 20X0 and it is estimated that Rs. 22,000 of the labour costs relate to that period. The building was completed on 1st January, 20X1 and brought in use 1st April, 20X1. X Limited had taken a loan of Rs. 40,00,000 on 1st April, 20X0 for construction of the building. The loan carried an interest rate of 8% per annum and is repayable on 1st April, 20X2.

Calculate the cost of the building that will be included in tangible non-current asset as an addition.

## 5. Illustration

ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

| | |
|---|---|
| Cost of the plant (cost per supplier's invoice plus taxes) | 25,00,000 |
| Initial delivery and handling costs | 2,00,000 |
| Cost of site preparation | 6,00,000 |
| Consultants used for advice on the acquisition of the plant | 7,00,000 |
| Interest charges paid to supplier of plant for deferred credit | 2,00,000 |
| Net present value of estimating dismantling costs to be incurred after 7 years | 3,00,000 |
| Operating losses before commercial production | 4,00,000 |

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

## 6. Illustration

Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of Rs. 10 million. The fair value of such asset is Rs. 15 million. It exchanges the land and building for a private jet, which has a fair value of Rs. 20 million and pays additional Rs. 3 million in cash.

Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction

## 7. Illustration

A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul.

A ship which cost Rs. 20 million with a 20-year life must have major overhaul every five years. The estimated cost of the overhaul at the five-year point is Rs. 5 million

## 8. Illustration

An entity acquired an asset 3 years ago at a cost of Rs. 5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.

At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits.

Show the necessary treatment in accordance of Ind AS 16. Calculate the depreciation charge for respective years.

## 9. Illustration

An asset which cost Rs. 10,000 was estimated to have a useful life of 10 years and residual value ₹ 2,000. After two years, useful life was revised to 4 remaining years.

Calculate the depreciation charge for the years 1,2,3.

## 10. Illustration

MS Ltd. has acquired a heavy machinery at a cost of Rs. 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is Rs. 45,00,000. The discount rate assumed is 5%.

Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used?

## 11. Illustration

On 1st April, 20X1, Sun ltd purchased some land for Rs. 10 million (including legal costs of Rs. 1 million) in order to construct a new factory. Construction work commenced on 1st May, 20X1. Sun ltd incurred the following costs in relation with its construction

- Preparation and levelling of the land – Rs. 3,00,000.
- Purchase of materials for the construction Rs. 6.08 million in total.
- Employment costs of the construction workers – Rs. 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – Rs. 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – Rs. 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period – Rs. 50,000.
- Costs of relocating employees to work at the new factory – Rs. 3,00,000
- Costs of the opening ceremony on 31st January, 20X2 – Rs. 1,50,000.

The factory was completed on 30th November, 20X1 (which is considered as substantial period of time as per Ind AS 23) and production began on 1st February, 20X2. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun Ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be Rs. 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs. 1 payable in 40 years' time at an annual discount rate of 8% is Rs. 0.046.

The construction of the factory was partly financed by a loan of Rs. 17.5 million taken out on 1st April, 20X1. The loan was at an annual rate of interest of 6%. Sun Ltd received investment income of Rs. 100,000 on the temporary investment of the proceeds.

Required:

Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 20X2. You should explain your treatment of all the amounts referred to in this part in your answer

## 12. Illustration

| | |
|---|---|
| Original Cost | ₹ 1,00,000 |
| Useful Life | 10 Years |
| Depreciation | Straight Line |
| Model | Cost |

At the end of 4 years, entity applies revaluation model. After 4 years, the fair value of the machinery is ₹ 80,000. Show accounting treatment.

## 13. Illustration

Show accounting treatment under revaluation model

**Case 1 -**

| Particulars | Year 1 | Year 2 |
|---|---|---|
| Carrying Amount | ₹ 1,00,000 | ₹ 90,000 |
| Fair Value | ₹ 1,20,000 | ₹ 1,00,000 |

**Case 2 –**

| Particulars | Year 1 | Year 2 |
|---|---|---|
| Carrying Amount | ₹ 1,00,000 | ₹ 90,000 |
| Fair Value | ₹ 1,20,000 | ₹ 80,000 |

**Case 3 –**

| Particulars | Year 1 | Year 2 |
|---|---|---|
| Carrying Amount | ₹ 1,00,000 | ₹ 90,000 |
| Fair Value | ₹ 1,20,000 | ₹ 65,000 |

**Case 4:**

| Particulars | Year 1 | Year 2 |
|---|---|---|
| Carrying Amount | ₹ 1,00,000 | ₹ 80,000 |
| Fair Value | ₹ 90,000 | ₹ 85,000 |

### 14. Illustration

Treatment of Revaluation Surplus & Excess depreciation

| **Particulars** | **Amount** |
|---|---|
| Original Cost | ₹ 1,00,000 |
| Useful Life | 10 Years |
| Depreciation | Straight line |
| Model | Cost |

At the end of 4 years, entity applies revaluation model. After 4 years, the fair value of the machinery is ₹ 80,000.

### 15. Illustration

H Limited purchased an item of PPE costing ₹ 100 million which has useful life of 10 years. The entity has a contractual decommissioning and site restoration obligation, estimated at ₹ 5 million to be incurred at the end of 10th year. The current market-based discount rate is 8%.

The company follows SLM method of depreciation. H Limited follows the Cost Model for accounting of PPE.

Determine the carrying value of an item of PPE and decommissioning liability at each year end when (a) There is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate

(b) At the end of Year 4, the entity expects that the estimated cash outflow on account of decommissioning and site restoration to be incurred at the end of the useful life of the asset will be ₹ 8 million (in place of ₹ 5 million, estimated in the past).

Determine in case (b), how H Limited need to account for the changes in the decommissioning liability?

### 16. Illustration

A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

| **Property, Plant and Equipment** | **Original Cost** | **Estimated useful life** |
|---|---|---|
| Buildings | 15,000,000 | 15 Years |
| Plant and machinery | 10,000,000 | 10 Years |
| Furniture and | 3,500,000 | 7 Years |

| | | |
|---|---|---|
| fixtures | | |

A Ltd. uses the straight-line method of depreciation. On 1st April, 20X4, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

| | |
|---|---|
| Buildings | 10 years |
| Plant and machinery | 7 Years |
| Furniture and fixtures | 5 Years |

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised.

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X5.

### 17. Illustration

An item of PPE was purchased for ₹ 9,00,000 on 1st April, 20X1. It is estimated to have a useful life of 10 years and is depreciated on a straight-line basis. On 1st April, 20X3, the asset is revalued to ₹ 9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes.

Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 20X3-20X4

### 18. Illustration

An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 2XX1. The plant has a useful life of 40 years. Its initial cost was ₹ 1,20,000 which included an amount for decommissioning costs of ₹10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. On March, 2X11, the net present value of the decommissioning liability has decreased by ₹ 8,000. The discount rate has not yet changed.

How the entity will account for the above changes in decommissioning liability in the year 2X11, if it adopts cost model?

### 19. Illustration

An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 20X1. The plant has a useful life of 40 years. Its initial cost was ₹ 1,20,000. This included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. Assume that a market-based discounted cash flow valuation of ₹ 1,15,000 is obtained at 31st March, 20X4. This valuation is after deduction of an allowance of ₹ 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On 31st March, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by ₹ 5,000. The entity decides that a full valuation of the asset is needed at 31st March, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at ₹ 1,07,000, which is net of an allowance for the reduced decommissioning obligation.

How the entity will account for the above changes in decommissioning liability if it adopts revaluation model?

### 20. Illustration

M Ltd. is setting up a new factory outside the Delhi city limits. To facilitate the construction of the factory and its operations, M Ltd. is required to incur expenditure on the construction/ development of electric substation. Though M Ltd. incurs (or contributes to) the expenditure on the construction/ development, it will not have ownership rights on these items, and they are also available for use to other entities and public at large. Whether M Ltd. can capitalize expenditure incurred on these items as property, plant, and equipment (PPE)? If yes, then how should these items be depreciated and presented in the financial statements of M Ltd. as per Ind AS?

## 21. Illustration

Flywing Airways Ltd is a company which manufactures aircraft parts and engines and sells them to large multinational companies like Boeing and Airbus Industries.

On 1 April 20X1, the company began the construction of a new production line in its aircraft parts manufacturing shed.

Costs relating to the production line are as follows ('000):

| | |
|---|---|
| Costs of materials (list price less a 20% trade discount) | 10,000 |
| Recoverable GST not included in the purchase cost | 1,000 |
| Employment costs of the construction staff for the three months to 30 June 20X1 | 1,200 |
| Other overheads directly related to the construction | 900 |
| Payments to external advisors relating to the construction | 500 |
| Expected dismantling and restoration costs | 2,000 |

The construction staff was engaged in the production line, which took two months to make ready for use and was brought into use on 31 May 20X1.

The other overheads were incurred in the two months period ended on 31 May 20X1. They included an abnormal cost of Rs.3,00,000 caused by a major electrical fault.

The production line is expected to have a useful economic life of eight years. At the end of that time Flywing Airways Ltd is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The amount of Rs.2 million mentioned above is the amount that is expected to be incurred at the end of the useful life of the production line. The appropriate rate to use in any discounting calculations is 5%. The present value of Re.1 payable in eight years at a discount rate of 5% is approximately Re.0·68.

Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is Rs.3 million. The Company computes its depreciation charge on a monthly basis.

No impairment of the plant had occurred by 31 March 20X2.

Analyze the accounting implications of costs related to production line to be recognized in the balance sheet and profit and loss for the year ended 31 March, 20X2.

# Ind AS 38
# Intangible Assets

## 1 Introduction

IND AS 38 prescribes the accounting treatment for intangible assets that are not dealt with specifically by another Standard.

*An asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.*

**Intangible Asset** An identifiable non-monetary asset without physical substance

**Control on Asset**
- Authority to get future economic benefits
- Not let others get future economic benefits

The future economic benefits include:

- Revenue from the sale of products or services;
- Cost savings; or
- Other benefits resulting from the use of the asset by the entity.

### 1.1 Examples of Intangible Items

**Intangible Items**

- **Marketing related**
  - Trade Mark
  - News paper mastheads
  - Internet Domain Names
  - Non-competitive agreements
- **Customer related**
  - Customer Lists
  - Customer Contracts
  - Customer Relationship
  - Non-contractual customer relationship
- **Technology related**
  - Trade secrets
  - Patents
  - Databases
  - Computer Software
- **Contract Based**
  - Franchise Agreements
  - Employment Contracts
  - License
  - Lease Agreements
- **Artistic related**
  - Musical Works
  - Magazines, Newspapers
  - Plays, operas and ballets
  - Pictures & photographs

Intangible items like customer lists, market share, customer relationships can be considered as Intangible Assets only if the entity can exercise control over these to generate future economic benefits, which is very rare. They should be separable or contractual and able to be sold at a value independently.

## 2 Intangible Assets - Elements

### 2.1 Identifiability

An Intangible Asset should be identifiable to distinguish it from goodwill for it be considered under IND AS 38. An entity must be able to separate the intangible asset from other assets.
Ex: A copyright of a movie is separable from the identity of a entertainment company or other assets in the company and it can be sold independently.

> Goodwill is the difference between the purchase price of a business and the fair value of its assets, net of liabilities [Refer IndAS 103]

**Conditions for Identifiability**

- Separable
- Arises from contractual / legal rights

An asset is identifiable if its either:

- **separable**, from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, not considering the company's intention; or
- **arises from contractual or other legal rights**, even if such rights are not transferable or separable from the entity.

Goodwill is not separately identifiable asset unless purchased.

### 2.2 Non-monetary

The classification of monetary assets and non-monetary assets is based on respective realizability of the assets in terms of money.

Monetary assets are assets whose economic benefits are determined in terms of currency units. Assets whose economic benefits will not be received in the form of fixed determinable units of currency are known as non-monetary assets.
Examples
Monetary – Account receivables
Non-Monetary - PPE

### 2.3 Non-physical substance

An Intangible Asset does not have physical substance - it should not be tangible i.e it should not perceptible by touch.

But sometimes some Intangible Assets are associated with physical substance / tangible item for storage purpose. Ex: software stored on a CD or a patent signed on the paper. In such circumstances, since the physical substance is insignificant, the CD with software will be considered as Intangible Asset.

If the tangible part is significant, it will be considered under IND AS 16 as Property, Plant & Equipment. Ex: smart phone with operating system.

Monetary assets like Account Receivables, Deposits with Bank etc are not considered to be intangible assets.

## 3 Recognition of Intangible Asset

**Recognition Conditions**
**(same as IND AS 16)**

- (1) Future Economic Benefits → Probable
- (2) Costs → Measured reliably

An item to be recognised as Intangible Asset, it should

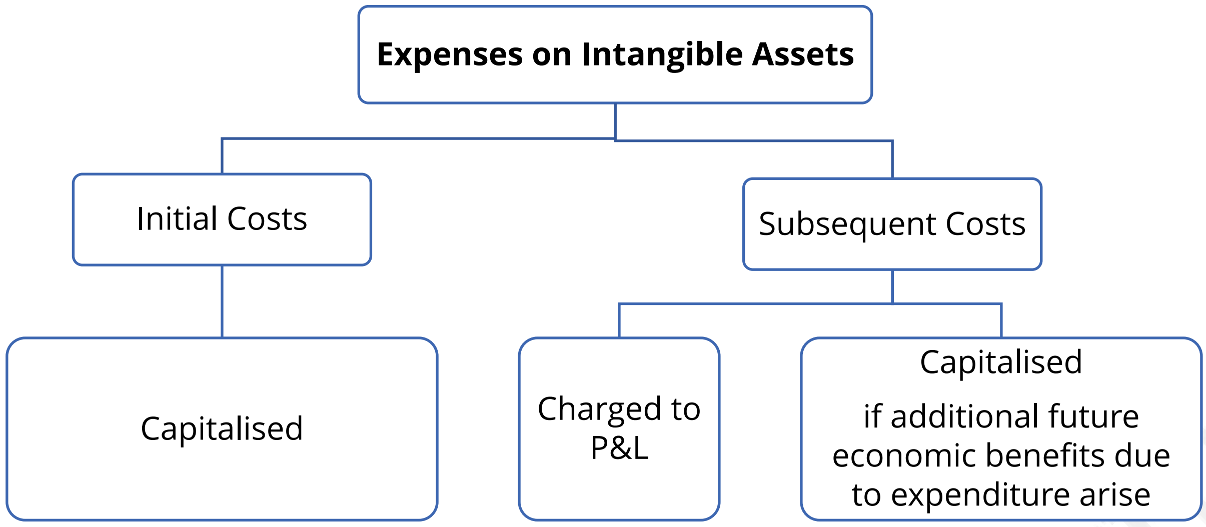
- meet definition criteria
    - non-monetary,
    - non-physical,
    - identifiable
- meet recognition criteria
    - future economic benefits to flow into the entity and control on benefits established
    - costs measured reliably

> An intangible item should meet both definition and recognition criteria to be considered as IA.

This recognition criteria applies to:

- Initial costs incurred to
    - acquire an intangible asset or
    - internally generate an intangible asset; and
- subsequent costs incurred to add to / replace part of / or service intangible asset.

It is assumed that the subsequent costs on intangible assets are generally for maintaining existing future economic benefits and are expensed unless the recognition criteria is met.




## 4 Measurement of Intangible Assets

Intangible Assets may be acquired or self-generated. In case of independent / separate acquisition of an intangible asset, it is assumed that future economic benefits will flow into the entity. There is no requirement for checking the viability of the economic benefits from such independent acquisition of intangible asset.

### 4.1 Costs for Acquired Intangible Assets

| | |
|---|---|
| Purchase Price | xxx |
| **Add:** | |
| Non-refundable taxes and duties | xxx |
| Installation costs | xxx |
| Professional Fees | xxx |
| Borrowing costs (If permitted by Ind AS 23) | xxx |
| **Any directly attributable cost** to bring the asset to the location and condition, necessary to **operate for its purpose intended** by the management | xxx |
| **Less:** | |
| Government grant received specific to the asset (Ind AS 20) | xxx |
| Trade discounts and rebates (If included in above costs) | xxx |
| **Cost of Intangible Asset** | xxxx |

**Cessation of Capitalisation of Costs.**

Capitalisation of intangible asset stops when the asset is ready for its intended use.

## 4.2 Costs for Internally Generated Assets

### 4.2.1 Goodwill

***<u>Internally generated goodwill is not recognised as an asset</u>*** because it does not meet the definition criterion nor the recognition criterion of an intangible asset i.e.

- it is not separable nor
- doesn't arise from contractual or other legal rights
- cannot be measured reliably at cost.

> IND AS 38 prohibits the recognition of internally generated goodwill as an asset.

Internally generated goodwill cannot be measured reliably as there are many factors that affect the fair value.

Goodwill can also arise from business combination. Such a goodwill can be recognised in the books of accounts as the acquisition price for business over and above the fair value of the net assets acquired (IND AS 103)

***<u>Internally generated Brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognised as intangible assets as per the standard.</u>***

## 4.3 Internally generated Intangible Assets other than Goodwill

- Internally generated IA
  - Research
    - Expensed
  - Development
    - Capitalised if 6 conditions met

**Research Phase –**

- It is a stage where new scientific or technical knowledge and understanding is obtained.
- Formulation, design evaluation and final selection of possible better alternatives is undertaken.
- In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.
- Therefore, this expenditure is recognised as an expense when it is incurred.

**Development Phase** – It is the stage where research findings are applied and feasibility of production of new or substantially improved items is decided. Design, construction and testing of pre-production or pre-use prototypes and models is done. This stage is before the commercial production is undertaken.

> If expense on Research and Development cannot be separated then it shall be expensed

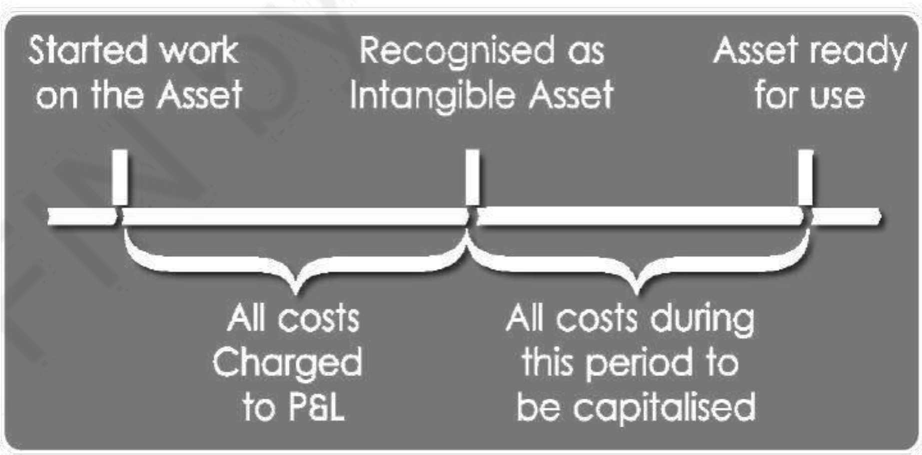
**Six Conditions for Capitalising Development Expenses:**

Expenses arising out of development will be capitalised if an entity can demonstrate all of the following

- Technical feasibility for completion of Intangible asset to make it available for use or sale
- Intention of entity to complete the intangible asset and use or sell it
- Ability to use or sell the intangible asset.
- Demonstrate generation of probable future economic benefits
- Adequate resources (like technical, financial or others) are available to complete the development.
- Measure reliably the expenditure attributable to the intangible asset during its development.

## 5 Costs - Intangible Asset - internally generated

The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. All costs till the date of recognition of the intangible asset are expensed to the statement of profit and loss. All cost from the date of recognition till the date the asset is ready to be put to use are capitalised.




### 5.1 Inclusions

Directly attributable costs -

- Direct material
- Cost of services directly used
- Employee costs
- Legal expenses essential for the intangible asset (filing of patent application)
- Other intangible assets (patents & licenses) used for making the intangible asset ready for use
- Borrowing costs as permissible under Ind AS 23

## 5.2 Exclusions

The following costs are excluded from the capitalisation for intangible asset:

- Selling Overheads
- Indirect Costs
- Initial operating losses
- Losses due to inefficiency
- Staff training costs

# 6 Intangible Assets in exchange of non-monetary asset

Intangible assets may be acquired in exchange for

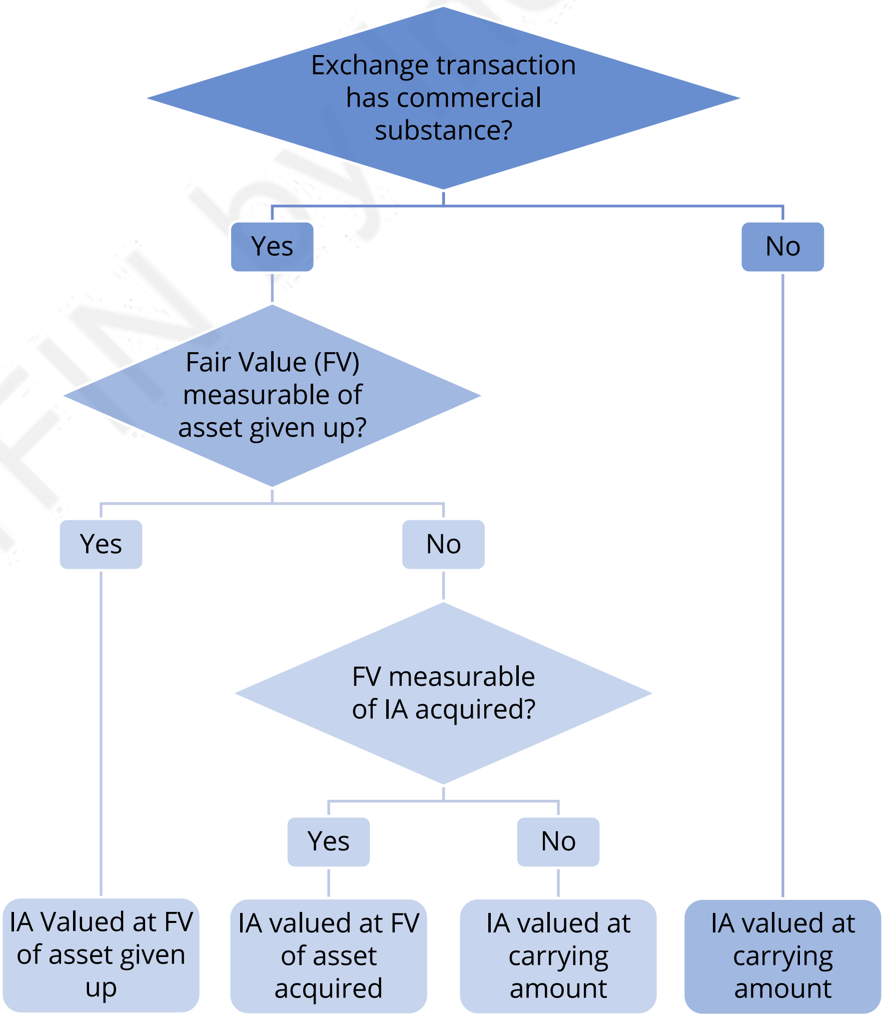
- a non-monetary asset or assets, or
- a combination of monetary and non-monetary assets.

The capitalisation cost of an intangible asset exchanged for non-monetary asset depends on the commercial substance of the transaction.

An exchange transaction has commercial substance if:

(a) risk, timing and amount of the cash flows of the asset received is different from that of the cash flows of the asset transferred;

(b) entity's operations significantly affected by the transaction;



## 7 Intangible Assets in the form of Govt. Grant

An intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant.
Such assets should be valued or capitalised in accordance with IND AS 20, i.e ***intangible assets received as grant at nominal consideration or free should be valued at nominal value or fair value.***
Any expenditure incurred in relation to such asset that is directly attributable to preparing the asset for its intended use can also be capitalised along with nominal or fair value.

## 8 Intangible Assets acquired as Business Combination

When an intangible asset is acquired in a business combination, the cost of that intangible asset is ***its fair value at the acquisition date.***
An acquirer recognises an identifiable intangible asset acquired at the acquisition date, separately from goodwill, even if the asset was not recognised by the acquiree before.
Even in-process research and development project of the acquiree can be valued by the acquirer if

- the project meets the definition of an intangible asset after acquisition; and
- asset is separately identifiable.

The acquirer may recognise a group of similar and related intangible assets as a single asset if the individual assets have similar useful lives.

## 9 Expenditure on Intangible Asset should be expensed

Expenditure on Intangible Asset should be charged to statement of profit and loss i.e. expensed, unless it meets the recognition criterion.
**Expenditure on an intangible item will be capitalised if:**

- it meets the definition and recognition criteria and becomes part of cost; or
- the item is acquired in a business combination and cannot be recognised as an intangible asset. Goodwill be recognised

*Once expensed or charged to P&L, an expenditure on Intangible Asset cannot be recapitalised.*

### 9.1 Expenditure always expensed:

- Research expenditure (except when it is acquired as part of a business combination)
- Start up costs
    - Establishment (legal & secretarial) costs
    - Incorporation costs
    - Starting new operations or products
- Training costs
- Advertising and promotional expenses
- Reorganising or relocating expenses

### 9.2 Expenses which do not create intangible Asset.

Any expense which does not create intangible assets should be expensed as below.

**When to expense?**

- Related to Goods
  - Expense when entity has right to receive goods
- Related to Services
  - Expense when entity receives services

An entity need not expense advance paid for goods or prepaid expenditure related to services in the year of payment.

***Important Note – Once an expense is recognised, it cannot be capitalised back as intangible asset in future.***

## 10 Amortisation

Amortisation is

- Systematic allocation
- Of depreciable amount
- Over the useful life of the Intangible Asset

**Depreciable Amount**
= Costs – Residual value

### 10.1 Residual Value

Residual value is usually the excess of current estimated realisable value over the estimated disposal costs assuming the asset is at its end of the useful life today.

**Generally,** Residual Value (RV) of an intangible asset is assumed to be zero

**Exception –** Third party commitment to purchase or an active market exists

| | |
|---|---|
| **Reviewed** | End of each period |
| **Change in estimate of RV** | Account as per Ind AS 8 |
| **If RV is higher than carrying Amount** | Amortisation amount = 0 |
| **If RV again falls below Carrying amount** | Restart amortisation |

### 10.2 Useful life of an Intangible Asset

The accounting for an intangible asset is based on its useful life.

**Useful life**

- **Finite**
  - Limited defined period of benefit to entity
  - Amortisation done over useful life
- **Indefinite**
  - No limit to the period of use of the intangible asset and its expected benefits
  - Amortisation not possible

> 'Indefinite' does not mean 'infinite'

*An intangible asset is considered to have indefinite useful life when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity*

### 10.2.1 Factors to determine the useful life

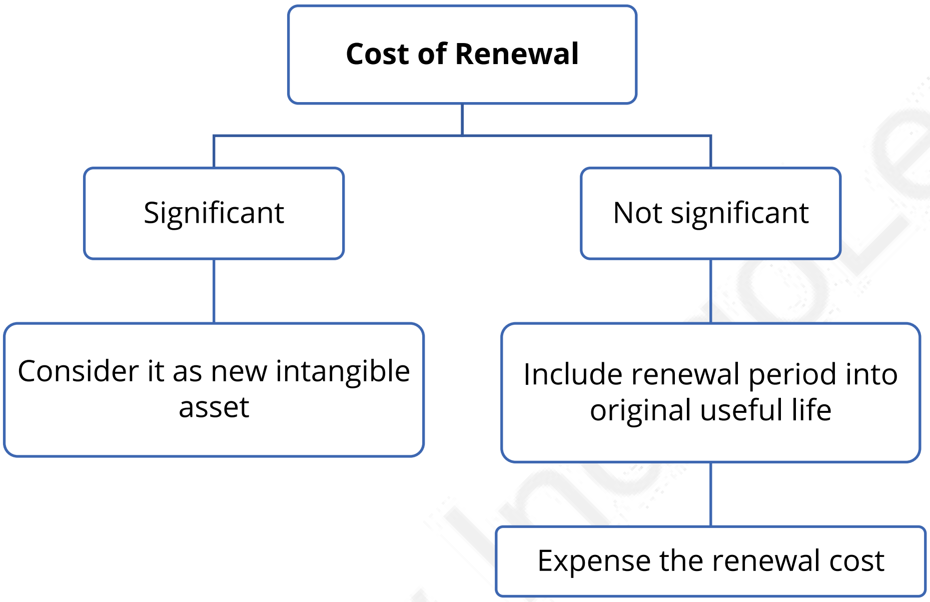
| | |
|---|---|
| **Usage** | • Expected usage of the asset by the entity and can it be managed by another team. |
| **Procuct Life Cycle** | • Product life cycles for the asset and public information on estimates of useful life of similar asset used in a similar way |
| **Obsolescence** | • Technical, technological , commercial or other type of obsolescence |
| **Industrial and market changes** | • Industrial stability in which the asset operate and changes in market demand for the products or services from the output |
| **Competitors** | • Expected actions by competitors or potential competitors |
| **Maintenance Expenses** | • Level of maintenance expenditure required to obtain the expected future benefits and management's intention to reach such level |
| **Control over Asset** | • Period of control over the asset and legal or similar limits on the use of assets, like expiry dates of related leases |
| **Interdependence** | • Whether the useful life is dependent on the useful lives of other assets of the entity |

### 10.2.2 Useful life dependent on Contracts

The useful life of an intangible asset arising from contractual or other legal rights **shall not exceed the period of the contractual or other legal rights**, but may be shorter depending on the period over which the entity expects to use the asset.

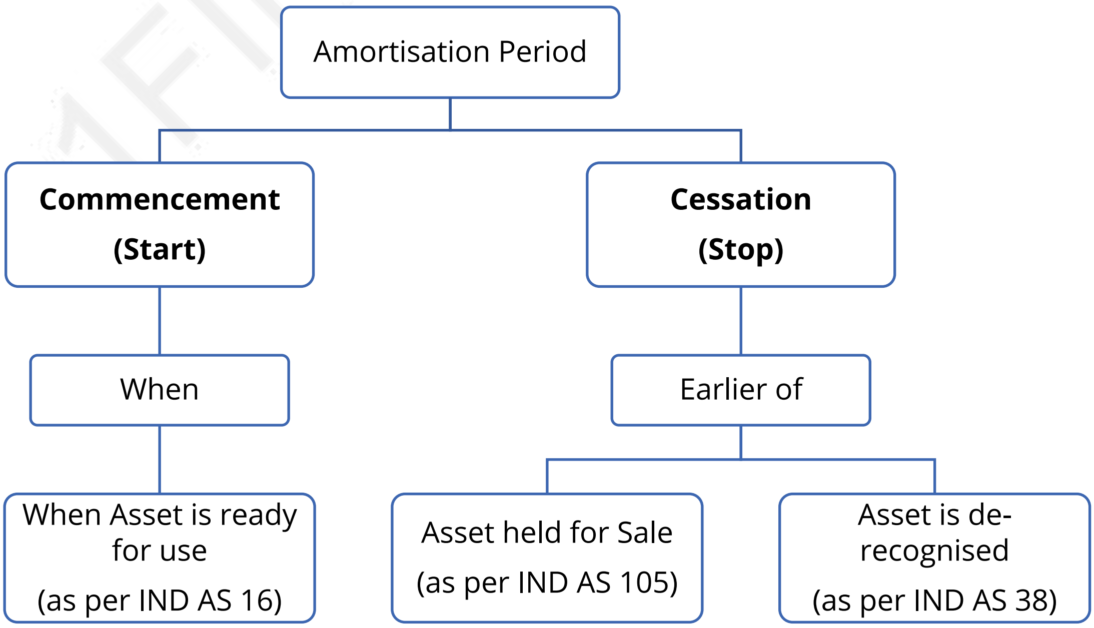
**Useful life ≤ Contractual period**

Renewal costs are considered significant or not-significant in comparison with the additional economic benefits received by the entity during the renewal period.




## 10.3 Amortisation Period

Amortisation is done for an intangible asset only if the intangible asset has finite useful life.



Amortisation does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105.

The amortisation period for an intangible asset with a finite useful life should be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period should be changed accordingly. Such change is accounted for as a change in accounting estimates in accordance with Ind AS 8.

### 10.4 Amortisation Methods

The amortisation method used should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity i.e. the consumption of economic benefit's pattern should be matched with the amortisation amount pattern.

If that pattern cannot be determined reliably, the straight-line method should be used.

Entity determines the predominant limiting factor inherent in an intangible asset and based on such factor, chooses the amortisation method. These methods include the straight-line method, the diminishing balance method and the units of production method.

***Revenue cannot generally determine the pattern of consumption, and thus revenue cannot be used as basis for amortisation.***

**Exception if**

- the contract specifically states that the revenue as the limiting factor (For eg asset can be used upto a certain amount of revenue generated) or
- revenue has high correlation with the consumption pattern,

then amortisation can be based on revenue.

The amortisation method should be reviewed at least at each financial year-end. If there has been a change in the expected pattern of consumption of the future economic benefits, amortisation method can be changed and such change is considered as change in accounting estimates as per IND AS 8.

If that pattern cannot be determined reliably, the straight-line method should be used.

Amortisation is usually recognised in profit or loss. Sometimes they are absorbed in producing other assets like inventories.

**Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used.**

### 10.5 Intangible Assets with Indefinite Useful Lives

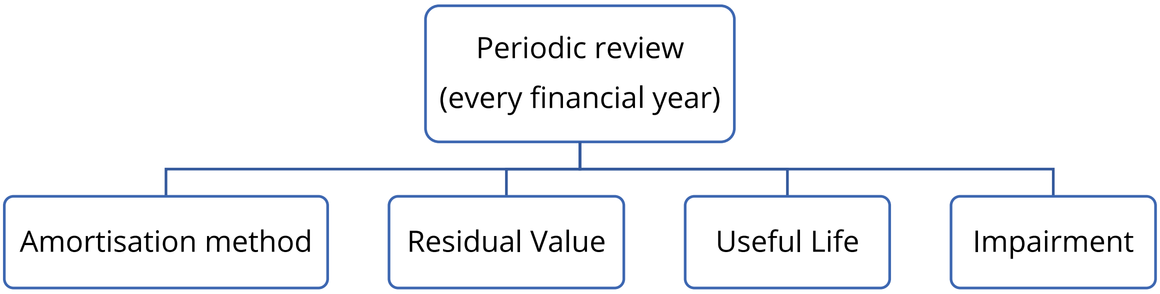
An entity is required to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount

(a) annually; and

(b) whenever there is an indication that the intangible asset may be impaired.

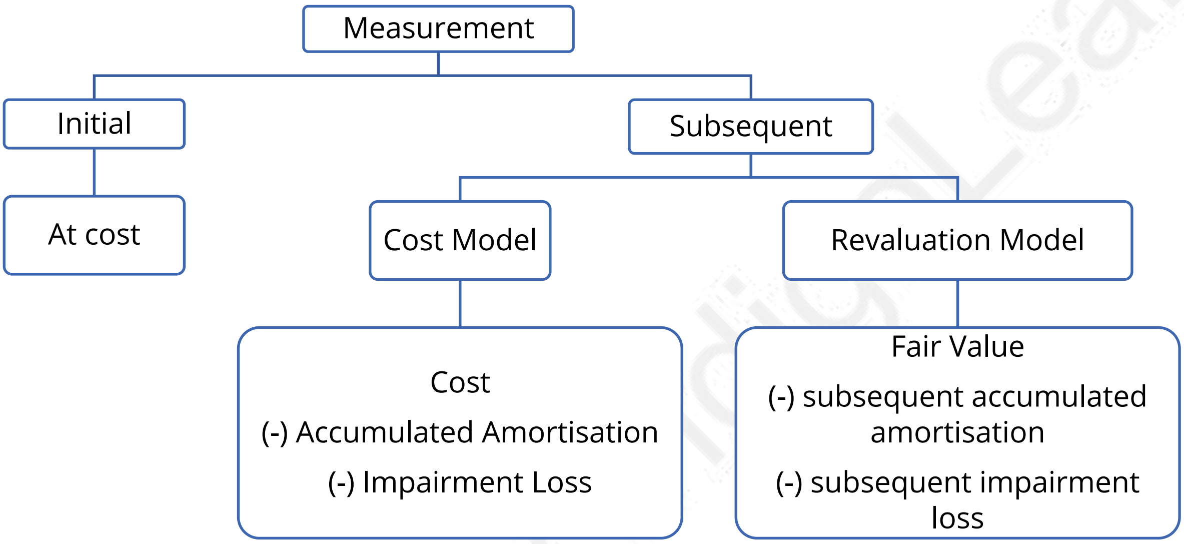
The change from indefinite to finite is considered as a change in an accounting estimate in accordance with Ind AS 8.

When the entity reassesses the useful life of an intangible asset as finite, it has to tests the asset for impairment and recognising any excess of the carrying amount over the recoverable amount as an impairment loss.




## 11 Subsequent Measurement

**Initial recognition is always at cost**




### 11.1 Revaluation Model

The revaluation model does not allow:

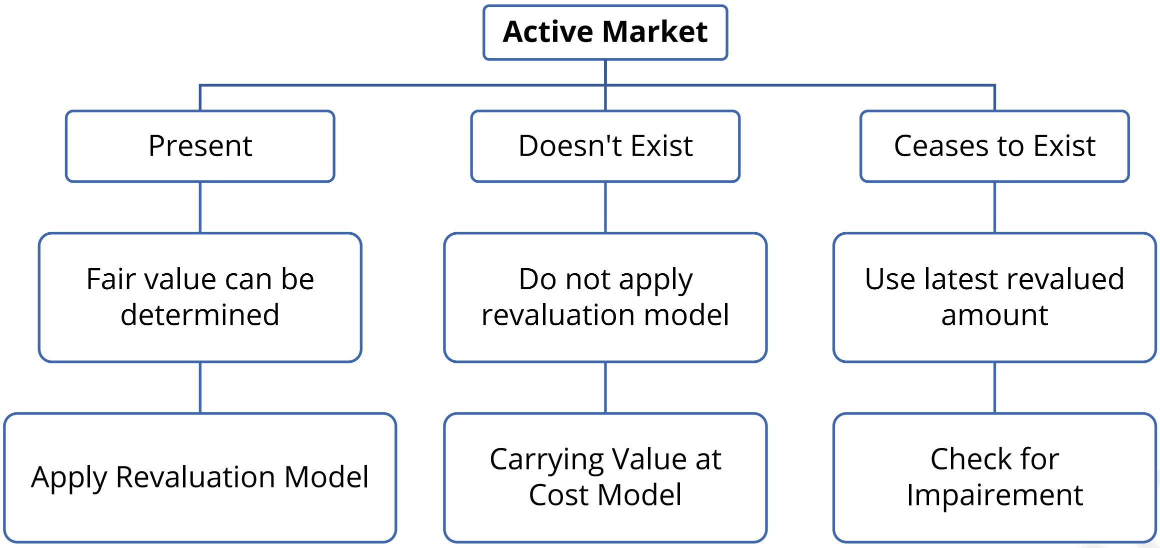
(a) the revaluation of intangible assets that have not previously been recognised as assets (i.e treated as expenses); or

(b) the initial recognition of intangible assets at amounts other than cost.

- Model must be followed by class of assets
- Carrying value should not differ significantly from the fair value
- Intangible assets received as government grants can be revalued.

### 11.2 Active Market

Fair value of the asset can be measured by reference to an active market at a subsequent measurement date. If there is no active market or the active market is unable to determine the fair value, then the IA will be revalued at earlier measured cost or earlier fair value.




## 11.3 Accounting under Revaluation Model

The increase in carrying amount shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss.

| First Time Revaluation | |
|---|---|
| **Increase in value**<br>**(Fair Value > Carrying Amount)** | Intangible Asset A/c Dr.<br>To Revaluation Surplus A/c |
| **Decrease in value**<br>**(Carrying amount > Fair value)** | P&L A/c (loss) A/c Dr.<br>To Intangible Asset A/c |
| **Subsequent Revaluation** | |
| **Increase in value**<br>**(Fair Value > Carrying Amount)** | ***If no downward revaluation earlier:***<br>Intangible Asset A/c Dr.<br>To Revaluation Surplus A/c |
| | ***If downward revaluation earlier, to the extent of loss:***<br>Intangible Asset A/c Dr.<br>To P&L A/c |
| **Decrease in value**<br>**(Carrying amount > Fair value)** | ***If no upward revaluation earlier:***<br>P&L A/c (loss) A/c Dr.<br>To Intangible Asset A/c |
| | ***If upward revaluation earlier, to the extent of upward revaluation :***<br>Revaluation Surplus A/c Dr.<br>To Intangible Asset A/c |

## 11.4 Presentation of Revaluation Amount

Revaluation amount can be presented either on

- Net basis – accumulated amortisation is adjusted to the gross carrying amount and the adjusted net carrying amount will be restated with the revaluation amount added.
- Gross basis – increase the gross carrying amount and the amortisation value proportionately.

## 12 Derecognition of Intangible Asset

- Intangible Asset is recognised when entity ascertains that the future economic benefits would flow to the entity.
- Intangible Asset is derecognised when
  - no future economic benefits are expected to flow into the entity or
  - the asset is disposed by the entity
- The difference between carrying amount and disposal proceeds is recognised in P&L.
- Disposal proceeds is determined in line with principles given under Ind AS 115
- If intangible assets are sold as leaseback, gain / loss is recognised as per IND AS 116, otherwise gain or loss are recognised in statement of profit or loss.

## 13 Disclosure

### 13.1 General Disclosures

An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) Useful life of IA - indefinite or finite (useful life, Amortisation rates)

(b) Amortisation methods – SLM, WDV, others;

(c) Gross carrying amount, accumulated amortisation, accumulated impairment losses
- beginning of the period
- end of the period;

(d) Line item(s) of P&L statement which includes amortisation

(e) Reconciliation (carrying amount) - beginning and end of the period showing:

(i) Additions
- Internal development additions,
- Acquired additions
  - separately
  - business combinations;

(ii) Disposals
- IA held for sale
- other disposals;

(iii) increases or decreases from
- revaluations
- impairment losses recognised or reversed in other comprehensive income

(iv) impairment losses recognised in P&L during the period

(v) impairment losses reversed in P&L during the period

(vi) any amortisation recognised during the period;

(vii) net exchange differences arising on translation (into presentation currency) of
- financial statements
- foreign operation;

(viii) other changes in the carrying amount during the period

| Opening Balance | **Movements (+ / -)** | | | | | | **Closing Balance** |
|---|---|---|---|---|---|---|---|
| | Additions | Disposal | Amortisation | Impairment | Revaluation | Exchange difference | |
| | | | | | | | |
| | | | | | | | |

## 13.2 Specific Disclosures

(i) Intangible Assets with indefinite useful life
- carrying amount of that asset
- reasons supporting indefinite useful life.
  - factor(s) that played a significant role in determining so

(ii) Individual IA material to financial statements
- description,
- carrying amount and
- remaining amortisation period

(iii) IA acquired as Govt. Grant and initially recognised at fair value
- fair value initially recognised for these assets;
- their carrying amount; and
- measured after recognition under the cost/revaluation model

(iv) Title Restrictions & Capital Commitments
- existence
- carrying amounts

(v) Pledged as Securities – Carrying amounts

(vi) Contractual commitments for the acquisition of IA

(vii) IA under Revaluation Model
- Every class of IA
  - Effective date of revaluation
  - Carrying amount of revaluation
  - Carrying amount of revalued asset as per Cost model
- Revaluation Surplus
  - Beginning and ending amount
  - Changes
  - Restriction on distribution to shareholders
- Methods & assumptions for estimating fair values

(viii) Research and Development Expenditure - An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

## 13.3 Voluntary Disclosure

An entity can disclose the following information:

a) a description of any fully amortised intangible asset that is still in use; and

b) a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the recognition criteria in this Standard or because they were acquired or generated before this standard was effective.

# 14 Exclusions from IND AS 38

| Exclusions | Ind As |
|---|---|
| Inventory | 2 |
| Deferred Tax Assets | 12 |
| Leases of Intangible Assets | 116 |
| Financial Assets | 32 |
| Assets arising out of employee benefits | 19 |
| Goodwill on business combination | 103 |
| Deferred acquisition cost and Intangible Asset from insurance contract | 104 |
| Non-current assets held for sale | 105 |

| | |
|---|---|
| Assets arising from contracts with customers | 115 |
| Mineral oils and ores | 106 |
| Amortisation method for intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements before the beginning of the first Ind AS financial reporting period as per the previous GAAP | |

Rights under license agreement excluded under IND AS 116 will be dealt by IND AS 38

## 15 IND AS 38 vs AS 26

| Basis of differences | AS 26 | IND AS 38 |
|---|---|---|
| **Definition of IA** | • Identifiable<br>• non-monetary asset<br>• without physical substance<br>• held for<br>  ○ use in the production or supply of goods or services,<br>  ○ for rental to others,<br>for administrative purposes | • identifiable<br>• non-monetary asset<br>• without physical substance<br><br>*Asset's purpose to hold for use is not a part of definition* |
| **Identifiability** | Does not define 'identifiability'. Separability from goodwill not a necessary condition | Provides detailed guidance in respect of identifiability. |
| **Recognition for Separately Acquired Intangible Assets** | Criterion of probable inflow of expected future economic benefits is always considered satisfied | No such provision |
| **Amortisation Method** | No such guidelines | Revenue based amortisation not appropriate |
| **Payment deferred beyond normal credit** | No such consideration | Considered |
| **IA under business combination** | No such provision in AS 26<br>AS 14 deals with Amalgamation in nature of purchase | Dealt in detail |
| **Subsequent expenditures on IA acquired under business combination** | No such guidance | Guidance available for treatment |
| **IA acquired under exchange** | No mention of treatment | Specific mention of treatment |

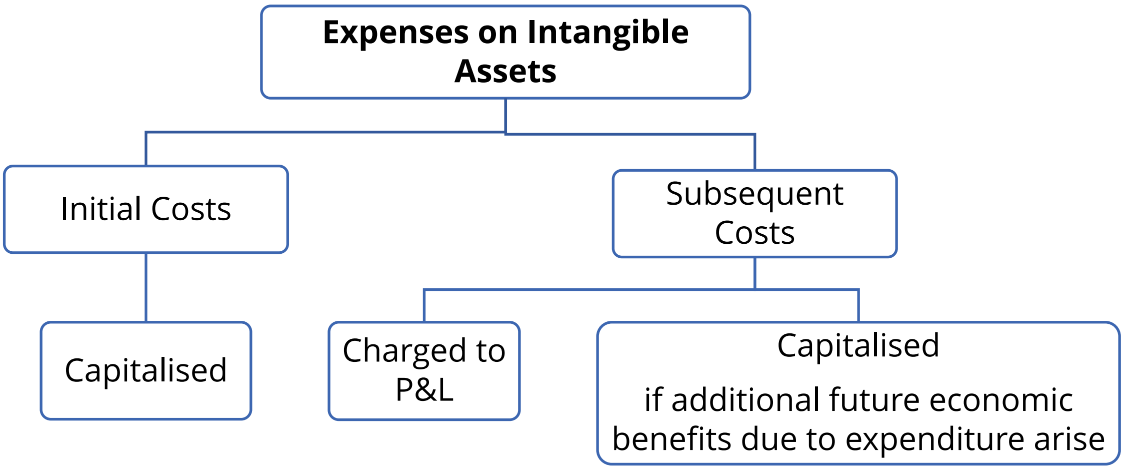
| | | |
|---|---|---|
| **IA acquired free of cost or at nominal price** | Use nominal value or cost of acquisition only. Fair value not considered. | Value IA at fair value or nominal value |
| **Useful life of IA** | Useful life always finite and presumption – use life cannot exceed 10 years | IA's useful life can be finite or indefinite. |
| **Expenses to be recognised** | No detailed guidelines | Detailed guidelines available |
| **Contractual & Legal Rights** | Does not include such a provision | Useful life may be less than legal life |
| **Residual value** | Residual value increase not available | Provision for increase in residual value available |
| **IA held for sale / retired from use** | Covered | Not covered (they are covered by Ind AS 105) |
| **Exclusions** | Paragraph 5 of AS 26, does not apply to accounting issues of specialised nature that arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, share issue expenses and discount allowed on the issue of shares | Discount or premium relating to borrowings and ancillary costs are not considered as they are dealt with by other Ind AS |
| **Exclusions** | No such exclusion | Toll road service concession agreement excluded |
| **Valuation Model as Accounting policy** | Revaluation model is not permitted. | Either the cost model or the revaluation model |

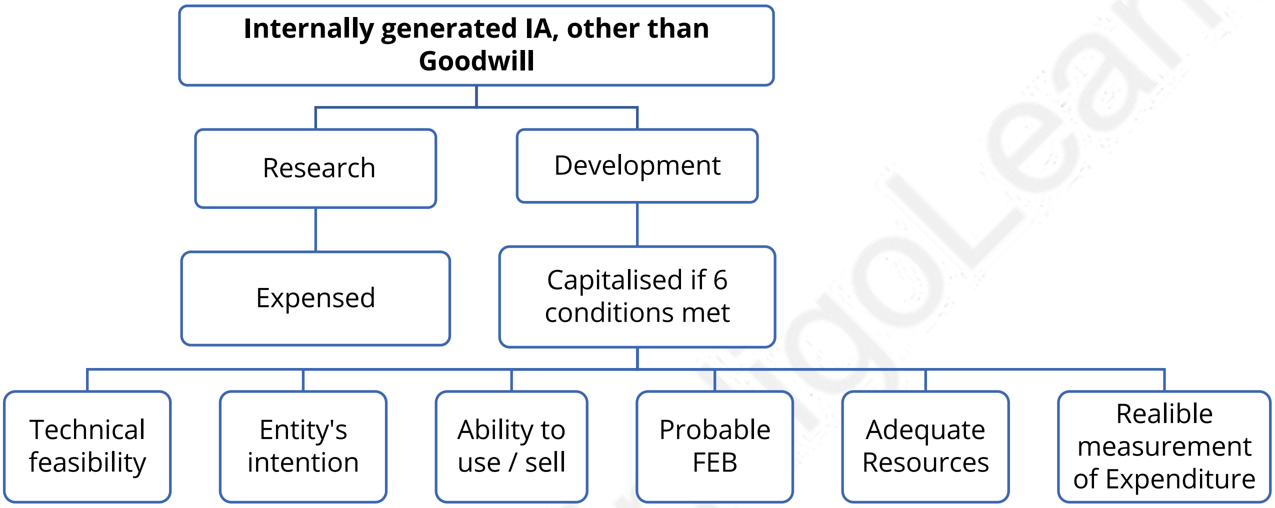
## 16 Summary of IND AS 38

Intangible Assets - An identifiable non-monetary asset without physical substance
An item to be recognised as Intangible Asset, it should

- meet definition criteria
  - non-monetary,
  - non-physical,
  - identifiable an
- meet recognition criteria
  - future economic benefits to flow into the entity and control on benefits established
  - costs measured reliably

> An intangible item should meet both definition and recognition criteria to be considered as IA.




**Costs**

All costs till the date of recognition of the intangible asset are expensed to the statement of profit and loss.

All cost from the date of recognition till the date the asset is ready to be put to use are capitalised.

**Intangible Asset exchanged for non-monetary asset**

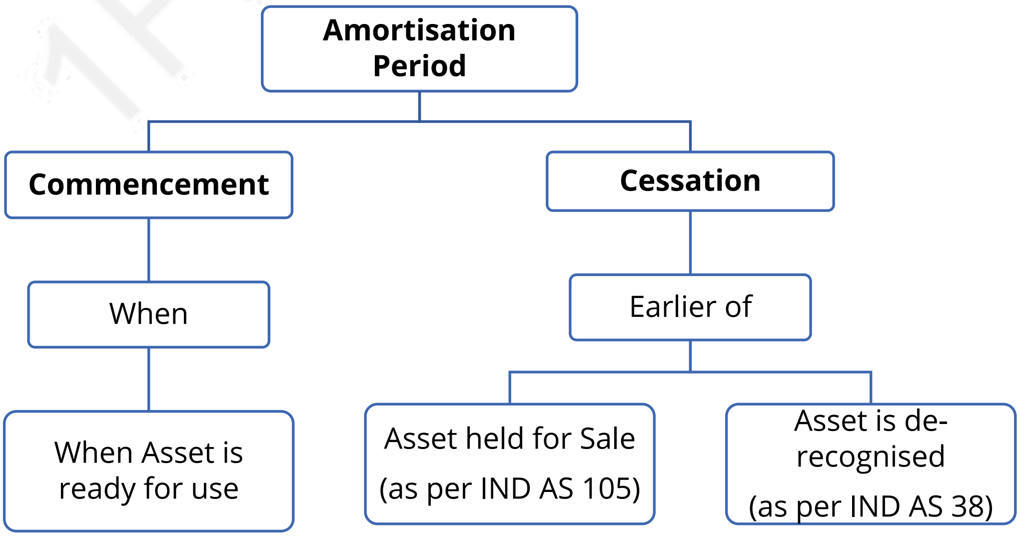
Exchange has commercial substance –

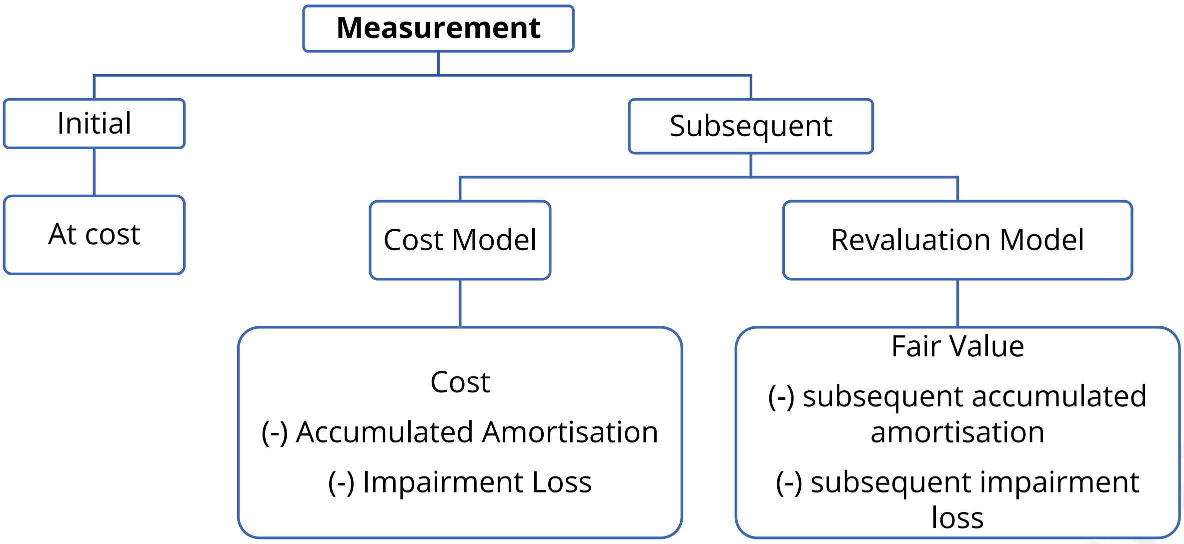
1st Priority - IA recognised at FV of asset given up

2nd Priority – FV of asset acquired if more evident

If FV not determinable or exchange lacks commercial substance – Carrying amount of asset given up.

**Amortisation**






### De-recognition

Intangible Asset is derecognised when

- no future economic benefits are expected to flow into the entity or
- the asset is disposed by the entity

## Ind AS 38
## Illustrations

### 1. Illustration

Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing. Which costs can be considered for capitilisation?

| | Costs incurred include (Rs.) |
|---|---|
| Cost of new solar technology | 10,00,000 |
| Trade discount provided | 1,00,000 |
| Training course for staff in new technology | 50,000 |
| Initial testing of new technology | 35,000 |
| Losses incurred while other parts of plant shut down during testing and training | 25,000 |

### 2. Illustration

16.1.1 Venus India Private Ltd acquired a software for its internal use costing Rs.10,00,000. The amount payable for the software was Rs. 600,000 immediately and Rs. 400,000 in one year time.

16.1.2 The other expenditure incurred were:-

16.1.3 • Purchase tax: Rs. 1,00,000

16.1.4 • Entry Tax: 10% (recoverable later from tax department) Legal fees: Rs. 87,000

16.1.5 • Consultancy fees for implementation: Rs. 1,20,000 Cost of capital of the company is 10%.

16.1.6 Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

## 3. Illustrations

A Company is preparing its accounts for the year ended 31st March, 20X2 and is unsure how to treat the following items.

1. Company has completed a big marketing and advertising campaign costing Rs. 2,40,000. The finance director had authorised this campaign on the basis that it would create Rs. 5,00,000 of additional profits over the next three years.
2. A new product was developed during the year. The expenditure aggregated Rs. 1,50,000 of which Rs. 1,00,000 was incurred prior to 30th September, 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs. 70,000.
3. Staff participated in a training programme which cost the company Rs. 300,000. The training organisation had made a presentation to the directors of Baxter outlining that the incremental profits to the business over the next twelve months would be Rs. 500,000.

What amounts should appear as assets in Venus Ltd. Balance sheet as at 31st March, 20X2?

## 4. Illustrations

Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license.

•The telecommunication license is carried at Rs. 5,00,000 in the books of Sun Ltd.

•The Software is carried at Rs. 10,000 in the books of the Earth Ltd which is not the fair value.

Advise journal entries in the following situations in the books of Sun Ltd and Earth Ltd:

1) Fair value of software is Rs. 5,20,000 and fair value of telecommunication license is Rs. 5,00,000.
2) Fair Value of Software is not measurable. However similar Telecommunication license is transacted by another company at Rs. 4,90,000.
3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

## 5. Illustrations

16.1.7 X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs. 20,00,000 and Rs. 18,00,000 respectively.

At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

(a) X Ltd. did not pay any cash to Y Ltd.

(b) X Ltd. pays Rs. 2,00,000 to Y Ltd.

## 6. Illustrations

16.1.8 An entity is developing a new production process.

16.1.9 During 20X1-20X2, expenditure incurred was Rs. 1,000, of which

16.1.10 • Rs. 900 was incurred before 1st March, 20X2 and

16.1.11 • Rs. 100 was incurred between 1st March, 20X2 and 31st March, 20X2.

16.1.12 The entity is able to demonstrate that at 1st March, 20X2, the production process met the criteria for recognition as an intangible asset.

16.1.13 The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 500.

16.1.14 During 20X2-20X3, expenditure incurred is Rs. 2,000. At the end of 20X3, the recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 1,900.

16.1.15 Explain the accounting treatment of expenditure incurred in 20X1-20X2 and 20X2-20X3 as per relevant Ind AS.

16.1.16

## 7. Illustrations

16.1.17 On 31st March, 20X1, Earth India Ltd. paid Rs. 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd.'s net assets had a fair value of Rs. 30,00,000.

16.1.18 In addition, Sun Ltd. also held the following rights:

- Trade Mark named "GRAND" – valued at Rs. 180,000 using a discounted cash flow technique.
- Sole distribution rights to an electronic product; future cash flows from which are estimated to be Rs. 150,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.

The 6-year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

## 8. Illustrations

X Limited engaged in the business of manufacturing fertilisers entered into a technical collaboration agreement with a foreign company Y Limited.

As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid Rs. 10,00,00,000 for the use of know-how for a period of 5 years.

X Limited estimates the production of fertiliser as follows:

| *Year* | *(In metric tons)* |
|---|---|
| *1* | *50,000* |
| *2* | *70,000* |
| 3 | 1,00,000 |
| 4 | 1,20,000 |
| 5 | 1,10,000 |

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively.

How will X Limited amortise the technical know-how fees as per Ind AS 38?

## 9. Illustrations

X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4 year license to manufacture a specialised drug at a cost of Rs. 1,00,00,000 at the start of the year. Production commenced immediately.

2. Also purchased another company at the start of year. As part of that acquisition, X Pharmacy Ltd. acquired a brand with a fair value of Rs. 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.

3. Spent Rs. 1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.

4. It has commenced developing a new drug 'Drug-A'. The project cost would be Rs. 10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.

- Cost incurred (accumulated) till 31st March, 20X1 is Rs. 5,00,00,000.
- Balance cost incurred during the financial year 20X1-20X2 is Rs. 5,00,00,000.

5. It has also commenced developing another drug 'Drug B'. It has incurred Rs. 50,00,000 towards research expenses till 31st March, 20X2. The technological feasibility has not yet been established.

How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

### 10. Illustrations

X Ltd. is engaged in the business of publishing Journals. They acquired 100% stake in Y Ltd., a company in the same industry. X Ltd. paid purchase consideration of Rs. 10,00,00,000 and fair value of net assets acquired is Rs. 8,50,00,000.

The purchase consideration includes payment for the following as well:

(a) Rs. 30,00,000 for obtaining the skilled staff of Y Ltd.

(b) Rs. 50,00,000 by way of payment towards 'Non-compete Fee' so as to restrict Y Ltd. to compete in the same line of business for next 5 years.

However, the above items (a) and (b) are not forming part of the net assets acquired of Rs. 8,50,00,000.

How should the above transactions be accounted for by X Ltd?

### 11. Illustrations

X Ltd. purchased a franchise from a restaurant chain at a cost of Rs.1,00,00,000 and the franchise has 10 years life.

In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made.

Can the franchise rights be treated as an intangible asset under Ind AS 38?

### 12. Illustrations

16.1.19 An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.

16.1.20 Over a period of time the entity has assembled a list of customers' names and addresses. The list is provided to other entities for a fee. The entity would like to recognise an asset in respect of the expected future economic benefits to be derived from the list. Can the customer list be treated as an intangible asset under Ind AS 38?

### 13. Illustrations

A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software.

X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset.

What would be your advice to X Ltd?

### 14. Illustrations

X Ltd. purchased a standardised finance software at a list price of Rs. 30,00,000 and paid Rs. 50,000 towards purchase tax which is non-refundable.

In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs. 7,00,000 towards customisation of the software for its intended use. X Ltd. also purchased a 5-year maintenance contract with the vendor company of Rs. 2,00,000.

At what cost the intangible asset will be recognised?

### 15. Illustrations

X Limited in a business combination, purchased the net assets of Y Limited for Rs. 4,00,000 on 31st March, 20X1.

The assets and liabilities position of Y Limited just before the acquisition is as follows:

| Assets | Cost (in Rs.) |
|---|---|

| | |
|---|---|
| Property, Plant & Equipment | 1,00,000 |
| Intangible asset 1 | 20,000 |
| Intangible asset 2 | 50,000 |
| Cash & Bank | 1,30,000 |
| **Liabilities** | |
| Trade payable | 50,000 |

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are Rs. 1,50,000, Rs. 30,000 and Rs. 70,000 respectively.
How would X Limited account for the net assets acquired from Y Limited?

### 16. Illustration

X Ltd. acquired Y Ltd. on 30th April, 20X1. The purchase consideration is Rs. 50,00,000. The fair value of the tangible assets is Rs. 45,00,000. The company estimates the fair value of "in-process research projects" at Rs. 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction.

Further, cost incurred by X Ltd. in relation to that research project is as follows:
(a) Rs. 5,00,000 – as research expenses
(b) Rs. 2,00,000 – to establish technological feasibility
(c) Rs. 7,00,000 – for further development cost after technological feasibility is established.
At what amount the intangible asset should be measured under Ind AS 38?

### 17. Illustration

X Ltd. is engaged is developing computer software. The expenditures incurred by X Ltd. in pursuance of its development of software is given below:
(a) Paid Rs. 2,00,000 towards salaries of the program designers.
(b) Incurred Rs. 5,00,000 towards other cost of completion of program design.
(c) Incurred Rs. 2,00,000 towards cost of coding and establishing technical feasibility.
(d) Paid Rs. 7,00,000 for other direct cost after establishment of technical feasibility.
(e) Incurred Rs. 2,00,000 towards other testing costs.
(f) A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs. 70,000.
On 15th March, 20X1, the development phase was complete and a cash flow budget was prepared and based on which net profit for the year was estimated to be equal Rs. 40,00,000. How X Ltd. should account for the above mentioned cost?

### 18. Illustration

Expenditure on a new production process in 20X1-20X2:

| | **Rs.** |
|---|---|
| 1st April to 31st December | 2,700 |
| 1st January to 31st March | 900 |
| | **3,600** |

The production process met the intangible asset recognition criteria for development on 1st January, 20X2. The amount estimated to be recoverable from the process is Rs. 1,000.
Expenditure incurred for development of the process in FY 20X2-20X3 is Rs. 6,000. Asset was brought into use on 31st March, 20X3 and is expected to be useful for 6 years.
What is the carrying amount of the intangible asset at 31st March, 20X2 and 31st March, 20X3. Also determine the charge to profit or loss for 20X1-20X2?
At 31st March, 20X4, the amount estimated to be recoverable from the process is Rs. 5,000.

What is the carrying amount of the intangible asset at 31st March, 20X4 and the charge to profit or loss for 20X3-20X4 on account of impairment loss?

### 19. Illustration

X Ltd. purchased a patent right on 1st April, 20X1, for Rs. 3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method.

As at 1st April, 20X2, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of Rs. 1,50,000 and decides to amortise over 2 years.

As at 1st April, 20X3, having perfected the related production process, the asset is now appraised at a value of Rs. 3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years.

Determine the value of intangible asset at the end of each financial year?

### 20. Illustration

One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors.

The senior engineer believes that the cost reductions will exceed the project costs within twenty-four months of their implementation.

Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of Rs. 18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset.

An offer of Rs. 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company Rs. 12,00,000 in perpetuity.

Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long-term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be Rs. 9,60,000 over this period. After that, she thinks that there is no certainty about its future.

What would be the appropriate accounting treatment of aforesaid issue?

### 21. Illustration (Nov 2019 Question Paper)

MNC Ltd. is in process of setting up a medicine manufacturing business which is at very initial stage. For this purpose, MNC Ltd. as part of its business expansion strategy acquired on 1st April, 2019, 100% shares of Akash Ltd., a company that manufactures pharmacy products. The purchase consideration for the same was by way of a share exchange valued at Rs. 38 crore. The fair value of Akash Ltd.'s assets and liabilities were Rs. 68 crore and Rs. 50 crore respectively, but the same does not include the following:

(i) A patent owned by Akash Ltd. for an established successful new drug that has a remaining life of 6 years. A consultant has estimated the value of this patent to be Rs. 8 crore. However, the outcome of clinical trails for the same are awaited. If the trails are successful, the value of the drug would fetch the estimated Rs. 12 crore.

(ii) Akash Ltd. has developed and patented another new drug which has been approved for clinical use. The cost of developing the drug was Rs. 13 crore. Based on early assessment of its sales success, a reputed valuer has estimated its market value at Rs. 19 crore. However, there is no active market for the patent.

(iii) Akash Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the company has been granted an exclusive five-year license on 1st April, 2018 to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is valuable asset which assures guaranteed sales and the cost to acquire the license is estimated at Rs. 7 crore of remaining period of life. It is expected to generate at least equivalent revenue.

Suggest the accounting treatment of the above transactions with reasoning under applicable Ind AS in the books of MNC Ltd.

### 22. Illustration

ABC Pvt. Ltd., recruited a player. As per the terms of the contract, the player is prohibited from playing for any other entity for coming 5 years and have to in the employment with the company and cannot leave the entity without mutual agreement.

The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches.

State whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38?

# Ind AS 40
# Investment Property

## 1. Introduction

### 1.1 Objective

- To prescribe acceounting treatment of Investment Property and owner occupied property.
- Recognition of Investment Property
- Determination of carrying amont and depreciation charges

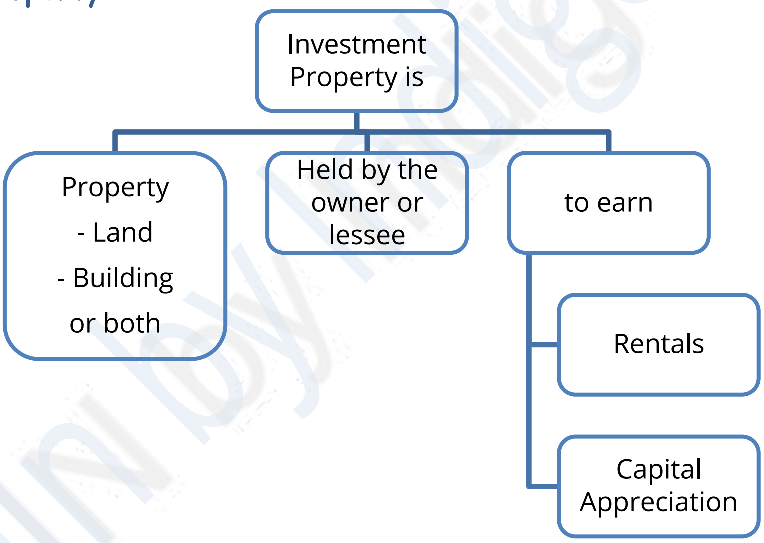
### 1.2 Scope

This standard does NOT deal with the following.

| | | |
|---|---|---|
| (b) | Biological assets related to agricultural activity | Dealt as per IndAS 16/ 41 |
| (d) | Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources | No Ind AS exists. Industry rules and regulations are followed. |

## 2. Definitions

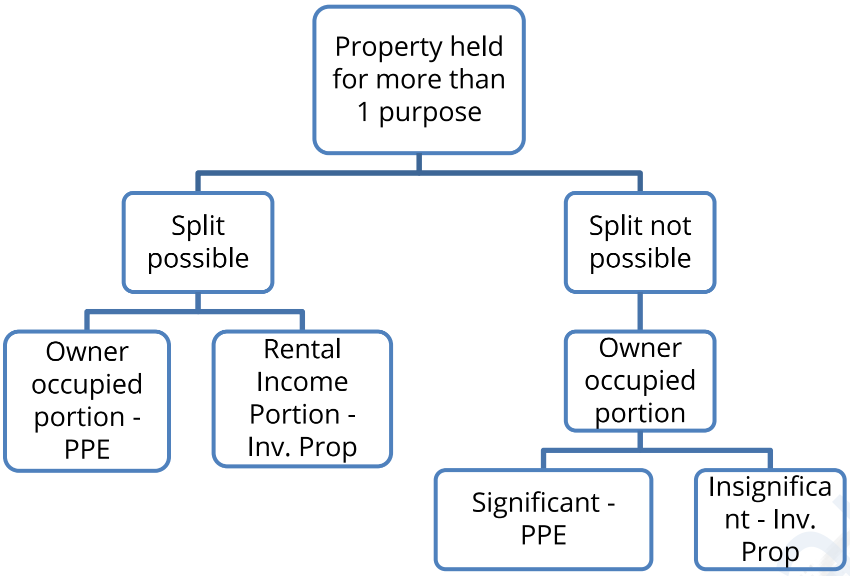
### 2.1 Investment Property




The following are not Investment Property

| | |
|---|---|
| Property held for use in the production or supply of goods or for administrative purpose (Including property occupied by employees) | PPE - Ind AS 16<br>(Including future owner occupied properties, property occupied by employees)<br>ROU Asset – Ind AS 116<br>This is called as owner occupied property. |
| Property held for sale in ordinary course of business | Inventory under Ind AS 2 |

## 2.2 Dual purpose property




Example of cases where split is possible – A building with 10 floors which can be independently transferred or let out. 6 floors are used for office and are classified as PPE and 4 floors are given on rent which are classified as investment property.

In cases where ancillary or additional services are provided and are significant, then the property may be classified as PPE. For example a hotel where rooms are given on rent along with other hotel related services. If services are insignificant as in the case of a security services along with office premises on rent, then office premises are classified as investment property.

## 2.3 Property given on rent to group companies

If one group company gives a property on rent to another group company, then in the standalone financial statements, the property is classified as investment property. However in the consolidated financial statements, the property is still owner occupied since the property is still used by the group and is not given on rent outside the group.

## 2.4 Nature of Investment Property

- Investment property is held for earning rentals and/or capital appreciation
- It generates cash independently of other assets in an entity. Hence it can be an independent Cash Generating Unit on its own.

## 2.5 Examples

- Land held for long term capital appreciation
- Land held for currently undetermined future use
- A builiding owned by the entity and leased out under an operating lease
- A building which is vacant and is held for leasing out
- Property under construction which would be held as investment property in future.

## 2.6 Carrying Amount

| | |
|---|---|
| Gross Book Value | xxx |
| (-) Accumulated Depreciation | xxx |
| (-) Accumulated Impairment Loss | xxx |
| **Carrying Amount** | **xxx** |

## 3. Recognition

**General Criteria for recognition of IP**

- Probable that future economic benefits associated with the item will flow to the entity
- Cost of item can be measured reliably

If investment property is held by a lessee then principles under Ind AS 116 would apply.

### 3.1 Measurement at Recognition

An owned investment property should **be initially measured at its cost.** The principles are same as those given under Ind AS 16.

### 3.2 If asset is purchased by payment of cash or credit.

The cost of an item of PPE comprises

| | |
|---|---|
| Purchase Price | xxx |
| **Add:** | |
| Non-refundable taxes and duties | xxx |
| Cost of site preparation | xxx |
| Construction cost | xxx |
| Professional Fees | xxx |
| Borrowing costs (If permitted by Ind AS 23) | xxx |
| **Any directly attributable cost** to bring the asset to the condition, necessary to **operate for its purpose intended** by the management | xxx |
| **Less:** | |
| Government grant received specific to the asset (Ind AS 20) | xxx |
| Trade discounts and rebates (If included in above costs) | xxx |
| **Cost of Investment Property to be capitalised** | xxxx |

#### 5.1.1 Exclusions from Cost of IP

- Startup costs
- Operating losses incurred before the investment property achieves planned level of activity.
- Abnormal amounts of wasted material, labour and other resources. Costs incurred in introducing a new product or service.

> The income and related expenses of incidental operations are recognised in profit or loss

### 3.3 IP acquired on deferred credit terms

- Recognised at cash price equivalent
- Difference between cash price and total payments is treated as interest expense.

### 3.4 Self – Constructed IP

The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

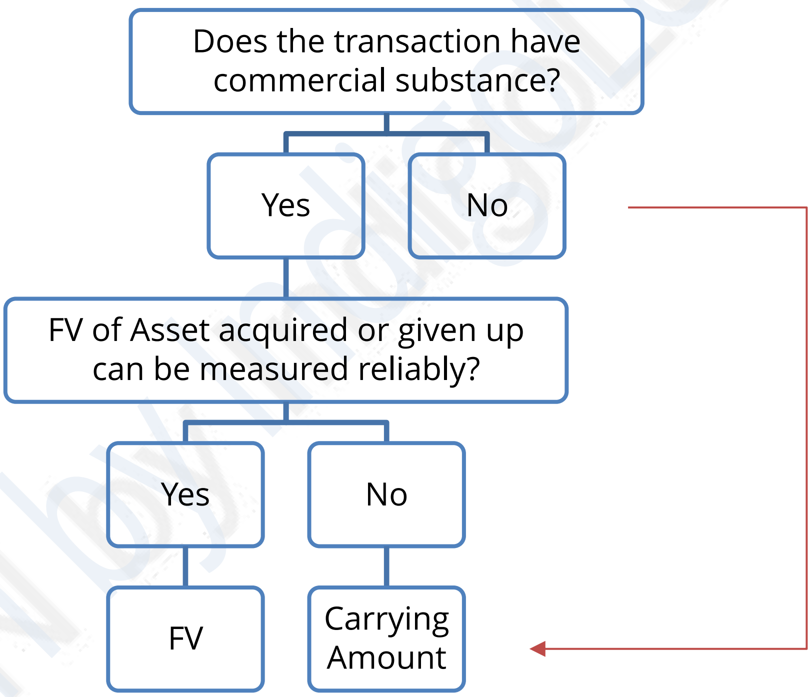
**Inclusions:**

- Costs of construction that directly relate to the specific assets
- Costs that can be attributable or allocated to the construction activity.
- Borrowing costs if IP is a qualifying asset as per Ind AS 23

**Exclusions:**

- Internal profits (Always take cost of construction and not sale price)
- The cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset.

### 3.5 IP is acquired by exchange of non-monetary assets




If both the above conditions are satisfied, IP is measured at

(a) Fair value of asset given up (1st Preference)
(b) Fair value of asset received

If both are available, consider whichever is more clearly evident.

If above conditions are not satisfied, IP is measured carrying amount of the asset given up.

**Commercial Substance:**

An exchange transaction has commercial substance if:

(a) The risk, timing, and amount of the cash flows of the asset received are significantly different from the cash flows of the asset transferred.
(b) There is a significant effect on the present value of the after tax cash flows that an entity expects to arise from the continuing use and disposal of the asset due to exchange transaction.

### Fair Value of the Asset:

The fair value of an asset is reliably measurable if:

a) The variability in the range of reasonable fair value measurements is not significant for that asset

b) The probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value.

## 4. Measurement after Recognition

An entity shall measure investment property as follows

- Ind AS 105 – If held for sale.
- Ind AS 116 – If held by a lessee as ROU Asset.
- Ind AS 16 – Under cost model in all other cases.
    - An entity is required to follow **COST MODEL** only. Revaluation model is not permitted.
    - An entity is required to measure the fair value for **DISCLOSURE** purpose.

## 5. Transfers

An entity shall transfer a property (reclassify) when there is a change in use.

| | |
|---|---|
| Ind AS 40 to Ind AS 16 | Commencement of owner occupation or development with view to owner occupation. |
| Ind AS 40 to Ind AS 2 | Commencement of development with a view to sell in ordinary course of business. |
| Ind AS 16 to Ind AS 40 | End of owner occupation |
| Ind AS 2 to Ind AS 40 | Inception of operating lease to another party |

## 6. Impairment

Entity must calculate the recoverable amount in accordance with Ind AS 36.
Compensation from third parties for items of IP that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

## 7. Derecognition

The carrying amount of an item of property, plant and equipment should be derecognised

(a) on disposal (Sale or finance lease)

(b) When the investment property is permanently withdrawn and no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition investment property is included in profit or loss when the item is derecognised. The entity may derecognise a component which is replaced with a new component (for e.g painting of walls). The principles are similar to the ones given for PPE.

In determining the date of disposal of an item of IP, an entity applies the criteria in Ind AS 115 (date recipient obtains control over IP) for recognising revenue. Ind AS 116 applies to disposal by a sale and leaseback.

## 8. Disclosure

- Accounting policy for Investment Property
- When classification is difficult, the criteria it uses to distinguish investment property from owner occupied property
- The extent to which fair value is based on vauation by an independent valuer possessing requisite skill.
- Amounts recognsied in P&L for
  - Rental income
  - Direct operating expenses related to IP generating rental income
  - Direct operating expenses related to IP which did not generate rental income.
- Existence and amount of restrictions on the realisability of investment property or remittance of income.
- Contractual obligations for purchase, repairs etc.
- Depreciation method used.
- Useful lives and depreciation rates.
- Gross carrying amount and accumulated depreciation at beginning and end of the reporting period.
- Reconciliation of carrying amount of investment property at beginning and end of the period
- Fair value of Investment property
  - A desrciption of IP
  - An explanation of why fair value cannot be measured reliably
  - Range of estimates within which fair value is likely to lie.

## ILLUSTRATIONS

### 1. Illustration

Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for Rs.5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying Rs. 6,25,000 as a one-time joining fee.

Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at Rs.5 crores. Advise.

Would you answer change if the office space was purchased with the intention of using it as an administrative centre of the company? (SM)

### 2. Illustration

X Limited purchased a building for Rs.30,00,000 on 1st May, 20X1 with an intention to earn rentals.
The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of Rs.1,00,000 and Rs.20,000 respectively were incurred in acquiring the building.

X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties.

Expenditures on redevelopment were:

a) Rs. 2,00,000 planning permission.
b) Rs.7,00,000 construction costs (including Rs.40,000 refundable purchase taxes)

What is the cost of the building as per Ind AS 40? (SM)

## 3. Illustration

Sun Ltd acquired a building in exchange of a warehouse whose fair value is Rs. 5,00,000 and payment of cash is Rs.2,00,000. The fair value of the building received by the Company is Rs.8,00,000. The company decided to keep that building for rental purposes.

Calculate the amount at which the building will be recognised. (SM)

## 4. Illustration

Moon Ltd has purchased a building on 1st April, 20X1 at a cost of Rs.10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10 years.

Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April, 20X5. On this date the fair value of the building is Rs.8 million. Moon ltd uses cost model for accounting of its investment property. (SM)

## 5. Illustration

X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

During June 20X1, X Ltd commenced construction of office building on it for own use. Presuming that the construction of the office building will still be in progress as at 31 March 20X2

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?
(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?
(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?
(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2? (SM)

## 6. Illustration

X Limited has an investment property (building) which is carried in Balance Sheet on 31st March, 20X1 at Rs.15,00,000. During the year X Limited has stopped letting out the building and used it as its office premise. On 31st March, 20X1, management estimates the recoverable amount of the building as Rs.10,00,000 and its remaining useful life as 20 years and residual value is nil.

How should X Limited account for the above investment property as on 31st March, 20X1? (SM)

## 7. Illustration

In financial year 20X1-20X2, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:
On 1st April, 20X1 - Purchase cost of the property Rs.1,80,00,000.
On 1st April, 20X1 – Non-refundable transfer taxes Rs.20,00,000 (not included in the purchase cost).
On 2nd April, 20X1- Legal cost related to property acquisition Rs.5,00,000. On 6th April, 20X1- Advertisement campaign to attract tenants Rs.3,00,000.
On 8th April, 20X1 - Opening ceremony function for starting business Rs.1,50,000.
Throughout 20X1-20X2, incurred Rs.1,00,000 towards day-to-day repair maintenance and other administrative expenses.

X Limited uses one of the six houses for office and accommodation of its few staffs. The other five houses are rented to various independent third parties.

How X Limited will account for all the above-mentioned expenses in the books of account? (SM)

## 8. Illustration

X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 20X1, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were Rs. 20,00,000.
On 31st March, 20X5, the fair value of the property was Rs.2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 20X5 and vacated the property on 30th September, 20X5. On 30th September, 20X5, the fair value of the property was Rs. 2,90,00,000.

On 1st October, 20X5, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 20X5 to 31st March, 20X6. The project was incomplete at 31st March, 20X6 and the directors of X Ltd. estimate that they need to spend a further Rs.40,00,000 to complete the project, after which each flat could be sold for Rs.50,00,000.

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 20X6 as per Ind AS. (SM)

## 9. Illustration

Shaurya Limited owns a Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.

Following information is relevant for Building A for the year ending 31st March, 20X2:

Building A was initially purchased at the cost of Rs.10 crores. At that time, the useful life of the building was estimated to be 20 years; out of which 5 years have been expired as on 1st April, 20X1. The company follows straight line method for depreciation.

During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 20X1 at the cost of Rs. 2 crores. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

Further, during the year 20X1-20X2 the company earned/incurred following direct operating expenditure relating to Building A and Building B:

| | | |
|---|---|---|
| Rental income from Building A | = | Rs. 75 lakhs |
| Rental income from Building B | = | Rs. 25 lakhs |
| Sales promotion expenses | = | Rs. 5 lakhs |
| Fees & Taxes | = | Rs. 1 lakhs |
| Ground rent | = | Rs. 2.5 lakhs |
| Repairs & Maintenance | = | Rs. 1.5 lakhs |
| Legal & Professional | = | Rs. 2 lakhs |
| Commission and brokerage | = | Rs. 1 lakhs |

The company does not have any restrictions and contractual obligations against Property - A and B. For complying with the requirements of Ind AS, the management sought an independent report from the specialists so as to ascertain the fair value of buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:
The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. And it is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs. 10.50 crores. The treatment of fair value of properties is to be given in the financials as per the requirements of Indian accounting standards.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet. (SM)

# Indian Accounting Standard 23
# BORROWING COST

## 1 Introduction

Ind AS 23 deals with Borrowing Costs – costs associated with Borrowed funds. Normally, such costs are taken to Statement of Profit and Loss as they represent an expense for the entity. However, certain borrowing costs are added to the cost of an asset.

### 1.1 Core Principle of Ind AS 23

Borrowing Costs that are directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset i.e., it is capitalised.

Other borrowing costs are recognised as an expense in the period in which they are incurred.

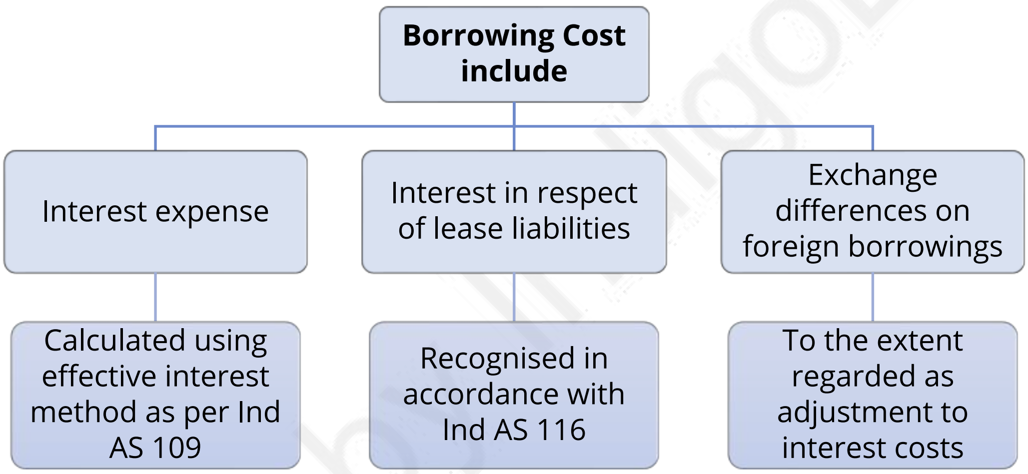
Ind AS 23 specifies about borrowing costs eligible for capitalisation and gives us guidelines for commencement, suspension, and cessation of capitalisation.

> Capitalisation of borrowing costs helps reflect true cost of an asset and correct profit/loss for an entity.

## 2 Important Terms

### 2.1 Borrowing Costs

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.




#### 2.1.1 Effective Interest Method

This method is covered in detail in Ind AS 109 – Financial Instruments. In short, this method considers discount, premium, fees associated with borrowings and involves finding a rate that exactly discounts estimated future cash payments to the amortised cost of borrowings. It is basically, an IRR for the borrowed amount.

**Example:** Company issues 10% debentures of ₹1,00,000 at 5% discount with a tenure of 3 years. Here, effective interest rate will be 12.12% and interest expense for 3 years shall be as follows:

| Year | Opening balance | Interest @12.12% | Payment | Closing balance |
|---|---|---|---|---|
| 1 | 95,000 | 11,514 | 10,000 | 96,514 |
| 2 | 96,514 | 11,697 | 10,000 | 98,211 |
| 3 | 98,211 | 11,788 | 1,10,000 | (0) |

#### 2.1.2 Exchange differences on foreign borrowings

- Company may borrow funds in a currency that is not its functional currency. E.g., an Indian company may take US $ loan
- This may have been done to take the benefit of lower interest costs of foreign currency borrowings
- But such foreign currency borrowings may involve exchange differences
- Regarding exchange difference required to be treated as borrowing costs:

➔ **Adjustment amount should be equivalent to exchange loss not exceeding the difference between cost of borrowing in functional currency vis-à-vis the cost of borrowing in a foreign currency**

**Example:** Company borrows $ 20,000 @ 3% for 1 year on 1st Jan, 20x1 when $ 1 = ₹ 75. Interest and loan are repayable on 31st Dec, 20x1. On 31st Dec, 20x1, exchange rate is $ 1 = ₹ 78. Company could borrow ₹ funds @ 6%.

| Date | $ borrowed | Exchange Rate | ₹ equivalent |
|---|---|---|---|
| 1 Jan 20x1 | 20,000 | 75 | 15,00,000 |
| 31st Dec 20x1 | 20,000 | 78 | 15,60,000 |
| Exchange Loss | 20,000 | 3 | 60,000 |

The exchange loss in this case is ₹ 60,000 [$ 20,000 x (₹ 78 - ₹ 75)]. Interest cost on this loan is ₹ 46,800 (3% x $ 20,000 x ₹ 78). Had the entity borrowed funds in ₹, the borrowing cost would have been ₹ 90,000 (₹ 15,00,000 x 6%).

₹ 43,200 is the savings in interest costs because of borrowing in $ vis-à-vis ₹. Company will treat exchange difference up to ₹ 43,200 (₹ 90,000 – ₹ 46,800) as a borrowing cost under this Standard. Thus, the total eligible borrowing cost is ₹ 90,000 (₹ 46,800 + ₹ 43,200).

➔ **The realised or unrealised gain to the extent of the unrealised exchange loss previously recognised as an adjustment should also be recognised as an adjustment to interest.**

**Example:** Company borrows $ 1,000 @ 4% on 1st Apr, 20x1 when $ 1 = ₹ 40. On 31st Mar, 20x2, exchange rate is $ 1 = ₹ 50. Company could borrow ₹ funds @ 12%.

At end of year 1, exchange loss (unrealised) is ₹ 10,000 [$ 1,000 x (₹ 50 - ₹ 40)]. Interest cost for year 1 is ₹ 2,000 (4% x $ 1,000 x ₹ 50). Had the entity borrowed funds in ₹, the borrowing cost would have been ₹ 4,800 (₹ 40,000 x 12%).

Company will treat exchange loss (unrealised) up to ₹ 2,800 (₹ 4,800 – ₹2,000) as a borrowing cost. So, total eligible borrowing cost for year 1 will be ₹ 4,800 (₹ 2,000 + ₹ 2,800).

**At end of Year 2 – If Exchange rate $ 1 = ₹ 48**
Interest cost for Year 2 is ₹ 1,920 ($ 1,000 x 4% x ₹ 48). Exchange gain (unrealised) is ₹ 2,000 ($ 1,000 x (₹ 50 – ₹48). Since in Year 1, unrealised exchange loss of ₹ 2,800 was adjusted in borrowing cost, exchange gain of ₹ 2,000 will be adjusted in the borrowing cost in this year. (Note: Exchange gain is less than exchange loss recognised in earlier year).
Net borrowing cost for year 2 will be (₹80) [₹ 1,920 - ₹ 2,000]

**At end of Year 2 – If Exchange rate $ 1 = ₹ 44**
Interest cost for Year 2 is ₹ 1,760 ($ 1,000 x 4% x ₹ 44). Exchange gain (unrealised) is ₹ 6,000 ($ 1,000 x (₹ 50 – ₹44). Since in Year 1, unrealised exchange loss of ₹ 2,800 was adjusted in borrowing cost, exchange gain upto ₹ 2,800 will be adjusted in the borrowing cost in Year 2 (Note: Exchange gain is more than exchange loss recognised in earlier year).
Net borrowing cost for year 2 will be (₹1,040) [₹ 1,760 - ₹ 2,800]

**Part Payment [$ 600] – At end of Year 1 i.e., on 31st Mar, 20x2**
Exchange rate on 31st Mar, 20x2 being $ 1 = ₹ 50, interest cost for year 1 is ₹ 2,000 (4% x $ 1,000 x ₹ 50). Had the entity borrowed funds in ₹, the interest cost would have been ₹ 4,800 (₹ 40,000 x 12%).

Realised exchange loss is ₹ 6,000 [$ 600 x (₹ 50 - ₹ 40)] and unrealised exchange loss is ₹ 4,000 [$ 400 x (₹ 50 - ₹ 40)]. Total exchange loss is ₹ 10,000.

Company will treat total exchange difference up to ₹ 2,800 (₹ 4,800 – ₹2,000) as a borrowing cost. So, total eligible borrowing cost for year 1 will be ₹ 4,800 (₹ 2,000 + ₹ 2,800). Out of exchange difference of ₹ 2,800 regarded as borrowing costs, ₹ 1,680 [$\frac{2,800}{10,000}$ x 6,000] relates to realised exchange loss and ₹ 1,120 [$\frac{2,800}{10,000}$ x 4,000] pertain to unrealised exchange loss.

Thus, in future years, realised or unrealised exchange gain only to extent of ₹ 1,120 will be treated as adjustment to interest cost.

### 2.2 Qualifying Asset

Qualifying asset is an asset that necessarily takes a **substantial period of time** to get ready for its intended use or sale.

**Depending on circumstances,** any of the following may be qualifying assets:

| | |
|---|---|
| (a) inventories | (d) intangible assets |
| (b) manufacturing plants | (e) investment properties |
| (c) power generation facilities | (f) bearer plants |

#### 2.2.1 Substantial period of time

- Ind AS 23 does not provide any guidance on what constitutes a **substantial period of time**
- Specific facts and circumstances should be considered in each case

Period of 12 months or more might be considered 'substantial'

#### 2.2.2 Qualifying assets - Exclusions

- Financial assets, and inventories that are manufactured, or otherwise produced, over a short period of time
- Assets that are ready for their intended use or sale when acquired are not qualifying assets.

## 3 Scope of Ind AS 23

- An entity shall apply this standard in accounting for borrowing costs.
- This standard does not apply to

➔ **actual or imputed cost of equity, including preferred capital not classified as a liability**
Example: Dividend paid on equity shares, cost of issuance of equity shares, cost of preference share capital (not classified as liability as per Ind AS 32)

➔ **qualifying assets that are measured at fair value**
Example: Biological asset accounted for under Ind AS 41
If the assets are measured under fair value model, then capitalisation would not affect measurement of the asset and would involve only reallocation between finance cost and fair value movement in the Statement of profit and loss.

➔ **inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis even if they take a substantial period to get ready for sale**
It becomes difficult in such situations to allocate borrowing costs to such inventories and monitoring those borrowing costs until the inventories are sold.

## 4 Recognition of Borrowing Costs

- Borrowing costs that are directly attributable to the acquisition, construction or production of a **qualifying asset** are capitalised as part of the cost of the qualifying asset
- Such borrowing cost are capitalised when below **two conditions are satisfied**:
  - ✓ it is probable that it will result in future economic benefits to the entity; and
  - ✓ costs can be measured reliably
- Other borrowing costs are recognised as an expense in the period in which they are incurred.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period.

### 4.1 Borrowing Costs eligible for Capitalisation

This includes those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.

> A notional borrowing cost cannot be capitalised.

Example: If a company incurs an expenditure of ₹ 1 lakh on construction of qualifying asset by taking a 10% loan of ₹ 50,000 and using own funds of ₹ 50,000, then borrowing costs associated with loan shall only be capitalised, Opportunity cost of own funds are not capitalised.

#### 4.1.1 Specific Borrowing Costs

- If an entity borrows funds specifically to obtain a qualifying asset, they are known as specific borrowings.
- Specific borrowings cost eligible for capitalisation would be **actual borrowing costs incurred** during the period ***less*** any investment income on temporary investment of those borrowings.
  - An entity may obtain borrowed funds and incur associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset.
  - In such circumstances, funds are often temporarily invested pending their expenditure on the qualifying asset.
  - In determining amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.

Actual borrowing costs incurred on that borrowing during the period − Investment income on temporary investment of those borrowings, if any = **Borrowing costs eligible for capitalisation**

#### 4.1.2 General Borrowing Costs

- All borrowings that are not specific represents general borrowings.
- If Specific borrowing remains outstanding after the related asset is ready for its intended use or sale, it becomes part of general borrowings.
- When general borrowings are used for qualifying assets, Ind AS 23 requires that, borrowing costs eligible for capitalisation is calculated by applying a **capitalisation rate** to the expenditures on qualifying assets.

### 4.2 Calculation of capitalisation rate

Capitalisation rate is the **weighted average of the borrowing costs** applicable to all the general borrowings of the entity that are outstanding during the period.

$$\textbf{Capitalisation Rate} = \frac{\text{Total borrowing costs on outstanding general borrowings}}{\text{Total outstanding general borrowings of entity during the period}}$$

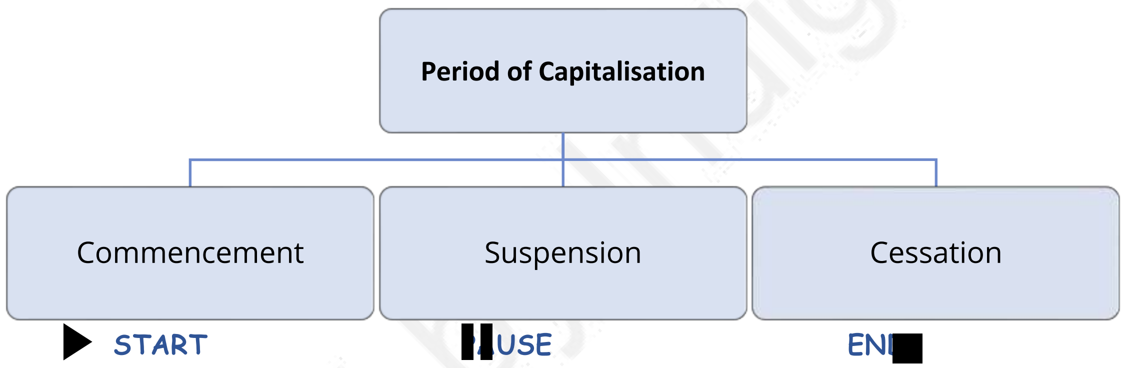
**Things to Note:**

- ✓ Amount of borrowing costs capitalised during a period shall not exceed amount of borrowing costs incurred during that period
- ✓ Capitalisation rate is calculated considering all general borrowings o/s during the financial year, not necessarily during construction period
- ✓ In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.

### 4.3 Expenditure to which capitalisation rate is applied

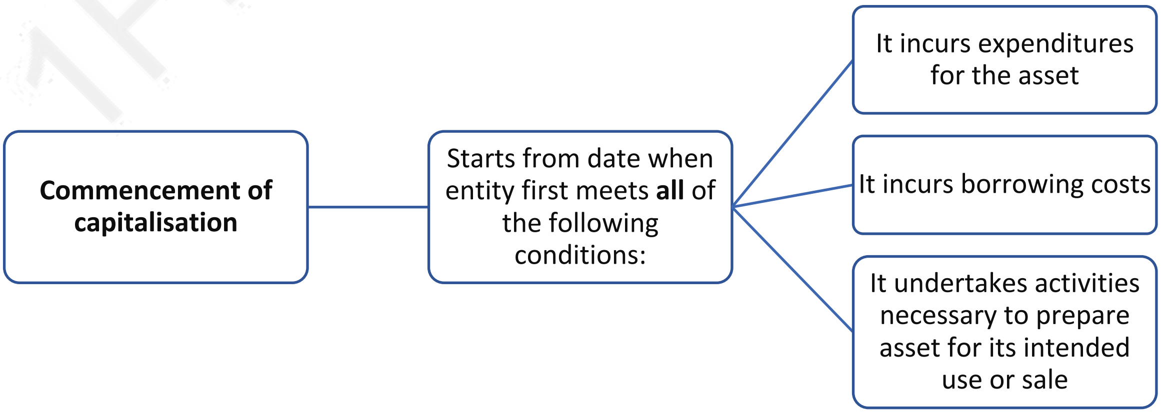
- Amount of expenditure on a qualifying asset include only those expenditures that have resulted in
  - payments of cash,
  - transfers of other assets or
  - the assumption of interest-bearing liabilities.
- Expenditures are reduced by any progress payments received and grants received in connection with the asset (Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance).

## 5 Period of Capitalisation




### 5.1 Commencement of Capitalisation

An entity is required to begin the capitalisation of borrowing costs as part of the cost of a qualifying asset on the commencement date.



**Activities necessary to prepare asset for its intended use or sale**

- **Includes** technical and administrative work prior to commencement of physical construction, such as activities associated with obtaining permits
- **exclude** holding of an asset when no production or development that changes the asset's condition is taking place

## 5.2 Suspension of Capitalisation

- Capitalisation of borrowing costs shall be suspended during extended periods in which **active development of a qualifying asset is suspended.**
- Such costs are costs of holding partially completed assets and do not qualify for capitalisation.
- Capitalisation of borrowing cost is **not suspended when temporary delay is a necessary part** of the process of getting an asset ready for its intended use or sale
    - Example: Capitalisation continues during extended period when high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

## 5.3 Cessation of Capitalisation

- Capitalisation of borrowing costs ceases when **substantially all activities necessary** to prepare qualifying asset for its intended use or sale are **complete.**
- An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might continue.
- If minor modifications, such as decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

### 5.3.1 When construction of qualifying asset is completed in parts

If each part is capable of being used while construction continues on other parts, entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

Example: A business park comprising several buildings, each of which can be used individually, is a qualifying asset for which each part is capable of being usable while construction continues on other parts.

Example: An industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill, is an example of qualifying asset that needs to be complete before any part can be used.

# 6 Disclosure Requirements

Entities are required to disclose:

(a) **amount of borrowing costs** capitalised during the period; and

(b) **capitalisation rate** used to determine the amount of borrowing costs eligible for capitalisation

## 7 Other Relevant Concepts

### 7.1 Dividends payable on shares classified as financial liabilities

- An entity might finance its operations in whole or in part by issue of preference shares and in some circumstances, these will be classified as financial liabilities (as per Ind AS 32).
- Dividends payable on these instruments would meet the definition of borrowing costs, subject to the fulfilment of certain conditions.

General rule: Dividends are not considered as Borrowing Costs.

### 7.2 Cessation of capitalisation for maturing inventories

- For maturing inventories, it is sometimes difficult to determine when 'period of production' ends, i.e., when inventories are being held for sale as opposed to being held to mature.
  - Example: Whisky is 'mature' after three years but goes on improving with age for many more years.
- Borrowing costs are added to the value of such maturing inventories for as long as it can be demonstrated that the particular item of inventory **continues to increase in value on account of** increasing age, rather than because of market fluctuations or inflation.
- If this cannot be demonstrated, then the inventories should be regarded as held for sale and no further borrowing costs should be capitalised.

### 7.3 Capitalising borrowing cost in group financial statements

| | |
|---|---|
| **Borrowings are taken by one company and qualifying asset is developed by another company within a group** | • Entity carrying out development should not capitalise any interest in its own financial statements as it has no borrowings<br>• Capitalise interest in the group financial statements |
| **Intra-group borrowings** | • Interest on such borrowings may be capitalised in entity's own financial statements, but not at the group level |
| **Amount of interest to be capitalised** | Interest capitalised should fairly reflect interest cost of the group on borrowings from third parties that could have been avoided if expenditure on qualifying asset were not made. |

## 8 Significant Differences between Ind AS 23 and AS 16

| Basis of differences | Ind AS 23 | AS 16 |
|---|---|---|
| **Qualifying Asset measured at Fair Value** | Does not require entity to apply standard to qualifying asset measured at fair value | Does not provide for such scope relaxation |
| **Calculation of interest expense** | Calculation of interest expense using effective interest rate method as described in Ind AS 109 | Borrowing costs to include: interest and other expenses, amortisation of discounts or premiums, amortisation of ancillary costs |
| **Reporting in Hyperinflationary Economies** | When Ind AS 29 is applied, part of the borrowing costs that compensates for inflation should be expensed | Does not contain similar clarification as no such standard on Hyperinflationary Economies |
| **Substantial Period of Time** | Explanation of 'Substantial Period of Time' is not included | Gives explanation for meaning of 'Substantial Period of Time' |
| **Borrowings of the Parent and its** | Specifically provides that in some circumstances, it is | No specific provision |

| | | |
|---|---|---|
| **Subsidiaries for Computing Weighted Average** | appropriate to include all borrowings of parent and its subsidiaries when computing weighted average of borrowing costs while in other circumstances, it is appropriate for each subsidiary to use weighted average of the borrowing costs applicable to its own borrowings. | |
| **Applicability to Inventories** | Excludes inventories that are manufactured/ produced in large quantities on a repetitive basis | Does not provide for such scope relaxation |
| **Disclosure of Capitalisation rate** | Requires disclosure of capitalisation rate | Does not have this disclosure requirement |

## 9 Other Points to Note

**Other things to note:**

- Capitalisation rate is calculated considering all general borrowings o/s during the financial year, not necessarily during construction period
- In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings.
- When an entity applies Ind AS 29 Financial Reporting in Hyperinflationary Economies, it recognises as an expense the part of borrowing costs that compensates for inflation during the same period.
- Borrowing costs in case of maturing inventories can be capitalised if inventory continues to increase in value on account of increasing age
- Dividends payable on shares classified as financial liabilities as per Ind As 32 are considered as Borrowing Costs
- Things to refer in detailed notes - Capitalising borrowing cost in group financial statements, significant differences between Ind As 23 and AS 16

## ILLUSTRATIONS

### 1. Illustration

A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

Should borrowing costs on the acquisition of the 3G license be capitalised until the network is ready for its intended use?

### 2. Illustration

A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.
Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete?

## 3. Illustration

Alpha Ltd. on 1st April, 20X1 borrowed 9% ₹ 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April, 20X1. The loan facility was availed on 1st April, 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

| | Factory | Office Building |
|---|---|---|
| 1st April, 20X1 | 5,00,000 | 10,00,000 |
| 1st October, 20X1 | 5,00,000 | 10,00,000 |

Calculate the cost of the asset and the borrowing cost to be capitalised assuming that the factory building was completed on 31$^{st}$ March, 20X2.

## 4. Illustration

Beta Ltd had the following loans in place at the end of 31st March, 20X2:

| Loan | 1st April, 20X1 | 31st March, 20X2 |
|---|---|---|
| 18% Bank Loan | 1,000 | 1,000 |
| 16% Term Loan | 3,000 | 3,000 |
| 14% Debentures | - | 2,000 |

14% debenture was issued to fund the construction of Office building on 1st July, 20X1 but the development activities has yet to be started. On 1st April, 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings.
Expenditure drawn down for the construction was: ₹ 500,000 on 1st April, 20X1 and ₹ 2,500,000 on 1st January, 20X2.

Calculate the borrowing cost that can be capitalised for the plant.

## 5. Illustration

X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended 31st March, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

| Date | Amount (₹) |
|---|---|
| 1st July, 20X1 | 2,50,000 |
| 1st December, 20X1 | 3,00,000 |

The details of borrowings and interest thereon are as under:

| Particulars | Average Balance (₹) | Interest (₹) |
|---|---|---|
| Long term loan @ 10% | 10,00,000 | 1,00,000 |
| Working capital loan | 5,00,000 | 65,0000 |
| | 15,00,000 | 1,65,000 |

Compute the borrowing costs that need to be capitalised.

## 6. Illustration

An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are ₹ 100,000 in September 20X1 and ₹ 250,000 in each of the months of October to December 20X1.
The entity has not taken any specific borrowings to finance the construction of the asset but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of ₹ 20 lacs and had an overdraft of ₹ 500,000, which increased to ₹ 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.
Calculate the capitalisation rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'.

## 7. Illustration

X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

(i) 15th May, 20X1: Loan interest relating to the project starts to be incurred
(ii) 2nd June, 20X1: Technical site planning commences
(iii) 19th June, 20X1: Expenditure on the project started to be incurred
(iv) 18th July, 20X1: Construction work commences

Identify commencement date.

## 8. Illustration

H Limited, a real estate company, gives immovable property on rent. It has completed on 31st May, 20X1, a commercial complex consisting of various offices that could be rented out. It expects that the commercial complex will be completely rented out by 30th June, 20X1.

However, due to adverse market conditions, only 10% of the commercial complex could be rented out by its reporting date of 31st March, 20X2. H Limited wants to capitalise the eligible borrowing costs incurred up to 31st March, 20X2. Discuss.

## 9. Illustration

Marine Transport Limited ordered 3 ships for its fleet on 1st April, 20X0. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 20X7. On 1st March, 20X2, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis.

Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended 31st March, 20X1 or 31st March, 20X2.

## 10. Illustration

K Ltd. began construction of a new building at an estimated cost of ₹ 7 lakh on 1st April, 20X1. To finance construction of the building it obtained a specific loan of ₹ 2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

| Amount | Rate of Interest per annum |
|---|---|
| ₹ 7,00,000 | 12% |
| ₹ 9,00,000 | 11% |

The expenditure incurred on the construction was:

| | |
|---|---|
| April, 20X1 | ₹ 1,50,000 |
| August, 20X1 | ₹ 2,00,000 |
| October, 20X1 | ₹ 3,50,000 |
| January, 20X2 | ₹ 1,00,000 |

The construction of building was completed by 31st January, 20X2. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 20X2.

## 11. Illustration

On 1st April, 20X1, entity A contracted for the construction of a building for ₹ 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

| Payment date | Amount (₹ '000) |
|---|---|
| 1st April, 20X1 | 200 |
| 30th June, 20X1 | 600 |
| 31st December, 20X1 | 1,200 |
| 31st March, 20X2 | 200 |

| Total | 2,200 |
|---|---|

Entity A's borrowings at its year end of 31st March, 20X2 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to ₹ 7,00,000. Interest of ₹ 65,000 was incurred on these borrowings during the year, and interest income of ₹ 20,000 was earned on these funds while they were held in anticipation of payments.
b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,000,000 and remained unchanged during the year; and
c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

## 12. Illustration

In a group with Parent Company "P" there are 3 subsidiaries with following business:
"A" – Real Estate Company
"B" – Construction Company
"C" – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

**Real Estate Company**

- Borrowings of ₹ 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to ₹ 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

**Construction Company**

- No borrowings during the period.
- Financed ₹ 10,00,000 of expenditures on qualifying assets using its own cash resources.

**Finance Company**

- Raised ₹ 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for general corporate purposes at the rate of 8%.

**Parent Company**

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

## 13. Illustration

How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

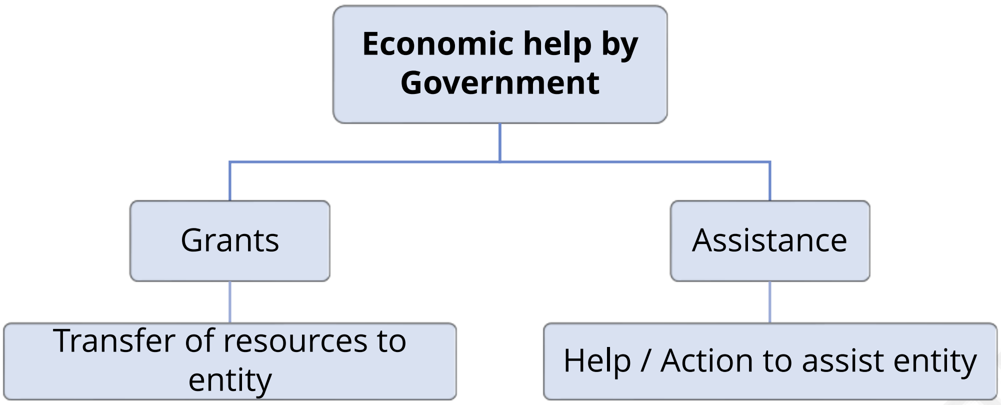
Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

## 14. Illustration

Nikka Limited has obtained a term loan of ₹ 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30th April, 20X2. An expenditure of ₹ 510 lacs was incurred on installation of Plant and Machinery, ₹ 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ₹ 56 lacs has been used for working capital purposes. Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ₹ 68.20 lacs during financial year 20X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28th February, 20X2?

## 1 Introduction




Examples

- Land free of cost to set up a cold storage unit
- 50% share of construction cost for industrial plant in remote area

### 1.1 Importance of accounting Government grants

It is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period.

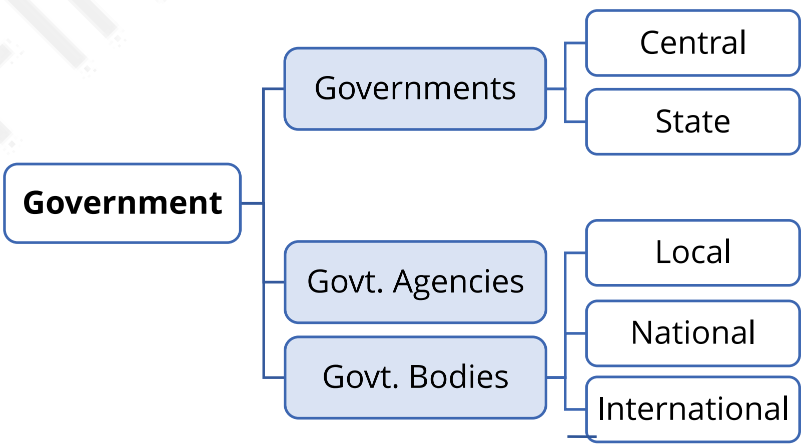
This helps investors and stakeholders in comparing the entity's financial statements with those of prior periods and with those of other entities, where such grants were not available.

Ind AS 20 provides guidelines for an appropriate method of accounting of such govt. grants so that the financial statements give a true and fair view of the financial position and performance.

Ind AS 20 is based on the accounting principle of "Matching"

## 2 Important Terms

### 2.1 Government



## 2.2 Government Assistance

**Government Assistance**

**Action by government** designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.

The purpose of providing Govt. Assistance is to encourage the entity to take an economic activity, which it would have not taken, if the said assistance was not available.
Government Assistance does not include mere infrastructural development or trading constraints for competitors
Ex: Approvals for speedy production of covid vaccination

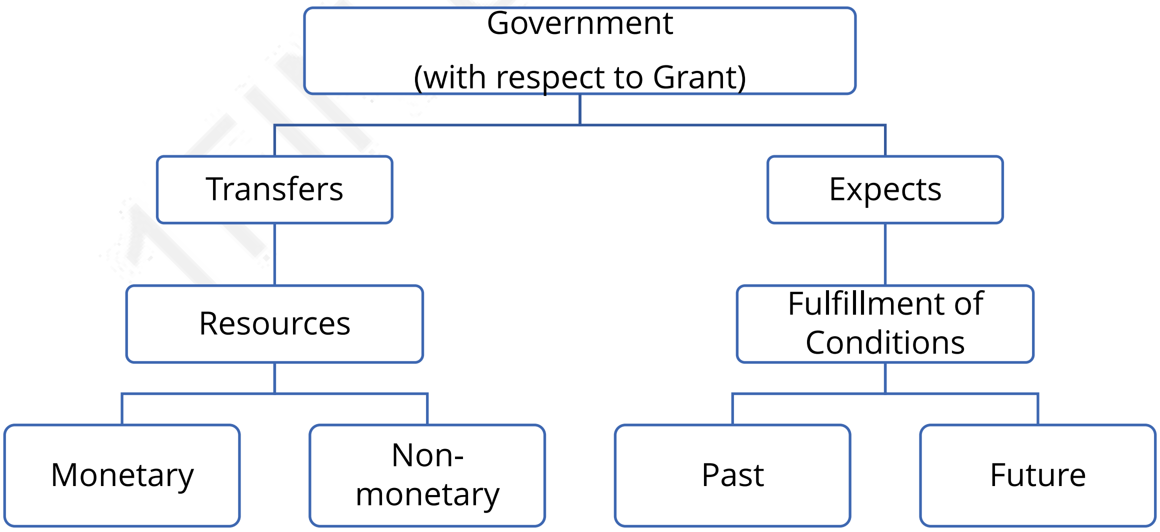
## 2.3 Government Grant

**Government grants**

Assistance by government in the form of **transfers of resources to an entity** in return for **past or future compliance** with certain **conditions** relating to the **operating activities** of the entity.

They are given under various names like subsidies, subventions, or premiums.
Examples:

- reimbursement of 20% capital expenditure to entity investing in underdeveloped remote zone




### 2.3.1 Exclusions

- assistance which cannot be reasonably valued and
- transactions with government which are in the course of normal trading transactions of the entity.

**Government Grant vs Government Assistance**

| Basis of differences | Grant | Assistance |
|---|---|---|
| **Meaning** | Assistance by government in the form of **transfers of resources to an entity** in return for past or future compliance with certain conditions relating to the operating activities of the entity. | **Action** by government designed **to provide an economic benefit** specific to an entity or range of entities qualifying under certain criteria. |
| **Examples** | Subsidies, Money given for research & development, loan at lower than market rate. | Revolving credit facility at a market rate of interest to an entity |

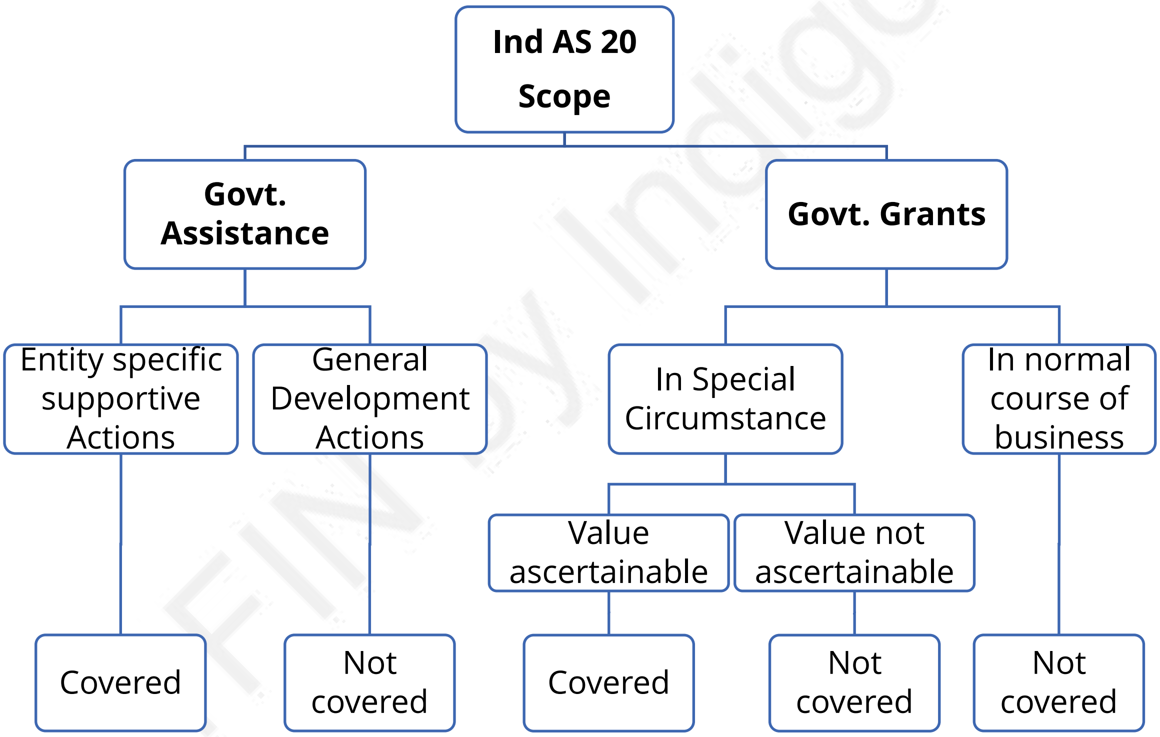
## 3 Scope / Applicability

### 3.1 Scope

Ind AS 20 is applied for:

(a) accounting and disclosure of government grants; and

(b) disclosure of other forms of government assistance.




### 3.2 Ind AS 20 - Exclusions

- government **participation in the ownership** of the entity E.g., picking up equity stake in an entity by the government.
- government grants that will be covered by Ind AS 41, **Agriculture**
- effects of **changing prices** or in supplementary information of a similar nature. E.g., benefits given due to change in a benchmarked price or minimum selling price given by the government.
- **income tax related benefits** like income tax holidays, investment tax credits, accelerated depreciation.

**Exclusion to Exclusion**

Sales tax exemption: Expert Advisory Committee (EAC) have opined that sales tax (now GST) foregone by government will be covered under Ind AS 20

## 4 Types Government Grants

### 4.1 Related to an Asset

Grants that the government provided to any qualified entity primarily to

- purchase,
- construct or
- acquire

any long-term assets.

The Govt. may also attach restriction of type or location of the assets or the period that those assets are to be purchased or acquired or held.

These grants are generally presented in the statement of financial position (Balance Sheet)

Ex: Reimbursement of the capital expense or a part of capital expense for setting up a food testing lab in a food processing zone set-up by the government

### 4.2 Related to Income

Grants related to other than those related to assets are called grants related to income.

These grants are generally presented in the Income Statement.

Ex: exemption to pay indirect taxes for 3 years from start of operations, if the entity is set-up in a specified location or state

## 5 Recognition of Govt. Grant

### 5.1 Essentials for Recognition

Government grants including non-monetary grants should be recognised by an entity when, there is a **reasonable assurance** that:

- the entity will **comply with the conditions** attached to the grants
  &
- the grants will be **received**.

Manner of receipt of grant does not affect the accounting treatment.

**Conditions to be Complied**

- Past Conditions
  - Reasonable assurance not required as these are complied before receiving the grant
- Futute Conditions
  - Reasonable assurance required for compliance

A grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.

> **Receipt of a grant is not conclusive evidence** that the conditions attaching to the grant have been or will be fulfilled.
>
> So, till the point, the conditions are satisfied by the entity, the grant will not be recognised and may be disclosed as a liability in the financial statements.

## 5.2 Accounting Treatment for Grant

### 5.2.1 Recognition in the Statement of Profit and Loss

There are two approaches for accounting of grants. **Ind AS 20 prescribes Income Approach.**

**Accounting for Grant**

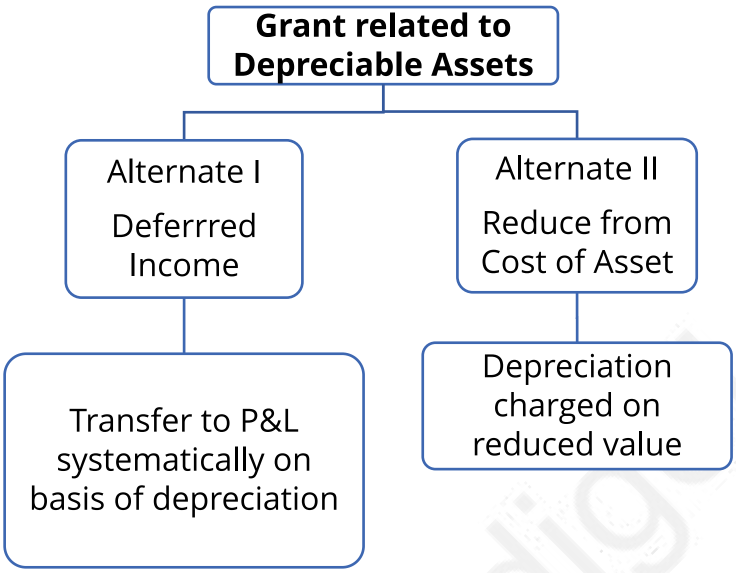
- Capital Approach
  - Grant treated as Capital Receipt under Equity i,e in Balance Sheet
- Income Approach
  - Grant treated as Revenue Receipt under Income statement (over one or more periods) systematically

Government grants are recognised on a systematic basis over the periods in which the entity recognises the related costs for which the grants are intended to compensate.

For e.g., a grant received for purchase of a capital asset can be recognised over the estimated useful life of the capital asset over which depreciation would be charged.

Recognition of Government grant in most cases is the period(s) over which an entity recognises the costs or expenses related to a government grant.

### 5.2.2 Grants related to Assets




Example: Accounting for Grant received in Cash Rs.10 lakhs for purchase of Asset

| **Scenario** | **Approach I**<br>**Deferred Income** | **Approach II**<br>**Capital Approach** |
|---|---|---|
| **Asset purchased =** | Asset A/c Dr. 30L<br>To Bank A/c 30L | Asset A/c Dr. 30L<br>To Bank A/c 30L |
| **At the time of Receipt of Grant** | Bank A/c Dr. 10L<br>To Govt. Grant Def Income A/c 10L | Bank A/c Dr. 10L<br>To Asset A/c 10L |
| **Deprecation (useful life 5 years) on SLM for first year** | Depreciation (P&L) A/c 6L<br>To Provision for Depreciation 6L | Depreciation (P&L) A/c 4L<br>To Provision for Depreciation 4L |
| **Grant recognised in P&L systematically** | Govt. Grant Def. Income A/c Dr. 2L<br>To P&L A/c 2L | |
| **Net Effect on P&L** | **Depreciation Rs.6 lakhs**<br>**Deferred Revenue Rs.2 lakhs**<br>**Net debit to P&L Rs.4 Lakhs** | **Depreciation Rs.4 lakhs**<br>**Deferred Revenue Nil**<br>**Net debit to P&L Rs.4 Lakhs** |

### 5.2.3 Non-Depreciable Assets

Grants related to non-depreciable assets can also be recognised in the same way,

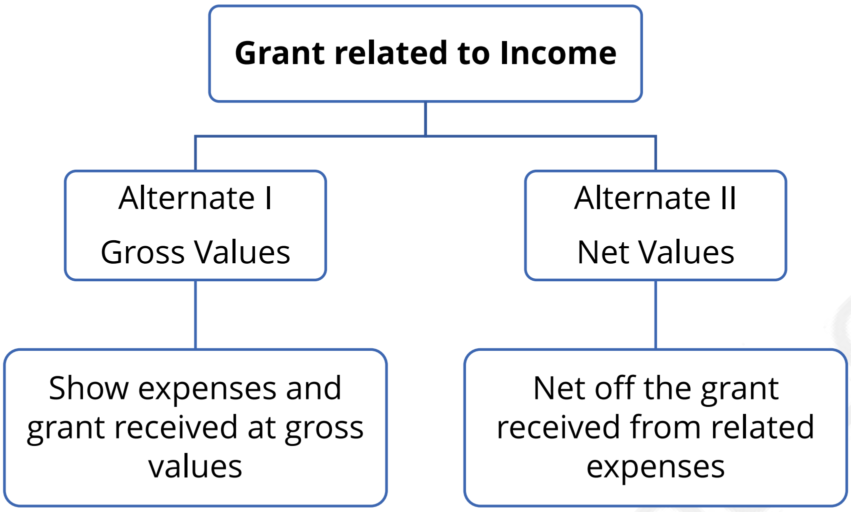
- reduce from cost of asset

- recognise in P&L over the period of time, based on conditions to be fulfilled over a period of time or if there are related costs to be incurred in relation to such non-depreciable asset.

### 5.2.4 Cash Flows for Govt. Grant presentation

Cash flows from grants and the corresponding acquisitions of the capital assets have to be disclosed on gross basis under the Investing Activities.

## 5.3 Accounting for Grant Related to Income




### 5.3.1 Presentation of grant related to income

Government grants related to income are presented as:

- **a credit** in the Statement of Profit and Loss, (separately or under a general heading such as 'Other income'); or

  **reduction** in reporting the related expense. For e.g., grant received for employment can be deducted from the employment or the payroll cost.

## 5.4 Government grants cannot be recognised receipts basis

Govt. Grants are recognised on accrual basis as it is in accordance with the accrual accounting assumption (Ind AS 1 Presentation of Financial Statements)

Govt. grant can be recognised on receipt if

- Conditions to receive are already satisfied and
- No future related costs are to be incurred

Also grant received by an entity from govt. as relief or to cover impact of losses can be recognised on receipt or when it becomes receivable, whichever is earlier as there are no other conditions associated with it and there are no further related costs.

### 5.5 Grants received in packages

When grants are received as part of packages i.e. a set of grants given to a single entity, each grant needs to be

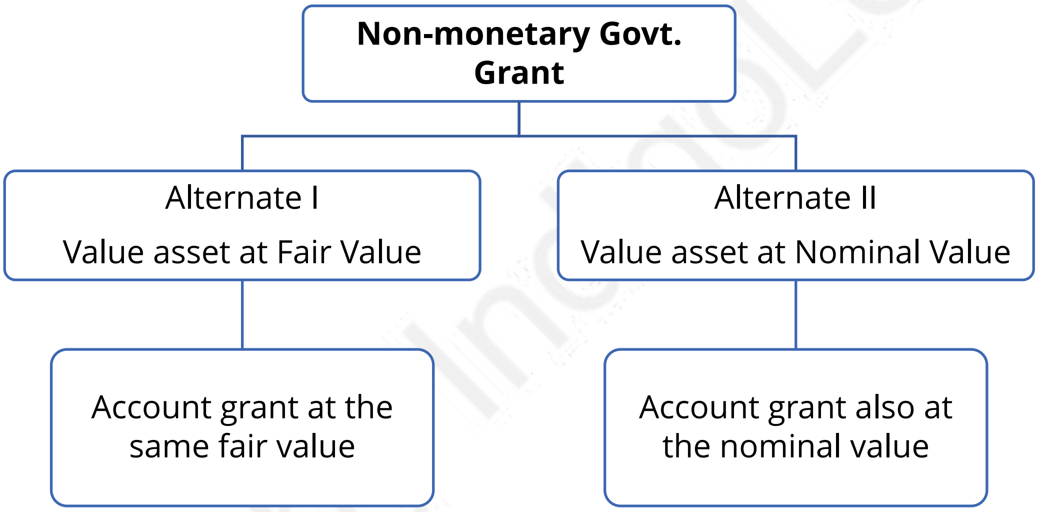
- Identified as grant related to asset or grant related to income
- Apply the recognition criteria based on
  - Conditions attached to each grant
  - Nature of each grant

## 6 Non-Monetary Govt. Grant

Non-monetary grants are those which do not involve transfer of cash or cash equivalents. Example – grant received in form of land.

Accounting treatment

- Use fair value; or
- Use nominal value




The fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value.

Eg: transfer of land as a grant. If the fair value of the land is for e.g., Rs. 10 crores, then the grant will be measured at Rs. 10 crores and the land would be measured at 10 crores.

## 7 Grants related to Loans

**Loans**

- Forgivable Loans (Repayment waived)
  - Grant to be recognised once conditions satisfied for loan forgiveness
    - Grant value = Grant received
- Concessional rate loan (nominal / low rate of interest)
  - Fair value as per Ind AS on Financial Intruments to be determined
    - Grant Value = Fair value - Actual value

For forgiveness of loan to be considered as a government grant, the entity should have reasonable assurance, that the conditions will be met.

**What happens if the government grants a loan below the market rate of interest?**

Example:

Market rate of interest is 9% p.a.,

- Government grants the loan at 3% p.a.

The benefit of a government loan at a below-market rate of interest is treated as a government grant]. Therefore, the loan shall be recognised and measured in accordance with Ind AS 109 Financial Instruments: Recognition and Measurement and the benefit shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109 and the proceeds received.

The entity shall consider the conditions and obligations attached to the grant.

## 8 Repayment of Grant

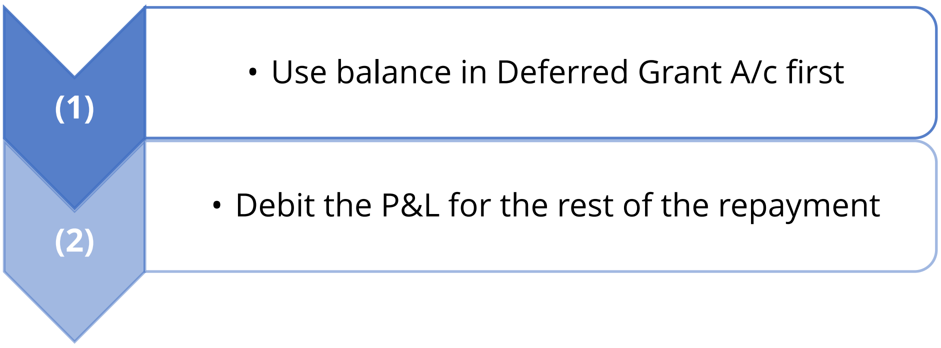
Govt. may at times ask for the grant to be returned in case the conditions are not fulfilled or the circumstances change.

Example: some disagreement with the government at a later stage or the entity decided to wind-up the establishment before the qualifying period.

Repayment of a grant related to income shall be applied first against any unamortised deferred credit (balance in the deferred grant account) recognised in respect of the grant.

If there is no balance in deferred grant account, the amount paid shall be recognised immediately in P&L A/c.

> Reverse the impact of grant received on repayment of Grant




Example: Entity received Rs.5 lakhs as grant and government sought repayment after 2nd year. If Rs.2 lakhs is recognised in P&L and there is a balance of Rs.3 lakhs in the deferred grant account at the end of second year.

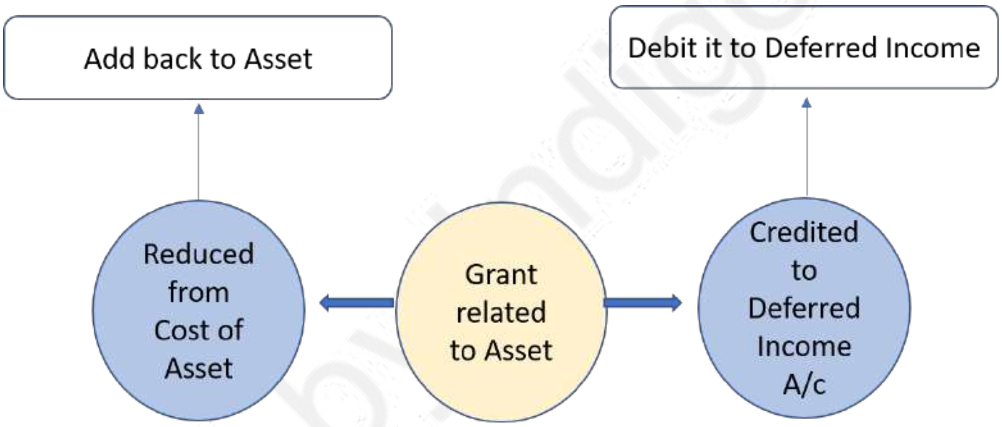
(i) If full refund is required - Rs.3 lakhs debited to deferred grant account and Rs.2 lakhs would be debited to P&L.

(ii) If only Rs.2 lakh to be repaid – Rs.2 lakhs debited to deferred grant account.

### 8.1 Treatment for refund of grant related to asset

Repayment of a grant related to an asset shall be recognised by reducing the deferred income balance by the amount repayable.

Depreciation amount is also adjusted due to the reversal. Reduced amount should be adjusted to P&L in the year of repayment.




### 8.2 Change in Estimate

If a government grant becomes repayable, it shall be accounted for as a change in accounting estimate as per Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

## 9 Government Assistance disclosure

For those government assistance in the form of

- transactions on which value cannot reasonably placed or
- transactions with government which cannot be distinguished from the normal trading transactions of the entity,

the entity should disclose the

  - nature,
  - extent and
  - duration

of such assistance / transaction.
Disclosure is important because the entity's performance is dependent on such assistance and non-disclosure in financial statements might be misleading for the stakeholders and investors.

## 10 Disclosures

The entity needs to disclose the following:

- accounting policy adopted for government grants,
- presentation methods adopted (the two approaches).
- nature and extent of government grants recognised in the financial statements
- government assistance from which the entity has directly benefited
- Unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

## 11 IND AS 20 vs AS 12

| Basis of differences | IND AS 20 | AS 12 |
|---|---|---|
| **Title** | Accounting for Government Grants and Disclosure of Government Assistance | Accounting for Government Grants |
| **Govt. Assistance** | Included in scope for the purpose of Ind AS | Does not include government assistance |
| **Recognition** | Prohibits recognition of grants directly in the shareholders' funds. | |
| **Monetary grants related to non-depreciable assets** | Cannot be credited to Capital Reserve<br>Taken to P&L A/c systematically using Deferred Income A/c | Credited to Capital Reserve |
| **Non-monetary govt. grant or assets given at a concessional price** | Accounted for at<br>• Fair value; or<br>• Nominal value | • Nominal value for Non-monetary assets given free of cost<br>• Acquisition cost for assets given at concessional price |
| **Grants in the nature of Promoter's contribution** | Not covered. | Credit to capital reserve and to be treated as shareholder's funds |
| **Loan at concessional rate** | Loan taken at fair value (determined as per Ind AS 109)<br>Value of concession to be recognised as grant. | Not covered |
| **Repayment of Govt. Grant** | Treated as Change in accounting estimate | Treated as extra-ordinary item |
| **Appendix Guidance** | Guidance for Govt. assistance recognition | No guidance |

## Illustrations

### 1. Illustration

A village of artisans in a district got devasted because of an earthquake. A Limited was operating in that district and was providing employment to the artisans. The government gave a grant of Rs.10,00,000 to A Limited so that 100 artisans are rehabilitated over a period of 3 years. Government releases Rs.2,00,000. Examine how the Government grant be realised.

### 2. Illustration

A Limited received from the government a loan of Rs. 50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant.
State how the grant will be recognized in the statement of profit or loss assuming:
Case 1: The loan is an immediate relief measure to rescue the enterprise.
Case 2: The loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years
Case 3: The loan is to finance a depreciable asset.

### 3. Illustration

A Limited wants to establish a manufacturing unit in a backward area and requires 5 acres of land. The government provides the land on a leasehold basis at a nominal value of Rs.10,000 per acre. The fair value of the land is Rs.1,00,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

### 4. Illustration

ABC Ltd. has received the following grants from the Government of Delhi for its newly started pharmaceutical business:

- Rs. 20 lakhs received for immediate start-up of business without any condition.
- Rs. 50 lakhs received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
  - that drugs should be available to the public at 20% cheaper from current market price; and
  - the drugs should be in accordance with quality prescribed by the World Health Organisation [WHO].
- Two acres of land (fair Value: Rs. 10 Lakhs) received for set up plant.
- Rs. 2 lakhs received for purchase of machinery of Rs. 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis.

How should ABC Ltd. recognise the government grants in its books of accounts?

## 5. Illustration

MNC Ltd. has received grant in the nature of exemption of custom duty on capital goods with certain conditions related to export of goods under Export Promotion Capital Goods (EPCG) scheme of Government of India. Whether the same is a government grant under Ind AS 20, Government Grants and Disclosure of Government Assistance? If yes, then how the same is to be accounted for.

## 6. Illustration

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters" contribution have been recognised in capital reserve and treated as part of shareholders" funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters" contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

## 7. Illustration

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of Rs. 1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clean-river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

(ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months" sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

Suggest the accounting treatment of, if any, for the two grants received and the flood- related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.

## 8. Illustration

An entity opens a new factory and receives a government grant of Rs. 15,000 in respect of capital equipment costing Rs. 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis.

Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20.

## 9. Illustration

A company receives a cash grant of Rs. 30,000 on 31 March 20X1. The grant is towards the cost of training young apprentices. Training programme is expected to last for 18 months starting from 1 April 20X1.
Actual costs of the training incurred in

- 20X1-20X2 was Rs. 50,000 and
- 20X2-20X3 was Rs. 25,000.

State, how this grant should be accounted for?

## 10. Illustration

Entity A is awarded a government grant of Rs.60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs. 1,00,000, rising by Rs.10,000 in each of the subsequent years.

Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3.

## 11. Illustration

X Ltd received a Govt. grant related to Income of Rs.5,00,000 in the year 20X1. X Ltd transferred Rs.1,00,000 to the statement of profit and loss systematically in the years 20X1 and 20X2 each. Due to certain non-fulfilment of conditions, government directed X Ltd. to repay the grant in 20X3.

How should X Ltd. reflect the grant repaid in the books of account, if
(i) the total grant of Rs.5,00,000 is repaid
(ii) the part of the grant of Rs.2,00,000 is repaid.

## 12. Illustration

A Ltd. has received a grant of Rs. 10,00,00,000 in the year 20X1-20X2 from local government in the form of subsidy for selling goods at lower price to lower income group population in a particular area for two years.

A Ltd. had accounted for the grant as income in the year 20X1-20X2. While accounting for the grant in the year 20X1-20X2, A Ltd. was reasonably assured that all the conditions attached to the grant will be complied with.

However, in the year 20X5-20X6, it was found that A Ltd. has not complied with the above condition and therefore notice of refund of grant has been served to it. A Ltd. has contested but lost in court in 20X5-20X6 and now grant is fully repayable.

How should A Ltd. reflect repayable grant in its financial statements ending 20X5-20X6?

## 1. Introduction

### 1.1 Objective

- Prescribe the methodology that an entity applies to ensure that its assets are not carried at more than their recoverable amount.
- Recognise impairment loss if the asset is carried at more than its recoverable amount.
- Specifies when an entity shall reverse an impairment loss
- Disclosure requirements

### 1.2 Scope

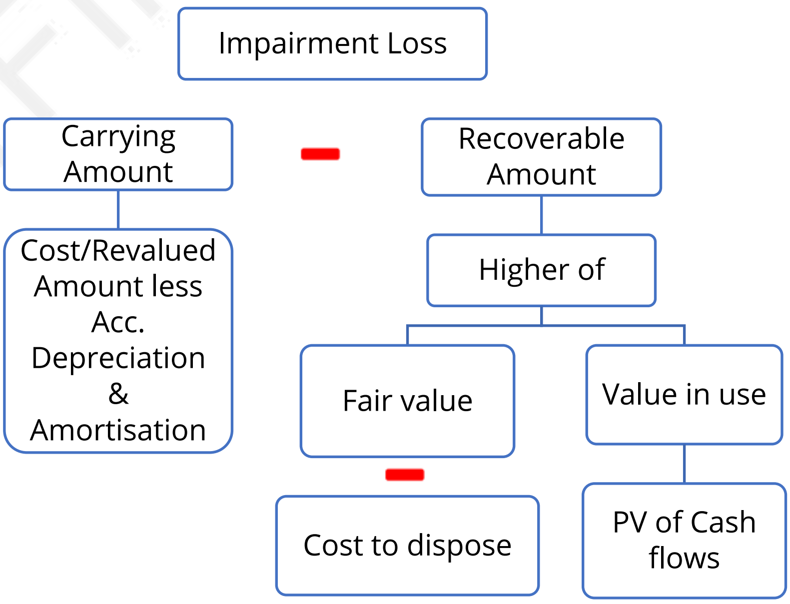
Applies to accounting for the impairment of all the assets **other than**

| | |
|---|---|
| (a) Inventories | Ind AS 2 |
| (b) Contract assets and assets arising from costs to obtain or fulfil a contract | Ind AS 115 |
| (c) Deferred tax assets | Ind AS 12 |
| (d) Assets arising from employee benefits | Ind AS 19 |
| (e) Financial Assets | Ind AS 109 |
| (f) Biological assets related to agricultural activity | Ind AS 41 |
| (g) Deferred acquisition costs and intangible assets arising from insurance contracts | Ind AS 104 |
| (h) Non-current assets (or disposal groups) classified as held for sale | Ind AS 105 |
| (i) Financial Assets | Ind AS 109 |

This standard applies to financial assets classified as

(a) Subsidiaries (Ind AS 110)
(b) Associates (Ind AS 28)
(c) Joint Ventures (Ind AS 111)

## 2. Definitions



### 2.1 Impairment Loss

It is the amount by which carrying amount exceeds the recoverable amount.

| Impairment loss = Carrying Amount – Recoverable Amount |
|---|

### 2.2 Recoverable Amount

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

### 2.3 Value in Use

Present value of the future cash flows expected to be derived from an asset or cash-generating unit.

### 2.4 Fair Value

Price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between market participants at the measurement date.

### 2.5 Costs of Disposal

Incremental costs directly attributable to the disposal of an asset or cash-generating unit, **excluding** finance costs and income tax expense.

### 2.6 Carrying Amount

Amount at which an asset is recognised **after deducting** any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

### 2.7 Cash Generating Unit

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For e.g. a Hotel division of ITC group

### 2.8 Corporate Assets

Corporate assets are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units. For e.g Corporate Head Office, Common shared service center.

## 3. Depreciation vs Impairment

| Depreciation/ Amortisation | Impairment of Asset |
|---|---|
| (a) Reduction in the value of the asset | (a) Reduction in the value of the asset |
| (b) It is allocation of depreciable amount on a systematic basis. | (b) It is done only when there are indications that the asset was impaired. |

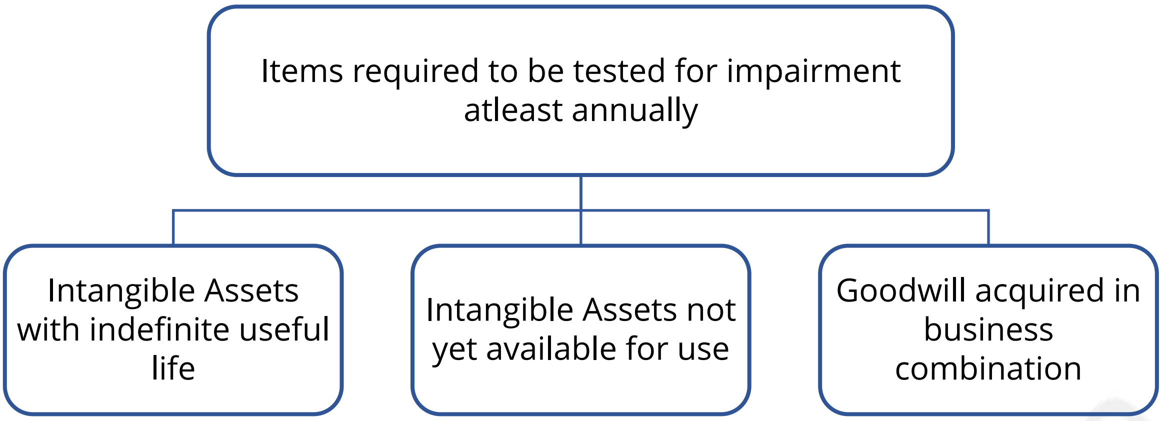
## 4. Identifying an Asset that may be impaired

### 4.1 General Rule -

Assess at the **end of each reporting period** whether there is **any indication** that an asset may be impaired.

If any indication exists, estimate the recoverable amount of the asset.

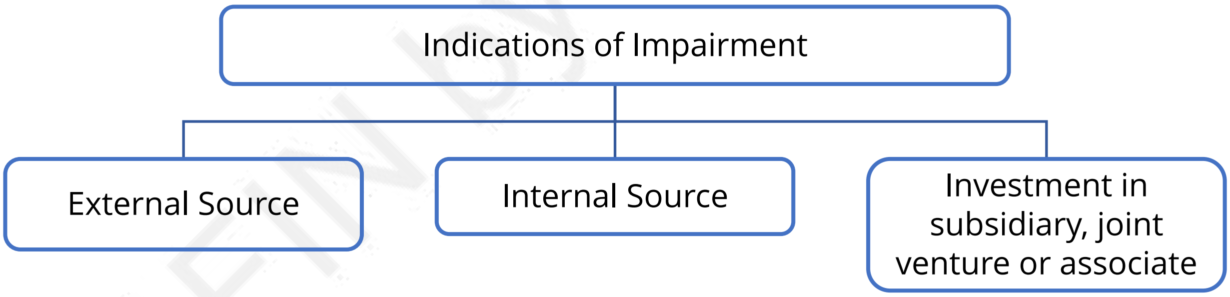
## 4.2 Exceptions to the general rule




### 4.2.1 Impairment in respect to Intangible Assets referred above –

- Impairment test may be performed at any time during an annual period, but it should be performed at the **same time every year.**
- Different intangible assets may be tested for impairment at different times.
- If the above intangible assets were initially recognised during the current annual period, that intangible asset shall be tested for impairment before the end of the current annual period.

## 5. Indications of Impairment




## 5.1 External source of Information

(a) Significant decline in the market value. Because of this, fair value less cost of disposal will be reduced.

(b) Significant changes in technology, market, economic or legal environment with **adverse effect** on entity.

(c) Increase in market interest rates or rate of returns. This affects discount rate used in calculating asset's value in use and decrease asset's recoverable amount

(d) Carrying amount of net assets > Market capitalisation of entity

Sometimes the above indications **may not affect the specific company** and management may have their own strategies to overcome the challenges

**For Example:**

(i) Increase in short term interest rate may not have direct impact on the value in use in long run.

(ii) Increase in outflows may be compensated by increase in selling price

### 5.2 Internal sources of Information

(a) Obsolescence or physical damage of an asset.

(b) Significant changes in use or expected use of an asset with an **adverse effect** on the entity.

Once the asset meets the criteria to be classified as **held for sale** – it will be **out of scope of Ind AS 36** and governed by Ind AS 105

(c) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

**For Example:**

| |
|---|
| Cash outflows for operating and maintaining asset > Budgeted |
| Actual net cash flows or operating profits < Budgeted |
| Decline in budgeted net cash flows / Increase in budgeted loss |
| Operating losses or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future. |

### 5.3 Investment in Subsidiary, Joint Venture and Associates - Indicators

If the investor recognises a dividend from the investment and evidence is available that

(a) Carrying amount of investment (in separate financial statements) > Carrying amount of investee's net assets (including associated goodwill) in the consolidated financial statements.

(b) Dividend > Total Comprehensive income of investee.

## 6. Measurement of Recoverable Amount

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.

### 6.1 Circumstances in which it is not necessary to calculate both an asset's fair value less costs of disposal and its value in use

(a) If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

(b) If there is no basis for making a reliable estimate of fair value less costs of disposal, recoverable amount is measured by reference to value in use alone.

If earlier computations show that recoverable amount > carrying amount (**significantly**), it need not to perform the same immediately unless there are significant changes which affect it.

## 7. Cash Generating Unit (CGU)

If recoverable amount cannot be determined for an individual asset, it is determined for a CGU. An entity identifies the lowest aggregation of assets (CGU) that generate largely independent cash inflows, **monitored for internal management purpose.**

CGUs shall be **identified consistently** from period to period for the same asset or types of assets **unless a change is justified**.

No impairment loss is recognised for the asset if the related cash-generating unit is not impaired.

### 7.1 Existence of active market for the output produced by asset/CGU

If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a CGU, even if some or all the output is used **internally**. E.g Refinery producing oil sold by other divisions, Power plants generating electricity for internal use.

If cash flows are **affected by internal transfer pricing**, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:

a) the future cash **inflows** used to determine the **asset's or CGU value in use**
b) Future cash **outflows** used to determine the **value in use of any other assets** or cash-generating units that are affected by the internal transfer pricing.

## 8. Fair Value Less Cost of Disposal (FVLCD)

### 8.1 Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### 8.2 Cost of Disposal

Costs of disposal are incremental costs **directly attributable to the disposal** of an asset or CGU, excluding finance costs and income tax expense.

**For Example:**

Stamp duty, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale.

Terminal benefits to employees and costs associated with reorganising a business following the disposal of an asset are not direct incremental costs to dispose the asset.

If the **disposal** of an asset would require the **buyer** to **take over a liability** and **single fair value** less cost of disposal is available for both the asset and the liability, then

**FVLCD** = Price to sell asset and the liability **Less** cost of disposal

## 9. Value in Use

Value in use is the present value of the future cash flows expected to be derived from an asset or CGU

Value in Use involves following steps

- Estimating future cash flows
- Appropriate discount rate

### 9.1 Estimation of Expected Future cash flows

(a) Cash flow projections should be based on reasonable and supportive evidence.

(b) The estimations must be based on economic conditions that will exist over the remaining useful life of the asset

More weightages must be given to external evidence

(c) Most recent financial budgets and forecasts that have been approved by the management to be considered.

- Forecasts should not be based on from future restructuring or enhancing the asset's performance.
- If entity is committed to future restructuring, include cashflows from such restructuring.

(d) Maximum period covered – 5 years (unless a longer period is justified)

(e) Cash flow projections beyond the budget period should be estimated by using a steady/declining/zero/negative growth rate.

**Increasing growth rate** can also be used only when it is **justified.**

(f) The growth rate used should not exceed the long term average growth rate of products, industry, country etc., unless a higher rate can be justified.

(g) Estimated Cash flows are based on following two approaches.

(i) Traditional approach – Best possible outcome

(ii) Expected value approach – Based on various possible outcomes.

### 9.1.1 Inclusions and Exclusions from Future cash flows –

| Inclusions | Exclusions |
|---|---|
| (i) Cash flows from the continuing use of the asset | (i) Cash inflows from assets that generate cashflows that are largely independent from the asset under review.<br>**Example:** Receivables |
| (ii) Net cash flows to be received (or paid) for the disposal of the asset at the end of its useful life. **(Estimated on arm's length transaction)** | (ii) Cash outflows that relate to obligations that have been recognised as liabilities.<br>**Example:** Payables |
| (iii) Day to day servicing of the asset, future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset. | (iii) Cash flows from entity's restructuring plans which are not yet committed.<br>If committed, its estimates of future cash outflows for the restructuring are included in a **restructuring provision** in accordance with **Ind AS 37** |
| (iv) Appropriate apportionment of corporate overheads **(care should be taken for internal charges, if any)** | (iv) Any internal charges incurred by the CGU for using corporate assets. |
| | (v) cash flows that are expected to arise from improving or enhancing the asset's performance. |
| | (vi) Cash flows from financing activities. |
| | (vii) Income tax receipts and payments. |

**Other Important Points:**

(i) For estimating net cash flow at the time of disposal, entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used.

(ii) Future cash flows reflect assumptions that are consistent with the way discount rate is determined.

- Time value of money is considered by discounting the estimated future cash flows. Hence, cash flows from financing activities are excluded.

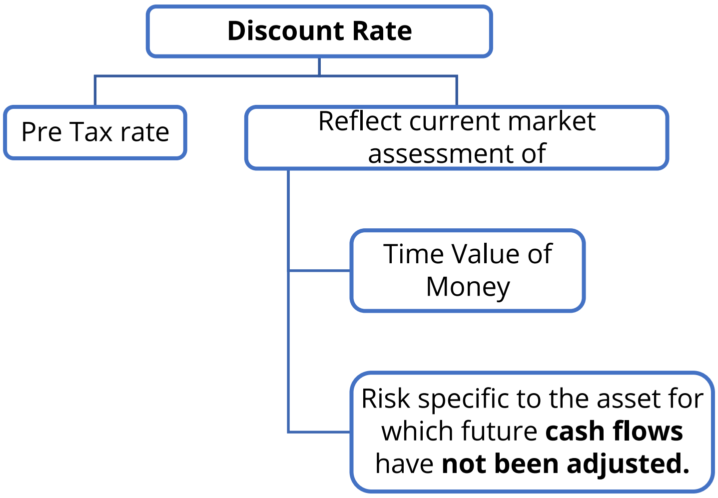
(iii) Estimates of future cash flows include future cash outflows which are necessary to maintain current standard of performance.
When individual asset/CGU consist of components with different estimated useful life, replacement cost of such components with shorter lives should be included in cash flows generated by the asset/CGU.

### 9.1.2 Foreign currency future cash flows

**(i)** Future cash flows are estimated in the currency in which they will be generated and then discounted using the discount rate appropriate for that currency.

(ii) Entity translates the present value using the spot exchange rate at the date if calculating value in use.

## 9.2 Discount Rates




**Risk Specific to the asset –**

(i) It is the rate if return that an investor requires to earn from the asset. If the business with asset/CGU is risky, the entity's expectation of return is high and vice versa.

(ii) Entity should use different rates for different assets or CGUs considering risks associated.

(iii) This asset specific rate is estimated from the rate

- Implicit in current market transactions for similar assets **(or)**
- Weighted average cost of capital of a listed entity that has single asset (or a portfolio) similar in terms of service potential and risks to the asset under review.

When **asset specific rate is not directly available** from the market, an entity uses other bases such as

(a) Weighted average cost of capital (WACC) determined using CAPM technique
(b) Enterprise incremental borrowing rate
(c) Other market borrowing rates.

(iv) The above rates can be adjusted by

- Adding specific risks associated with projected cash flows
- Excluding risks that are not relevant to the projected cash flows.

Country risks, currency risks, price risks, cash flow risks also to be considered.

## 9.3 Adjustment to Inflation in cash flows and Discount rate

(i) Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation.

(ii) If the discount rate includes the effect of general inflation, future cash flows are estimated in nominal terms.

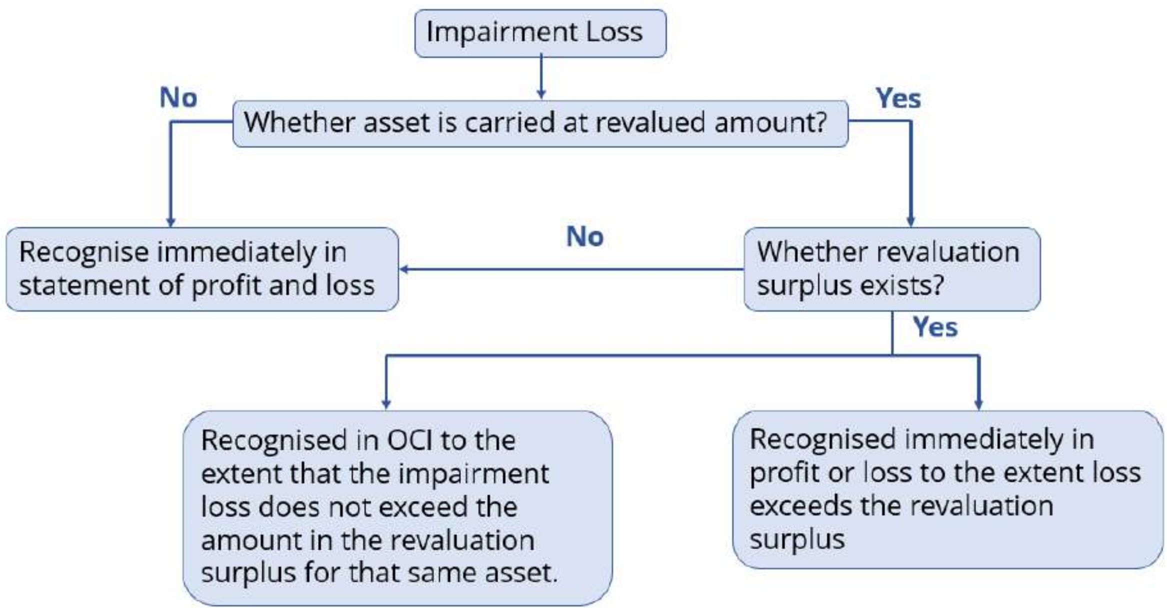
(iii) If the discount rate excludes the effect of general inflation, future cash flows are estimated in real terms **(but includes future specific price increase or decrease)**

The entity **adjusts** the **cash flows from the disposal** of an asset for the effect of both future price increases **due to general inflation** and specific future price increase or decrease.

If estimates of future **cash flows** from the asset's continuing use and the **discount rate exclude** the effect of general **inflation**, the entity also **exclude**s this effect from the estimate of net cash flows **on disposal**.

## 10. Recognition and Measurement of Impairment Loss

### 10.1 Individual Assets




**Other important points**

(a) When Impairment loss > carrying amount of the asset, an entity shall recognise a liability.

(b) After recognition of impairment loss, depreciation/amortisation to be calculated on the revised carrying amount over its remaining useful life.

(c) After recognition, any related deferred tax assets and liabilities are determined in accordance with Ind AS 12 by comparing revised carrying amount with its tax base.

Recoverable amount of individual asset cannot be determined if

- Asset does not generate independent cash flows
- Asset's value in use cannot be estimated to be close to its FVLCD

## 10.2 Cash Generating Unit

### 10.1.1 Carrying amount of CGU

| Inclusions | Exclusions |
|---|---|
| (i) Carrying amount of only those assets that can be attributed **directly**, or allocated on a **reasonable and consistent** basis, to the CGU and will generate future cash flows. | (i) Carrying amount of any recognised liability **unless** the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability. |

- If disposal of CGU would require the buyer to assume the liability,

**FVLCD of CGU** = Estimated selling price of assets & liability of CGU – cost of disposal.

- Carrying amount of liability is deducted in determining CGU's value in use and it's carrying amount to perform meaningful comparison.

### 10.1.2 Order of allocating impairment loss to assets of CGU

(a) First, reduce the carrying amount of any goodwill allocated to the CGU or group of units.
(b) Then, to other assets of the unit (group of units) pro rata on the basis of carrying amount of each asset in the unit (group of units)

Carrying amount of **individual asset** within CGU shall **not** be reduced **below** the **highest of**

- FVLCD
- Value in Use
- Zero

If any particular asset carrying amount becomes zero after impairment, the remaining impairment loss should be allocated to other assets on pro rata basis as if the asset does not exist.

## 11. Goodwill

For impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be **allocated** to each of the acquirer's CGU or groups of CGUs that are expected to **benefit from the synergies** of the combination on non-arbitrary basis, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

### 11.1 Size of CGU to which goodwill is allocated

CGU or Group of CGU to which goodwill is allocated shall

- Represent the **lowest level** within the entity at which the goodwill is monitored for **internal management purpose**
- **Not** be **larger** than an **operating segment** as per Ind AS 108

### 11.2 Timing of impairment test of Goodwill

(a) The annual impairment test for a CGU to which goodwill has been allocated may be performed at **any time during an annual period**, provided the test is performed **at the same time** every year.

(b) Different CGUs may be tested for impairment at different times.

If the **initial allocation** of goodwill acquired in a business combination **cannot be completed** before the end of the annual period in which the business combination is effected, that initial allocation **shall** be **completed before** the **end of the first annual period** beginning after the acquisition date.

If the initial accounting for a business combination can be **determined only provisionally** by the end of the period in which the combination is effected, the acquirer –

(a) Accounts for the combination using the **provisional values**.

(b) Recognises any **adjustments** to provisional values as a result of completing the initial accounting within measurement period, which **will not exceed 12 months** from the date of acquisition

### 11.3 Disposal of operation with CGU to which goodwill has been allocated

Goodwill associated with the operation disposed shall be

(a) Included in the **carrying amount of the operation** when determining the gain or loss on disposal
(b) Measured on the basis of **relative values** of the operation disposed of and portion of CGU retained **unless** the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.

### 11.4 Change in composition of CGU to which goodwill has been allocated

In some cases, the entity reorganises the composition of CGUs (i.e., merging and demerging of CGUs) for corporate reporting purpose. In such case,
(a) Goodwill shall be reallocated to the units affected.
(b) Reallocation shall be performed using a relative value apprroach unless the entity can demonstrate some other better method.

### 11.5 Testing CGU with goodwill for impairment

| Situation | When to Test? |
|---|---|
| When goodwill is related to the CGU but not allocated | Only when there is an indication that it may be impaired. |
| When goodwill is allocated to the CGU | (a) Annually &<br>(b) whenever there is an indication that CGU is impaired. |

If CGU **includes** in carrying amount an **intangible asset** that has indefinite useful life or not yet available for use, that asset can be tested for impairment only as a part of CGU and unit also to be tested for impairment **annually**.

### 11.6 Priority for testing impairment

| | |
|---|---|
| If the assets in CGU to which goodwill has been allocated are tested for impairment at the same time as the unit | Individual assets shall be tested before the unit |
| If the CGUs constituting a group of CGUs to which goodwill has been allocated are tested for impairment at the same time as the unit | Individual units shall be tested before the group of units |

### 11.7 Two Step approach for goodwill allocated to a group of CGUs

When goodwill is allocated to a group of CGUs for the purpose of impairment testing but cannot be allocated on a non-arbitrary basis to individual CGUs, the individual CGUs must be tested for impairment before the group of CGUs containing the associated goodwill.

### 11.8 Rolling forward detailed calculations from a preceding period

**Goodwill:**

The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit to which goodwill has been allocated may be used in the impairment test of that unit in the current period provided **all the following criteria are met**:

a) the assets and liabilities making up the unit have not changed significantly since the most recent recoverable amount calculation
b) In the most recent calculation, recoverable amount > carrying amount (**substantially**)
c) The likelihood that a current recoverable amount determination would be less than the asset's carrying amount **is remote.**

**Intangible Assets:**

The most recent **detailed calculation** of such an asset's recoverable amount made in a **preceding period** may be used in the impairment test for that asset in the current period, provided **all** of the following criteria are met:

(a) If the intangible asset does **not** generate cash inflows from continuing use that are largely **independent** of those from other assets or groups of assets and is therefore tested for impairment as part of the CGU to which it belongs, the **assets and liabilities** making up that **unit** have **not changed** significantly since the most recent recoverable amount calculation
(b) In the most recent calculation, recoverable amount > carrying amount (**substantially**)
(c) The likelihood that a current recoverable amount determination would be less than the asset's carrying amount **is remote.**

## 12. Corporate Assets

Corporate assets include group or divisional assets. They do **not generate** cash inflows **independently** of other assets or groups of assets and their carrying amount cannot be fully attributed to the cash-generating unit under review.

For Example:
Head office building, EDP equipment, research centre.

Recoverable amount of individual corporate asset cannot be determined unless it is disposed of.

Corporate assets are tested for impairment in the context of the CGU or group of CGUs to which asset belongs.

### 12.1 Allocation of corporate assets to CGUs for impairment

**Allocating Corporate Assets to CGU for Impairment**

Can corporate assets be **allocated** to CGU on **reasonable and consistent** basis

**Yes**

I. Compare the total carrying amount of CGU **along with corporate assets** with the recoverable amount.

II. If there is any impairment loss –
Apply the impairment loss **first on Goodwill** and the remaining loss should be on the assets of CGU (including corporate assets) on **pro rata basis** of their carrying amounts

**No**

I. Compare the carrying amount of CGU (**Excluding Corporate assets**) with the recoverable amount.
If there is any impairment loss –
Apply **first on goodwill** and remaining on pro rata basis

II. Identify **smallest group of CGUs** to which corporate asset can be allocated on a **reasonable and consistent** basis

III. Compare the carrying amount of CGUs (**including corporate assets**) with recoverable amount of group of assets and allocate impairment loss.

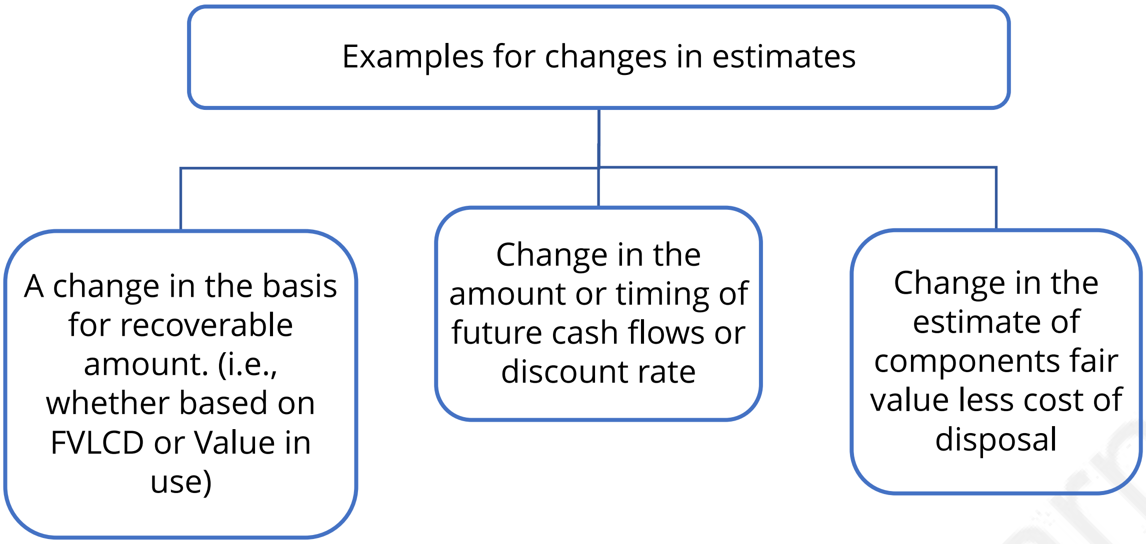
## 13. Reversal of an Impairment Loss

At every balance sheet date, entity should assess whether there is **any indication** that the impairment loss recognised in the previous years may be decreased or no longer exist.
Entity must estimate recoverable amount of that asset if any such indication exists.

> Impairment loss recognised for goodwill shall not be reversed in a subsequent period.

### 13.1 Change in Estimates

Impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a **change in the estimates** used to determine the asset's recoverable amount since the last impairment loss was recognised




## 13.2 Unwinding of Discount

- Asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer.
- However, the service potential of the asset has not increased.
- In such cases, an impairment loss is not reversed just because of the passage of time even if the recoverable amount is > carrying amount.

## 13.3 Indicators of reversal of Impairment Loss

| External Indicators | Internal Indicators |
|---|---|
| (i) Significant increase in market value | (i) Significant change in the way the asset is used or expected to be used. |
| (ii) Significant changes in technological, economic, legal, market environment which have positive effect on the entity. | (ii) Evidence from internal reporting that indicates that the economic performance of the asset is /will be better than expected. |
| (iii) Decrease in market interest rates and those are likely to affect discount rates | (iii) Withdrawal of commitment for restructuring, discontinuing operations etc, which gives positive effect to entity. |

## 13.4 Reversal of Impairment in case of Individual Asset

### 13.4.1 If NO Revaluation done in prior periods:

(a) Reverse the impairment loss by recording below journal entry

| | |
|---|---|
| Dr. | Asset A/c |
| Cr. | Impairment Loss |

- The **increased carrying amount** of an asset shall **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 years.

- **Maximum** impairment loss reversal = Impairment loss previously recognised

### 13.4.2 If Revaluation done in prior periods:

Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase.

A reversal of an impairment loss is recognised in other comprehensive income and increases the revaluation surplus for that asset. However, to the extent that an impairment loss on the same revalued asset was previously recognised in profit or loss, a reversal of that impairment loss is also recognised in profit or loss.

| | |
|---|---|
| Dr. | Asset A/c |
| Cr. | Impairment Loss (P&L) (to the extent recognised in P&L) |
| Cr. | Revaluation Surplus (Balancing figure) |

Depreciation (Amortisation) charge for the asset should be computed prospectively i.e., on the revised carrying amount after deducting residual value, over the remaining useful life of the asset.

## 13.5 Reversal of Impairment in case of CGU

A reversal if an impairment loss for a CGU should be allocated to **all** assets in CGU **except goodwill** on a pro rata basis of the carrying amount

The increase in **carrying amount of Individual Assets** in CGU shall **not be increased above the lower of**

- Its Recoverable Amount (If determinable)
- Actual carrying amount as if impairment loss had not been recognised previously

The amount of the reversal of the impairment loss should be allocated to each asset on a pro rata basis.

## 14. Non-Controlling Interests – The impact on goodwill impairment testing

Goodwill acquired in business combination is allocated to acquirer's CGU or group of CGUs which are expected to benefit from the synergies of the business combination.
The amount of goodwill recorded by an entity when it acquires a controlling stake in a subsidiary that is less than 100% of its equity depends on which of the two following methods have been used to calculate it.

**Fair Value Method:**
If non-controlling interest is measured at its acquisition-date fair value, it means that NCI share of goodwill is recognised in consolidated in financial statements.

**Proportionate interest in Net Identifiable Assets:**

(a) If an entity measures non-controlling interest as its proportionate interest in the net identifiable assets of the subsidiary at the acquisition date, goodwill attributable to the non-controlling interest is included in the recoverable amount of the CGU but is not recognised in the parent's consolidated financial statement.
(b) Acquirer shall gross up the carrying amount of goodwill to the CGU to include goodwill attributable to the non-controlling interest.
(c) The adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the CGU is impaired.

If a subsidiary is itself a CGU, the impairment loss is allocated between the parent and the non-controlling interest in the same proportion of profit and loss allocation.

## 15. Disclosures

### 15.1 General

- An entity is required to disclose the **amount of impairment losses** and **reversals of impairment losses** recognised in profit or loss and in OCI during the period **for each class of assets**.

### 15.2 Entities Reporting Segment Information

- An entity shall disclose the **amount of impairment losses** and **reversals of impairment losses** recognised in profit or loss and in OCI during the period **for each reportable segment**

### 15.3 Recognition / Reversal of material impairment losses

(a) An entity is required to disclose
  - the **events and circumstances** that led to the recognition or reversal
  - the **amount of the impairment loss** recognised or reversed
  - Some additional disclosures w.r.t individual asset and CGU are as follows

| For Individual asset | For CGU |
|---|---|
| • Nature **of the asset**<br>• Reportable segment **to which the asset belongs**<br>• Recoverable **amount** | • **Description** of CGU<br>• Amount of impairment loss recognised or reversed by **class of assets** & by **reportable segment**<br>• Description of the current and former way of **aggregating assets** and the **reasons** for changing<br>• **Recoverable** amount |

### 15.4 Other impairment losses/reversals material in aggregate to the financial statements

(a) An entity shall disclose

- **the main classes of assets** affected by impairment losses and reversals of impairment losses
- The **main events and circumstances** that led to the recognition of these impairment losses and reversals of impairment losses.

### 15.5 Unallocated Goodwill

An entity shall disclose the **amount of unallocated goodwill** along with **reasons**

### 15.6 Information to be disclosed for CGUs to which significant goodwill or indefinite – life intangible assets have been allocated

(a) An entity is required to disclose the following information

- **Carrying amount** of goodwill, intangible assets with indefinite useful life allocated to the unit (group of units)
- **Basis** on which the unit's (group of units') recoverable amount has been determined
- If the recoverable amount of unit is based on value in use / FVCD, disclose the following

| Value in use | Fair value less cost of disposal |
|---|---|
| • Key assumptions **on cash flow projections** | • **Key assumptions** on determination of Fair value less cost of disposal |
| • **Description of** management's approach **to determining the values assigned to each key assumption** | • Description of **management's approach** to determining the values assigned to each key assumption |
| • Period **over which management has** projected cash flows **and explanations for why** longer period **(> 5 years) is** justified | • **Level** of the fair value hierarchy (Ind AS 113) |
| • Growth rates **used along with justifications if any** | • Any change in valuation techniques along with reasons |
| • Discount rates **applied** | • If FVCD is measured using discounted cash flow projections, disclose<br>✓ the period over which management has projected cash flows<br>✓ the growth rate used<br>✓ the discount rate(s) applied |

(b) If a reasonably possible **change in a key assumption** would cause the unit's **carrying amount to exceed its recoverable amount**

- the **amount** by which recoverable amount exceeds its carrying amount
- the **value assigned** to the key assumption
- the amount by which the value assigned to the key assumption must change, after incorporating any **consequential effects of that change on the other variables** used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.

### 15.7 Information to be disclosed for CGUs to which insignificant goodwill or indefinite-life intangible assets have been allocated

(a) The amount so **allocated** to each unit (group of units) is **not significant** in **comparison with** the entity's **total carrying amount** of goodwill or intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to those units (groups of units).

(b) In addition, if the **recoverable amounts** of any of those units (groups of units) are based on the **same key assumptions** and the aggregate carrying amount of goodwill or intangible assets with indefinite useful lives allocated to them is **significant** in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:

- the **aggregate carrying amount** of goodwill, intangible assets with indefinite useful lives allocated to those units
- a description of the **key assumptions**
- Description of **management's approach** to determining the values assigned to each key assumption
- If a reasonably possible change in the key assumptions would cause the aggregate of the units carrying amounts to exceed the aggregate of their recoverable amounts
  - the amount by which the **aggregate** of the units **recoverable amounts exceeds** the aggregate of their **carrying amounts**
  - the **values assigned** to the key assumptions
  - the amount by which the values assigned to the key assumptions must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units recoverable amounts to be equal to the aggregate of their carrying amounts.

## 16. Significant Differences between Ind AS 36 with AS 28

| Particulars | Ind AS 36 | AS 28 |
|---|---|---|
| Applicability | Applies to financial assets classified as subsidiaries, associates, joint ventures. | Does not apply to the above assets |
| Biological Asset | Excludes biological assets related to agricultural activity. | Does not specifically exclude |

| | | |
|---|---|---|
| Impairment testing for an intangible asset with an indefinite useful life | Annual impairment testing | No annual impairment testing |
| Reversal of Goodwill | Prohibits the recognition of reversal | Impairment loss recognised for goodwill should be reversed in a subsequent period when it was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events that have occurred that reverse the effect of that event |
| Allocation of Goodwill | Goodwill is allocated to CGUs that are expected to benefit from the synergies of the business combination. | When goodwill cannot be allocated reasonably and consistently to the CGU, two levels of impairment tests are carried out, viz., bottom-up test and top-down test. |
| Additional Guidance | Gives additional guidance on following aspects:<br>(a) Estimating Value in use<br>(b) Reasonableness of the assumptions on which cash flows are based<br>(c) Present value techniques | Does not provide such guidelines. |

## Illustrations

### 1. Illustration

Apex Ltd. is engaged in manufacturing of steel utensils. It owns a building for its headquarters. The building used to be fully occupied for internal use. However, recently the company has undertaken a massive downsizing exercise as a result of which 1/3rd of the building became vacant. This vacant portion has now been given for on lease for 6 years. Determine the CGU of the building.

### 2. Illustration

Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31st March, 20X4. The discount rate is 15%

| Year | Cash Flow (₹ in lakh) |
|---|---|
| 20X4-20X5 | 2,000 |
| 20X5-20X6 | 3,000 |
| 20X6-20X7 | 3,000 |
| 20X7-20X8 | 4,000 |
| 20X8-20X9 | 2,000 |
| Residual Value at 31st March, 20X9 | 500 |

- Property, plant & equipment was purchased on 1st April, 20X1 for ₹ 20,000 lakh
- Useful Life was 8 Years
- Residual Value estimated at the end of 8 years - ₹ 500 lakh
- Fair value less cost to disposal - ₹ 10,000 lakh

Calculate impairment loss, if any on the property, plant and equipment. Also calculate the revised carrying amount and revised depreciation of property, plant and equipment

## 3. Illustration

Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of ₹ 36 million excludes the benefit to be derived from a future reorganization, but the second value of ₹ 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments.
Whether the business segment needs to be Impaired?

## 4. Illustration

On 31st March, 20X1, XYZ Ltd. makes following estimate of cash flows for one of its asset located in USA:

| Year | Cash flows |
|---|---|
| 20X1-20X2 | US $ 80 |
| 20X2-20X3 | US $ 100 |
| 20X3-20X4 | US $ 20 |

Following information has been provided:

| Particulars | India | USA |
|---|---|---|
| Applicable discount rate | 15% | 10% |

Exchange rates are as follows:

| As on | Exchange rate |
|---|---|
| 31st March, 20X1 | ₹ 45/US $ |

| As on | Expected Exchange rate |
|---|---|
| 31st March, 20X2 | ₹ 48/US $ |
| 31st March, 20X3 | ₹ 51/US $ |
| 31st March, 20X4 | ₹ 55/US $ |

Calculate value in use as on 31st March, 20X1.

## 5. Illustration

Cash flow of ₹ 1,000 may be received in one year, two years or three years with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows assuming applicable discount rate of 5%, 5.25% and 5.5% in year 1, 2 and 3, respectively.

## 6. Illustration

From the following details of an asset, find out:

(a) Impairment loss and its treatment.

(b) Current year depreciation for the year end

**Particulars of assets:**

| | |
|---|---|
| Cost of asset | ₹ 56 lakh |
| Useful life | 10 years |
| Salvage value | Nil |
| Carrying value at the beginning of the year | ₹ 27.30 lakh |
| Remaining useful life | 3 years |
| Recoverable amount at the beginning of the year | ₹ 12 lakh |
| Upward revaluation done in last year | ₹ 14 lakh |

## 7. Illustration

On 1st January Year 1, Entity Q purchased a machine costing ₹ 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to ₹ 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be ₹ 1,00,000 and its estimated remaining useful life to be 10 years.

**Calculate:**

a) The carrying amount of the machine on 31st December Year 2 and the revaluation surplus arising on 1st January Year 3.
b) The carrying amount of the machine on 31st December Year 3 (immediately before the impairment).
c) The impairment loss recognised in the year to 31st December Year 4 and its treatment thereon
d) The depreciation charge in the year to 31st December Year 4.

**Note:** During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings.

## 8. Illustration

PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

| | ₹ '000 |
|---|---|
| Year ended 31st March 20X7 | 276 |
| Year ended 31st March 20X8 | 192 |
| Year ended 31st March 20X9 | 120 |
| Year ended 31st March 20Y0 | 114 |

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for ₹ 6,00,000 and related selling expenses in this regard could have been ₹ 96,000. The machine had been revalued previously, and at 31st March 20X6 an amount of ₹ 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was ₹ 6,60,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for?

## 9. Illustration

A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is ₹ 500, which is equal to the present value of the restoration costs.

The entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around ₹ 800. This price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately ₹ 1,200, excluding restoration costs. The carrying amount of the mine is ₹ 1,000. How the impairment loss is to be accounted for?

## 10. Illustration

Entity A acquires Entity B for ₹ 50 million, of which ₹ 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two of Entity A's CGUs with the net assets being allocated as follows

| | | | **₹ in million** |
|---|---|---|---|
| | CGU 1 | CGU 2 | Total |
| Fair value of acquired identifiable tangible and intangible assets | 25 | 10 | 35 |

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.

Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as ₹ 33 million and ₹ 17 million respectively.

Determine the allocation of goodwill to each CGU?

## 11. Example

An entity sells for ₹ 100 an operation that was part of a cash-generating unit to which goodwill has been allocated. The goodwill allocated to the unit cannot be identified or associated with an asset group at a level lower than that unit, except arbitrarily. The recoverable amount of the portion of the cash-generating unit retained is ₹ 300.

Since the goodwill allocated to the cash-generating unit cannot be non-arbitrarily identified or associated with an asset group at a level lower than that unit, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the unit retained. Therefore, 25 per cent of the goodwill allocated to the cash-generating unit is included in the carrying amount of the operation that is sold.

## 12. Example

Goodwill had previously been allocated to cash-generating unit A. The goodwill allocated to A cannot be identified or associated with an asset group at a level lower than A, except arbitrarily. A is to be divided and integrated into three other cash-generating units, B, C and D.
Since the goodwill allocated to A cannot be non-arbitrarily identified or associated with an asset group at a level lower than A, it is reallocated to units B, C and D on the basis of the relative values of the three portions of A before those portions are integrated with B, C and D.

## 13. Example

Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for ₹ 20 million and CGU B for ₹ 30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ₹ 10 million. The recoverable amounts are based on value-in-use of ₹ 18 million for CGU A and ₹ 38 million for CGU B.
Determine whether the carrying values of CGU A and B are impaired.

## 14. Example

| Assets | Carrying Amount | Fair Value less cost of disposal | Impairment | Revised carrying amount |
|---|---|---|---|---|
| Plant & Machinery | 1,00,000 | 50,000 | | |
| Building | 80,000 | 85,000 | | |
| Electric Equipment | 40,000 | - | | |
| Goodwill | 50,000 | NA | | |
| Patents | 20,000 | NA | | |
| Other Monetary assets | 60,000 | 60,000 | | |
| Total | 3,50,000 | | | |
| Recoverable amount | 2,00,000 | | | |

## 15. Illustration

ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on 31st March, 20X1 are as follows:

| Cash-generating units | Carrying amount | (₹ in crore) Remaining useful life |
|---|---|---|

| | | |
|---|---|---|
| A | 500 | 10 |
| B | 750 | 20 |
| C | 1,100 | 20 |

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years

| | | (₹ in crore) |
|---|---|---|
| **Corporate asset** | **Carrying amount** | **Remarks** |
| X | 600 | The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units. |
| Y | 200 | The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash- generating units. |

Recoverable amount as on 31st March, 20X1 is as follows:

| Cash-generating units | Recoverable amount (₹ in crore) |
|---|---|
| A | 600 |
| B | 900 |
| C | 1,400 |
| ABC Ltd. | 3,200 |

Calculate the impairment loss, if any. Ignore decimals.

## 16. Illustration

XYZ Limited has a cash-generating unit 'Plant A' as on 1st April, 20X1 having a carrying amount of ₹ 1,000 crore. Plant A was acquired under a business combination and goodwill of ₹ 200 crore was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no residual value. On 31st March, 20X2, Plant A has a recoverable amount of ₹ 600 crore. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

## 17. Illustration

A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs of disposal is less than its carrying amount. The machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.

**Scenario 1** - budgets/forecasts approved by management reflect no commitment of management to replace the machine.

**Scenario 2** - budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

How to account for the impairment loss of machine in above scenarios?

## 18. Illustration

E Ltd. owns a machine used in the manufacture of steering wheels, which are sold directly to major car manufacturers.

- The machine was purchased on 1st April, 20X1 at a cost of ₹ 5,00,000 through a vendor financing arrangement on which interest is being charged at the rate of 10% per annum.
- During the year ended 31st March, 20X3, E Ltd. sold 10,000 steering wheels at a selling price of ₹ 190 per wheel.
- The most recent financial budget approved by E Ltd.'s management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for ₹ 200 during 20X3-20X4, the price rising in later years in line with a forecast inflation of 3% per annum.
- During the year ended 31st March, 20X4, E Ltd. expects to sell 10,000 steering wheels. The number is forecast to increase by 5% each year until 31st March, 20X8.
- E Ltd. estimates that each steering wheel costs ₹ 160 to manufacture, which includes ₹ 110 variable costs, ₹ 30 share of fixed overheads and ₹ 20 transport costs.
- Costs are expected to rise by 1% during 20X4-20X5, and then by 2% per annum until 31st March, 20X8.
- During 20X5-20X6, the machine will be subject to regular maintenance costing ₹ 50,000.
- In 20X3-20X4, E Ltd. expects to invest in new technology costing ₹ 1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from ₹ 110 to ₹ 100 and the share of fixed overheads from ₹ 30 to ₹ 15 (subject to the availability of technology, which is still under development).
- E Ltd. is depreciating the machine using the straight-line method over the machine's 10 year estimated useful life. The current estimate (based on similar assets that have reached the end of their useful lives) of the disposal proceeds from selling the machine is ₹ 80 000 net of disposal costs. E Ltd. expects to dispose of the machine at the end of March, 20X8.
- E Ltd. has determined a pre-tax discount rate of 8%, which reflects the market's assessment of the time value of money and the risks associated with this asset.

Assume a tax rate of 30%. What is the value in use of the machine in accordance with Ind AS 36?

## 19. Illustration

A Ltd. purchased an asset of ₹ 100 lakh on 1st April, 20X0. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows

| As on | Recoverable amount |
|---|---|
| 31st March, 20X1 | ₹ 60 lakh |
| 31st March, 20X2 | ₹ 40 lakh |
| 31st March, 20X3 | ₹ 28 lakh |

Calculate the amount of impairment loss or its reversal, if any, on 31st March, 20X1, 31st March, 20X2 and 31st March, 20X3.

## 20. Illustration

On 1st April 20X1, Venus Ltd acquired 100% of Saturn Ltd for ₹ 4,00,000. The fair value of the net identifiable assets of Saturn Ltd was ₹ 3,20,000 and goodwill was ₹ 80,000. Saturn Ltd is in coal mining business. On 31st March, 20X3, the government has cancelled licenses given to it in few states.

As a result Saturn's Ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result, Venus Ltd has to estimate the recoverable amount of goodwill and net assets of Saturn Ltd on 31st March, 20X3.

Venus Ltd uses straight line depreciation. The useful life of Saturn's Ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So, the entire operation of Saturn Ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn Ltd as a CGU. Its value in use is estimated by the management at ₹ 2,12,000.

Suppose by 31st March, 20X5 the government reinstates the licenses of Saturn Ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's Ltd net asset is re-estimated. The value in use is expected to be ₹ 3,04,000 and fair value less cost to disposal is expected to be ₹ 2,90,000.

Calculate the impairment loss, if any. Also show the accounting treatment for reversal of impairment loss and the subsequent depreciation thereon.

## 21. Illustration

Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India. There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 2 Lakh and Goodwill amounting to ₹ 1.50 Lakhs is included in such CGU.

Machinery A was purchased on 1st April 2013 for ₹ 10 Lakhs and residual value is ₹ 50 thousands. Machinery B was purchased on 1st April, 2015 for ₹ 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

| Year | Cash Flows from Machinery A |
|---|---|
| 1 | 1,50,000 |
| 2 | 1,00,000 |
| 3 | 1,00,000 |
| 4 | 1,50,000 |
| 5 | 1,00,000 (excluding Residual Value) |
| Total | 6,00,000 |

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is ₹ 7 lakhs. The valuation fee was ₹ 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.50 lakhs. Specialised packaging cost would be ₹ 25 thousand and legal fees would be ₹ 75 thousand.

The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 Lakhs ie on 31st March, 2019. The Recoverable value of Machine A is ₹ 4,50,000 and combined Machine A and B is ₹ 7,60,000 as on 31st March, 2019

Required:

a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.
b) Compute the prospective depreciation for the year 2018-2019 on the above assets.
c) Compute the carrying value of CGU as at 31st March, 2019.

## 22. Illustration

A Ltd acquires 80% shares of a subsidiary B Ltd. for ₹ 3,200 thousand. At the date of acquisition, B Ltd.'s identifiable net assets is ₹ 3,000 thousand. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

| | ₹ in '000 |
|---|---|
| Purchase Consideration | 3,200 |
| NCI (3,000 x 20%) | 600 |
| | 3,800 |
| Less: Net Assets | (3,000) |
| Goodwill | 800 |

At the end of next financial year, B Ltd.'s carrying amount is reduced to ₹ 2,700 thousand (excluding goodwill).
Recoverable amount of B Ltd.'s assets is
Case (i) ₹ 2,000 thousand,
Case (ii) ₹ 2,800 thousand
Calculate impairment loss allocable to Parent and NCI in both the cases.

## 23. Illustration

Sun Ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July, 20X1, Sun Ltd acquired an 80% interest in Pluto Ltd. Details of the acquisition were as follows:
Sun Ltd acquired 800,000 shares in Pluto Ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July, 20X1 was ₹ 4 per share and the fair value of a Pluto's share was ₹ 1.40 per share. The costs of issue were 5% per share.
Sun Ltd incurred further legal and professional costs of ₹ 100,000 that directly related to the acquisition.
The fair values of the identifiable net assets of Pluto Ltd at 1st July, 20X1 were measured at ₹ 1.3 million. Sun Ltd initially measured the non-controlling interest in Pluto Ltd at fair value. They used the market value of a Pluto Ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd was required at 31st March, 20X2 or 20X3.
Pluto Ltd comprises three cash generating units A, B and C. When Pluto Ltd was acquired the directors of Sun Ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

| Unit | Carrying value (before goodwill allocation) | Recoverable amount | |
|---|---|---|---|
| | ₹ '000 | ₹ '000 | |
| A | 600 | 740 | |
| B | 550 | 650 | |

| | | | |
|---|---|---|---|
| C | 450 | 400 | |

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd in the consolidated Balance Sheet of Sun ltd at 31st March, 20X4 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto ltd.

## 24. Illustration

Parent acquires an 80% ownership interest in Subsidiary for ₹ 2,100 on 1st April, 20X1. At that date, Subsidiary's net identifiable assets have a fair value of ₹ 1,500. Parent chooses to measure the non-controlling interests as the proportionate interest of Subsidiary's net identifiable assets. The assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Since other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ₹ 500 related to those synergies has been allocated to other cash-generating units within Parent. On 31st March, 20X2, Parent determines that the recoverable amount of cash-generating unit Subsidiary is ₹ 1,000. The carrying amount of the net assets of Subsidiary, excluding goodwill, is ₹ 1,350. Allocate the impairment loss on 31st March, 20X2.

# 1 Introduction

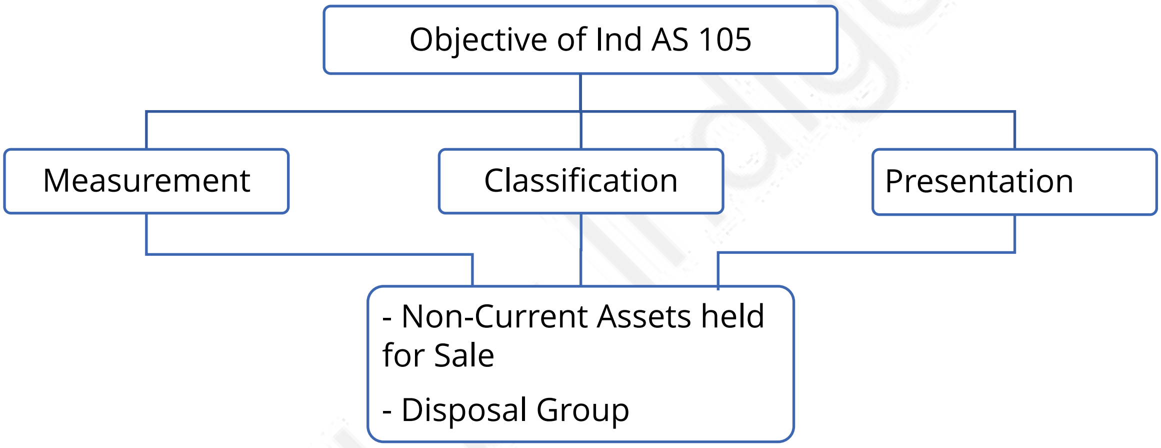
A fixed asset which was being used in the production, supply of goods and services, for administrative purposes or earn rentals or for capital appreciation kept aside for sale by the entity is called as **non-current asset held for sale.**

Ind AS 105 will be applicable for
- Property, Plant and Equipment
- Intangible Assets
- Investment Property
- Investment in Other Companies

When the entity wants to sell group of assets like
- Unit of a Company
- Branch
- Division
- Cash Generating Unit
- Segment

Such group of assets is known as Disposal Group

## 1.1 Objective




## 1.2 Scope

- Classification & Presentation - All recognised non-current asset and all disposal groups
- Measurement – All recognised non-current asset and all disposal groups except few

### 1.2.1 Measurement Provisions not applicable (Scoped Out Non-Current Assets)

- Deferred tax assets under Ind AS 12
- Assets arising from Employee Benefits – Ind AS 19
- Financial Assets – Ind AS 109
- Non-Current Assets related to Agricultural – Ind AS 21
- Contractual Rights under Insurance Contract – Ind AS 104

## 1.3 Impairment of Assets vs Non-Current Assets held for Sale

| Impairment | Non-Current Assets held for sale |
|---|---|
| Impairment happens when the asset is being used | These assets are determined only after the usage is stopped |
| Depreciation is charged even after impairment | Depreciation is not charged after such classification |

### 2.1 Non-Current Asset

Asset which is not a Current Asset

### 2.2 Current Asset

An Asset which

- expects to realise the asset, or intends to sell or consume it, in
  - its normal operating cycle
  - within 12 months after the reporting period;
- is held primarily for the purpose of trading;
- is cash or a cash equivalent, except
  - if it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

### 2.3 Disposal Group

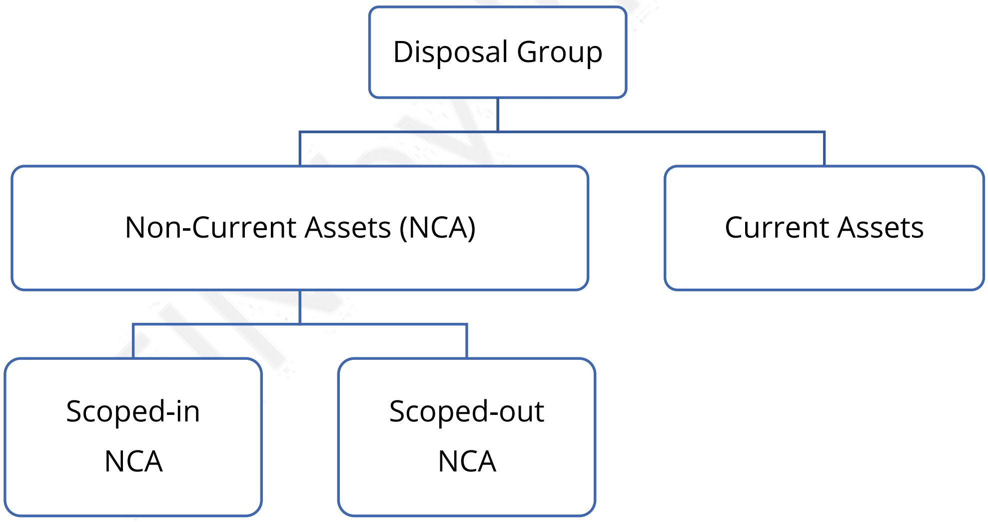
A cash generating unit including the following

- Group of assets of a business combination
- liabilities directly associated with those assets
- Goodwill allocable to the business combination

disposed in a single transaction of sale / transfer

When entity decides to sell disposal group, it will be presented as disposal group held for sale.

A disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.




## 3 When to Classify a NCA as "Held for Sale"

An entity is required to classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use

As long as the future economic benefits to the entity are received from the usage of asset, the asset cannot be classified as "Held for Sale".

### 3.1 Conditions for classification

Asset must be

- available for immediate **sale in its present condition** and
- **Sale** must be highly **probable**

If asset is not saleable in the present condition (if an asset needs repair to sell it), then it cannot be classified as "Held for Sale"

**Conditions**

- The appropriate level of management must be committed to a plan to sell
- Active engagement to find the buyer should have been initiated – like advertisement for auction / sale
- Asset / disposal group should be actively marketed for sale at reasonable price
- Sale is expected to be completed within one year from date of classification
- Significant changes to or withdrawal from plan to sell are unlikely

> The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

### 3.2 Events or circumstances may extend the period to complete the sale beyond one year.

Entity can continue to classify such asset as held for sale if

- delay is caused by events or circumstances beyond the entity's control and
- entity is committed to sell - sufficient evidence to exist.

  Examples for delay – regulatory approvals

### 3.3 Examples

3.3.1 An entity is committed to its selling plan of a manufacturing facility in its present condition and so classifies it as held for sale. After a firm purchase commitment, the buyer's inspection identifies environmental damages not previously known to exist. The entity is required by the buyer to make good the damage, which will extend the timeframe of one year to complete the sale within one year. However, the entity has initiated actions to make good the damage and satisfactory rectification is highly probable. In this situation, exception to one-year requirement will be met.

3.3.2 An entity in the mining industry is committed to a plan to sell a disposal group that represents a significant portion of its regulated operations. The sale requires regulatory approval, which could extend the period required to complete the sale beyond one year. Actions necessary to obtain that approval cannot be initiated until after a buyer is known and a firm purchase commitment is obtained. However, a firm purchase commitment is highly probable within one year. In this situation, the exception to one-year requirement will be met.

3.3.3 A company is committed to a plan to sell a non-current asset and classifies the asset as held for sale at that date. During the initial one-year period, the market conditions that existed at the date the asset was classified initially as held for sale deteriorate and, as a result, the asset is not sold by the end of that period. During that period, the company actively solicited but did not receive any reasonable offers to purchase the asset and, in response, reduced the price. The asset continues to be actively marketed at a price that is reasonable given the change in market conditions. In this situation, the exception to the one-year requirement will be met. At the end of the initial one-year period, the asset would continue to be classified as held for sale.

## 4 Other Aspects

### 4.1 Sale includes Exchanges

Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance in accordance with Ind AS 16, Property, Plant and Equipment.

## 4.2 Asset acquired for subsequent disposal

Asset acquired exclusively with a view to subsequent disposal can be classified as "Held for Sale" as at the acquisition date, if

(i) The one year requirement is met (subject to exceptions above)

(ii) It is highly probable that any other condition that is not met at the time of acquisition, will be met within a short period (usually within three months).

## 4.3 Held for Distribution to Owners is "Held for Sale"

A non-current asset (or disposal group) is classified as held for distribution to owners when the entity is committed to distribute the asset (or disposal group) to the owners.

All the requirements of Ind AS 105 applicable to a non-current asset held for sale shall apply to a non-current asset held for distribution

**Conditions**

(i) assets must be available for immediate distribution in their present condition and

(ii) the distribution must be highly probable i.e.

a. actions to complete the distribution must have been initiated

b. distribution is expected to be completed within one year from the date of classification.

c. it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn.

d. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.



## 4.4 Non-current assets to be abandoned

Non-current assets (or disposal groups) to be abandoned include

- non-current assets (or disposal groups) that are to be used to the end of their economic life and
- non-current assets (or disposal groups) that are to be closed rather than sold.

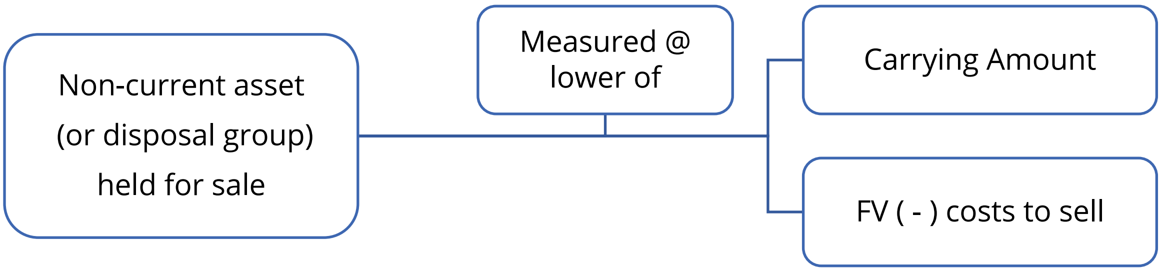
If the disposal group is to be abandoned, the entity shall present the results and cash flows of the disposal group as discontinued operations, if it meets the criteria prescribed in Ind AS 105, at the date on which it ceases to be used.

> An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned.

## 4.5 Non-current Asset temporarily taken out of use

A non-current asset that has been temporarily taken out of use will not be treated as

- Held for sale; or
- abandoned.




## 5.1 Steps

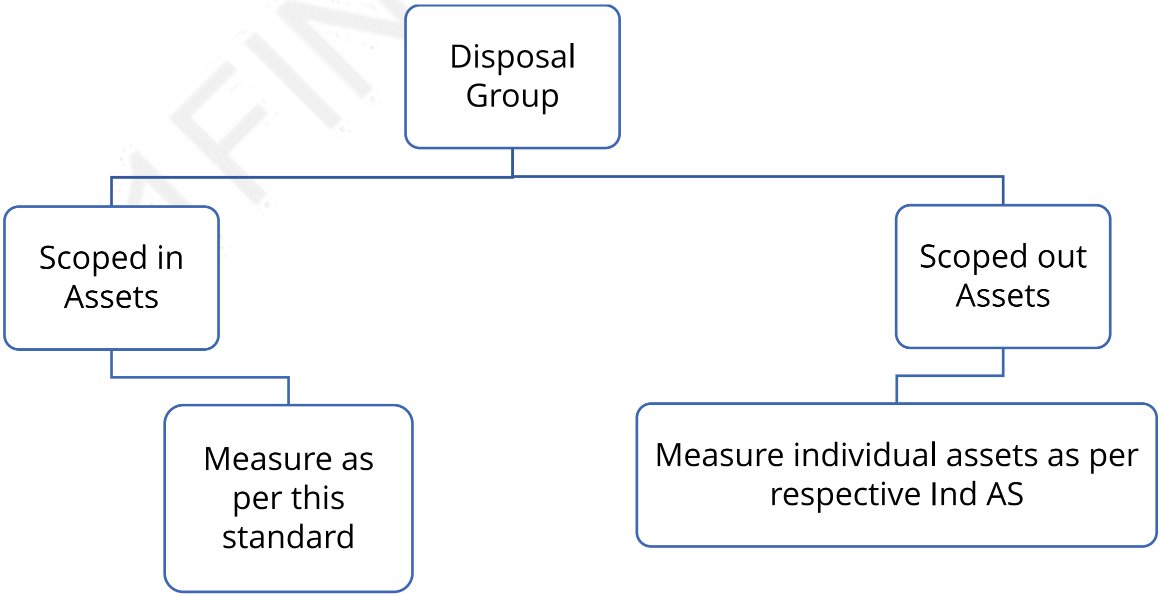
(i) Measure carrying amount (prior to classification) in accordance with applicable Ind AS i.e., AS 16 for PPE or AS 40 for Investments
(ii) Determine Fair value less cost to sell
(iii) Value of non-current asset (or disposal group) is lower of (i) or (ii)
Note: For Non-current asset held for distribution, fair value less cost to distribute is considered

**Cost to Sell**

**Cost to sell are the incremental costs excluding income taxes and finance costs.** If sale or disposal is expected to happen after 1 year, then present value concept is to be applied to "costs to sell" i.e., in step (ii) consider "Fair Value – present value of costs to sell"

If a non-current asset is acquired as business combination for subsequent disposal, such asset is measured at Fair Value less costs of sell.

## 5.2 Disposal Group – Subsequent measurement




The carrying amount of disposal group is compared with the Fair value less costs to sell.

## 6 Recognition of Impairment losses and reversals

**Loss** - An entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell.
**Gain** - An entity shall recognise a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognised (under Ind AS 105 or Ind AS 36)
**Disposal Group** - The impairment loss (or any subsequent gain) recognised for a disposal group shall be allocated

- First to goodwill
- Next to other assets in the ratio to their carrying amounts.

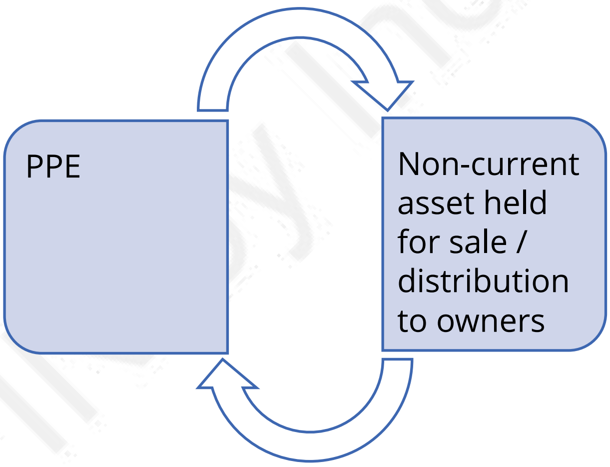
A gain or loss not previously recognised by the date of the sale of a non-current asset (or disposal group) shall be recognised at the date of derecognition.

Reversal of impairment loss is not allowed on goodwill.

**Depreciation on non-current assets held for sale**

An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale.

## 7 Reclassification




Remeasure at lower of

- Carrying amount before classification after adjusting depreciation/ amortisation/revaluation, etc. (which would have been provided) and
- Recoverable amount (i.e., higher of value in use and FV less cost to sell)

The difference of carrying amount and remeasured value is adjusted to P&L A/c.
If the asset was measured at revaluation model, difference will be revaluation increase / decrease.

### 7.1 Held for sale to Held for distribution and vice-versa

If an entity reclassifies an asset (or disposal group) directly

- from being held for sale to being held for distribution to owners, or
- from being held for distribution to owners to being held for sale,

apply the classification, presentation and measurement requirements in this Ind AS that are applicable to the new method of disposal as per Ind AS 105.

### 7.2 Individual Assets in the group re-classified

If an entity removes an individual asset or liability from a disposal group classified as held for sale / distribution to owners, the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group.
The remaining non-current assets of the group shall be measured individually at the lower of their carrying amounts and fair values less costs to sell (or costs to distribute) at that date.

## 8 Presentation and Disclosure Requirement

### 8.1 Presentation

- Non-current assets held for sale separately from other assets in the balance sheet
- Assets and Liabilities of disposal group should be presented separately from other assets and liabilities in balance sheet
- Income or expense recognised in OCI relating to non-current assets held for sale should be presented separately.

**Presentation**

Presentation is required only for major classes of assets and liabilities

Exception: Disposal group is a newly acquired subsidiary

Loss on Assets held for sale should be presented in P&L under "Profits from continuing operations"

### 8.2 Comparative Amounts

Comparative amounts for non-current assets (or disposal group) for prior periods are not to be reclassified or represented.

### 8.3 Disclosure

An entity should disclose the following in the notes to the financial statements in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

(a) Description of the non-current asset (or disposal group);

(b) Description of facts and circumstances (ex: decrease in demand, obsoletion, competition, etc.) of the sale, or leading to the expected disposal and the expected manner and timing of that disposal;

(c) Gain or loss recognised and if not presented separately on the face of the statement of profit and loss, the caption in the statement of profit and loss that includes that gain or loss.

(d) If applicable, the reportable segment in which the non-current asset (or disposal group) is presented in accordance of Ind AS 108 Operating Segments.

(e) If there is a change of plan to sell, a description of facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented.

## 9 Discontinued Operations

Component of an Entity → (i) Disposed off; or (ii) Classified as held for sale → Discontinued Operations

Discontinued Operation is a component of an entity that either has been disposed of or is classified as held for sale and:

(a) represents a separate **major line of business** or **geographical area** of operations; or

(b) is part of a **single co-ordinated plan** to dispose of a separate major line of business or geographical area of operations; or

(c) is a **subsidiary acquired** exclusively with a view to **resale**.

A component of an entity is a cash generating unit or a group of cash-generating units while being held in use.

### 9.1 Separate Presentation

Profits and Losses from discontinued operations shall be presented separately to enable the users to evaluate the impact of discontinued operations.

An entity shall disclose a single amount in the statement of profit and loss comprising the total of:

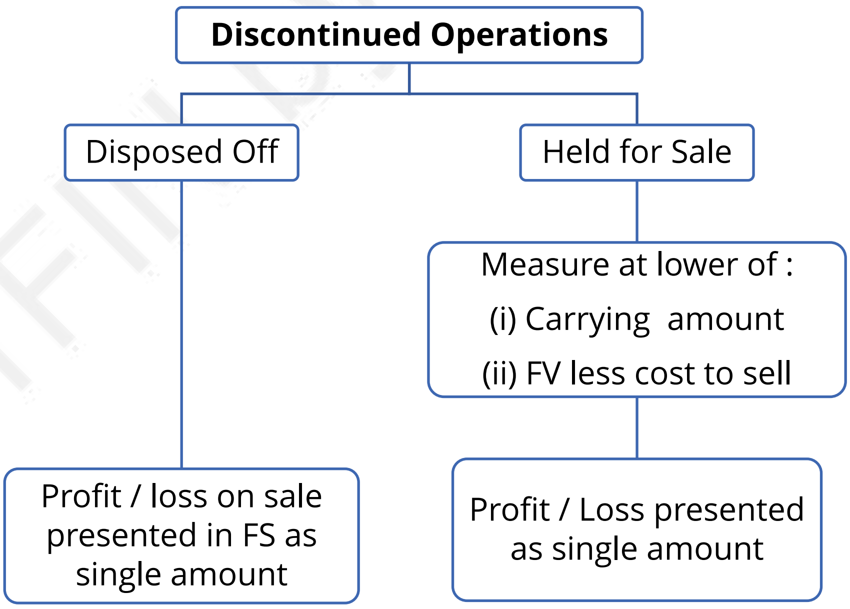
(a) the post-tax profit or loss of discontinued operations; and

(b) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation

Information related to discontinued operations shall be presented on the face of the FS.

**Presentation in FS:**

| **Particulars** | **Note No** | **20X2-20X3** | **20X1-20x2** |
|---|---|---|---|
| Profit before tax | | | |
| Tax expense<br>1. Current tax<br>2. Deferred tax | | | |
| Profit(loss) for the period from continuing operation | | | |
| **Profit(loss) for the period from discontinuing operations** | | | |
| **Tax expense of discontinuing operations** | | | |
| **Profit(loss) from discontinuing operations** | | | |



## 10 Disclosures – Discontinued Operations

Profit or loss from discontinued operations should be broken into the following in the notes or in the statement of profit and loss

- (i) Revenue
- (ii) Expense
- (iii) Pre-tax profit
- (iv) Gain or loss on disposal or on measurement
- (v) Related tax expense

> Analysis is not required for newly acquired subsidiaries classified as held for sale on the date of acquisition

### 10.1 Consolidated Financial Statements & Discontinued Operations

In CFS, entity must disclose amount attributable to owners of the parent from continuing operations and discontinued operations

### 10.2 Cash Flow Statement

Disclose attributable net cashflows of discontinued operations in the Cash Flow Statement under

- (i) Operating Activities
- (ii) Investment Activities
- (iii) Financing Activities

> Disclosure may be in notes or in cash flow statements

### 10.3 EPS

EPS of discontinued operation shall be disclosed separately.
EPS computed as per Ind AS 33 from discontinued operations shall be disclosed in addition to disclosure of EPS from continuing operations.

### 10.4 Previous Comparative Periods

When the amounts relating to discontinued operations are presented separately, the comparative figures for prior periods are also re-presented, so that the disclosures relate to all operations that have been discontinued.

> **Adjustment to Prior Period disposals**
>
> Adjustments in current period related to discontinued operation in prior period shall be shown separately

### 10.5 Reclassification of discontinued operations

When a discontinued operation is reclassified as continuing operation, profit and loss should be shown as part of continuing operation. Prior period amounts should be re-presented.

## 11 IND AS 105 vs AS 24

| Basis of differences | AS 24 | IND AS 105 |
|---|---|---|
| **Scope** | (i) Talks about discontinuing operations<br>(ii) Doesn't deal with non-current assets held for sale | (i) Talks about discontinued operations<br>(ii) Deals with non-current asset held for sale |
| **Initial disclosure event** | Specifies about the initial disclosure event in respect to a discontinuing operation. | Doesn't mention about initial disclosure event. |
| **Period for sale completion** | Doesn't specify any time period with regards to expected sale completion | Sale is expected to be completed within 1year to |

| | | |
|---|---|---|
| | | classify as asset as held for sale |
| **Measurement** | Measurement referred to other relevant Ind AS | Non-current assets held for sale are measured at lower of<br>• Carrying amount<br>• Fair value less cost to sell |
| **Abandonment of Assets** | Can be classified discontinuing operation | Should not be classified as held for sale. |
| **Change of plan to sell** | Does not provide any specific guidance | Provides guidance regarding changes to the plan |

## Illustrations

### 1. Illustration

Recognise the loss / gain on the recognised value of Disposal group held for sale from the following details:

| Assets | Carrying amount at reporting date before classification | Carrying amount remeasured just before classification |
|---|---|---|
| Goodwill | 1,500.00 | 1,500.00 |
| PPE (Revaluation Model) | 4,600.00 | 4,000.00 |
| Building (at cost) | 5,700.00 | 5,700.00 |
| Inventory | 2,400.00 | 2,200.00 |
| Investments in Equity Sh. | 1,800.00 | 1,500.00 |
| **Total Carrying amount** | **16,000.00** | **14,900.00** |
| | | |

The entity has estimated that FV less costs to sell will be 13,000.00

### 2. Illustrations

A freehold property was originally acquired for Rs.40,00,000. Some years later, after cumulative depreciation of Rs.11,00,000 has been recognised, an impairment loss of Rs.3,50,000 is recognised, taking the carrying amount to Rs.25,50,000, which represents the estimated value in use of the property. Shortly thereafter, as a consequence of a proposed move to new premises, the freehold property is classified as held for sale.

At the time of classification as held for sale:

- carrying amount is Rs.25,50,000; and
- fair value less costs to sell is assessed at Rs.25,00,000.

Accordingly, the initial write-down on classification as held for sale is Rs.50,000 and the property is carried at Rs.25,00,000. Following classification as held for sale, no further depreciation is recognised.

At the next reporting date, the property market has improved and fair value less costs to sell is reassessed at Rs.26,50,000.

Six months after that, the property market has continued to improve, and fair value less costs to sell is now assessed at Rs.30,00,000.

Subsequently, the property is sold for Rs.30,00,000, at which time a gain of Rs.1,00,000 is recognised.

### 3. Illustrations

11.1.1 Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

| Asset/ (liability) | Carrying amount as on 31st March, 20X1 (In '000) |
|---|---|
| Attributed goodwill | 200 |
| Intangible assets | 950 |

| | |
|---|---|
| Financial asset measured at fair value through other comprehensive income | 300 |
| Property, plant & equipment | 1100 |
| Deferred tax asset | 250 |
| Current assets – inventory, receivables, and cash balances | 600 |
| Current liabilities | (850) |
| Non-current liabilities – provisions | (300) |
| **Total** | **2,250** |

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.
The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

| **Asset/ (liability)** | **Carrying amount as on 15th September 20X1 (In '000)** |
|---|---|
| Attributed goodwill | 200 |
| Intangible assets | 930 |
| Financial asset measured at fair value through other comprehensive income | 360 |
| Property, plant & equipment | 1020 |
| Deferred tax asset | 250 |
| Current assets – inventory, receivables, and cash balances | 520 |
| Current liabilities | (870) |
| Non-current liabilities – provisions | (250) |
| **Total** | **2160** |

Entity A proposed to sell the disposal group at Rs.19,00,000. It estimates that the costs to sell will be Rs.70,000. This cost consists of professional fee to be paid to external lawyers and accountants.
As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

| **Available for sale:** | **(In '000)** |
|---|---|
| Financial assets | 410 |
| Deferred tax assets | 230 |
| Current assets- Inventory, receivables, and cash balances | 400 |
| Current liabilities | 900 |
| Non- current liabilities- provisions | 250 |

The disposal group has not been trading well and its fair value less costs to sell has fallen to 16,50,000.
Required:
What would be the value of all assets/ labilities within the disposal group as on the following dates in accordance with Ind AS 105?
(a) 15 September, 20X1 and
(b) 31st March, 20X2

## 4. Illustrations

S Ltd purchased a property for 6,00,000 on 1st April, 20X1. The useful life of the property is 15 years. On 31st March, 20X3, S Ltd classified the property as held for sale. The impairment testing provides the estimated recoverable amount of 4,70,000.
The fair value less cost to sell on 31st March, 20X3 was 4,60,000.31190 On 31st March, 20X4 management changed the plan, as property no longer met the criteria of held for sale. The recoverable amount as at 31st March, 20X4 is 5,00,000.

Provide the accounting treatment of events for the year ending 31st March, 20X3 and 31st March, 20X4 and value the property at the end of 20X3 and 20X4

## 5. Illustrations

11.1.2 On February 28, 20X1, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.

11.1.3 Can the property be classified as held for sale at the reporting date i.e. 31st March, 20X1?

## 6. Illustrations

On 1st March, 20X1, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on 31st March, 20X1, it is expected that the factory will be sold by 28th February, 20X2. However, in May 20X1, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on 26th June, 20X1. Should the factory be shown as held for sale as on 31st March, 20X1?

## 7. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- On 21 March 20X1, XYZ announced the Board's intention to sell its shares in a subsidiary company, Alpha, contingent upon the approval of Alpha's shareholders. It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.

## 8. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- PQR has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC, on 14 March 20X1. The assets will be transferred on 28 April 20X1 from which date the Group will outsource its delivery activities to another company, LMN

## 9. Illustration

Identify which of the following is a disposal group at 31 March 20X1:

- On 16 January 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31 March 20X1 heads of agreement had been signed although due diligence and the negotiation of final terms are still in process. The transaction is expected to be completed in April 20X1.

## 10. Illustration

On 1st June, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On 31st July, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y.

However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by 30th November, 20X1 and the sale is expected to be completed by 31st March, 20X2. Entity X follows December year end.

The assets and liabilities attributable to this manufacturing unit are as under:

| Particulars | Carrying value as on 31st December, 20X0 | Carrying value as on 31st July, 20X1 |
|---|---|---|
| Goodwill | 500 | 500 |
| Plant and Machinery | 1,000 | 900 |
| Building | 2,000 | 1,850 |
| Debtors | 850 | 1,050 |
| Inventory | 700 | 400 |
| Creditors | (300) | (250) |
| Loans | (2,000) | (1,850) |
| | 2,750 | 2,600 |

The fair value of the manufacturing unit as on 31st December, 20X0 is 2,000 and as on 31st July, 20X1 is 1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., 31st

December, 20X1. The fair value as on 31st December, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. The measurement of the manufacturing unit as on the date of classification as held for sale.
3. The measurement of the manufacturing unit as at the end of the year.

### 11. Illustration

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 20X1. During the 3 months ended 30th June, 20X1 following events occurred:

On 1st April, 20X1, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities:

On 1st April, 20X1, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill – 60,000
- Property, Plant & Equipment (average remaining estimated useful life two years) - 20,00,000
- Inventories - 10,00,000

From 1st April, 20X1, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 20X1 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 20X1, market condition has improved and as on 1st August, 20X1 the Company received and accepted a firm offer to purchase the division for 33,00,000.

The sale is expected to be completed on 30th September, 20X1 and 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 20X1. During the period from 1st April to 30th June inventories of the division costing 8,00,000 were sold for 12,00,000. At 30th June, 20X1, the total cost of the inventories of the division was 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale of the division will be reported in the interim financial statements for the quarter ended 30th June, 20X1 giving relevant explanations.

### 12. Illustration

11.1.4 A Ltd. Is to sell a non-current asset, being a piece of land. The piece of land has been contaminated and require the entity to carry out ₹ 1,00,000 of work in order to rectify the contamination. If the land was not contaminated, it could be sold for 3,00,000. With the contamination it is worth only ₹ 2,00,000. The work that is needed to rectify the contamination will extend the period of sale by one year from the date the land is first marketed for sale.

Required: In the following situations, examine with suitable reasons whether land can be classified as held for sale in accordance with Ind AS 105

**Situation 1 -** The land is marketed for ₹ 3,00,000 and A Ltd. Was not aware of the contamination till the time a firm purchase agreement was signed with a purchaser. The purchaser found contamination through a survey. The purchaser signed the firm purchase commitment on condition that the contamination damage will be rectified.

**Situation 2 -** A Ltd. Marketed the land for ₹3,00,000, knowing about the contamination when the proposal to sale the land went in the market. However, A Ltd. Marketed with an agreement that it would carry out the rectification work within few months from signing the firm purchase commitment.

**Situation 3 -** A Ltd. Knew about the contamination prior to float the proposal to sell the land and markets it for ₹ 2,00,000 with no obligation on itself to rectify or fix the contamination.

### 13. Illustration

PB Limited purchased a plastic bottle manufacturing plant for ₹ 24 lakh on 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017, PB Limited temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of PB Limited decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held for sale. The fair value less cost to sell on 30th September, 2017 and 31st March, 2018 was ₹ 13.5 lakh and ₹ 12 lakh respectively.
The accountant has made the following working.

| **Carrying amount on initial classification as held for sale** | **₹** | **₹** |
|---|---|---|
| Purchase price of Plant<br>Less: Accumulated Depreciation [(₹24,00,000/8)x2.5 years] | 24,00,000<br>7,50,000 | 16,50,000 |
| Fair value less cost to sell as on 31st March 2017 | | 12,00,000 |
| The value lower of the above two | | 12,00,000 |

Balance Sheet extracts as on 31st March, 2018

| Particulars | ₹ |
|---|---|
| Assets<br>Current Assets<br>Other Current Assets<br>Assets classified as held for sale | <br><br><br>12,00,000 |

**Required:** Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the correct treatment showing necessary workings.

### 14. Illustration

Determine whether the following are discontinued operations

| S. No | Particulars |
|---|---|
| 1. | MNO disposes of a component of the entity by selling the underlying assets. The sales transaction is incomplete at the reporting date. |
| 2 | PQR has ceased activities that meet the definition of a discontinued operation without selling any assets |
| 3. | STU ceases activities and has already completed the sale of the underlying assets at the reporting date. |
| 4. | VWX will sell or has sold assets that are within the scope of Ind AS 105, but does not discontinue any of its operations |
| | |
| | |

### 15. Illustration

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in Chandani Chowk in New Delhi.
The company will continue to run 200 other outlets in New Delhi.

All Ind AS 105 criteria for held for sale classification were first met at 1st October, 20X1. The outlet will be sold in June, 20X2.
Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analyse

### 16. Illustration – Nov 22 [8 Marks]

Violet Limited is a beverages manufacturing company having various plants across India. There is Machinery A in the Surat plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also be sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machinery A it cannot produce output as well. The company considers this group of assets as a Cash Generating Unit and an Inventory amounting to Rs. 1.65 lakhs and Goodwill amounting to
Rs. 1.50 lakhs is included in such CGU.
Machinery A was purchased on 1st April 2016 for Rs. 12 lakhs and residual value is

Rs. 60 thousand. Machinery B was purchased on 1st April, 2018 for Rs. 5 lakhs with no residual value. The useful life of both Machinery A and B is 10 years. The company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of company is 10% p.a.

| Year | Cash Flows from Machinery A |
|---|---|
| 1 | 2,00,000 |
| 2 | 1,50,000 |
| 3 | 1,00,000 |
| 4 | 1,50,000 |
| 5 | 1,00,000 (Excluding Residual Value) |
| Total | 7,00,000 |

On 31st March, 2021, the professional valuers have estimated that the current market value of machinery A is Rs. 8.5 lakhs. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is Rs. 1.60 lakhs. Specialized packaging cost would be Rs. 30,000 and legal fees would be Rs. 68,000.

The inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is Rs. 10 lakhs as on 31st March, 2021. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is

Rs. 11 lakhs i.e. on 31st March, 2022. The recoverable value of Machinery A is Rs. 5,50,000 and combined for Machinery A and Machinery B is Rs. 8,00,000 as on 31st March, 2022.

You are required to:

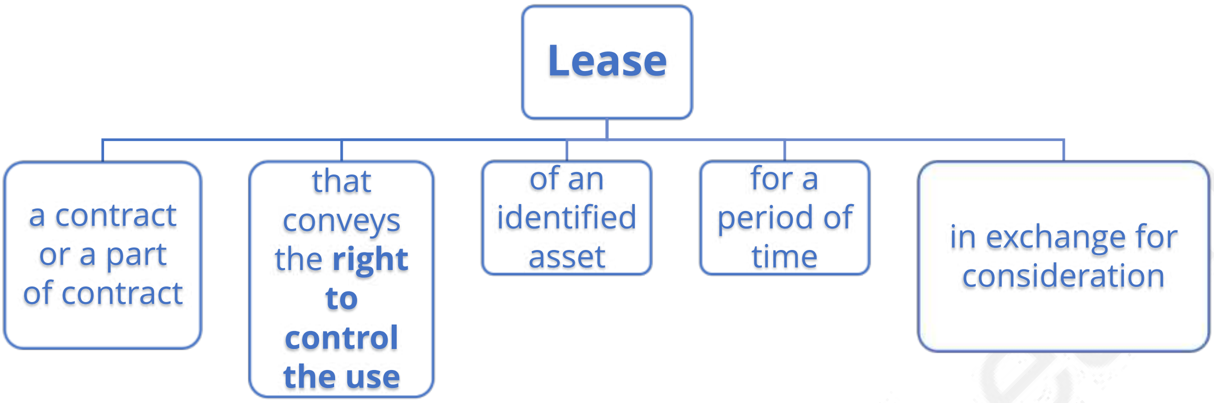
(i) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2021 by providing all the relevant working notes to arrive at such calculation.

(ii) Compute the carrying value after considering prospective depreciation for the year 2021-2022 on the above assets.

(iii) Compute the carrying value of CGU as at 31st March, 2022.

(Note: Present value factor of Rs. 1 should be taken upto 4 decimals for the purpose of calculation)

# 1 Identifying a Lease




**An entity assess whether a contract is / contains a lease** at inception of a contract. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

## 1.1 Identified Asset

A contract contains a lease only if it relates to an identified asset. An asset can be either

- explicitly specified in a contract or
- implicitly specified at the time it is made available for use by the customer.

### 1.1.1 Substantive Substitution Rights (SSR)

A customer does not have right to use an identified asset if the supplier has **substantive substitution right** to substitute the asset throughout the period of use. SSR should be checked at inception of contract and should not be based on future events.

**Conditions for SSR**

- The supplier has practical ability to substitute alternative assets throughout the period of use and
- The supplier would benefit economically from the exercise of its right to substitute the asset.

**Cases when SSR does not exist**

- Right arises **after a period of time or on occurrence of an event** (say an asset breakdown)
- If the customer cannot determine whether or not the supplier has substantive substitution right

Note – AS 19 does not have any requirement of SSR.

### 1.1.2 Assets not physically distinct

An identified asset is generally physically distinct.
A portion or part of an asset or its capacity that is not physically distinct (e.g. in case of shared pipelines, tanks, optic fibres) is not an identified asset unless it represents significantly all (generally about 90%+) of the capacity of the asset.

## 1.2 Right to Control

A contract conveys the right to control the use of an asset to the customer if the customer has

- The **right to obtain substantially all of the economic benefits** from the use of an identified asset throughout the period of use **and**
- The **right to direct the use** of the identified asset.

*Note – AS 19 does not provide guidance regarding right to direct and considers only right to use an identified asset.*

An entity should consider all forms of service contracts, supply contracts and lease arrangements to evaluate right to control the use of an asset.
If customer has the right to control the use of an asset for only a portion of the term of the contract, then the contract contains lease for that portion of lease term.

### 1.2.1 Right to obtain substantially all of the economic benefits

A customer can obtain economic benefits either directly or indirectly by using, holding or subleasing the asset. An entity must consider economic benefits that arise from the defined scope of right to use the asset.
Economic benefits include

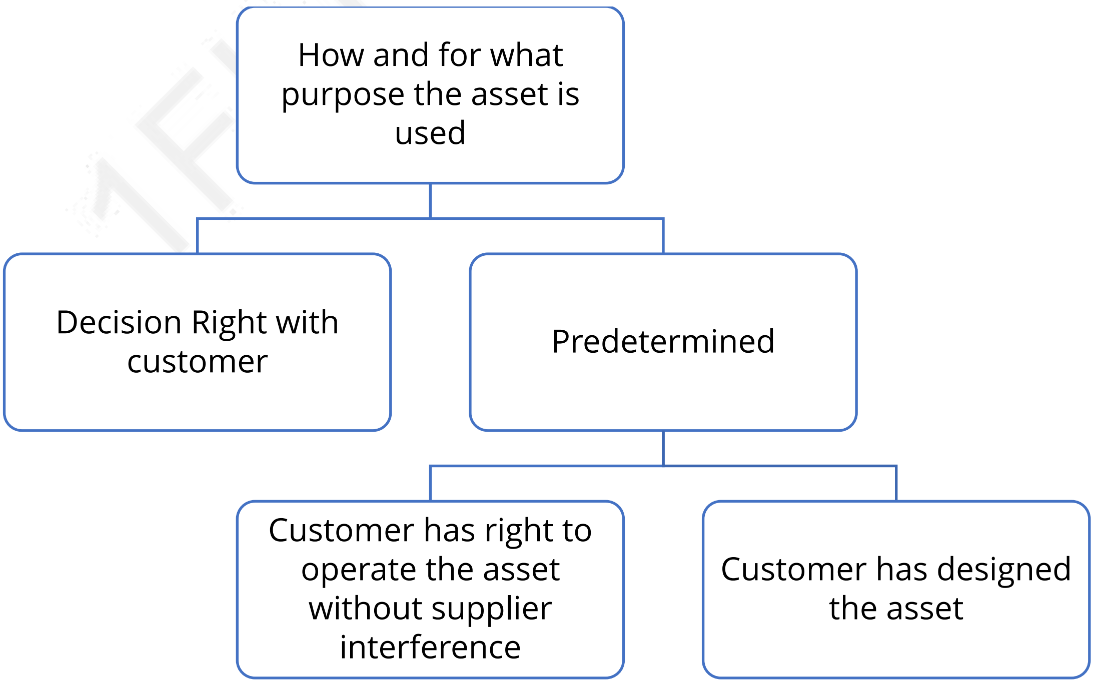
- asset's primary outputs (goods and service)
- by-products (including renewal credits generated)
- benefits from using the asset that is realised in a commercial transaction with a third party (e.g. sub-leasing)

Customer can obtain substantially all of the economic benefits even in case of following –

**Supplier's protective clauses –** A contract that contains a clause that protects supplier's interest (e.g to prevent unauthorised use of the asset) in the asset.

**Supplier/Third party payment –** A contract requiring payment of a variable amount to supplier or to a third party based on cash flows generated from the use of an asset

### 1.2.2 Right to direct the use of the identified asset is with customer if



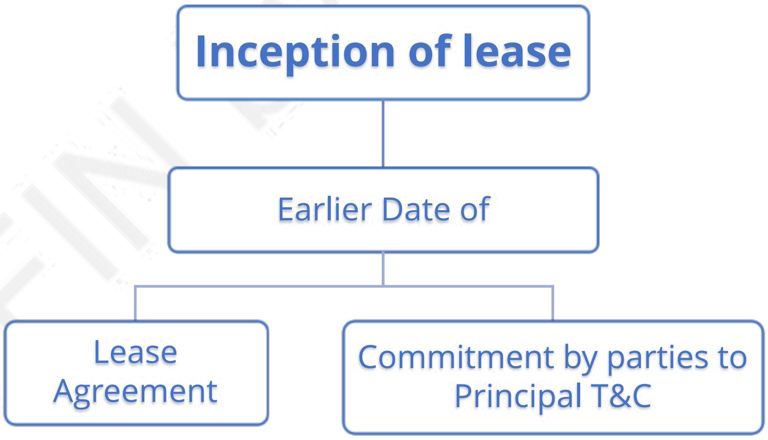
- If the customer has the **right to direct how** and for **what purpose** the asset is used throughout the period of use; or
- if the relevant **decisions** about how and for what purpose the asset is used are **predetermined** and:
  - the **customer has the right to operate the asset** (or to direct others to operate the <u>asset</u> in a manner that it determines) throughout the period of use, without the lessor having the right to change those operating instructions; or
  - the **customer designed the asset in a way** that predetermines how and for what purpose the asset will be used throughout the period of use.

Right to direct is more important than the right to use.

| Rights | Examples |
|---|---|
| To change the output that is produced by the asset | • Deciding whether to use containers for transportation or storage<br>• Deciding the mix of products to be sold from a retail outlet |
| Change when the output is produced | Deciding when an item of machinery would be used |
| Change where the output is produced | • Deciding the destination for a vehicle<br>• Deciding the location of usage of machinery |
| Decide whether to produce the output | Whether to operate a particular asset to produce output. |
| Decide the quantity of output | How much of quantity of output to be produced |

## 2 Inception and Commencement of Lease

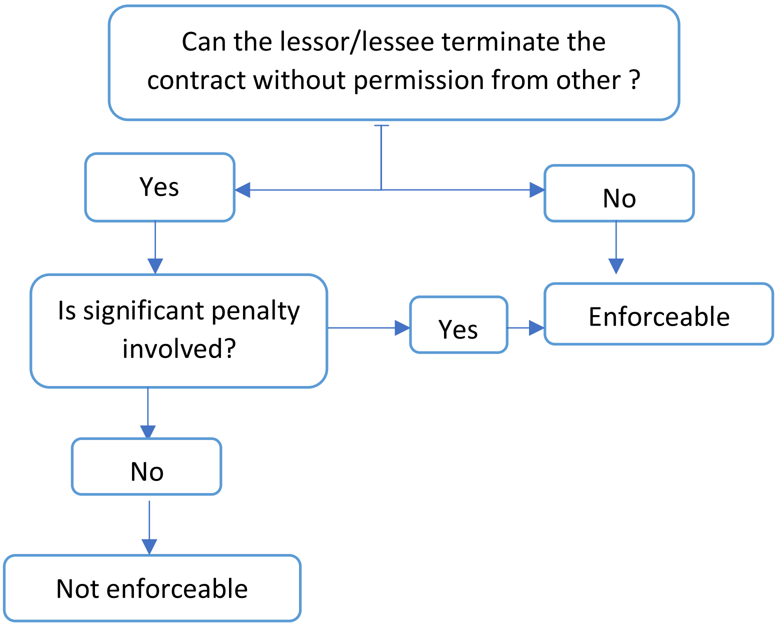
Customers and suppliers must determine whether a contract contains a lease at the **inception of lease.**




**Commencement date** is the date on which lessor makes an underlying asset available for use by the lessee (irrespective of whether the lessee has started operations or has started rental payments)

| Inception date | Commencement Date |
|---|---|
| Entity assesses whether the contract contains lease | Entity recognises lease related transactions |
| | Lease period begins at this date |

## 3 Lease term




### 3.1 Non-Cancellable Period

Non-Cancellable period is the period during which the contract is enforceable.

Rent free Period + Non Cancellable Period + Option to extend (Reasonably Certain - Yes) + Option to Terminate (Reasonably certain -No) = Lease Term

### 3.2 Relevant Factors

- Lease term begins at **lease commencement date**
- If only the lessor has the right to terminate the lease, the period covered by the option is considered as non-cancellable.
- Lease term is aggregate of non-consecutive period if the lease is taken for non-continuous period.
- Option to extend/terminate to be assessed at lease commencement date. Assessment is
    - based on facts and circumstances.
    - Not based on just intentions or past practices

**Considerations to assess options**

| **Contractual Terms** | **Asset Related Factors** |
|---|---|
| Lease rentals in optional period | Specialised Asset |
| Variable or contingent payment | Location of underlying asset |
| T&C after initial optional period | Leasehold improvements |
| Cost of replacement | Availability of alternatives |

- Longer the lease term, more difficult it is to assess whether the option would be exercised or not.
- Significance of underlying asset to the lessee's operation impacts the lessee's decision to extend the lease
- Option to extend or terminate might be linked with other contractual terms like residual value guaranteed

### 3.3 Reassessment of reasonable certainty by lessee

If a significant event or change in circumstance occurs which

- is within the control of the lessee and
- affects whether the lessee is reasonably certain
  - to exercise (the option to extend) or
  - not to exercise (the option to terminate)

### 3.4 Revision of the lease term

The entity will revise the lease term if there is a change in the non-cancellable period of a lease.

| Option to extend (Not included*) | Option to Terminate (Included*) |
|---|---|
| Lessee exercises at a later date | Does not exercise at a later date |
| An event occurs which obliges the lessee to exercise | An event occurs which prevents the lessee to exercise |

*In determining the lease term

## 4 Lessee Accounting

Lessee is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.
At the commencement of lease, the lessee recognises Right-of-use Asset (ROU Asset) and a Lease Liability.
There is no distinction in accounting treatment irrespective of whether it is an operating lease or finance lease (Under AS 19, the accounting differs on whether the lease is an operating lease or finance lease)

### 4.1 ROU Asset & Lease Liability

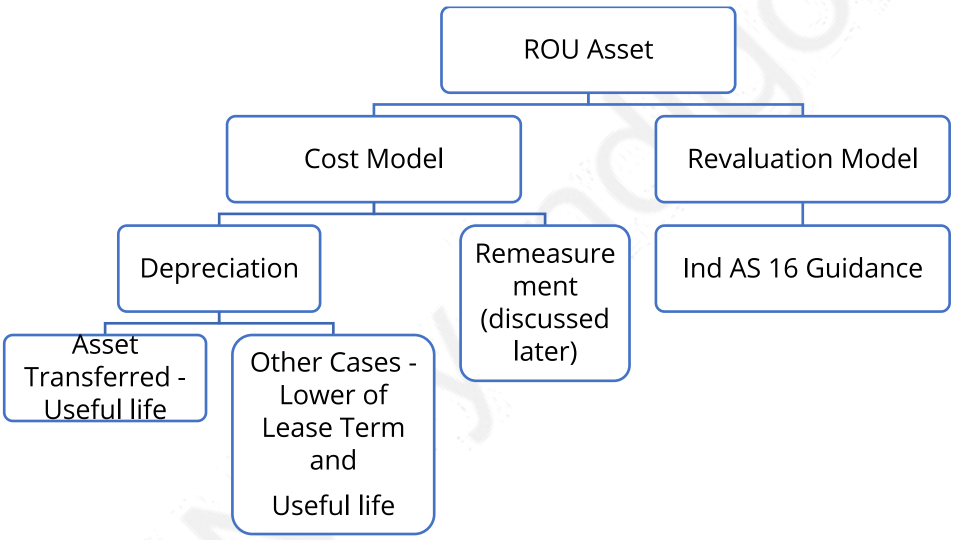
| *Right of Use Asset =* | |
|---|---|
| Lease Liability | PV of Lease payments to be paid discounted at rate implicit in the lease or incremental borrowing cost (if implicit rate is not known) |
| + Lease payment made at / before commencement | Advance lease payments |
| - Lease incentives received | |
| + Initial Direct Cost | Incurred by lessee |
| + PV of estimated dismantling, restoration cost | Similar to decommissioning costs under Ind AS 16. Liability accounted as per Ind AS 37 |

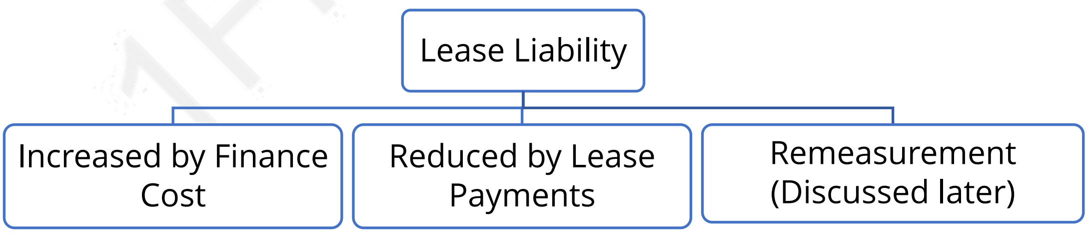
## 4.2 Lease Payments to be paid

| *Lease Payments =* | |
|---|---|
| Fixed Lease payments | Generally determined in the contract |
| + In substance fixed lease payments | Though variable, considered as fixed (like minimum variable payment) |
| - Lease incentives received | |
| + Variable payments dependent on index or rate | Variable based on rates like LIBOR, annual increment etc are considered.<br>Performance based variable payments are excluded. |
| + Residual value guaranteed by lessee | |
| + Exercise price of purchase option | If the lessee is likely to exercise the purchase option |

For determining the liability only unpaid lease payments are considered.

## 4.3 Subsequent Measurement

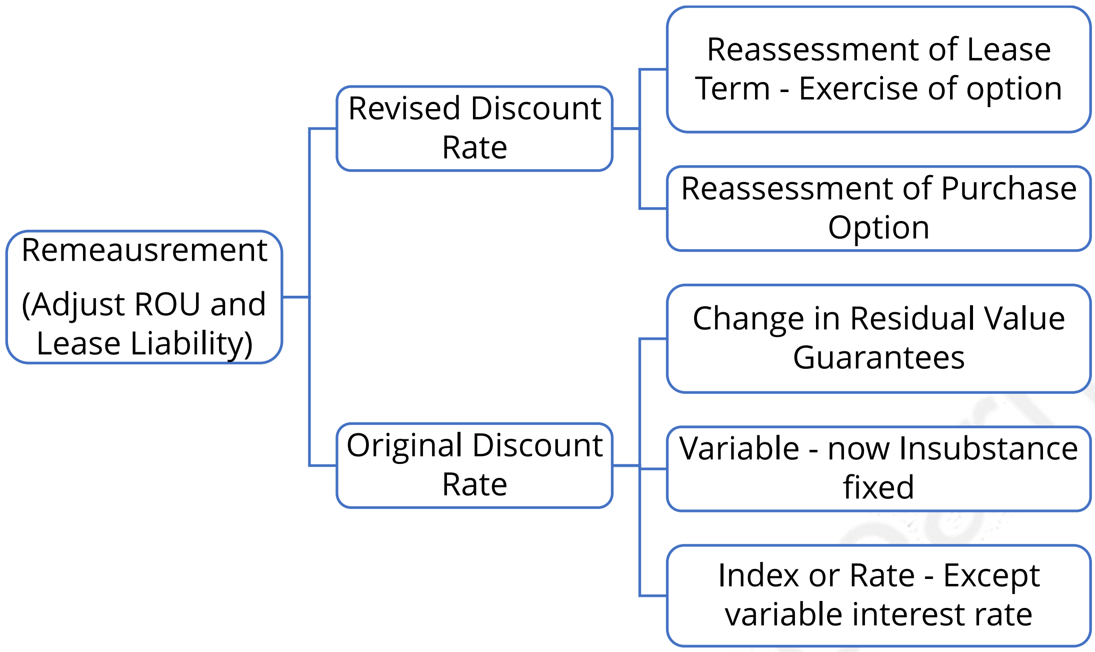



## 4.4 Important Points

- Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability (also referred to as interest rate implicit in the lease or IRR) – Refer example in class
- Amounts to be debited to Profit and Loss
  - Interest expense (unless it meets the capitalisation requirement)
  - Variable lease payment

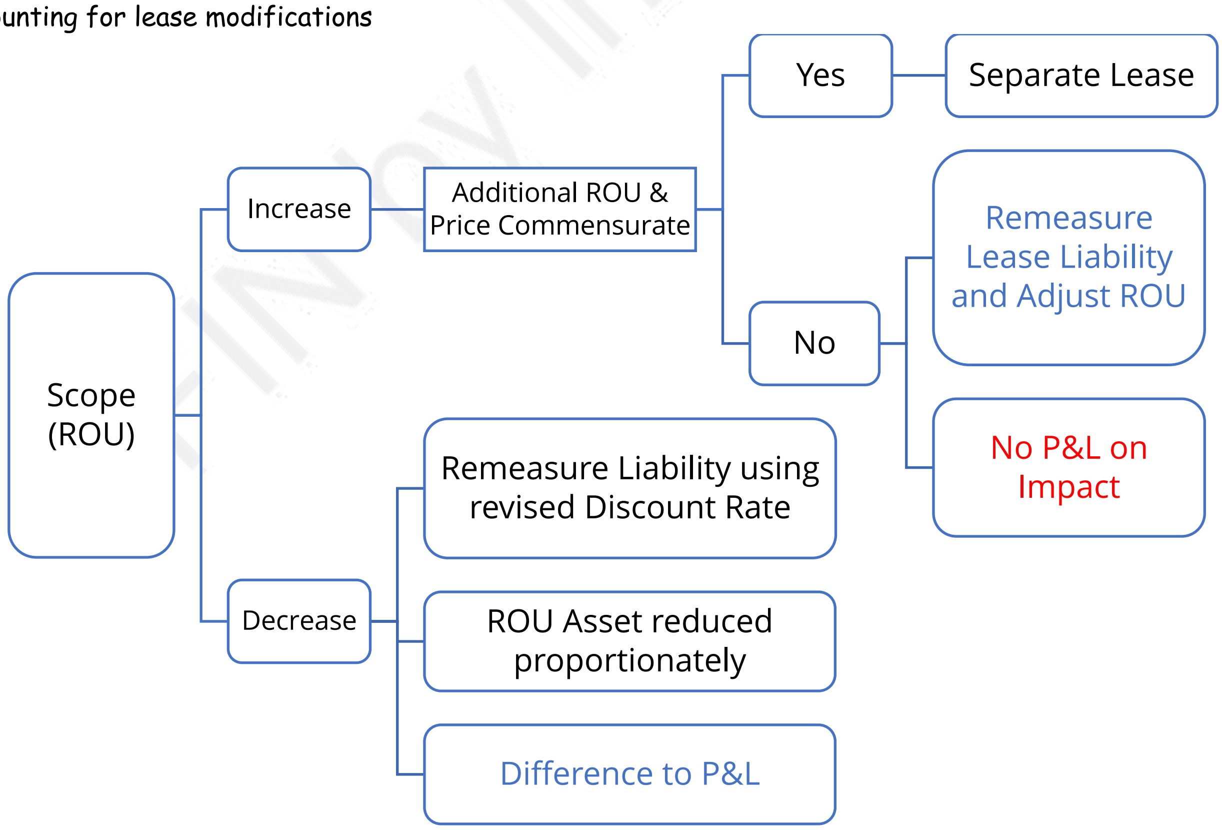
### 4.5 Remeasurement of Lease Liability

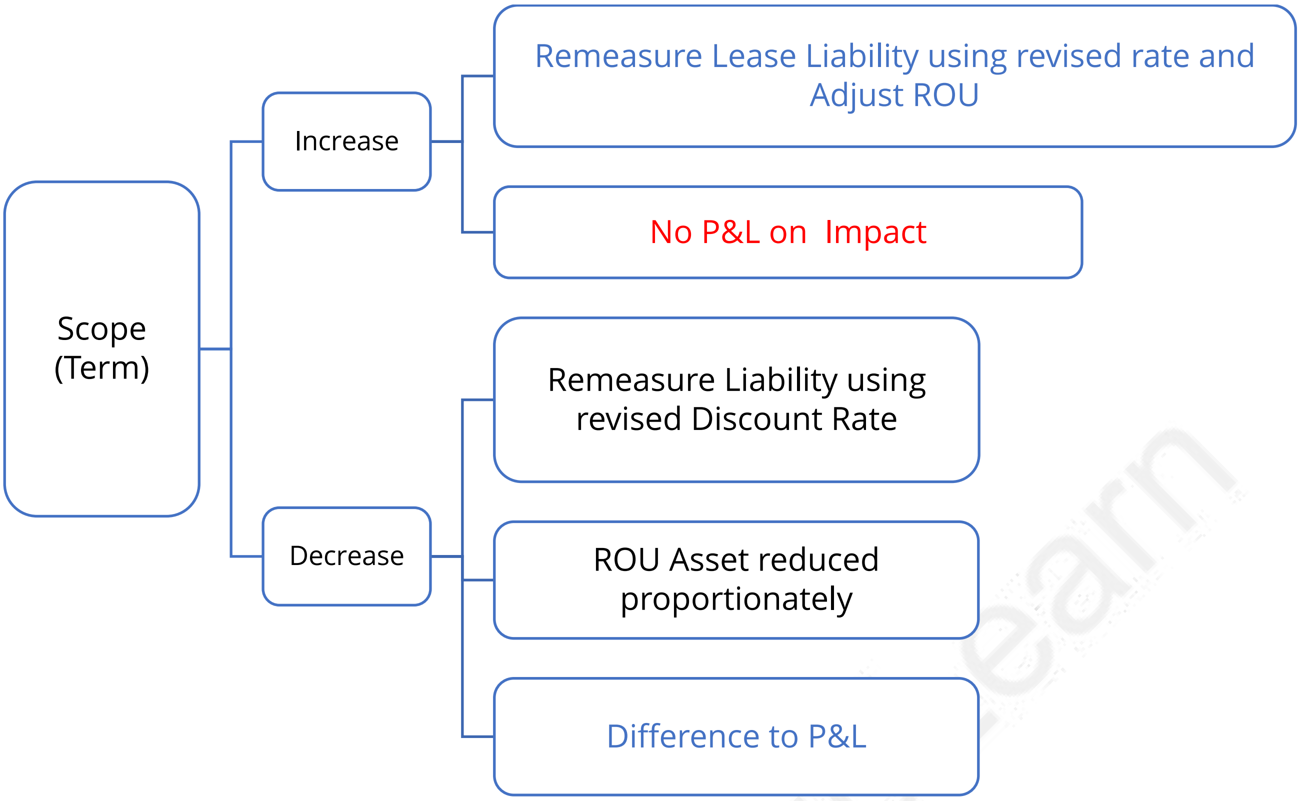



- The remeasurement of lease liability is adjusted to ROU Asset (increase or decrease). There is no impact on P&L.
- If ROU asset has 'Nil' carrying amount, reduction in lease liability is recognised in P&L.

## 5 Lease Modifications

Accounting for lease modifications





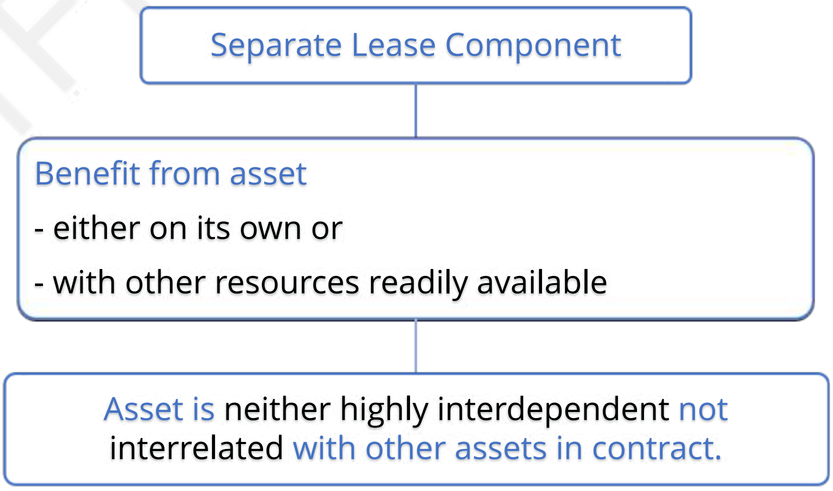

*For any other lease modifications (e.g change in considerations) there is no impact to P&L. All adjustments are made to ROU Asset & Lease Liability Account.*

A Lease modification is a change in the **scope** of a lease or the **consideration** for a lease that was not a part of the original terms and conditions of the lease.

- Lease Extension
- Early termination of lease
- Change in timing of lease payment
- Additional space
- Surrendering part of asset

## 6 Separation of Lease & Non-Lease components

### 6.1 Separate Lease components (More than one ROU asset in a single contract)



If both of above conditions are not satisfied, then the right to use multiple assets is considered as a single component.
E.g. A contract to lease computer monitor and cpu would be considered as a single ROU. A contract to lease a truck and a car would be considered as having two ROUs – one for truck and other for car.

### 6.2 Separating lease components from non-lease components

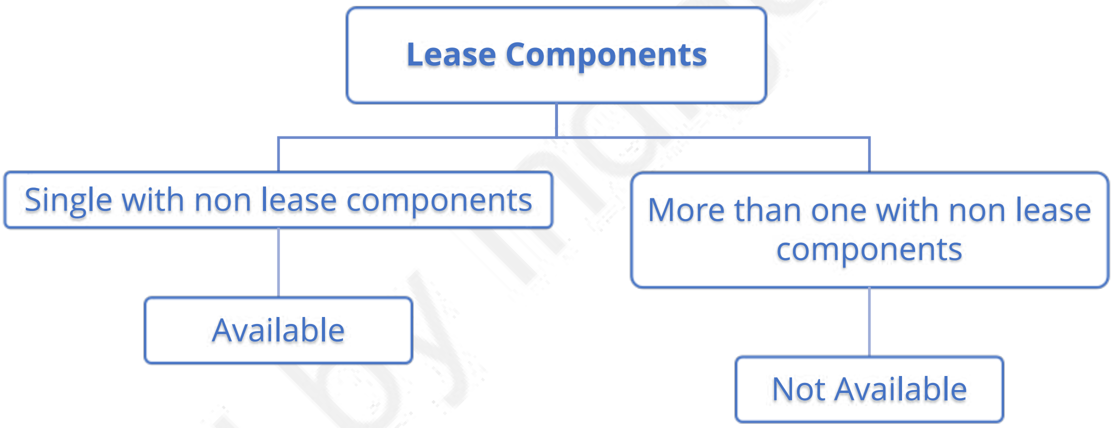
A contract may contain lease component (ROU Asset) and an agreement to supply other (related) goods and services (non-lease component).

| Lease Component | Non Lease Component |
| --- | --- |
| Right to use Property | Maintenance services like utility, security, cleaning etc. |
| Right to use coffee machine | Supply of consumables like coffee beans |
| Right to use a Truck | Service of drivers |

The non-lease component are identified and accounted for separately from lease component. The non-lease component should involve transfer of goods or services from the lessor to lessee.

### 6.3 Optional exemption (using practical expedient) – only to lessee

A **lessee** can make an accounting policy election by class of underlying asset to account for each separate lease component of a contract and any associated non-lease components as a **Single Lease Component.**

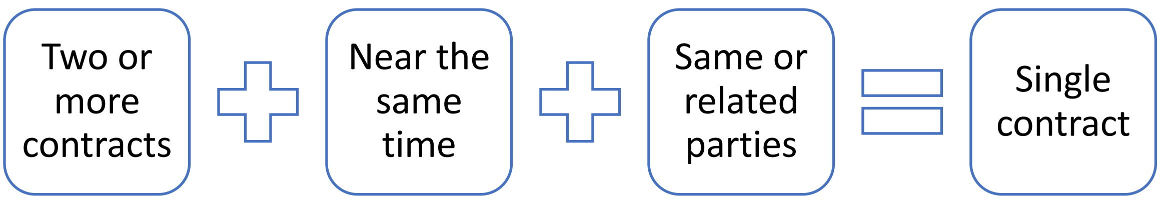



### 6.4 Determining and allocating the consideration in the contract - Lessee

Allocation of consideration in the contract are allocated to lease component(s) and non-lease component(s) on a relative stand-alone price basis.
**Basis of Allocation :**

- Observable/estimated lease consideration
- Observable/estimated fair value of components

### 6.5 Contract Combination




Two or more contracts entered into at or near the **same time** with the **same counterparty (or related parties of counterparty)** is considered as a single contract if any one of the following criteria is met.

**Combination criteria**

| | |
|---|---|
| Negotiation | - Contracts are negotiated as a package<br>- With overall commercial objective |
| Consideration | Consideration paid in one contract is dependent on consideration paid on another. |
| Lease Component | ROU assets under different contract are a single lease component |

An entity may apply practical expedient to use portfolio approach for leases with similar characteristics if it is reasonably expected that the effects on financial statements would not differ materially.

*AS-19 does not provide guidance on separation of lease and non lease component. Entire contract including the non-lease component would be accounted as leased under AS-19*

## 7 Presentation

| | |
|---|---|
| **Balance Sheet**<br>ROU Assets & Lease Liabilities | - Separately from other assets/liabilities<br>- If presented together with owned assets/other liabilities, disclosure about the line items<br>- **Investment Property** is disclosed as Investment property (not as ROU)<br>- ROU assets and lease liabilities are not netted off. |
| **Profit & Loss** | Separately disclose interest on expense and lease liability |
| **Cashflow** | Repayment of Lease Liabilities and Interest – Financing Activity<br>Short term/low value lease payments – Operating Activity<br>Variable lease payment – Operating Activity |

## 8 Disclosure Requirements – Lessee

### 8.1 Quantitative disclosures for the following –

| **Balance Sheet** | **Profit & Loss** |
|---|---|
| Additions to ROUs | Interest Expenses |
| Carrying value of ROUs by class | Short term/Low value lease expense |
| Maturity Analysis of lease liabilities separately from other liabilities | Variable lease payments expensed |
| | Income from subleasing |
| | Gains or losses arising from sale and leaseback |

- If lessee has applied short term /low value lease exemption, the fact has to be disclosed.
- Lease commitments of short term lease if the portfolio of short term lease is different from the portfolio to which practical expedient is applied.
- If ROU asset meets the criteria of Ind AS 40, disclosures required by Ind AS 40
- If revaluation model is applied, disclosures required by Ind AS 16

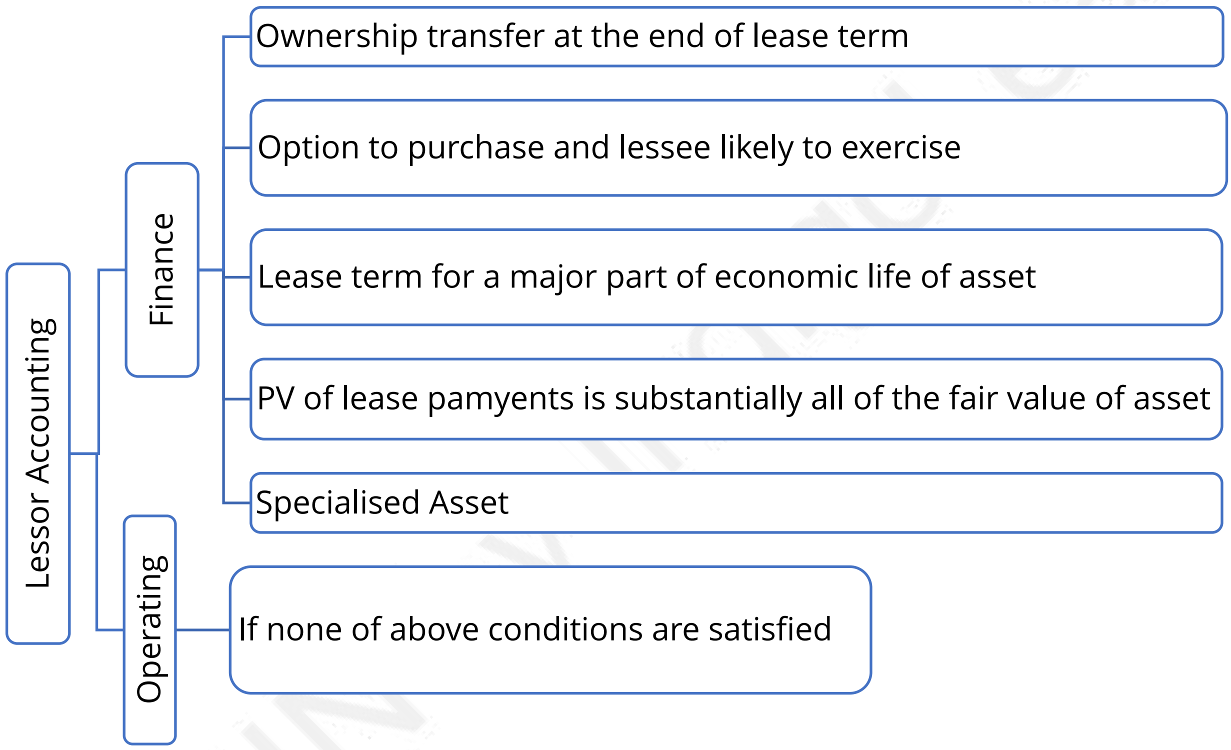
### 8.2 Qualitative disclosures

- A summary of the nature of the entity's leasing activities;

- Potential cash outflows the entity is exposed to that are not included in the measured lease liability, including:
    - Variable lease payments;
    - Extension options and termination options;
    - Residual value guarantees; and
    - Leases not yet commenced to which the lessee is committed.
- Restrictions or covenants imposed by leases; and
- Sale and leaseback transaction information.

## 9 Lessor Accounting – Lease Classification

Lease classification is done at inception and is not reassessed unless there is a lease modification.
A lease is classified as a finance lease if it ***transfers substantially all the risks and rewards*** incidental to ownership of an underlying asset.
A lease is classified as an operating lease if it ***does not transfer*** substantially all the risks and rewards incidental to ownership of an underlying asset.




### 9.1 Finance Lease Examples

- the lease **transfers ownership** of the underlying asset to the lessee by the end of the lease term;
- the lessee has the **option to purchase** the underlying asset at a **price** that is expected to be **sufficiently lower than the fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;
- the lease term is for the **major part of the economic life** of the underlying asset even if title is not transferred;
- at the inception date, the **present value of the lease payments** amounts to at least substantially all of the **fair value of the underlying asset**; and
- the underlying asset is of such a **specialised nature** that only the lessee can use it without major modifications.

If any one of the above criteria is met, the lease is classified as a finance lease.

**Additional Conditions which can lead to a finance lease**

- if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

- gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

*Basically, these conditions indicate that lessee takes, in substance, the ownership of the asset for the lease term.*

### 9.2 Classification for land and buildings

- The classification for land and buildings is done separately as land normally has an indefinite useful life.
- The lessor allocates lease payments between the land and the buildings elements in proportion to the relative fair values of the elements at the inception date.

### 9.3 Key Concepts for lessor accounting

*Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease.*

**Gross Investment in Lease = Lease Payments + UGRV**

| |
|---|
| ***Lease Payments =*** |
| *Fixed Lease payments* |
| *+ In substance fixed lease payments* |
| *- Lease incentives paid* |
| *+ Variable payments dependent on index or rate* |
| *+ Residual value guaranteed by lessee* |
| *+ Residual value guaranteed by third party unrelated to lessor (capable of fulfilling the obligation)* |
| *+ Exercise price of purchase option* |

**UGRV (Unguaranteed residual value)** is that portion of the residual value of the underlying asset, the realisation of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

### 9.4 Other Considerations

- Lease rentals based on a market rate for use of asset – Operating Lease
- Lease rentals based on a financing rate for use of funds – financing lease
- Put (option to sell) and call (Option to buy) options
  - Predetermined rate – Finance Lease
  - Market rate – Operating lease
- Lease of land and building – To be assessed separately.
- Lease classification is reassessed only in case of lease modification.

## 10 Lessor Accounting – Recognition

### 10.1 Finance Lease

At lease commencement a lessor accounts for a finance lease as follows

| | |
|---|---|
| **Dr. Lease Receivable** | *Recognises net investment in the lease* |
| **Cr. Asset** | *Derecognises the carrying amount of the underlying asset.* |
| **Profit / Loss (Bal figure)** | *Recognises selling profit or loss in P/L* |

### 10.1.1 Net investment in lease

Net Investment in Lease is the PV of Lease payments and UGRV discounted using the interest rate implicit in the lease (discount rate)

### 10.1.2 Interest Rate Implicit in the lease

The rate of interest which makes the following two equal

| PV of | Sum of |
|---|---|
| • Lease payments<br>• UGRV | • FV of asset<br>• IDC* of lessor |

*In case of manufacturer/dealer lessor, IDC is not considered to computed IRR. Since IDC is included in computation of IRR, the interest rate would be less and the finance income recognised would automatically be lesser.

*Students are not required to compute IRR in exams and this would be provided.*

### 10.1.3 Finance Lease – Subsequent Measurement

- Recognise finance income over the lease term (the pattern should reflect constant periodic return on the net investment in lease)
- Lease payment are applied to reduce the lease receivable and to recognise finance income.
- Derecognition and impairment requirements of Ind AS 109 are applied.
- If there is a reduction in estimated UGRV, the lessor shall revise the income allocation over the lease term.
- Variable lease payments that are not included in net investment in the lease are recognised in P&L.

## 10.2 Operating Lease – Initial & Subsequent

| *Recognise* | *Explanation* |
|---|---|
| **Cr. Income** | *Lease payments on SLM basis or any other systematic basis* |
| | *Variable lease payments* |
| **Dr. Depreciation** | *On asset as per applicable Ind AS* |
| **Dr. Asset** | *Initial direct cost and recognise the cost as expense in same manner as lease income.* |

# 11 Manufacturer – Dealer Lessor

### Finance Lease

| *Recognise* | *Explanation* |
|---|---|
| **Revenue** | *Lower of*<br>*- Fair value of underlying asset and*<br>*- PV of lease payments* |
| ***Cost of sale*** | *Cost / carrying amount less PV of UGRV* |
| **Selling Profit or loss** | *Difference between Revenue and Cost of Sale* |

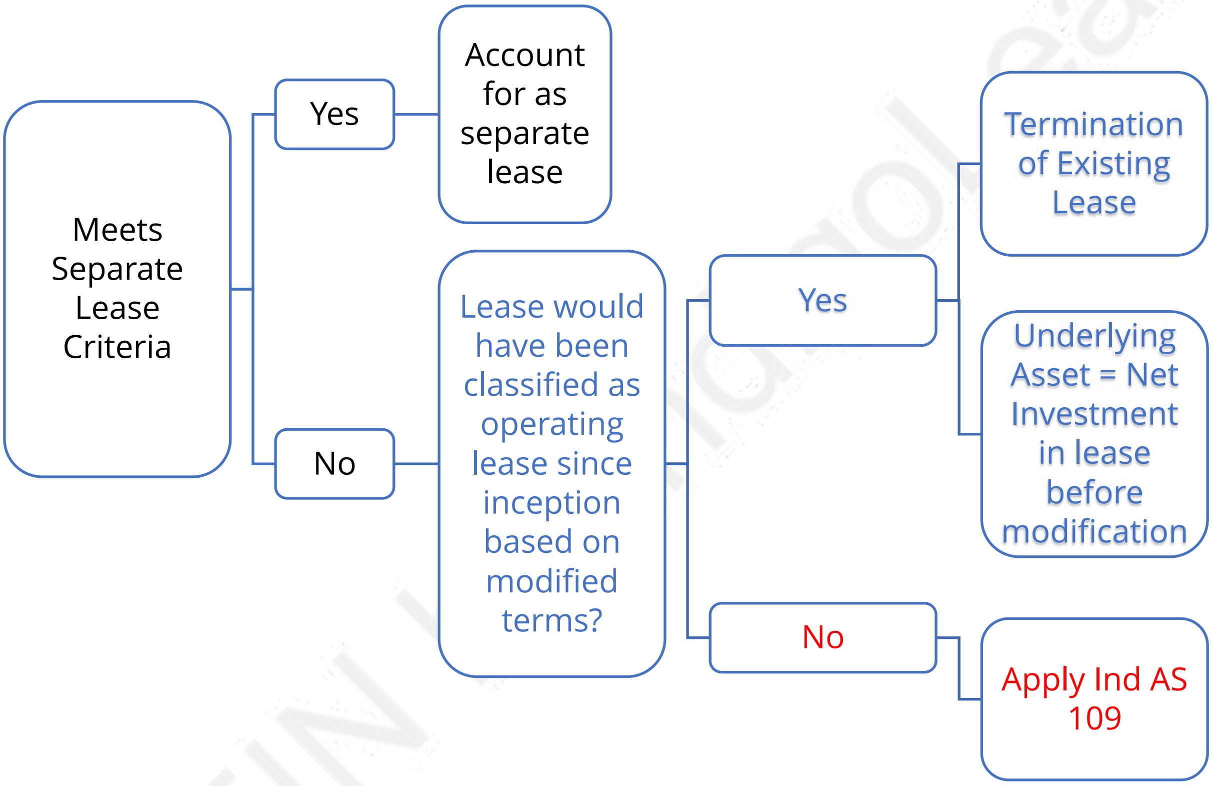
- Profit / Loss should represent profit/loss from an outright sale.
- If artificially low interest rates are quoted, Lessor recognises profit considering market rates of interest.
- Cost incurred by lessor are expensed at commencement and are not considered to be a part of Initial Direct Cost.

### Operating Lease

No Profit / Loss is recognised in case of an operating lease.

## 12 Lease Modification

### 12.1 Finance Lease Modification




### 12.2 Operating Lease Modification

- Accounted as a new lease
- Any prepaid or accrual of lease payments – treated as payment for new lease

## 13 Lessor – Presentation and Disclosure

### 13.1 Presentation

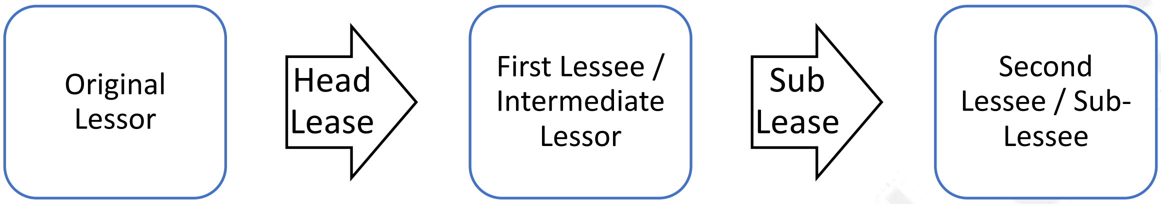
| Finance Lease | Operating Lease |
|---|---|
| Receivable<br>- Net Investment in Lease<br>- Classification as current and non-current | Follow principles given under Ind AS 16/38 |

### 13.2 Disclosures

| Finance Lease | Operating Lease |
|---|---|

| | |
|---|---|
| – Selling profit or loss;<br>– Finance income on the net investment;<br>– Income from variable lease payments;<br>– Qualitative and quantitative explanation of changes in the net investment; and<br>– Maturity analysis of lease payments receivable. | – Lease income, separately disclosing variable lease payments;<br>– Disclosure requirements of Ind AS 16 for leased assets, separating leased assets from non-leased assets;<br>– Other applicable disclosure requirements based on the nature of the underlying asset (eg. Ind AS 36, Ind AS 38, Ind AS 40 and Ind AS 41); and<br>– Maturity analysis of lease payments. |

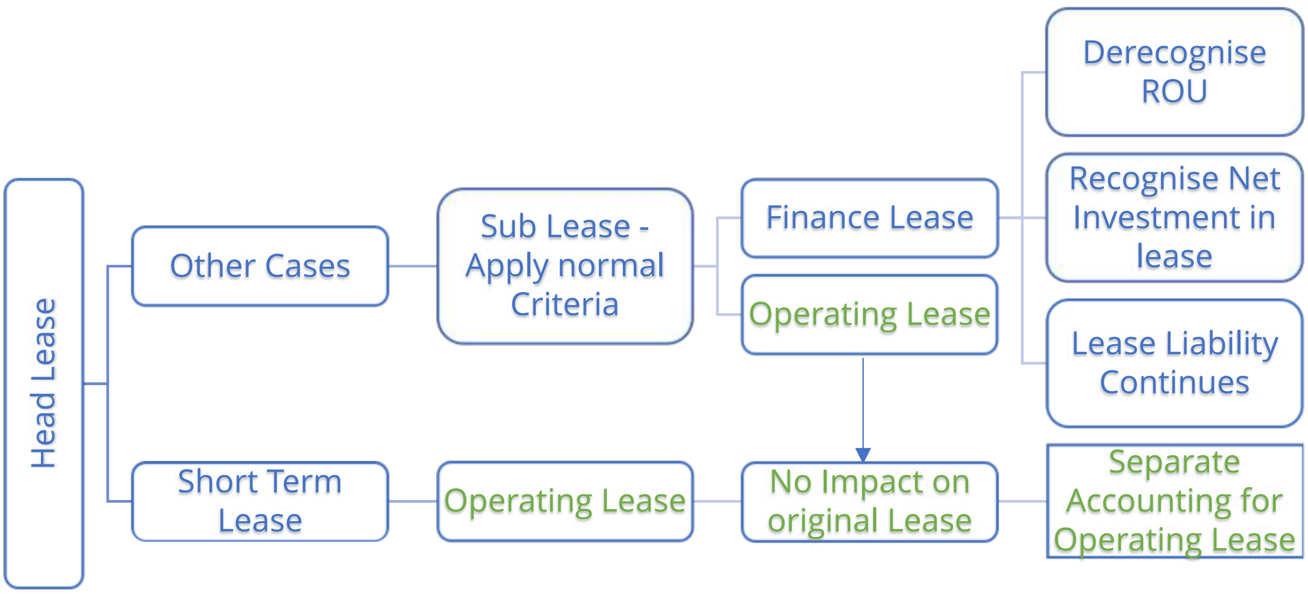
## 14 Sub-Leases




14.1 A 'Sub-lease' is defined as a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the original lease ('head lease') between the head lessor and lessee remains in effect.

### 14.2 Accounting for Sub-Lease

- Intermediate lessor uses interest rate implicit in lease. If the same cannot be determined, the interest rate in head lease can be used after adjusting for initial direct cost.
- Combination criteria to be checked.
- Exemption under low value lease cannot be applied.



## 15 Sale and Leaseback transactions

A sale and leaseback transaction involves the transfer of an asset by an entity (the seller-lessee) to another entity (the buyer-lessor) and the leaseback of the same asset by the seller-lessee.
The seller-lessee and buyer-lessor should apply principles under IndAS 115 to determine whether the transaction qualifies as a sale transaction – Test of transfer of control.

### 15.1 Fair Value Adjustments

Sale proceeds are adjusted if the transaction is not at fair value i.e,

- The value of consideration for sale of an asset does not equal to the fair value of asset or
- The payment for lease are not at market rates.

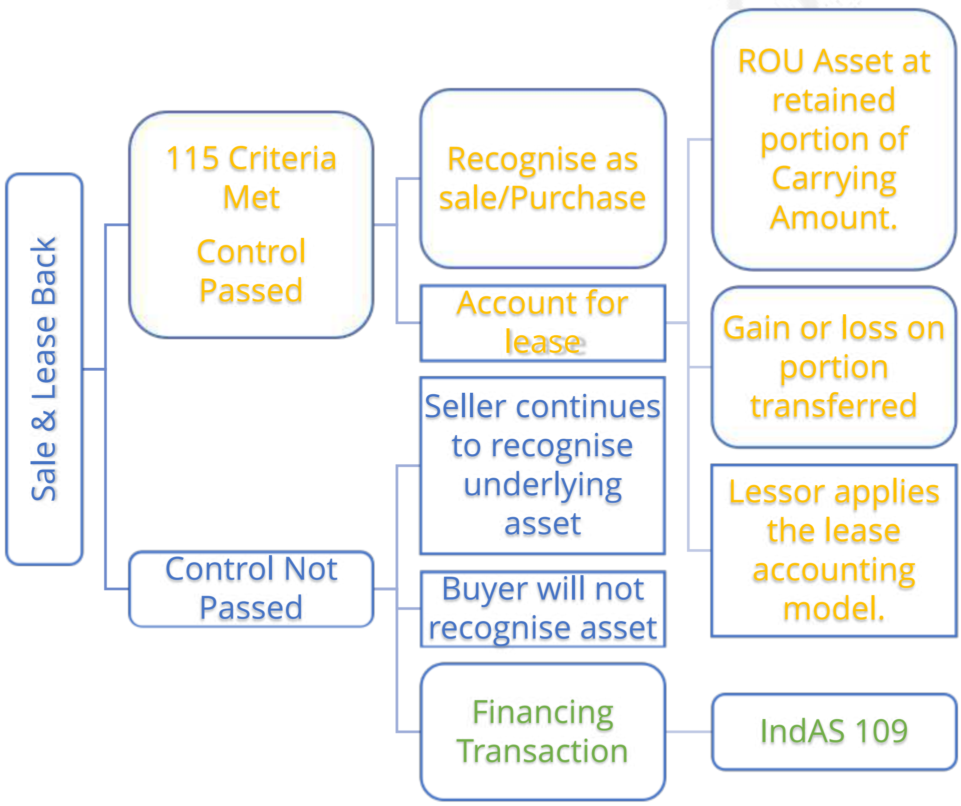
**How to adjust for fair value differences?**

Step 1 – Check which is more determinable

- Difference between sale consideration and Fair value of Asset
- Difference between PV of lease rentals and PV of market lease rentals

Step 2 – Treatment of difference

- Sale price is less or PV of lease rentals is less
  - Difference added to sale consideration and
  - Considered as prepayment for measurement of ROU asset
- Sale price is greater or PV of lease rentals is greater
  - Difference reduced from sale consideration and
  - Considered as additional financing received.




### 15.2 Disclosures

- Additional quantitative and qualitative disclosures.
- Gains and losses from sales and lease back separately
- Lessee's reason for sale and lease back transactions
- Key terms and conditions of sale and leaseback
- Payments not included in measurement of lease liability
- Cash flow effect of sale and lease back transactions.

## 16 Transition Approach

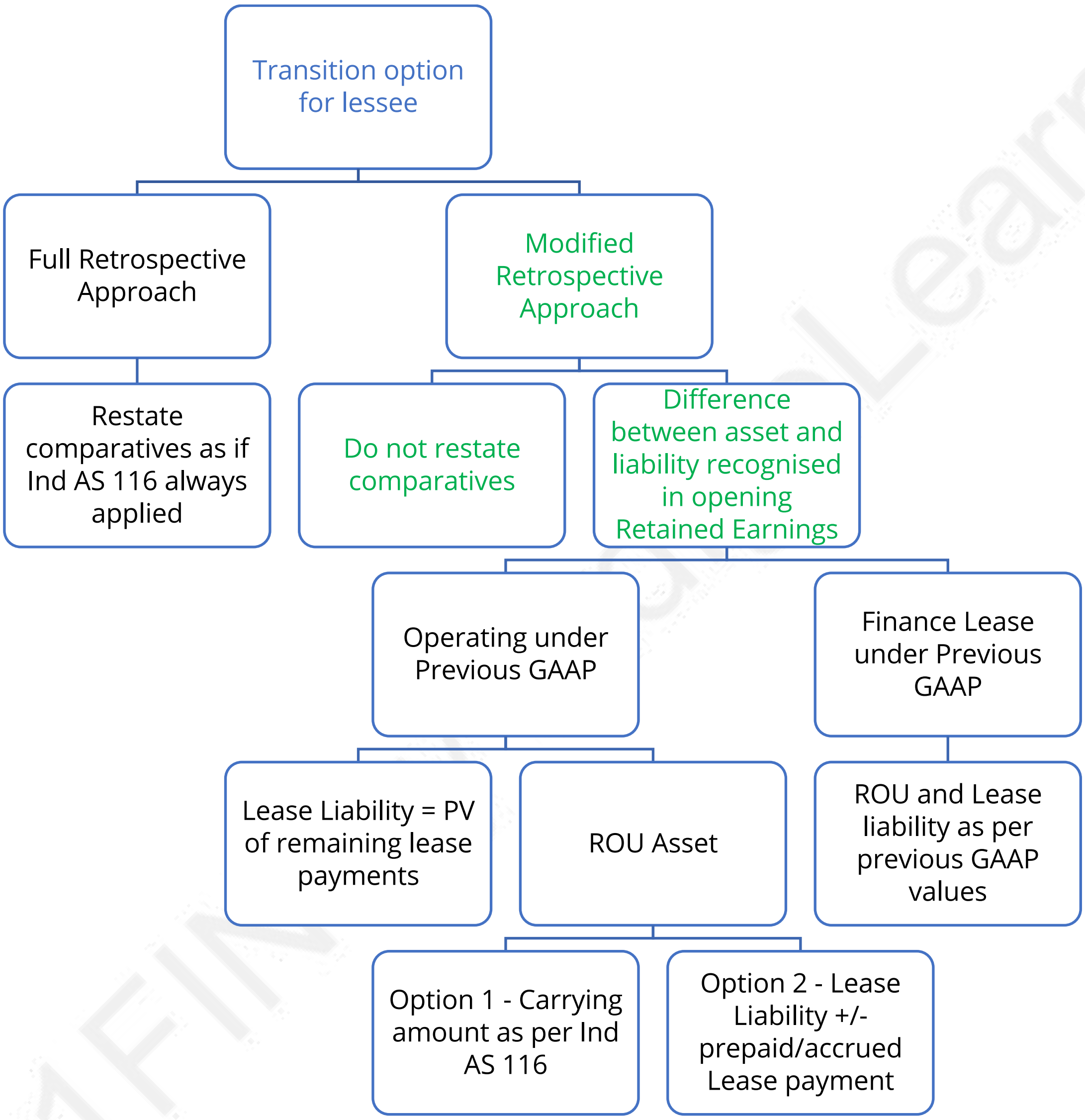
### 16.1 Definition

The Lessee can choose either of the following

- Apply the lease definition to all contracts (old and new)
- Apply the lease definition to only new contracts (Practical expedient)

A single choice has to be made for all contracts. Disclosures to be made as per Ind AS 8

### 16.2 Transition approach - Lessee




### 16.3 Transition approach - Lessor

A lessor is not required to make any adjustments on transition for leases except in case of intermediate lessor for sub leases.
In case of subleases which were classified as operating leases applying Ind AS 17 but finance leases applying Ind AS 116, the sublease will be accounted as a new finance lease on the date of initial application.
Gain or loss arising is included in cumulative catch-up adjustment to retained earnings.

### 16.4 Other points

- An entity shall not reassess sale and leaseback transactions entered into before the date of initial application to determine whether the transfer of the underlying asset satisfies the requirements under Ind AS 115.

## 17 Scope and Exclusions

Ind As 116 applies to all leases including leases of ROU assets in a sublease except for

| Exclusions | Covered by |
|---|---|
| **Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources** | Ind AS 106 |
| **Leases of biological assets held by lessee** | Ind AS 41 |
| **Service concession arrangements** | Appendix D of Ind AS 115 |
| **Licences of Intellectual Property** | Ind AS 115 |
| **Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights** | Ind AS 38 |

## 18 Recognition Exemptions

A lessee can elect not to apply Ind AS 116's recognition requirements to:

1. Short-term leases (Option to be taken by class of asset)
   A lease that has a lease term of 12 months or less and does not include an option to purchase the underlying asset.

2. Leases for which the underlying asset is of low-value (entity's judgement) [E.g – Mobile phone]

   Conditions for low-value exemption
   - Lessee can benefit from the use of underlying asset on its own or together with resources that are readily available to lessee
   - Underlying asset is not highly dependent on or highly interrelated with other assets.

   Head lease do not qualify as low value assets.

### 18.1 Accounting Treatment

The lease payments shall be recognised as an expense on either a Straight-line basis over the lease term or another systematic basis, if that basis is more representative of the pattern of the lessee's benefit.
If a lessee accounts for "short-term leases" as per the approach mentioned above, it shall consider the lease to be a "new lease" for the purposes of Ind AS 116 if:
(a) there is a lease modification; OR
(b) there is any change in the lease term

## Indian Accounting Standard 116 - LEASES ILLUSTRATIONS

## 1. Illustration

Customer XYZ enters a 10-year contract with Supplier ABC for the use of rolling stock specifically designed for Customer XYZ.

The rolling stock is designed to transport materials used in Customer XYZ's production process and is not suitable for use by other customers.

The rolling stock is not explicitly specified in the contract but, Supplier ABC owns only one rolling stock that is suitable for Customer XYZ's use.

If the rolling stock does not operate properly, the contract requires Supplier ABC to repair or replace the rolling stock.

Whether there is an identified asset?

## 2. Illustration

Customer XYZ enters a ten-year contract with Supplier ABC for the use of a car. The specification of the car is specified in the contract (i.e. brand, type, colour, options, etc.)

At inception of the contract, the car is not yet built.

Whether there is an identified asset?

## 3. Illustration

An electronic data storage provider (supplier) provides services through a centralised data centre that involve the use of a specified server (Server No. 10). The supplier maintains many identical servers in a single accessible location and determines, at inception of the contract, that it is permitted to and can easily substitute another server without the customer's consent throughout the period of use.

Further, the supplier would benefit economically from substituting an alternative asset, because doing this would allow the supplier to optimise the performance of its network at only a nominal cost.

In addition, the supplier has made clear that it has negotiated this right of substitution as an important right in the arrangement, and the substitution right affected the pricing of the arrangement.

Whether the substitution rights are substantive and whether there is an identified asset?

## 4. Illustration

Assume the same facts as in earlier Scenario except that Server No. 10 is customised, and the supplier does not have the practical ability to substitute the customised asset throughout the period of use.

Additionally, it is unclear whether the supplier would benefit economically from sourcing a similar alternative asset.

Whether the substitution rights are substantive and whether there is an identified asset?

## 5. Illustration

Customer XYZ enters into a 15-year contract with Supplier ABC for the right to use five fibres within a fibre optic cable between Mumbai and Pune.

The contract identifies five of the cable's 25 fibres for use by Customer XYZ.

The five fibres are dedicated solely to Customer XYZ's data for the duration of the contract term. Assume that Supplier ABC does not have a substantive substitution right.

Whether there is an identified asset?

## 6. Illustration

Customer XYZ enters into a ten-year contract with Supplier ABC for the right to transport oil from India to Bangladesh through Supplier ABC's pipeline.

The contract provides that Customer XYZ will have the right to use of 95% of the pipeline's capacity throughout the term of the arrangement.

Whether there is an identified asset?

## 7. Illustration

Entity X, a garment manufacturer enters into an arrangement with a warehouse facility Y for the right to store the ready garments in a specified storage warehouse.

The warehouse has twenty rooms serially numbered and the rooms one to eleven are contractually allocated to Entity X with exclusive right to use.

Y does not have substitution rights. The storage space which is allocated to Entity X represents the 55% of the total storage capacity of Y.

Whether the storage space (capacity portion) used by Entity X meets the criterion of an identified asset?

## 8. Illustration

Entity X (PNG provider) enters into an arrangement for 15 years with Entity Y for using 60 % of the capacity of a gas pipeline.

The quantity of gas which is to be sent in the pipeline is decided by Entity X. Entity Y makes all decisions regarding operation and maintenance of the pipeline.

Entity X pays a fixed capacity charge per month and a variable amount which depends on the quantity of gas transported.

Entity Y may allow third parties to use the remaining unused 40 % capacity only if Entity X refuses to utilise the same, i.e., Entity X has the right of first refusal.

Whether the pipeline meets the criterion of an identified asset?

## 9. Illustration

Entity Y owns a large shopping centre. Customer X enters into a contract to lease a specified retail space for five years.

Under the contract, Entity Y can require X to relocate to another retail space within the shopping centre.

Entity Y would need to pay for costs of relocation and provide X with another space of similar attributes.

Entity Y would only benefit economically from relocating X if a major new tenant were to move in, taking up a large amount of space at a sufficiently higher rate than the existing tenants.

Although it is possible that those circumstances may arise, at inception of the contract, it is not likely that those circumstances will arise.

Whether Entity Y has substantive substitution rights?

## 10. Illustration

Company MNO enters into a 15-year contract with Power Company PQR to purchase all of the electricity produced by a new solar farm.

PQR owns the solar farm and will receive tax credits relating to the construction and ownership of the solar farm, and MNO will receive renewable energy credits that accrue from use of the solar farm.

Who has the right to substantial benefits from the solar farm?

## 11. Illustration

Entity A contracts with Supplier H to manufacture parts in a facility.

Entity A designed the facility and provided its specifications. Supplier H owns the facility and the land.

Entity A specifies how many parts it needs and when it needs the parts to be available.

Supplier H operates the machinery and makes all operating decisions including how and when the parts are to be produced, as long as it meets the contractual requirements to deliver the specified number on the specified date.

Assuming supplier H cannot substitute the facility and hence is an identified asset.

Which party has the right to control the use of the identified asset (i.e., equipment) during the period of use?

## 12. Illustration

Entity X (customer) enters into a contract for six years with Entity Y (supplier). As per contract, Entity Y is required to install an air-conditioning plant in its office premises.

Air-conditioning plant is designed as per the specifications provided by Entity X.

To optimize the efficiency of the air conditioning plant, Entity Y provides operation and maintenance services on regular basis and as and when required throughout the contract period.

However, Entity X decides and directs the hours of operation and the floors of the building on which and at what time the cooling is required and the temperature to be maintained by the air conditioning plant.

Whether Entity X has right to direct the use of the air conditioning plant?

## 13. Illustration

Entity X, a utility company (customer) enters into a contract for twenty years with Entity Y, a power company (supplier) to install, operate and maintain a solar power station to fulfil the power requirements of Entity X. The team of professionals engaged by Entity X determined the location of the power station and the specifications of the power station. The power station is to be constructed as per the design and other specifications provided by Entity X.

Entity X has the exclusive right to receive and the obligation to take any energy produced.

Whether Entity X has right to direct the use of the solar power station?

## 14. Illustration

Entity X takes on lease a crossover which is explicitly specified in the contract, for a period of two years. As per the contract, Entity X can drive it only up to a maximum of 1,50,000 kilometres during the period of two years.

Considering the cap on the number of kilometres that the crossover can be driven by it, whether Entity X obtains substantially all of the economic benefits from use of the crossover?

## 15. Illustration

Entity ABC enters into a lease for equipment that includes a non-cancellable term of six years and a two-year fixed-priced renewal option with future lease payments that are intended to approximate market rates at lease inception.

There are no termination penalties or other factors indicating that Entity ABC is reasonably certain to exercise the renewal option. What is the lease term?

## 16. Illustration

Entity XYZ enters into a lease for a building that includes a non-cancellable term of eight years and a two-year, market-priced renewal option.

Before it takes possession of the building, Entity XYZ pays for leasehold improvements.

The leasehold improvements are expected to have significant value at the end of eight years, and that value can only be realised through continued occupancy of the leased property.

What is the lease term?

## 17. Illustration

Entity PQR enters into a lease for an identified retail space in a shopping centre.
The retail space will be available to Entity PQR for only the months of October, November and December during a non-cancellable term of seven years.
The lessor agrees to provide the same retail space for each of the seven years. What is the lease term?

## 18. Illustration

Retailer M enters into a five-year lease for a building floor, followed by two successive five-year renewal options.

On the commencement date, Retailer M is not reasonably certain to exercise the extension option.

At the end of third year, Retailer M extended to include another floor from year 4 due to a business acquisition.

For this purpose, the lessee concludes a separate seven-year lease for an additional floor in the building already leased.

Is Retailer M required to reassess the lease term in this case?

## 19. Illustration

Company N has taken 10 vehicles on lease for an initial period of 5 years with an extension option at the option of the lessee for a further period of 5 years at the same rental amount.

The remaining useful life of the vehicles as on the commencement date of the lease is 15 years. Company N has determined at the commencement date that it is reasonably certain to exercise the extension option and hence it has taken a period of 10 years for the lease.

At the end of 4th year, there is an announcement by the government that all the cars of this particular model have to be discontinued from the road within 1 year due to the change in the pollution norms in the country. Will the lease term be reassessed in this case?

## 20. Illustration

Given,

- Fair Value of the car, currently – Rs.40 lakhs
- Instalment payments at the end of each year for the first three years – Rs.10 lakhs
- Incentive for extension – Rs.1 lakh
- Instalment Payments for year 4 and 5 – Rs.5 lakhs
- Amount payable for usage – Rs.5 per km driven and minimum per year – Rs.1 lakh
- Option exercisable at end of $5^{th}$ year – Purchase car at Rs.5 lakh
- Useful life of the car – 10 years

Compute the lease liability using implicit rate of return.

## 21. Illustration

Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.

– If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month.

What is considered as lease payment in this case?

## 22. Illustration

Entity P enters into a five-year lease for office space with Entity Q.

The initial base rent is Rs.1 lakh per month.

Rents increase by the greater of 1% of Entity P's generated sales or 2% of the previous rental rate on each anniversary of the lease commencement date. What are the lease payments for purposes of measuring lease liability?

## 23. Illustration

Company N leases a production line.

The lease payments depend on the number of operating hours of the production line – i.e., N has to pay Rs.1,000 per hour of use.

The annual minimum payment is Rs.10,00,000.

The expected usage per year is 1,500 hours

## 24. Illustration

An entity enters into a 10-year lease of property. The lease payment is to be done at the beginning of each year. The lease payment for the first year is Rs. 1,000.

The lease payments are linked to the consumer price index (CPI), i.e., not a floating interest rate. The CPI at the beginning of the first year is 100.

Lease payments are updated at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108.

You are required compute the lease liability at the commencement of the lease and at the lease payment is adjusted assuming a discount rate of 8%.

## 25. Illustration

Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is Rs.100,000.

Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

## 26. Illustration

Entity XYZ is a medical equipment manufacturer and a supplier of the related consumables. Customer ABC operates a medical centre. Under the agreement entered into by both parties, Entity XYZ grants Customer ABC the right to use a medical laboratory machine at no cost and Customer ABC purchases consumables for use in the equipment from Entity XYZ at Rs. 100 each.

The consumables can only be used for that equipment and Customer ABC cannot use other consumables as substitutes. There is no minimum purchase amount required in the contract.

Based on its historical experience, Customer ABC estimates that it is highly likely to purchase at least 8,000 units of consumables annually. Customer ABC has appropriately assessed that the arrangement contains a lease of medical equipment. There are no residual value guarantees or other forms of consideration included in the contract. Whether these payments affect the calculation of lease liability and ROU Asset? How does Entity XYZ and Customer ABC would allocate these lease payments?

## 27. Illustration

An entity (a lessee) enters into a lease and guarantees that the lessor will realise Rs. 20,000 from selling the asset to another party at the end of the lease.

At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe Rs.8,000 at the end of the lease.

Whether the lessee should include the said payment of Rs.8,000 as a lease payment?

## 28. Illustration

Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on 1 January, 20X1:

- The lease commencement date is 1 February 20X1.
- Entity Y must pay Entity Z the first monthly rental payment of Rs. 10,000 upon execution of the lease.
- Entity Z will pay Entity Y Rs. 50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred Rs. 1,000 of initial direct costs, which are payable on 1 February 20X1. Entity Y calculated the initial lease liability as the present value of the lease payments discounted using its incremental borrowing rate because the rate implicit in the lease could not be readily determined; the initial lease liability is Rs. 8,50,000.

How would Lessee Company measure and record this lease?

## 29. Illustration

Company H leases an aircraft for a period of 5 years. The aircraft must undergo a planned check after every 100,000 flight hours. At the end of the lease, company H must have a check performed (or refund the costs to the lessor), irrespective of the actual number of flight hours.

What are the lease payments for purposes of calculating ROU asset?

## 30. Illustration

Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:

Rs. 20,000 in year one

Rs. 30,000 in year two

Rs. 50,000 in year three.

For simplicity purposes, there are no other elements to the lease payments (like purchase options, lease incentives from the lessor or initial direct costs). Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term.

How would Entity ABC would account for the said lease under Ind AS 116?

## 31. Illustration

Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5-year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs. 50 Lacs.

Company EFG has an option to purchase the property at the end of the lease term for Rs. 30 lacs. The first advance annual payment is Rs. 5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives Company EFG an incentive of Rs. 2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement.

Company EFG is reasonably certain to exercise that purchase option. How would EFG measure the right-of-use asset and lease liability over the lease term?

## 32. Illustration

Given,

- Lease Term – 10.00 years
- Annual Lease Payment (beginning) Rs.2,00,000
- First lease payment before commencement of lease:
  - Initial direct cost (Lessee) Rs.20,000
  - Reimbursement of IDC by Lessor Rs.5,000
- Implicit rate of return in lease is not readily determinable
  - Incremental borrowing rate @ 6%

Show accounting in books of lessee at commencement of lease

## 33. Illustration

Entity W entered into a contract for lease of retail store with Entity J on January 01/01/20X1. The initial term of the lease is 5 years with a renewal option of further 3 years.

The annual payments for initial term and renewal term is Rs. 100,000 and Rs. 110,000 respectively. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 01/01/20X2 will be based on the CPI available at 31/12/20X1.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/20X4 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/20X4 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. In the first quarter of 20X4, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life.

Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease in the first quarter of 20X4?

## 34. Illustration

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs. 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined.

Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., Rs. 1,00,000 payable at the end of each year from Year 7 to Year 14).

Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a.

How should the said modification be accounted for?

## 35. Illustration

Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are Rs. 50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are Rs. 30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a.

How should the said modification be accounted for?

## 36. Illustration

Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from Rs. 1,00,000 per year to Rs. 95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a. The annual lease payments are payable at the end of each year.

How should the said modification be accounted for?

## 37. Illustration

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are Rs. 1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a.

At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to:

(a) include an additional 1,500 sq. mtr of space in the same building starting from the beginning of Year 6 and

(b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is Rs. 1,50,000 payable at the end of each year (from Year 6 to Year 8).

Lessee's incremental borrowing rate at the beginning of Year 6 is 7% p.a.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

How should the said modification be accounted for?

## 38. Illustration

Calculate of Lease liability and ROU Asset at commencement when,

- Lease Term is 2 years
- Date of commencement is 1st April 2019
- Lease payment at end of every quarter is Rs.1,00,000
- Discount factor per annum is 8%

## 39. Illustration

Computation for low value assets

- Lease Term – 3 years
- Lease payment each year
    - Year 1 – Rs.2,000
    - Year 2 – Rs.2,500
    - Year 3 – Rs.2,100

## 40. Illustration

Entity X (lessee) manufactures phone handsets. X enters into a 10-year lease contract with Entity Y (lessor) of a non-specialised machine to be used in manufacturing parts for phone A1. It expects this model of phone to remain popular with customers until it completes development and testing of an upgrade model – phone A2, which is expected to be launched in near future, i.e., within one year. The current machine can be easily replaced and the cost to install it in X's manufacturing facility is not significant. X and Y each have the right to terminate the lease without a penalty on each anniversary of the lease commencement date. The lease agreement does not provide any purchase option in respect of the leased asset to Entity X.

Whether the recognition exemption for 'short term leases' as per paragraph 5 of the Ind AS 116 is available to Entity X?

Would the answer be different, if the development and testing of the upgraded model is expected to be completed in three years rather than one year?

## 41. Illustration

Entity L rents an office building from Landlord M for a term of 10 years. The rental contract stipulates that the office is fully furnished and has a newly installed and tailored HVAC system. It also requires Landlord M to perform all common area maintenance (CAM) during the term of the arrangement. Entity L makes single monthly rental payment and does not pay for the maintenance separately. The office building has a useful life of 40 years and the HVAC system and office furniture each has a life of 15 years.

What are the units of account in the lease?

## 42. Illustration

**Scenario A:**

A lessee enters into a five-year lease of equipment, with fixed annual payments of Rs. 10,000. The contract contains fixed annual payments as follows: Rs. 8,000 for rent, Rs. 1,500 for maintenance and Rs. 500 of administrative tasks. How the consideration would be allocated?

**Scenario B:**

Assume the fact pattern as in scenario A except that, in addition, the contract requires the lessee to pay for the restoration of the equipment to its original condition. How the consideration would be allocated?

## 43. Illustration

A lessee enters into a lease of an equipment. The contract stipulates the lessor will perform maintenance of the leased equipment and receive consideration for that maintenance service. The contract includes the following fixed prices for the lease and non-lease component:

| | |
|---|---|
| Lease | Rs. 80,000 |
| Maintenance | Rs. 10,000 |
| **Total** | **Rs. 90,000** |

Assume the stand-alone prices cannot be readily observed, so the lessee makes estimates, maximising the use of observable information, of the lease and non-lease components, as follows:

| | |
|---|---|
| Lease | Rs. 85,000 |
| Maintenance | Rs. 15,000 |
| Total | Rs. 1,00,000 |

In the given scenario, assuming lessee has not opted the practical expedient, how will the lessee allocate the consideration to lease and non-lease component?

## 44. Illustration

A Lessee enters into a ten-year lease contract with a Lessor to use an equipment. The contract includes maintenance services (as provided by lessor). The Lessor obtains its own insurance for the equipment. Annual payments are Rs. 10,000 (Rs. 1,000 relate to maintenance services and Rs. 500 to insurance costs).

The Lessee is able to determine that similar maintenance services and insurance costs are offered by third parties for Rs. 2,000 and Rs. 500 a year, respectively. The Lessee is unable to find an observable stand-alone rental amount for a similar equipment because none is leased without related maintenance services provided by the lessor.

How would the Lessee allocate the consideration to the lease component?

## 45. Illustration

Entity X (lessee) entered into a lease agreement ('lease agreement') with Entity Y (lessor) to lease an entire floor of a shopping mall for a period of 9 years. The annual lease rent of Rs. 70,000 is payable at year end.

Entity X simultaneously entered into another agreement ('facilities agreement') with Entity Y for using certain other facilities owned by Entity Y such as passenger lifts, DG sets, power supply infrastructure, parking space etc., which are specifically mentioned in the agreement, for annual service charges amounting to Rs. 1,00,000. As per the agreement, the ownership of the facilities shall remain with Entity Y. Lessee's incremental borrowing rate is 10%.

The facilities agreement clearly specifies that it shall be co-existent and coterminous with 'lease agreement'. The facility agreement shall stand terminated automatically on termination or expiry of 'lease agreement'.

Entity X has assessed that the stand-alone price of 'lease agreement' is Rs. 1,20,000 per year and stand-alone price of the 'facilities agreement' is Rs. 80,000 per year. Entity X has not elected to apply the practical expedient to separate non-lease component(s) from lease component(s)

How will Entity X account for lease liability as at the commencement date?

## 46. Illustration

Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = Rs. 68. The average rate for Year 1 was Rs. 69 and at the end of year 1, the exchange rate was Rs. 70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1?

## 47. Illustration

A Dealer-Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- Lessor receives annual lease payments of Rs 15,000, payable at the end of the year. Lessor expects the residual value of the equipment to be Rs 50,000 at the end of the 10-year lease term.
- Lessee provides a residual value guarantee that protects Lessor from the first Rs 30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., Rs 50,000).
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of Rs.1,00,000 and a fair value of Rs 1,11,000.

- The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset.
- The interest rate implicit in the lease is 10.078%.

How should the Lessor account for the same in its books of accounts?

### 48. Illustration

Following details regarding a lease are given

- Commencement: Year 1
- Lease Term: 5 years
- Lease payments: Fixed Rs.2,00,000
- Residual value: Rs.2,50,000
- Guaranteed by lessee: Rs.2,00,000
- Unguaranteed RV Rs.50,000
- Fair value of the asset: Rs.10,00,000
- Useful life of the car: 6 years

It is unlikely that the Rs.50,000 of unguaranteed RV will be available at the end of year 2. Compute the loss due to the revised residual value.

### 49. Illustration

Lessor L enters into an eight-year lease of 40 lorries with Lessee M that commences on 1 January 2018. The lease term approximates the lorries' economic life and no other features indicate that the lease transfer or does not transfer substantially all of the risks and rewards incidental to ownership of the lorries. Assuming that substantially all of the risks and rewards incidental to ownership of the lorries are transferred, L classifies the lease as a finance lease.
During the COVID-19 pandemic, M's business has contracted. In June 2020, L and M amend the contract so that it now terminates on 31 December 2020.
Early termination was not part of the original terms and conditions of the lease and this is therefore a lease modification.
How this will be accounted for by lessor?

### 50. Illustration

Entity X (lessee) entered into a contract with Entity Y (lessor) to lease an office equipment for a period of 5 years.
The following is the information about the lease and the leased assets at lease inception.

| | |
|---|---|
| Lease term | 5 years (no renewal option held by either party) |
| Purchase option | None |
| Annual lease payments | INR 1,95,000 |
| Payment date | Annually on April 1 |
| Fair value of the leased equipment | INR 12,00,000 |
| Entity Y's carrying amount of the leased equipment | INR 12,00,000 |
| Estimated RV | INR 4,00,000 |
| GRV | INR 3,00,000 |
| Implicit rate in the lease | 5% |
| Economic life of the leased equipment | 10 years |

Other Title to the asset remains with Entity Y.

At the end of year 1 of the lease, Entity X and Entity Y agree to modify the lease to shorten the lease term by two years.
The relevant information at the modification is given below

| | |
|---|---|
| Modification date | Beginning of year 2 |

| | |
|---|---|
| Remaining modified lease term | 2 years |
| Remaining economic life of the leased equipment | 7 years |
| Purchase option | None |
| Annual lease payments | INR 1,90,000 |
| Payment date | Annually on April 1 |
| Fair value of the leased equipment | INR 10,00,000 |
| Estimated residual value at the end of next 2 years | INR 7,00,000 |
| Residual value guarantee at the end of next 2 years | INR 3,50,000 |
| Interest Rate implicit lease | 5.43% |

## 51. Illustration

Lessor L leases retail space to Lessee Z and classifies the lease as an operating lease. The lease includes fixed lease payments of Rs. 10,000 per month.

Due to the COVID-19 pandemic, L and Z agree on a rent concession that allows Z to pay no rent in the period from July, 2020 to September 2020 but to pay rent of 20,000 per month in the period from January 2021 to March 2021. There are no other changes to the lease.

How this will be accounted for by lessor?

## 52. Illustration

Lessor M enters into a 10-year lease of office space with Lessee K, which commences on 1 April 2015. The rental payments are 15,000 per month, payable in arrears. M classifies the lease as an operating lease. M reimburses K's relocation costs of K of 600,000, which M accounts for as a lease incentive. The lease incentive is recognised as a reduction in rental income over the lease term using the same basis as for the lease income – in this case, on a straight- line basis over 10 years.

On 1 April 2020, during the COVID-19 pandemic, M agrees to waive K's rental payments for May, June and July 2020.

This decrease in consideration is not included in the original terms and conditions of the lease and is therefore a lease modification.

How this will be accounted for by lessor?

## 53. Illustration

Entity X (lessee) enters into an arrangement with Entity Y to lease 10,000 square feet of office space for a period of 10 years. The annual lease payments are INR 1,00,000 in the first year, increased by 5 percent each year thereafter, payable in arrears. The economic life of office space if 40 years.

The present value of office space is not substantially all of the fair value of the office space. Furthermore, the title does not transfer to Entity X as a consequence of the lease and the lease does not contain an option for Entity X to purchase the office space.

At the beginning of Year 6, Entity X and Entity Y agree to amend the original lease for the remaining 5 years to include an additional 10,000 square feet of office space in the same building for an additional annual fixed payment of INR 1,50,000.

How would Entity Y account for the modification in the lease contract?

## 54. Illustration

An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of Rs. 30,00,000. Immediately before the transaction, the building is carried at a cost of Rs. 15,00,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with annual payments of Rs. 2,00,000 payable at the end of each year.

The terms and conditions of the transaction are such that the transfer of the building by Seller- lessee satisfies the requirements for determining when a performance obligation is satisfied in Ind AS 115 'Revenue from Contracts with Customers'.

The fair value of the building at the date of sale is Rs. 27,00,000. Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee.

Buyer-lessor classifies the lease of the building as an operating lease.

How should the said transaction be accounted by the Seller-lessee and the Buyer-lessor?

## 55. Illustration

A retailer (lessee) entered into 3-year lease of retail space beginning at 1 April 2017 with three annual lease payments of Rs. 2,00,000 due on 31 March 2018, 2019, and 2020, respectively. The lease is classified as an operating lease under Ind AS 17. The retailer initially applies Ind AS 116 for the first time in the annual period beginning at 1 April 2019. The incremental borrowing rate at the date of the initial application (i.e., 1 April 2019) is 10% p.a. and at the commencement of the lease (i.e., 1 April 2017) was 12% p.a. The ROU asset is subject to straight-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the lessee to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee using all the following transition approaches:

a. Full Retrospective Approach
b. Modified Retrospective Approach

# 1 Objective

The objective of Ind AS 37 is to ensure that

appropriate ***recognition*** criteria and ***measurement*** bases are applied to

-provisions,

-contingent liabilities and

-contingent assets and

***sufficient information*** is disclosed in the notes to enable users to understand their

-nature,

-timing and

-amount.

# 2 Scope

Ind AS 37 should be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:

1) for **executory contracts**, except where the contract is onerous; and
2) **financial instruments** that are within the scope of Ind AS 109, Financial Instruments;
3) those covered by another Standard such as:

| Exclusion | Covered by |
|---|---|
| Revenue from contracts with customers | Ind AS 115<br>(Onerous contracts covered under Ind AS 37) |
| Income Taxes | Ind AS 12 |
| Leases | Ind AS 116<br>(Onerous contracts covered under Ind AS 37) |
| Employee Benefits | Ind AS 19 |
| Insurance Contracts | Ind AS 104 |
| Contingent consideration in a business combination | Ind AS 103 |

# 3 Important Terms

## 3.1 Executory Contract

- Executory contracts are contracts under which
  - neither party has performed any of its obligations or
  - both parties have partially performed their obligations to an equal extent

Ind AS 37 is applied to executory contracts only if they are onerous.

## 3.2 Onerous Contract

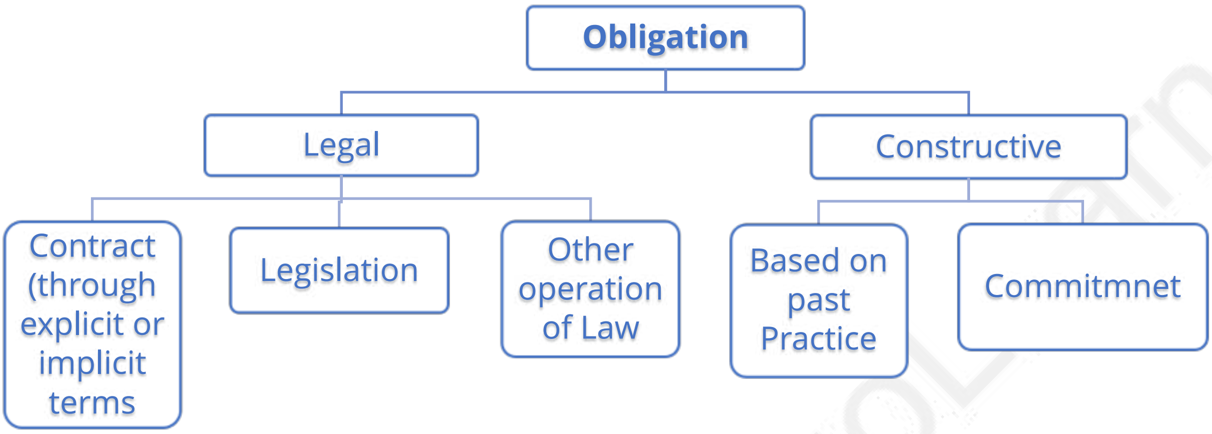
- is a contract in which the unavoidable costs of meeting the obligation
- exceed the economic benefits expected to be received under the contract

### 3.3 Liability

- is a present obligation of the entity
- arising from past events,
- the settlement of which is expected to result
- in an outflow from the entity of resources embodying economic benefits.

### 3.4 Obligating Event

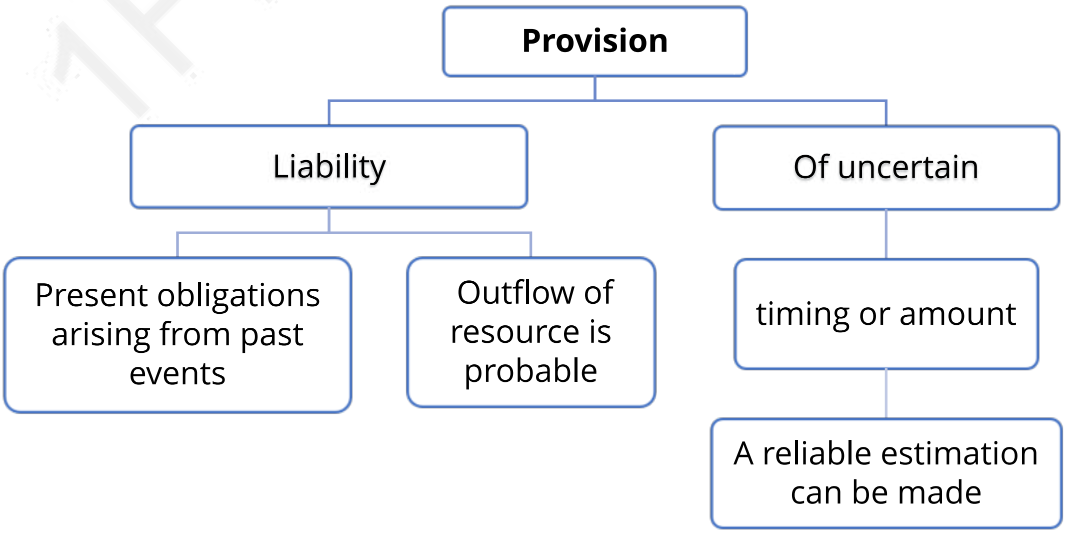
- is an event that creates a legal or constructive obligation
- that results in an entity having no realistic alternative to settling that obligation.




**Example:** X Ltd. is engaged in the manufacture of fertilisers. Effluents discharged in the manufacturing process have polluted the river near the manufacturing plant. The residents of the nearby locality launched a massive agitation against the pollution as a result X Ltd. agreed to their demands to reduce the water pollution by installing the necessary Effluent Treatment Plant.
However, during the year no steps are taken to install the plant. No legislation requiring the company to reduce its pollution is in existence.
In this case, though there is no law but by promising to take steps to reduce pollution, X Ltd. has created a valid expectation on the part of public that it will discharge its responsibilities. So, the obligation in this case is a **constructive obligation.**

## 4 Provisions

A *provision* is a liability of uncertain ***timing*** or ***amount.***



## 4.1 Recognition of Provision

provision should be recognised when all the conditions are satisfied

*a)* an entity has a *present obligation* (legal or constructive) as a result of a *past event;*
b) it is *probable that an outflow of resources embodying economic benefits* will be required to settle the obligation; and
c) a *reliable estimate* can be made of the amount of the obligation.

Present obligation + as a result of a *past event* + outflow of resources is probable + Reliable estimate can be made = Recognise a Provision

### 4.1.1 Past Event and Present Obligation

- A ***past event*** that leads to a ***present obligation*** is called an ***obligating event***.
- ***Obligating event***, is the event where the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

a) where the settlement of the obligation can be enforced by law; or
b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

Past Event

- leading to **present obligation** → recognise **provision** (if recognition criteria are met);
- Where it is **not clear** whether there is a **present obligation**, → **past event** shall be evaluated based on the available **evidence**
  - where it is **probable** that a **present obligation** exists at the end of the reporting period, → recognise **provision** (if recognition criteria are met);
  - where it is more likely that **no present obligation** exists at the end of the reporting period → disclose a **contingent liability** (if outflow of resources is not remote)
- not leading to **present obligation** → don't recognise **provision**

➔ ***No provision is recognised for costs that need to be incurred by an entity to operate in the future.***

➔ ***Only those obligations arising from past events existing independently of an entity's future actions (i.e., the future conduct of its business) that should be recognised as provisions***

**Example 1:** Refurbishment costs

**Case(i):** No legislative requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected.

*Present obligation as a result of a past obligating event* – No present obligation

*Conclusion* – No provision is recognised.

***Note:*** The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists **(even if the company has plans to replace the linings)**

**Case(ii):** legislative requirement

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected.

*Present obligation as a result of a past obligating event* – There is no present obligation.

*Conclusion* – No provision is recognised.

**Note:** The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in Case(i) on refurbishment costs. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft - the entity could avoid the future expenditure by its future actions, for example by selling the aircraft.

➔ ***The entity can avoid the future expenditure by its future actions. In such a case, it has no present obligation for that future expenditure and no provision is recognised.***

**Example 2:** Legal requirement to fit smoke filters

Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 20X1. The entity has not fitted the smoke filters. It is assumed that a reliable estimate can be made of any outflows expected.

**(a) At March 31, 20X1, the end of the reporting period**

*Present obligation as a result of a past obligating event* – There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

*Conclusion* – No provision is recognised for the cost of fitting the smoke filters.

**(b) At March 31, 20X2, the end of the reporting period**

*Present obligation as a result of a past obligating event* – There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

*An outflow of resources embodying economic benefits in settlement* – Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

*Conclusion* – No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

### 4.1.2 Probable Outflow of Resources Embodying Economic Benefits

- For a liability to qualify for recognition
  - there must be not only a ***present obligation***
  - but also, the probability of an ***outflow of resources*** embodying economic benefits to settle that obligation.
- Where it is not probable that a present obligation exists,
  - an entity discloses a ***contingent liability***,
  - unless the possibility of an outflow of resources embodying economic benefits is ***remote***.

For the purpose of Ind AS 37, an outflow of resources or other event is regarded as probable, if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not.

**Example 3:** Refurbishment costs – legislative requirementAn entity in the oil industry causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates.

One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years.
At March 31, 20X1, it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year-end. It is assumed that a reliable estimate can be made of any outflows expected.
*Present obligation as a result of a past obligating event* – The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.
*An outflow of resources embodying economic benefits in settlement* – Probable.
*Conclusion* – A provision is recognised for the best estimate of the costs of the clean-up.

**Example 4:** Contaminated land and constructive obligation
An entity in the oil industry (having 31 March year-end) causes contamination and operates in a country where there is no environmental legislation.
However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy. It is assumed that a reliable estimate can be made of any outflows expected.
*Present obligation as a result of a past obligating event*- The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of

the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.
*An outflow of resources embodying economic benefits in settlement*- Probable.
*Conclusion*- A provision is recognised for the best estimate of the costs of clean-up.

**Example 5:** Offshore oilfield
An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. 90% of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil.
At the end of the reporting period, the rig has been constructed but no oil has been extracted. It is assumed that a reliable estimate can be made of any outflows expected.
*Present obligation as a result of a past obligating event* – The construction of the oil rig creates a legal obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event.
At the end of the reporting period, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.
An outflow of resources embodying economic benefits in settlement – Probable.
Conclusion – A provision is recognised for the best estimate of 90% of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig.
The 10% of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

### 4.2 Changes in Provisions

- Provisions should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate
- If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provision should be reversed.
- Where discounting is used, the carrying amount of a provision increases in each year. This increase is recognised as borrowing cost / finance cost.

### 4.3 Use of Provisions

A provision should be used only for expenditures for which the provision was originally recognised. Repurposing of the provisions is not allowed.

### 4.4 Provisions & Other Liabilities

Since there is uncertainty about the timing or amount of the future expenditure required in settlement of the provisions, they are different from liabilities. By contrast:
a) trade payables are liabilities to pay for goods or services that have been received or supplied.
b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid.

#### 4.4.1 Examples on provisions and other liabilities:

| Nature of obligation | Recognition as provision (Yes/No) | Reasons |
|---|---|---|
| Amount payable for utilities like electricity, gas, etc. | No | It represents an accrual of liability to pay for services that have been received and<br>the amount and timing of payment can be determined with a reasonable certainty. |
| Goods or services received, but not invoiced | No | It represents trade payables even if invoice has not been received and<br>the amount and timing of payment would be driven by the terms agreed with the supplier. |
| Financial guarantee given by the parent to lenders for loan taken by its subsidiary | No | Financial guarantees are within the scope<br>of Ind AS 109 *Financial Instruments* |
| Warranty obligations | Yes | It is additional cost that the seller may have to incur to rectify product defects. This is in the nature of provision as there is an uncertainty associated with the amount and timing of the liability. |

## 5 Contingent Liabilities

- A Contingent Liability is
  - a *possible obligation* that arises from *past events* and
  - whose existence will be confirmed only by the *occurrence or non-occurrence* of one or more uncertain *future events* not wholly within the control of the entity.

(or)

  - a *present obligation* that arises from *past events* but is not recognised because:
  - *Outflow of resources* embodying economic benefits to settle the obligation are *not probable*; or
  - Reliable estimation cannot be made.

An entity should not recognise a contingent liability, it should be **disclosed**, unless possibility of an outflow of resources embodying economic benefits is not remote

**Example:**
A tax case pending before the court, the liability for payment arising or not in respect of which depends on the outcome of court decision is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

**The principles describing provisions and contingent liabilities is as follows:**

| | | |
|---|---|---|
| There is a present obligation that probably requires an outflow of resources. | → A provision is recognised. | → Disclosures are required for the provision. |
| There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.. | → No provision is recognised. | → Disclosures are required for the contingent liability. |
| There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote. | → No provision is recognised. | → No disclosure is required. |

- If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision should be recognised in the financial statements of the period in which the change in probability occurs.

## 6 Contingent Assets

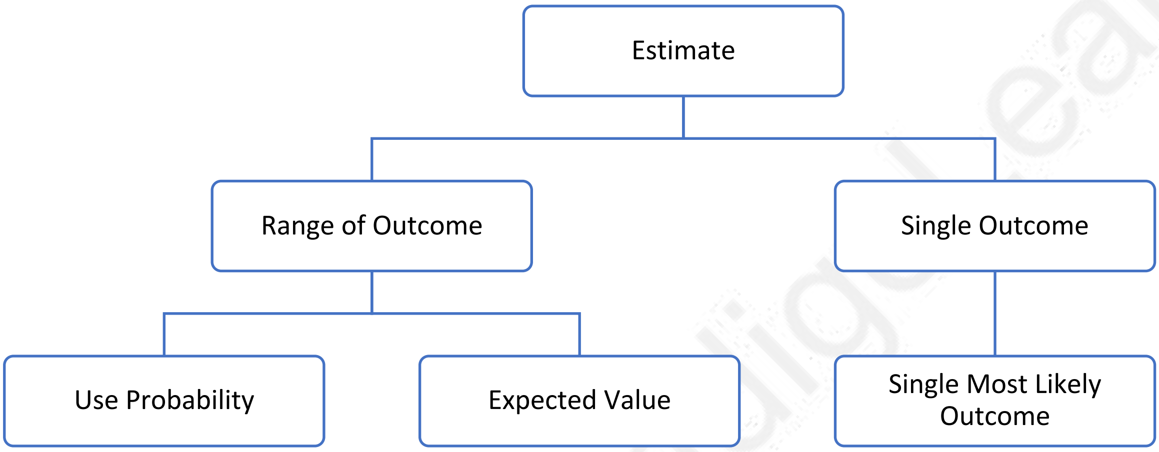
- Contingent Asset is
  - a *possible asset* that arises from *past events* and
  - whose existence will be confirmed only by the *occurrence or non-occurrence* of one or more uncertain *future events* not wholly within the control of the entity
- An entity should not recognise a contingent asset
- A contingent asset should be disclosed, where an inflow of economic benefits is probable.
- Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements.
- If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

| Likelihood of outcome | Probability | Contingent liability | Contingent asset |
|---|---|---|---|
| Virtually certain | > 95% | Recognise provision | Recognise asset |
| Probable | 50% - 95% | Recognise Provision | Disclose |
| Possible but not probable | 5% - 50% | Disclose the contingency | No disclosure |
| Remote | < 5% | Ignore | Ignore |

**Example:** X Ltd. filed a legal suit against a supplier of goods for compensation against damages on non-supply of contracted goods.
This meets the definition of a ***contingent asset*** since there is a possible asset (compensation against damages) that arises from past event (contract with the supplier) and whose existence will be confirmed by the occurrence or non-occurrence of uncertain future event not wholly within the control of the entity (i.e., the outcome of the legal suit).

## 7.1 Best Estimate

- The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.
- The estimates of outcome and financial effect are determined using
  - the judgement of the management of the entity,
  - experience of similar transactions,
  - reports from independent experts,
  - Subsequent events




**Example 1:**
An entity faces a single legal claim, with a 40 per cent likelihood of success with no cost and a 60 percent likelihood of failure with a cost of ₹1 million.
Expected value is not valid in this case because the outcome will never be a cost of ₹600,000 (60 percent × ₹1 million); the outcome will either be nil or ₹1 million.
Ind AS 37 indicates that the provision may be estimated at the individual most likely outcome. In this case, it is more likely that a cost of ₹1 million will result and, therefore, a provision for ₹1 million should be recognised.
**Example 2:**
An entity is required to replace a major component of an asset under warranty. Each time replacement costs ₹ 1 million. From experience, there is a 30 per cent chance of a single failure, a 50 per cent chance of two failures, and a 20 per cent chance of three failures.
In the given case the most likely outcome is two failures, costing ₹ 2 million. The expected value is ₹ 1.9 million [(30 percent x ₹ 1 million) + (50 per cent x ₹ 2 million) + (20 per cent x ₹ 3 million)].

The expected value supports the provision 2 million.

## 7.2 Risk and Uncertainties

- Risks and uncertainties should be taken into account in reaching the best estimate of a provision.

- A risk adjustment should be made for the amount that the entity would pay in excess of the expected present value of outflows due to uncertainty attached with the actual outcome.
- Risk adjustment can be accounted for in number of ways such as:
  - Adding it to the expected present value of future outflows.
  - Adjusting the estimates of future outflows.
  - Adjusting the discount rate.

### 7.3 Present value

- The amount of a provision should be the **present value** of the expenditures expected to be required to settle the obligation.
- **The discount rate (or rates) should be a pre-tax rate (or rates)** that reflect(s) current market assessments of the time value of money and the risks specific to the liability.

### 7.4 Future Events

Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

### 7.5 Expected Disposal of Asset

Gains on the expected disposal of assets should not be taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision.

**Example:**
At the end of 20X1, an entity is demonstrably committed to the closure of some facilities, having drawn up a detailed plan and made appropriate announcements. The expected impact of the plan is as follows:

| | 20X2 | 20X3 |
|---|---|---|
| Committed closure costs | ₹ 10,00,000 | |
| Gain from sale of property | | ₹ 2,00,000 |

The provision required at the end of 20X1 is ₹ 10,00,000 (ignoring discounting). The expected gain on the sale of the property is dealt with separately under the derecognition criteria in Ind AS 16.

## 8 Reimbursements

- Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is **virtually certain** that reimbursement will be received if the entity settles the obligation.
- The reimbursement should be treated as a **separate asset**.
- The amount recognised for the reimbursement should **not exceed** the amount of the provision.
- In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

## 9 Application of Recognition & Measurement Rules

### 9.1 Future Operating Losses

- Provisions should not be recognised for future operating losses

- as future operating losses do not meet the definition of a liability

## 9.2 Onerous Contracts

- contract in which unavoidable cost of meeting the obligation exceed the economic benefits expected to be received from such contract
- Provision to be created at Lower of:
  - Damages payable if exited from the contract or
  - Net loss that arises if the contract is executed

**Example 1:** Contract not onerous
An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000.
The gas will be used to generate electricity, which will be sold at a profit. The economic benefits from the contract include the benefits to the entity of using the gas in its business and, because the electricity will be sold at a profit, the contract is not onerous.

**Example 2:** Impairment of assets
The contract's terms and market prices are the same as in example 1.
However, the electricity is sold at a loss, and the entity makes an overall operating loss. All of the gas purchased by the entity is used to generate electricity using dedicated assets. The electricity is sold to a wide range of customers. The entity first considers whether the assets used to generate electricity are impaired.
To the extent that there is still a loss after the assets have been written down, a provision for an onerous contract should be recorded.

**Example 3:** Sale to third party at below purchase price
The contract terms and market price are the same as in example 1.
However, in this example, the entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit (5p below cost). The entity determines that it would have to pay ₹ 55,000 to exit the purchase contract.
The only economic benefit from the purchase contract costing ₹ 2,30,000 are the proceeds from the sales contract, which are ₹ 1,80,000.
Therefore, a provision should be made for the onerous element of ₹ 50,000, being the lower of the cost of fulfilling the contract and the penalty cost of cancellation (₹ 55,000).

## 9.3 Restructuring

- is a programme that is planned and controlled by management, and materially changes either
  a) the scope of a business undertaken by the entity; or
  b) the manner in which that business is conducted.

**Examples,**

a) sale or termination of a line of business;
b) closure of business locations in a country or region or the relocation of business activities from one country or region to another;
c) changes in management structure, for example, eliminating a layer of management; and
d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations

- A provision for restructuring costs should be recognised only when the general recognition criteria for provisions set out the standard are met.
- A constructive obligation to restructure arises only when an entity:
  a) has a detailed formal plan for the restructuring identifying at least:
     i. business or part of a business concerned;
     ii. principal locations affected;
     iii. location, function, and approximate number of employees who will be compensated for terminating their services;
     iv. expenditures that will be undertaken; and
     v. when the plan will be implemented; and
  b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

- A restructuring provision should include only **include the direct expenditure arising from the restructuring,** which are:
  - necessarily entailed by the restructuring; and
  - **not associated with the on-going activities** of the entity.
- A restructuring provision does not include such cost as:
  - retraining or relocating continuing staff;
  - Marketing; or
  - Investment in new system and distribution networks.

**Example 1:** Closure of a division – no implementation before end of the reporting period
On March 12, 20X1 the board of an entity decided to close down a division. Before the end of the reporting period (March 31, 20X1) the decision was not communicated to any of those affected and no other steps were taken to implement the decision. it is assumed that a reliable estimate can be made of any outflows expected.

*Present obligation as a result of a past obligating event* – There has been no obligating event and so there is no obligation.
*Conclusion* – No provision is recognised.
**Example 2:** Closure of a division – communication/implementation before end of the reporting period
On March 12, 20X1, the board of an entity decided to close down a division making a particular product. On March 20, 20X1 a detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division. It is assumed that a reliable estimate can be made of any outflows expected.
*Present obligation as a result of a past obligating event* – The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.
*An outflow of resources embodying economic benefits in settlement* – Probable.
*Conclusion* – A provision is recognised at March 31, 20X1 for the best estimate of the costs of closing the division.

## 10 Disclosure Requirements

- For each class of provision, an entity should disclose:
  - the carrying amount at the beginning and end of the period;
  - additional provisions made in the period, including increases to existing provisions;
  - amounts used (i.e., incurred and charged against the provision) during the period;
  - unused amounts reversed during the period; and

- the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

➢ An entity should disclose the following for each class of provision:
  - a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
  - an indication of the uncertainties about the amount or timing of those outflows.
  - the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

➢ Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:
  - an estimate of its financial effect, measured in the standard;
  - an indication of the uncertainties relating to the amount or timing of any outflow; and
  - the possibility of any reimbursement.

➢ When an entity is creating a class of provisions, the entity should aggregate similar items

➢ Where an inflow of economic benefits is probable, an entity should disclose a brief description of the **nature of the contingent assets** at the end of the reporting period, and, where practicable, **an estimate of their financial effect**, measured using the principles set out for provisions in the standard.

## 11 Levies- Appendix C of Ind AS 37

### 11.1 What is Levy?

➢ A charge imposed by governments on entities in accordance with laws and/or regulations. It leads to outflow of resources embodying economic benefits

**It excludes,**
  - outflows of resources that are within the scope of other Ind AS
  - fines or other penalties that are imposed for breaches of the legislation
  - payment made to the government for acquiring assets or for rendering services as per the contractual agreement
  - liabilities that arise from emissions trading schemes.

**Other relevant examples:**

**Example 1:** A Court case

After a wedding in 20X1-20X2, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability.

Up to the date of approval of the financial statements for the year to31 March 20X2 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable.

However, when the entity prepares the financial statements for the year to 31 March 20X3, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. It is assumed that a reliable estimate can be made of any outflows expected.

**(a) At 31 March 20X2**

*Present obligation as a result of a past obligating event* – On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

*Conclusion* – No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

**(b) At 31 March 20X3**

*Present obligation as a result of a past obligating event* – On the basis of the evidence available, there is a present obligation.
*An outflow of resources embodying economic benefits in settlement –* Probable.
*Conclusion –* A provision is recognised for the best estimate of the amount to settle the obligation.
**Example 2:** Warranty
A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale.
On past experience, it is probable (i.e., more likely than not) that there will be some claims under the warranties. It is assumed that a reliable estimate can be made of any outflows expected.
*Present obligation as a result of a past obligating event –* The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.
*An outflow of resources embodying economic benefits in settlement –* Probable for the warranties as a whole.
*Conclusion –* A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period.

## 12 Significant differences in IND AS 37 & AS 29

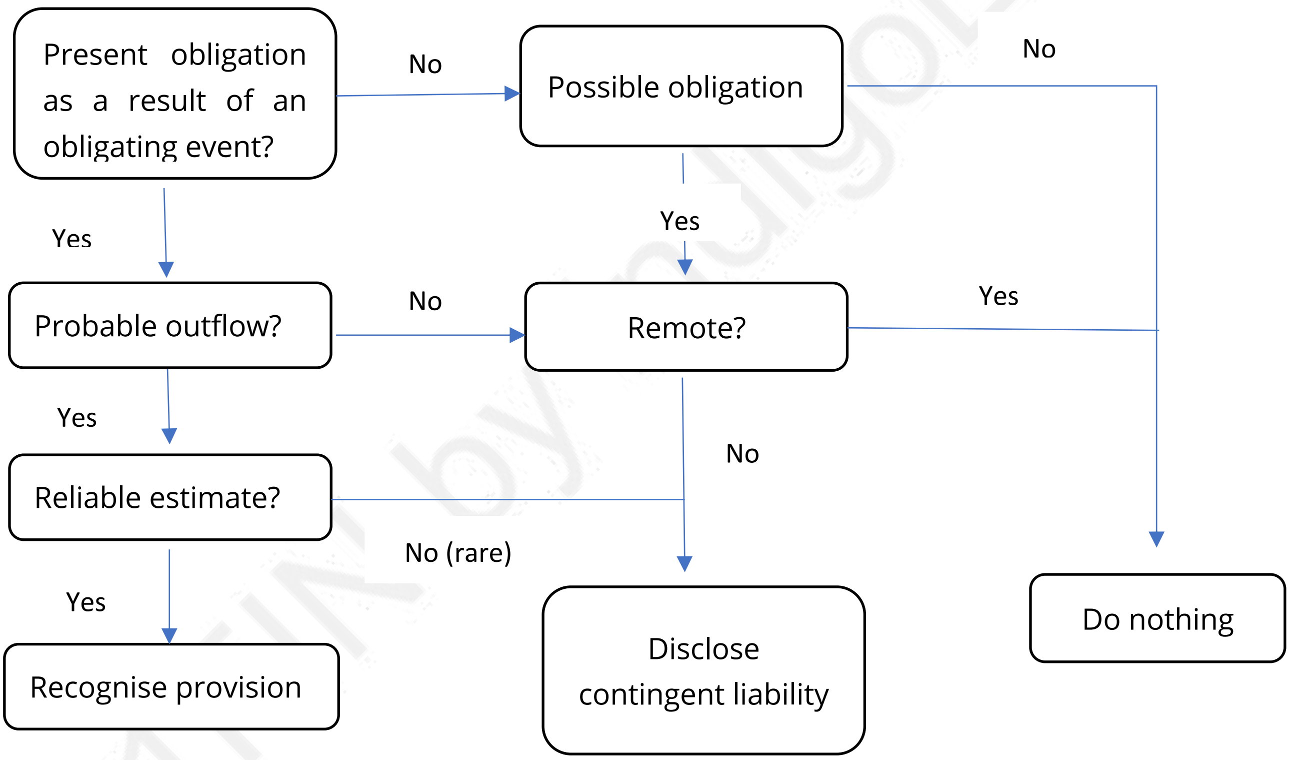
| Basis of differences | IND AS 37 | AS 29 |
|---|---|---|
| Definition Constructive Obligations, Provision and Obligating Event | Specifically defines "constructive obligation".<br>A provision is a liability uncertain amount or timing.<br>Specifically talks about obligating event. | doesn't define specifically.<br>Provision is a liability which can be measured only by using substantial degree of estimation.<br>Doesn't talk about obligating event. |
| Discounting | When the effect of time value of money is material, discounting is required. | Discounting is not permitted except for decommissioning, restoration and similar liabilities associated with PPE |
| Contingent asset | Not recognised but disclosed in the financial statements when an inflow of economic benefits is probable. | Neither recognised nor disclosed in the financial statements and are usually disclosed in the report of the approving authority. |
| Onerous Contracts | Makes it clear that before a separate provision for an onerous contract is established, an entity should recognise any impairment loss that has occurred on assets dedicated to that contract in accordance with Ind AS 36. | There is no such specific provision |
| Additional guidance | gives guidance on:<br>(a) Rights to Interests arising | Does not give such guidance. |

| | | |
|---|---|---|
| | from Decommissioning, Restoration and Environmental Rehabilitation Funds<br>(b) Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment<br>(c) Levies (imposed by government). | |

## 13 Summary

- The amount of a provision should be the **present value** of the expenditures expected to be required to settle the obligation.
- The discount rate should be a **pre-tax rate.**

**Decision tree:**




**Important Points:**

*No provision is recognised for costs that need to be incurred by an entity to operate* ***in the future.***

*Only those obligations arising from past events existing independently of an entity's future actions (i.e., the future conduct of its business)* ***that should be recognised as provisions***

*The entity can avoid the future expenditure by its future actions. In such a case, it has no present obligation for that future expenditure and no provision is recognised.*

Provisions should not be recognised for future operating losses as future operating losses do not meet the definition of a liability

Gains on the expected disposal of assets should not be taken into account in measuring a provision

- Provisions should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate.
- Provision should be reversed, if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation

## ILLUSTRATIONS

### 1. Illustration

X Ltd. is engaged in the manufacture of fertilisers. Effluents discharged in the manufacturing process have polluted the river near the manufacturing plant. The residents of the nearby locality launched a massive agitation against the pollution. X Ltd. agreed to their demands to reduce the water pollution by installing the necessary Effluent Treatment Plant. However, during the year no steps are taken to install the plant. No legislation requiring the company to reduce its pollution is in existence.

### 2. Illustration

ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.

Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

## 3. Illustration

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. It is assumed that a reliable estimate can be made of any outflows expected.

Should the provision be recognised?

## 4. Illustration

Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 20X1. The entity has not fitted the smoke filters till March 31, 20X2. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

## 5. Illustration

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

## 6. Illustration

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

## 7. Illustration

X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?

## 8. Illustration

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. 90% of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil. At the end of the reporting period, the rig has been constructed but no oil has been extracted. It is assumed that a reliable estimate can be made of any outflows expected.

## 9. Illustration

After a wedding in 20X1-20X2, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 March 20X2 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 March 20X3, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. It is assumed that a reliable estimate can be made of any outflows expected. Should the provision be recognised?

## 10. Illustration

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of ₹ 1 million would result. If major defects were detected in all products sold, repair costs of ₹ 4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects and 5% of the goods sold will have major defects. In accordance with the standard, an entity assesses the probability of an outflow for the warranty obligations as a whole.

## 11. Illustration

An entity faces a single legal claim, with a 40 per cent likelihood of success with no cost and a 60 percent likelihood of failure with a cost of ₹ 1 million. Expected value is not valid in this case because the outcome will never be a cost of ₹ 600,000 (60 percent × ₹ 1 million); the outcome will either be nil or ₹ 1 million. Ind AS 37 indicates that the provision may be estimated at the individual most likely outcome. In this example, it is more likely that a cost of ₹ 1 million will result and, therefore, a provision for ₹ 1 million should be recognised.

## 12. Illustration

X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at ₹ 50,00,000, the present value of which is ₹ 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation?

## 13. Illustration

ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ₹ 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate.

Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.

## 14. Illustration

At the end of 20X1, an entity is demonstrably committed to the closure of some facilities, having drawn up a detailed plan and made appropriate announcements. The expected impact of the plan is as follows:

| | 20X2 | 20X3 |
|---|---|---|

| | | |
|---|---|---|
| Committed closure costs | ₹ 10,00,000 | |
| Gain from sale of property | | ₹ 2,00,000 |

The provision required at the end of 20X1 is ₹ 10,00,000 (ignoring discounting). The expected gain on the sale of the property is dealt with separately under the derecognition criteria in Ind AS 16.

## 15. Illustration

X Beauty Solutions Ltd. is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding (enforceable agreement) with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of ₹ 30,00,000 becomes payable to customers by X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable?

## 16. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. The gas will be used to generate electricity, which will be sold at a profit. Is this an onerous contract?

## 17. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. What if electricity sold at a loss?

## 18. Illustration

An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. Assume the entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit. The entity determines that it would have to pay ₹ 55,000 to exit the purchase contract. What is the provision to be made?

## 19. Illustration

X Sugars Ltd. has entered into a sale contract of ₹ 3,00,00,000 with Y Chocolates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract.

In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of ₹ 30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment.

It is, however covered by an insurance policy.

According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy.

The cost of goods lost was ₹ 2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of ₹ 30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end?

## 20. Illustration

The annual reporting period of ABC Ltd. ends on March 31. As per the legislation of the State government, a levy is imposed on ABC Limited in full when it generates revenue in financial year 2016-17. The levy imposed by the government is calculated by reference to revenue generated by ABC Ltd. in previous financial year. ABC Ltd. had generated revenue of ₹ 200 crores in financial year 2015-16. For financial year 2016-17, it starts to generate revenue on April 5, 2016.

ABC Ltd. paid the levy on July 10, 2016. What is the obligatory event that gives rise to recognition of a liability to pay a levy in the present case?

What are the principles for recognising the levy in the annual financial statements and interim financial report?

## 21. Illustration

X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ₹ 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

## 22. Illustration

Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating therefrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price. Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?

## 23. Illustration

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 20X2 as per the notified Ind AS. The financial statements are due to be approved for issue on 15th May 20X2. Following are a few transactions that have taken place in some of its subsidiaries during the year:

G Ltd. is a wholly-owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 20X2, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 20X2. They made a public announcement of their decision on 15th February 20X2.

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 20X2. U Ltd. would collect any amounts still owed by G Ltd.'s customers after 31st May 20X2. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.:

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay ₹ 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May 20X2. As per latest estimates made on 15th May 20X2, the total relocation cost is ₹ 63 lakhs.
- G Ltd. had taken a property on operating lease, which was expiring on 31st March 20X6. The present value of the future lease rentals (using an appropriate discount rate) is ₹ 430 lakhs. On 15th May 20X2, G Ltd. made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March 20X2 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 60 lakhs till 30th April 20X2.

What are the provisions that the Company is required to make as per Ind AS 37?

## 24. Illustration

A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

## 25. Illustration

Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non-performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required?

## 26. Illustration

Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ₹ 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ₹ 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ₹ 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

## 27. Illustration

Sun Limited has entered into a binding agreement with Moon Limited to buy a custom-made machine for ₹ 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry.

## 28. Illustration

Mini Ltd. took a factory premises on lease on 1.4.2016 for ₹ 2,00,000 per month. The lease is operating lease. During March 2017, Mini Ltd. relocates its operation to a new factory building.The lease on the old factory premises continues to be live up to 31.12.2019.The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months up to 31.12.2019 should be provided in the accounts for the year ending 31.3.2017. Mini Ltd. seeks your advice.

## 29. Illustration

Vishnu Company has at its financial year ended 31st March, 2017, fifteen law suits outstanding none of which has been settled by the time the accounts are approved by the directors.

The directors have estimated the possible outcomes as below:

| Result | Probability | Amount of loss |
|---|---|---|
| For first ten cases | | |
| Win | 0.6 | |
| Loss-low damages | 0.3 | 90,000 |
| Loss-High damages | 0.1 | 1,60,000 |
| For remaining five cases | | |
| Win | 0.5 | |
| Loss-low damages | 0.3 | 60,000 |
| Loss-High damages | 0.2 | 95,000 |

The directors believe that the outcome of each case is independent of the outcome of all the others. Estimate the amount of contingent loss and state the accounting treatment of such contingent loss.

# Ind AS 19
# Employee Benefits

## 1 Objective

- to prescribe the *accounting* and *disclosure* for employee benefits.
- Ind AS 19 requires an entity to recognise:
  - a liability for advance services received from an employee; and
  - an expense for consumption of economic benefits raised from the service provided by an employee in exchange for employee benefits.

## 2 Scope

- The employee benefits to which this Standard applies include those provided:
  - under ***formal plans or other formal agreements*** between an entity and individual employees, groups of employees or their representatives;
  - under ***legislative requirements***, or through industry arrangements; or
  - by those ***informal practices*** that give rise to a constructive obligation.
- This Standard does not deal with reporting by employee benefit plans (e.g by provident fund trusts)
- This Standard shall be applied by an employer in accounting for all employee benefits, **except those to which Ind AS 102, Share-based Payment,** applies

## 3 Employee benefits

- ***Employee benefits*** means all forms of consideration given by an entity
  - in exchange for **service rendered** by employees or
  - for the **termination** of employment.

**Employee benefits includes**

| **Short Term Benefits** | **Post Employee Benefits** | **Other Long Term Benefits** | **Termination Benefits** |
|---|---|---|---|
| Expected to be settled wholly before 12 months | Payable after the completion of employment | Other than short-term, post-employment and termination benefits | Provided in exchange for the termination of an employee's employment |

| Employee benefits Include benefits provided either to | Employee benefits may be settled by payments made either- | An employee may provide services to an entity on a- |
|---|---|---|
| employees; or | directly to the employees; or | full-time; or |
| their dependants; or | their spouses; or | part-time; or |
| their beneficiaries. | their children; or | permanent; or |
| | their other dependants; or | casual; or |
| | others, such as insurance companies | temporary basis. |

## 4 Short term employee benefits

- Short-term employee benefits include items expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services.

- Short term employee benefits include
  - wages, salaries and social security contributions;
  - paid annual leave and paid sick leave;
  - profit-sharing and bonuses; and
  - non-monetary benefits

- Reclassification of a short-term employee benefit is not required if the entity's expectations of the timing of settlement of such benefits changes temporarily.

### 4.1 Short-term paid absences

An employer may compensate an employee for absence for various reasons including holidays, sickness and short-term disability, maternity or paternity

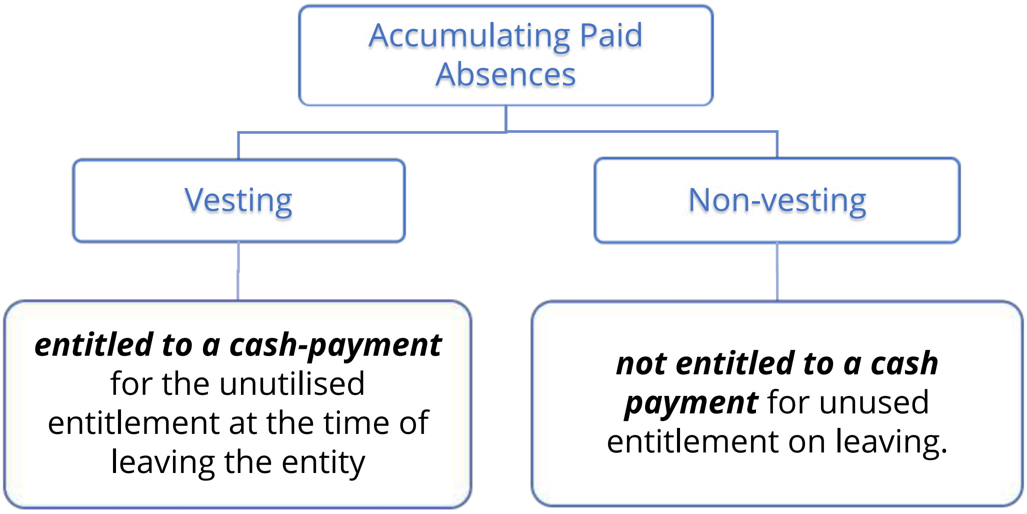
Entitlement to paid absences fall into two categories as follows:

#### 4.1.1 Non-accumulating Paid Absences

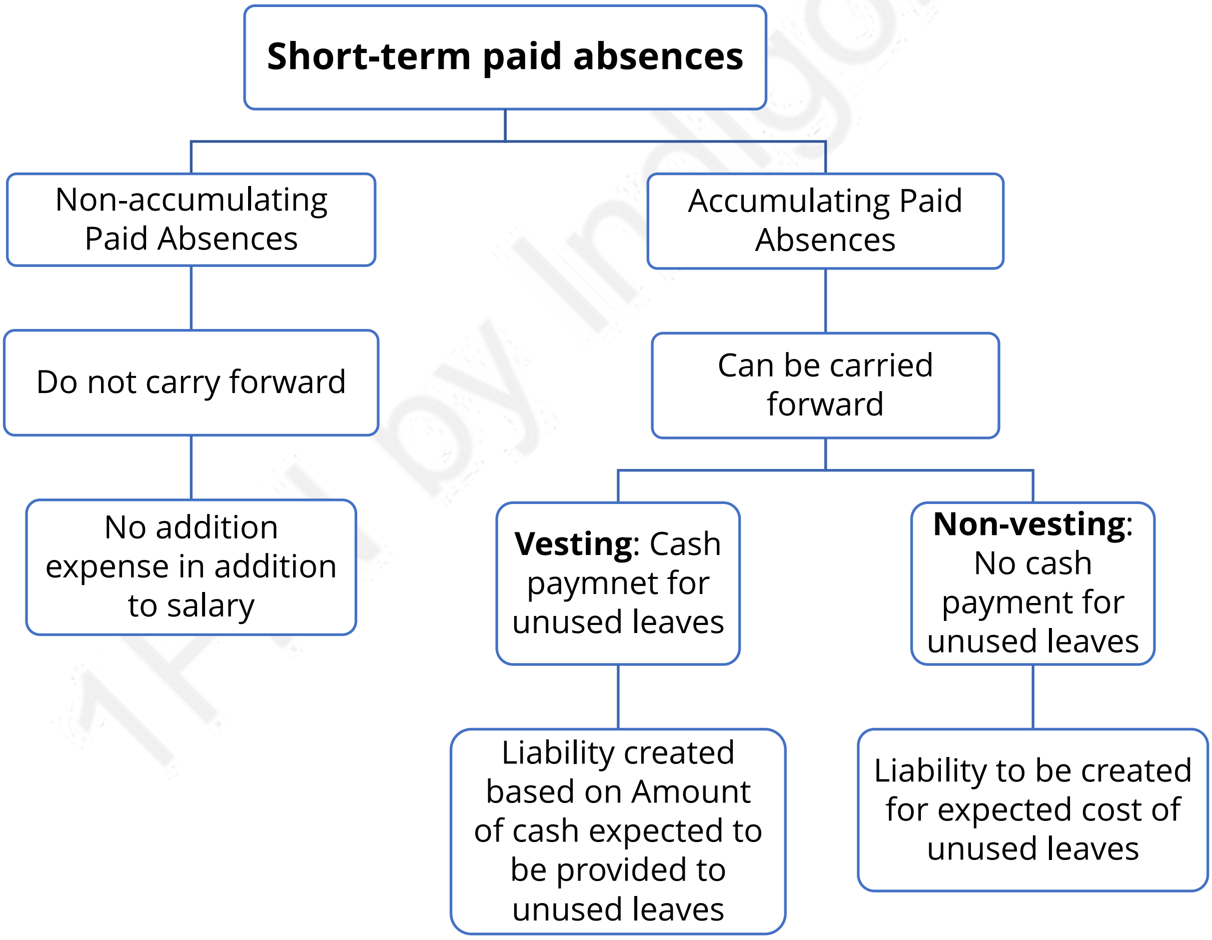
- These are the absences that ***do not carry forward*** and they will lapse if the current period's entitlement is not used in full by the employee.
- They do not entitle employees to a cash payment for unused entitlement on leaving the entity.
- No specific accounting treatment is needed.

#### 4.1.2 Accumulating Paid Absences

- These are the absences that are ***carried forward and can be used in future*** periods if the employee is not able to use them in current period.




- An entity shall measure the expected cost of accumulating compensated absences as the **additional amount that the entity expects to pay as a result of the unused entitlement** that has accumulated at the end of the reporting period




## 4.2 Profit-sharing and Bonus Plans

- An entity may pay employees a percentage of profits as remuneration (generally called as bonus)

- Expected costs of profit-sharing and bonus plans shall be recognised when,
  - the entity has a ***present obligation*** (legal or constructive) to make such payments as a result of past events; and
  - a ***reliable estimate*** of the obligation can be made by the entity.

- An obligation under profit-sharing and bonus plans results from employee service and not from a transaction with the entity's owners.
- An entity recognises the cost of profit-sharing and bonus plans not as a distribution of profit but as an expense.

### 4.3 Recognition and Measurement of Short-term Benefits

- Accounting for short term benefits has two characteristics:
  - Measured on an **undiscounted basis;** and
  - Do not require any actuarial valuation for their measurement.

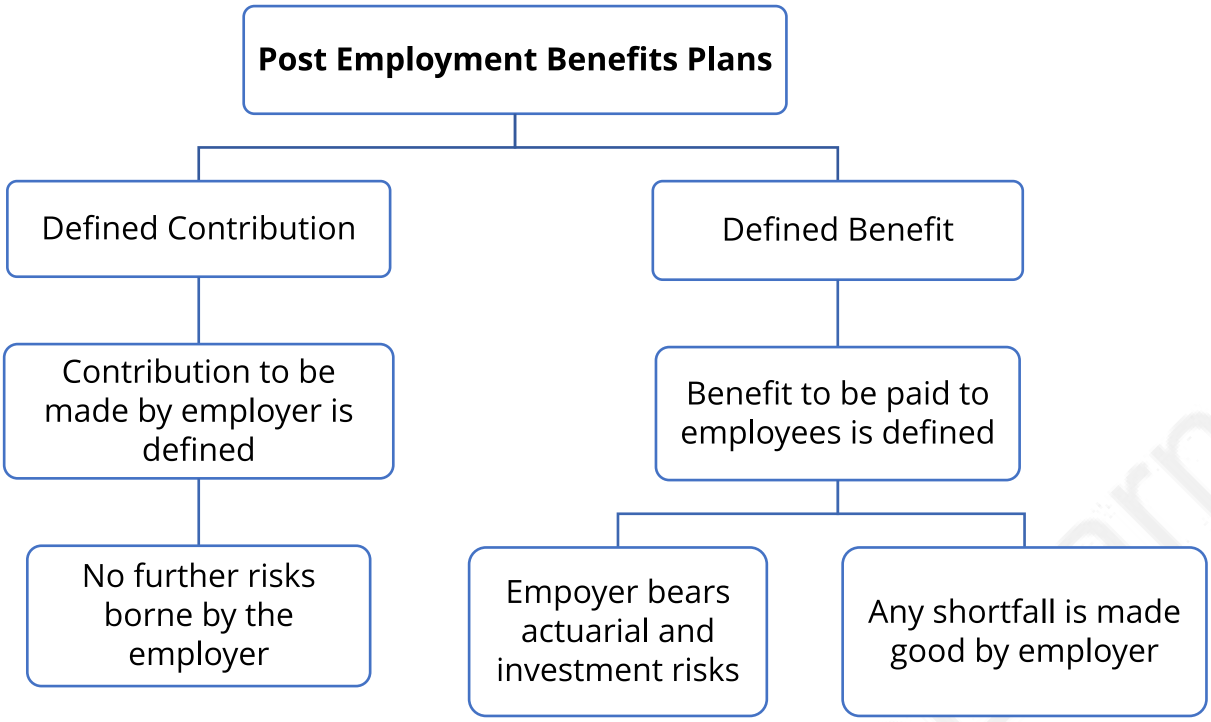
- The undiscounted amount of short-term employee benefits expected to be paid in exchange for that service shall be recognised:
  - ***As a liability*** after deducting any amount already paid.
  - ***As an asset*** (if amount paid exceeds the undiscounted amount of the benefits for the period)
  - ***as an expense***, if it doesn't form part of the cost of an asset as per any other Ind AS.

### 4.4 Disclosure of Short-term employee benefits

| | |
|---|---|
| **Ind AS 19** | does not require specific disclosures |
| **Other Ind AS** | may require disclosures. |
| **Examples** | **Ind AS 24:** Requires disclosures about employee benefits for key management personnel<br>**Ind AS 1:** Presentation of Financial Statements, requires disclosure of employee benefits expense. |

## 5 Post-employment benefits

- Post-employment benefits include:
  - Retirement benefits such as pensions and lump sum payments on retirement
  - Other post-employment benefit such as post-employment life insurance and post-employment medical care.




### 5.1 Defined contribution plans

- The entity's ***obligation*** (legal or constructive) is limited to the ***amount that it agrees*** to contribute to the fund.
- The amount of the post-employment benefits received by the employee is determined by the amount of contribution paid by an entity
- Under defined contribution plan
    - ***actuarial risk*** *(that benefits will cost more than expected)* and
    - ***investment risk*** *(assets invested will be insufficient to meet expected benefits)*
    - will fall on the ***employee***
- ***Discounting*** should be done if contribution is payable after ***12 months*** from reporting date

### 5.2 Defined Benefit plans

- The entity's ***obligation*** is to provide the ***agreed benefits (****Benefits are defined)* to current and former employees;
- The ***actuarial risk*** and ***investment risk*** fall on the ***entity***
- If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

**Differences**

| **Particulars** | **Defined Contribution Plans** | **Defined Benefit Plans** |
|---|---|---|
| **Entity's obligation** | Limited to the amount that it agrees to contribute to the fund. | To provide the agreed benefits to current and former employees. |

| | | |
|---|---|---|
| **Determination of the amount of post-employment benefit** | determined by the amount of contribution paid by an entity and employee + return on it | Pre-determined / as agreed |
| **Risk bearer** | Actuarial risk and investment risk fall on the employee | These risks fall on entity |

## 5.3 Accounting for Defined Contribution Plans

- The reporting entity's obligation for each period is determined by the amounts to be contributed for that period.

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Compensation Expenses Dr.<br>To Liability / Bank (Payable/Paid) | XXXX | <br>XXXX |

- No actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss.
- The obligations are measured on an undiscounted basis, except where the obligation falls due after twelve months after the end of the annual reporting period

### 5.3.1 Recognition and measurement

- When an employee has rendered service to an entity during a period, the entity shall

Recognise the contribution payable to a defined contribution plan in exchange for that service

| | | |
|---|---|---|
| As a liability (accrued expense), after deducting any contribution already paid | As an asset (prepaid expense) if contribution already paid under a defined contribution plan exceeds the contribution due for service before the end of the reporting period<br>Asset to be recognised at the PV of any economic benefits available in the form of a ***cash refund*** or a ***reduction in future payments*** | As an expense if not included in the cost of an asset as per other Ind AS |

### 5.3.2 Disclosure

An entity shall disclose

- the amount recognised as an expense for defined contribution plans.
- information about contributions to defined contribution plans for key management personnel (as per Ind AS 24).

## 5.4 Accounting for Defined Benefit Plans

Accounting for defined benefit plans is complex because -

- ***actuarial assumptions*** are required to measure the obligation and the expense;
- there is a possibility of ***actuarial gains and losses***;
- the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

### 5.4.1 Recognition and measurement

- Defined benefit plans can be:

- unfunded or
- funded.

➢ The payment of funded benefits when they **fall due depends** on
- the financial position and the investment performance of the fund; and
- an entity's ability to make good any shortfall in the fund's assets.

➢ The entity underwrites the actuarial and investment risks associated with the plan i.e. the entity assumes ultimate liability.

➢ The expense recognised for a defined benefit plan is not always equal to the amount of the contribution due for the period.

### 5.4.2 Actuarial Assumptions

➢ The benefit payable to beneficiaries depends on multiple factors (variables)

➢ Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits

➢ Actuarial assumptions shall be ***unbiased*** and ***mutually compatible***.

**Actuarial assumptions comprise of**

| | |
|---|---|
| Demographic Assumptions | • Average age of employees<br>• Mortality- during and after employment<br>• Rate of employee turnover, disability & early retirement<br>• Proportion of plan member with dependants<br>• Length of service etc. |
| Financial Assumptions | • Discount rate<br>• Future salary & benefit levels<br>• Inflation rates<br>• In case of medical benefits, future medical cost, including claim handling costs etc. |

### 5.4.3 Discount rate

➢ The rate which is used to discount post-employment benefit obligations is determined by reference to ***market yields on government bonds*** at the end of the reporting period

➢ Subsidiaries, associates, joint ventures and branches domiciled outside India shall discount post-employment benefit obligations arising on account of post-employment benefit plans using the rate determined by reference to ***market yields*** at the end of the reporting period on ***high quality corporate bonds***

### 5.4.4 Defined Benefit Obligation (DBO)

| | |
|---|---|
| **Defined Benefit Obligation** | Obligation under a defined benefit plan |
| **PV of Defined Benefit Obligation** | PV of obligation resulting from employee service in current and prior periods |

How to calculate DBO?

| *Particulars* | *Amount (Rs.)* |
|---|---|
| **Opening Balance- DBO** | **XXXX** |
| (+) Current Service cost | XXXX |
| (+) Interest cost | XXXX |
| (+/-) Past Service Cost | XXXX |
| (+) Actuarial Loss | XXXX |
| (-) Actuarial Gain | XXXX |
| (-) Benefit Payment | XXXX |
| (-) Gain on Settlement | XXXX |
| (+) Loss on Settlement | XXXX |
| **Closing balance- DBO** | **XXXX** |

### 5.4.5 Current service cost

Current service cost is an increase in present value of DBO resulting from employee service during the current period.

***Increase in the present value*** *of defined benefit obligation:*

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Employee Benefit Cost A/c Dr.<br>To Defined Benefit Obligation | XXXX | <br>XXXX |

### 5.4.6 Interest Cost

Interest cost is the increase in DBO due to passage of time. Interest is computed by multiplying opening balance of DBO with the discount rate.

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Employee Benefit Cost A/c (Interest ) Dr.<br>To Defined Benefit Obligation | XXXX | <br>XXXX |

### 5.4.7 Past service cost

Change in the present value of the defined benefit obligation for employee service in prior periods resulting from a ***plan amendment*** or ***curtailment*** is known as past service cost

| | |
|---|---|
| **Plan amendment** | the introduction or withdrawal of, or changes to, a defined benefit plan |
| **Curtailment** | a significant reduction by the entity in the number of employees covered by a plan |

- An entity shall recognise past service cost as an expense at the earlier of the following dates:
  - when the plan amendment or curtailment occurs; and
  - when the entity recognises related restructuring costs
- Past service cost may be,
  - ***Positive***- when benefits are introduced or changed so that the present value of the defined benefit obligation increases or

- *Negative*- when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases.

***Increase in the present value*** *of defined benefit obligation:*

| Particulars | | *Debit* | *Credit* |
|---|---|---|---|
| Employee Benefit Cost A/c<br>To Defined Benefit Obligation | Dr. | XXXX | <br>XXXX |

***Decrease in the present value*** *of defined benefit obligation:*

| Particulars | | *Debit* | *Credit* |
|---|---|---|---|
| Defined Benefit Obligation A/C<br>To Employee Benefit Cost A/c | Dr. | XXXX | <br>XXXX |

### 5.4.8 Gain or loss on settlement

- A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan
- The gain or loss on a settlement is the difference between:
  - the present value of the defined benefit obligation on the date of settlement; and
  - the settlement price.
- Gain or loss on the settlement of a defined benefit plan is recognised by the entity when the settlement occurs.

***Loss on Settlement***

| Particulars | | *Debit* | *Credit* |
|---|---|---|---|
| Employee Benefit Cost A/C<br>To Defined benefit liability A/c | Dr. | XXXX | <br>XXXX |

***Gain on Settlement***

| Particulars | | *Debit* | *Credit* |
|---|---|---|---|
| Defined benefit liability A/C<br>To Employee Benefit Cost A/C | Dr. | XXXX | <br>XXXX |

**Service Cost** = Current Service Cost + Past Service Cost + Gain/loss on settlement

### 5.4.9 Actuarial gains and losses

- Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from:
  - experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
  - the effects of changes in ***actuarial assumptions.***

**Actuarial gain/loss** will be recognised in ***Other Comprehensive Income***

***Actuarial Loss***

| Particulars | | *Debit* | *Credit* |
|---|---|---|---|
| Other Comprehensive Income A/c<br>To Defined Benefit Liability A/C | Dr. | XXXX | <br>XXXX |

*Actual Gain*

| Particulars | *Debit* | *Credit* |
|---|---|---|
| Defined Benefit Liability A/C Dr.<br>To Other Comprehensive Income A/c | XXXX | <br>XXXX |

### 5.4.10 Benefit Payment

*Payment of Employee benefits*

| Particulars | *Debit* | *Credit* |
|---|---|---|
| Defined Benefit Obligation A/C Dr.<br>To Bank A/c | XXXX | <br>XXXX |

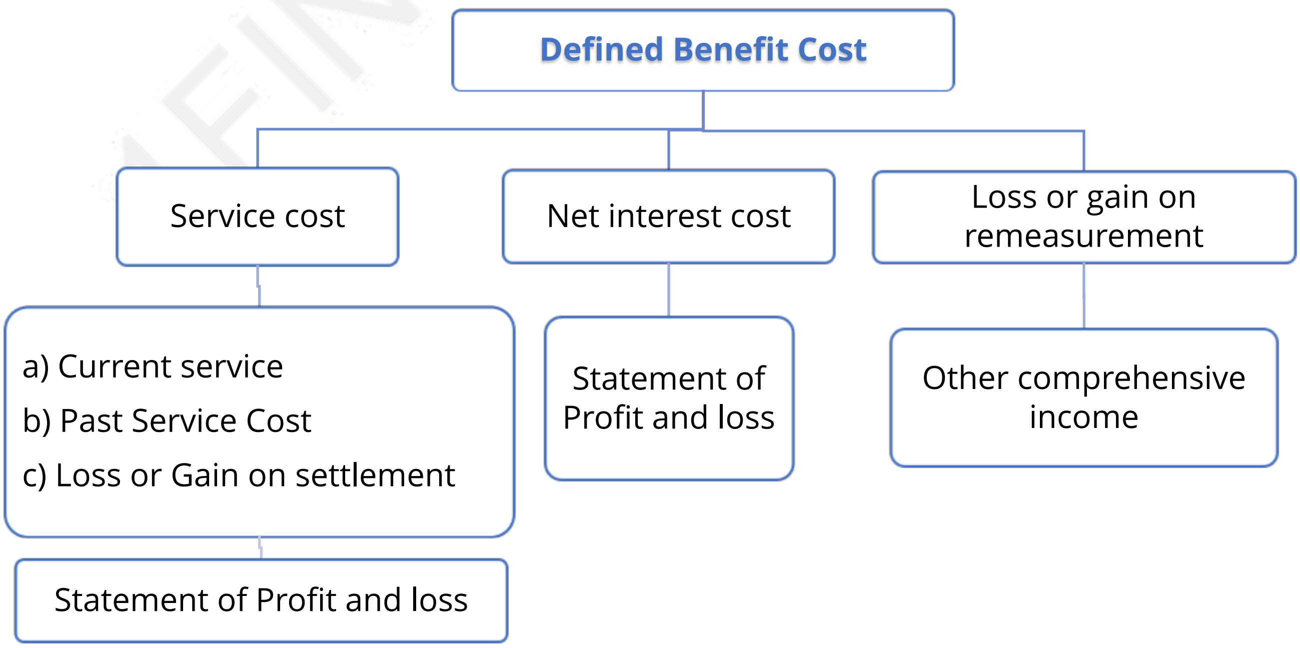
### 5.4.11 Steps involved in accounting by an entity for defined benefit plans

| | |
|---|---|
| **Determine the deficit or surplus** | PUCM (Projected Unit Credit Method)<br>Discounting<br>Fair value of plan assets |
| **Determine the amount of the net defined benefit liability (asset)** | As the amount of the deficit or surplus |
| **Determine the amounts to be recognised in Profit or Loss** | Current service cost<br>Past service cost<br>Net interest |
| **Determine the remeasurements of the net defined benefit liability (asset)** | Actuarial Gain or Loss<br>Return on Plan Assets<br>Any Change in effect of Asset Ceiling |

**Projected Unit Credit Method (PUCM)**

Each period of service as which rise to additional unit of benefit entitlement and measures each unit separately to build up final obligation

## 5.5 Components of Defined Benefit Cost



### 5.6 Net interest on the net defined benefit liability (asset)

- The change during the period in the net defined benefit liability (asset) that arises from the passage of time
- An entity shall determine net interest on the net defined benefit liability (asset) by multiplying the net defined benefit liability (asset) by the discount rate.
- If an entity remeasures the net defined benefit plan (asset), the entity shall determine interest for the remainder of the annual reporting period after plan amendment.

### 5.7 Remeasurements of the net defined benefit liability (asset)

Remeasurements of the net defined benefit liability (asset) comprise:

- actuarial gains and losses;
- Actual Return – Expected Return
  - the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset);
- any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

Recognise remeasure gain/loss in ***other comprehensive income***

| *Particulars* | *Net Liability* |
|---|---|
| Opening Balance | XXXX |
| **Add:** | |
| Current Service cost | XXXX |
| Past Service Cost | XXXX |
| Net Finance Cost | XXXX |
| Loss on Settlement | XXXX |
| **Less:** | |
| Gain on Settlement Benefits Paid | **XXXX** |
| **Expected Closing Balance** | XXXX |
| Actual Closing Balance | XXXX |
| **Gain/(Loss) on remeasurement** | **XXXX** |

## 6 Plan Assets

Plan assets comprise

a) assets held by a long-term employee benefit fund and
b) qualifying insurance policies

### 6.1 Assets held by a long-term employee benefit fund

Assets (other than non-transferable financial instruments issued by the reporting entity) that:

- are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and
- are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, ***unless either:***

i. the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

ii. the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

### 6.2 Qualifying insurance policies

- Insurance policy issued by an insurer that is not a related party of the reporting entity
- if the proceeds of the policy:
  a) can be used only to pay or fund employee benefits under a defined benefit plan; and
  b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, ***unless either***:
     i. the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or
     ii. the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

*Contribution by an employer to the fund*

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Plan Asset A/C Dr. | XXXX | |
| To Bank A/c | | XXXX |

*Payments to employees by the fund*

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Employee Benefit Obligation A/C Dr. | XXXX | |
| To Plan Asset A/c | | XXXX |

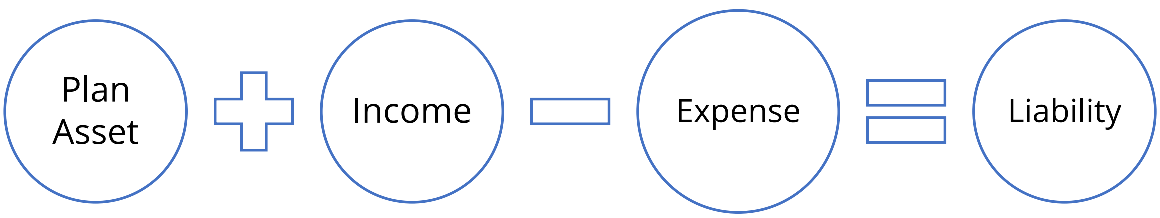
### 6.3 Return on plan assets

Interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:

- any costs of managing plan assets; and
- any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.

***Return on plan assets***

| **Particulars** | ***Debit*** | ***Credit*** |
|---|---|---|
| Plan Asset A/C Dr. | XXXX | |
| To Employee Benefit Cost A/c | | XXXX |



### 6.4 Deficit or surplus in benefit plan

| | | | |
|---|---|---|---|
| ***PV of DBO > Fair value of Plan Assets*** | Deficit | → | Net liability |
| ***PV of DBO > Fair value of Plan Assets*** | Surplus | → | Net Asset |

| | |
|---|---|
| ***Asset > Obligation*** | Overfunded plan |
| ***Asset < Obligation*** | Underfunded plan |

> **Asset ceiling**: PV of any economic benefits available in the form of a ***refunds from the plan*** *or* a ***reduction in future contributions to plan***

An entity shall recognise the net defined benefit liability (asset) in the balance sheet at Lower of

- the surplus in the defined benefit plan; and
- the asset ceiling, determined using the discount rate

### 6.5 Net defined benefit liability (asset)

The deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling

## 7 Types of Defined Benefit Plan / Defined Contribution Plan

### 7.1 State Plan

- Established by legislation
- Operated by government (*CG/SG/Autonomous*)

**Examples**

- Statutory Provident Fund
- National Pension Scheme

> Generally, State plans are defined contribution plans

### 7.2 Multi-Employer Plan

Plans **other than** state plans

- Pool of assets are contributed by various entities that are ***not under common control***
- Use those assets to provide benefits to employees of ***more than one entity,*** on the basis that contributions and benefits are determined without regard to ***the identity of the entity*** that employs the employees

### 7.3 Accounting for Multi-Employer Plan

Multi-Employer Plan

- Defined Benefit plan
  - Actuarial risk and investmen risk fall on the entity
  - Recognise proportionate share in,
    a) Plan assets
    b) Denifed benefit obligation
    c) Cost associated with the plan
- Defined Contribution plan
  - Actuarial risk and investment risk fall on the employee
  - Recognise contribution paid as expense

- Sufficient ***information*** is ***not available*** to use defined benefit accounting, account for the plan as if it were a defined contribution plan

## 7.4 Group Administration Plan

- Aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes
- Reduce investment management and administration costs.
- Group administration plans are classified as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan

## 7.5 Defined Benefit Plans that Share Risks between Entities under Common Control

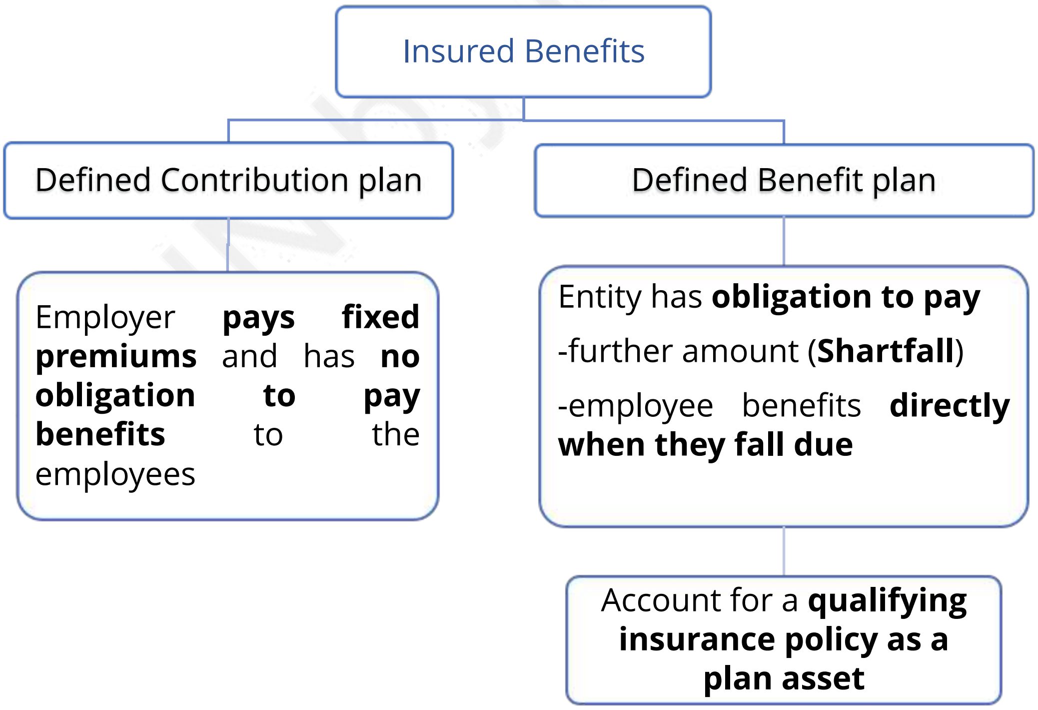
### 7.5.1 For Defined Benefit plan

| Particulars | *Debit* | *Credit* |
|---|---|---|
| Employee benefit cost A/C Dr.<br>To Contribution Payable A/c | XXXX | <br>XXXX |

### 7.5.2 For Defined Contribution plan

| | |
|---|---|
| ***There is a contractual agreement*** | Recognise cost in the statement of Profit and loss in individual financial statements |
| ***If no such agreement*** | ➢ Recognise cost in financial statements of sponsoring employer for the plan (group entity)<br>➢ Other group entities recognise cost equal to contribution payable |

## 7.6 Insured Benefits



## 8 Presentation of Post-Employment Benefits.

### 8.1 Offset

An asset relating to one plan will be offset against a liability relating to another plan when, and only when, the entity:

- has a ***legally enforceable right*** to use a surplus in one plan to settle obligations under the other plan; and
- there is ***an intention*** either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.

### 8.2 Current/Non-current

Ind AS 19 does not specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

## 9 Disclosures

### 9.1 Disclosures of Defined Benefit plan

An entity shall disclose information that:

a) explains the characteristics of its defined benefit plans and risks associated with them;
b) identifies and explains the amounts in its financial statements arising from its defined benefit plans; and
c) describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

### 9.2 Disclosures of Multi-employer plans

If an entity participates in a multi-employer defined benefit plan, it shall disclose:

a) a description of the funding arrangements, including the method used to determine the entity's rate of contributions and any minimum funding requirements;
b) a description of the extent to which the entity can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan;
c) a description of any agreed allocation of a deficit or surplus on:
   i. the entity's withdrawal from the plan.
   ii. if wind-up of the plan; or
d) If the entity accounts for that plan as if it were a defined contribution plan in accordance with paragraph 34, it shall disclose the following,
   i. the fact that the plan is a defined benefit plan.
   ii. the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan.
   iii. the expected contributions to the plan for the next annual reporting period
   iv. information about any deficit or surplus in the plan that may affect the amount of future contributions,
   v. an indication of the level of participation of the entity in the plan compared with other participating entities.

### 9.3 Disclosures of Defined Benefit Plans that share risks between entities under common control

If an entity participates in a defined benefit plan that shares risks between entities under common control, it shall disclose:

a) the contractual agreement or stated policy for charging the net defined benefit cost or the fact that there is no such policy.
b) the policy for determining the contribution to be paid by the entity.

c) Disclosure of defined benefit cost (reconciliation etc) or defined contribution payable as applicable
d) Cross reference to another entity's financials statements can be done if the information about plan is available and group's entity financial statements are available

## 10 Other Long Term Employee Benefits

| | |
|---|---|
| ***Settlement*** | >12 months from the end of financial reporting period |
| ***Benefits*** | Other than<br>➢ Short-term employee benefits<br>➢ Post-Employee benefits<br>➢ Termination benefits |
| ***Example*** | ➢ Long-term paid absences<br>➢ Jubilee/Long term service benefits<br>➢ Long-term disability benefits<br>➢ profit-sharing and bonus plan<br>➢ deferred remuneration. |

### 10.1 Accounting for other long-term employee benefits

For other long-term employee benefits, an entity shall recognise the net total of the following amounts in profit or loss,

a) service cost;
b) net interest on the net defined benefit liability (asset); and
c) remeasurements of the net defined benefit liability (asset).

## 11 Termination benefits

Termination benefits result from either:

- an entity's decision to terminate the employment or
- an employee's decision to accept an offer of benefits in exchange for the termination of employment.

**Termination benefits does not Include,**

- Employee benefits resulting from termination of employment ***at the request of the employee without an entity's offer***
- as a result of mandatory retirement requirements

### 11.1 Recognition of termination benefits

- Recognise a liability and expense for termination benefits

| | |
|---|---|
| ***Expected to be settled before 12 months*** | Apply the requirements for ***short-term*** employee benefits |
| ***Expected to be settled before 12 months*** | Apply the requirements for ***long-term*** employee benefits |

- An entity is required to recognise a liability and expense for termination benefits at the ***earlier*** of the following dates:

  a) when the entity can no longer withdraw the offer of those benefits; and

b) when the entity recognises costs for a restructuring which is within the scope of Ind AS 37 and involves the payment of termination benefits.

## 12 Appendix B

Issues addressed are

a) Refund from a plan
b) Reduction in future contributions
c) Minimum funding requirement

| | |
|---|---|
| ***Right to refund*** | ➢ Available only if the entity has unconditional ***right to a refund***<br>➢ The amount of refund is determined as the full amount or a proportion of the surplus → ***no adjustment for time value of money***<br>➢ If the refund if fixed amount → ***consider time value of money*** |
| **Economic benefit available as a contribution reduction** | ➢ No minimum requirement<br>➢ Economic benefits → Reduction in future cost |
| ***Minimum funding requirement*** | The ***minimum amount*** or the level of contribution that ***must be given to a plan*** over the given period<br>**Prepayment** → reduces future minimum funding requirement contributions |

## 13 Significant differences between Ind AS 19 and AS 15

| Basis of differences | IND AS 19 | AS 15 |
|---|---|---|
| **Constructive Obligations** | In Ind AS 19, employee benefits arising from constructive obligations are also covered | AS 15 does not deal with the same |
| **Definition of Employee** | Ind AS 19 the term 'employee' includes directors | As per AS 15, the term 'employee' includes whole-time directors |
| **Other Definitions** | Definitions of short-term employee benefits, other long-term employee benefits, and past service cost is different in Ind AS 19 | Different definitions are given in AS 15 |
| **Contractual Agreement between a Multi-employer Plan and its Participants** | Deals with contractual agreement | AS 15 does not deal with it |
| **Participation in a Defined Benefit Plan Sharing Risks Between Various** | Covered | Not covered |

| | | |
|---|---|---|
| **Entities under Common Control** | | |
| **Recognition of Past Service Cost** | Past service should be recognised immediately | Recognise past service cost as an expense on a **straight-line basis** over the average period **until the benefits become vested.**<br>To the extent that the **benefits are already vested** immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should **recognise** past service cost **immediately**. |
| **Frequency of Actuarial valuation** | Ind AS 19 does not specify sufficient regularity | Detailed actuarial valuation to determine the PV of DBO Is carried out at least once every 3 years and fair value of plan assets are determined at each balance sheet date. |
| **Recognition of Actuarial Gains and Losses** | Shall be recognised in other **comprehensive income** | Recognise immediately in the statement of profit and loss |
| **Financial Assumptions** | shall be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled | AS 15 does not clarify the same |
| **Discounting of Post-employment Benefit Obligations** | Special guidance on the discount rate for subsidiaries associates joint ventures and branches **domiciled outside India** | Rate used to for discounting should always be determined by **reference to** market yields at the balance sheet date on **government bond**. |
| **Contribution from employee or third parties to defined benefit plans** | Specific guidance under Ind AS 19 | No specific guidance |
| **Guidance on Interaction of Ceiling of Asset Recognition and Minimum Funding Requirement** | Specific guidance under Ind AS 19 | No specific guidance |

## 1. Illustration

Mr. Rajan is working for Infotech Ltd. Consider the following particulars:

Annual salary of Mr. Rajan = ₹ 30,00,000

Total working days in 20X0-X1 = 300 days

Leaves allowed in 20X0-X1 as per policy = 10 days

Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days

The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.

Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.

## 2. Illustration

Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

| | 20X0-X1 | 20X1-X2 |
|---|---|---|
| Annual salary | 30,00,000 | 30,00,000 |
| Working days | 300 days | 300 days |
| Leave allowed | 10 days | 10 days |
| Leave taken | 7 days | 13 days |
| Leave unutilized carried forward to next year | 3 days | NIL |

**Scenario I**

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2.

Infotech Ltd. contends that it will record Rs. 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2.

Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years.

**Scenario II**

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 2 days of 20X0-20X1 subsequently. However, in 20X1-20X2, Mr. Niranjan availed in actual all 3 days of brought forward leave.

Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.

## 3. Illustration

Sundaram Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled to:

- 30 casual leaves out of which 10 casual leaves may be carried forward to the next year; and
- 10 sick leaves out of which 2 sick leaves may be carried forward as paid leave.

At 31st March, 20X1, the average unused entitlement is 5 days per employee for casual leaves and 1 day per employee for sick leave. On an average, it is found that the number of such employees who would be claiming casual leaves would be 30 and 10 employees who would claim sick leaves.

Compute the liability to be recognised in respect of sick leaves and casual leaves by the entity at the end of the financial year 20X0-20X1.

## 4. Illustration

An entity has 100 employees, who are each entitled to ten working days of paid sick leave for each year. Unused sick leave may be carried forward for one financial year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis).

At 31 March 20X1, the average unused entitlement is two days per employee. Based on past experience, the management expects that only 20% of the employees will use 1 day from their carried forward leave. Salary per day is Rs. 2,500.

Compute the expenses in respect of the short-term compensated absences, if they are assumed to be

(a) vested short-term compensated absences, and

(b) non-vested short-term compensated absences.

## 5. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates observed during past 10 years represents 6% per annum. Acer Ltd. provides the following benefits to all its employees:

Paid vacation - 10 days per year regardless of date of hiring. Compensation for paid vacation is 100% of employee's salary and unused vacation can be carried forward for 1 year.

As of 31st March, 20X1, unused vacation carried forward was 3 days per employee, average salary was Rs. 15,000 per day and accrued expense for unused vacation in 20X0-20X1 was Rs. 65,00,000. During 20X1-20X2, employees took 9 days of vacation in average. Salary increase in 20X1-20X2 was 10%.

How would Acer Ltd. recognize liabilities and expenses for these benefits as of 31st March, 20X2?. Pass the journal entry to show the accounting treatment.

## 6. Illustration

An entity has 100 employees, who are each entitled to five working days of paid sick leaves for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (LIFO basis).

At 31st March, 20X1, the average unused entitlement is two days per employee. The entity expects, on the basis of experience that is expected to continue, that 92 employees will take no more than five days of paid sick leaves in 20X1-20X2 and that the remaining eight employees will take an average of six and a half days each.

Would the entity require to recognize any liability in respect of leaves?

## 7. Illustration

Laxmi Mills is a profit-making entity and has reported profit of Rs.200 crore in the financial year 20X1-20X2.

According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation.

Under this plan, an entity is under an obligation to pay if the employees complete a specified period with the organisation. Laxmi Mills has estimated that due to staff turnover in the organisation, the estimated pay-out would be around 4.5%.
Compute the liability and expense of the company under this plan.

### 8. Illustration

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates as observed during past 10 years represents 6% per annum. Acer provides the following benefits to all its employees:
Annual bonus - during past 10 years.
Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented Rs. 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate.
How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

### 9. Illustration

A company pays each employee a lump-sum one-time benefit upon retirement. This benefit is computed based on the employee's years in service in the company and the final salary prior to retirement. To cover its liabilities from this remuneration, the company contributes 3% of annual gross salaries to the fund. Would this obligation represent a defined contribution plan or a defined benefit plan and why?

### 10. Illustration

In accordance with applicable legislation, company contributes 12% and employees 12% of annual gross salaries to the provident and pension fund. Upon retirement, the employees will get the accumulated balance that is calculated based on employee's years of service and his average salary for past 15 years before retirement. The pension will be paid out of the state fund assets and the company has no further obligation except to make contributions. Would this obligation represent a defined contribution plan or a defined benefit plan?

### 11. Illustration

Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year i.e., in November of the related financial year and in June after the financial year- end. Total annual gross salaries for 20X0-X1 amounted to Rs. 50 crores. Contribution made by Acer Ltd. in November 20X0 was Rs. 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).

How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?

### 12. Illustration

In 2017-18, Diana Ltd. has 3,000 employees in the company.
As per the company policy, the employees are given 30 days of Privilege Leave (PL), 12 days of Sick Leave (SL) and 12 days of Casual Leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 1,000 employees will take 5 days of PL and 2 days of SL and 2,000 employees will avail 10 as PL and 5 as SL.

Also, the company has been incurring profits since incorporation. It has been decided in 2017-18 to distribute profits to its employees @ 8% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Diana Ltd. is to be around 7%. The profits earned during 2017-18 is Rs. 12,000 lakh.
Diana Ltd. also has a post-employment benefit plan available which is in the nature of defined contribution plan where contribution to this fund amounts to Rs. 500 lakh which will fall due within 12 months from the end of accounting period. The company has paid Rs. 120 lakh to its employees in 2017-18. What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Diana Ltd. as per the provisions of relevant Ind AS? [May 19 (N), 5 marks]

## 13. Illustration

A company has an employee benefit plan which involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is Rs. 10,000 and is assumed to increase at 7 per cent (compound) each year.
Taking a discount rate at 10 per cent per year, you are required to show
(a) benefits attributed (year on year) and
(b) the obligation in respect of this benefit (year on year)
for an employee who is expected to leave at the end of year 5.

## 14. Illustration

AKJ Ltd is a listed company engaged in the business of manufacturing of electronic equipment. The company has various branch offices spread out across India and has 1,000 employees.
As per the statutory requirements, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years -

(a) on his superannuation, or
(b) on his retirement or resignation, or
(c) on his death or disablement due to accident or disease.

The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.
The amount payable is determined by a formula linked to number of years of service and last drawn salary. The amount payable to an employee shall not exceed Rs.10,00,000.
How should the amount of employee benefit, if any, be attributed to each year of service?

## 15. Illustration

OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at Chennai. The company has been operating in Indian market for the last 10 years.
The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.
On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:

- Employees with more than seven years' service on 1 January 20X8 – Rs. 2,75,000
- Employees with less than 7 years of service – Rs. 2,21,000 (average 4 years to go)

What would be the accounting treatment in this case?

## 16. Illustration

RKA Private Ltd is an old company established in 19XX. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of Rs.11,000 crores and planning to get listed in the next year.

The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as on 1st April X1 and 31st March X2 (Rs. Lacs)

| Particulars | 1st April | 31st March |
|---|---|---|
| Present Value of benefit obligation | 1,400 | 1,580 |
| Fair Value of plans assets | 1,140 | 1,275 |

For the financial year ended 31st March, 20X2, service cost was Rs. 55 lacs. The company made a contribution of an amount of Rs. 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%.

You are required to -

(a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.

(b) Give the journal entries in respect of amount(s) to be recognized.

## 17. Illustration

SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.

SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.

Following information is available for SA Pvt Ltd:

**Plan Assets**

On 1st April, 20X1, the fair value of plan assets was ₹ 10,000.

Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000

Amount paid on 31st March, 20X2 – ₹ 300

On 31st March, 20X2, the fair value of plan assets was ₹ 14,700

Actual return on plan assets – ₹ 2,000

**Defined Benefit Obligation**

On 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.

On 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500.

Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.

Current Service Cost – ₹ 2,500

Benefit paid – ₹ 300

Discount rate used to calculate defined benefit liability - 10%.

As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).

## 18. Illustration

A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 20X1, the annual market yield on government bonds was 5%. During the year ended 31st March, 20X2, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 20X2.

The actuaries advised that the current service cost for the year ended 31st March, 20X2 was ₹ 62,00,000. On 28th February, 20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by ₹ 15,00,000 from that date.

During the year ended 31st March, 20X2, A Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 80,00,000. Before 31st March, 20X2, A Ltd. made payments of ₹ 75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000.

Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 20X2 as per Ind AS. Finance cost is to be computed on the opening balances.

## 19. Illustration

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March,20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31 March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000.

Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

# 1 Objective of General Purpose Financial Reporting

- The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to
  - existing and potential investors,
  - lenders and
  - other creditors in making decisions relating to providing resources to the entity.
- Those decisions involve decisions about:
  - buying, selling or holding equity and debt instruments;
  - providing or settling loans and other forms of credit; or
  - exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Users of FS
- Investors
- Lenders
- Govt.
- Public
- Employees
- Customers
- Suppliers

# 2 Limitation of General Purpose Financial Reporting

- Do Not provide all information that the users require. An improvement to address this issue is integrated reporting.
- Do not provide specific information required by users like regulators, members of public etc.
- Do not show value created
- Based on historical information

# 3 Information Provided by General Purpose Financial Reporting

| | |
|---|---|
| Financial Position | Economic Resources - Assets |
| | Claims or Obligations - Liabilities |
| Effects of transactions and other events | Financial Performance - Income |
| | Cash flows |
| | Changes not resulting from financial performance |

## 3.1 Economic Resources and Claims

Information about the nature and amounts of a reporting entity's economic resources and claims can help users to identify the reporting entity's financial strengths and weaknesses. That information can help users to:

- assess the reporting entity's:
  - liquidity and solvency,
  - its needs for additional financing and

- how successful it is likely to be in obtaining that financing
- assess management's stewardship of the entity's economic resource
- predict how future cash flows will be distributed among those with a claim against the reporting entity

### 3.2 Changes in Economic Resources and Claims

Changes in a reporting entity's economic resources and claims result from:

- that entity's financial performance and
- other events or transactions such as issuing debt or equity instruments.

### 3.3 Changes in economic resources and claims not resulting from financial performance

A reporting entity's economic resources and claims may also change for reasons other than financial performance, such as issuing debt or equity instruments. Information about this type of change is necessary to give users a complete understanding of why the reporting entity's economic resources and claims changed and the implications of those changes for its future financial performance.

## 4 Financial Statements

The objective of financial statements is to provide financial information about the reporting entity's:

- assets, liabilities and equity; and
- income and expenses

The information is provided in

- in the balance sheet, by recognising assets, liabilities and equity;
- in the statement of profit and loss, by recognising income and expenses; and
- in other statements and notes, by presenting and disclosing information about:
  - recognised assets, liabilities, equity, income and expenses, including information about their nature and about the risks arising from those recognised assets and liabilities;
  - assets and liabilities that have not been recognised, including information about their nature and about the risks arising from them;
- cash flows;
- contributions from holders of equity claims and distributions to them; and
- the methods, assumptions and judgements used in estimating the amounts presented or disclosed, and changes in those methods, assumptions and judgements

## 5 Elements of Financial Statements

| Information provided by general purpose financial reports | Element of financial statements | Definition or description |
|---|---|---|
| Economic Resources | Asset | A present economic resource controlled by the entity as a result of past events.<br>An economic resource is a right that has the potential to produce economic benefits. |
| Claim | Liability | A present obligation of the entity to transfer an economic resource as a result of past events. |
| | Equity | The residual interest in the assets of the entity after deducting all its liabilities. |

| | | |
|---|---|---|
| Changes in economic resources and claims,reflecting financial performance | Income | Increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims. |
| | Expenses | Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims |
| Other Changes in resources and claims | | Contributions from holders of equity claims, and distributions to them.<br>Exchanges of assets or liabilities that do not result in increases or decreases in equity. |

**Meaning of Control**

- It is the present ability to direct the use of the economic resource
- obtain the economic benefits that may flow from it
- if one party controls an economic resource, no other party controls that resource.

**Obligation**

- To pay cash
- To deliver goods or services
- To exchange economic resources with another party on unfavourable terms
- To transfer economic resource if an event occurs
- To issue financial instrument which will oblige the entity to transfer economic resource

**Asset = Liability + Equity**

| | **Income** | **Expense** |
|---|---|---|
| **Assets** | Increase | Decrease |
| **Liabilities** | Decrease | Increase |
| **Equity** | Increase | Decrease |
| **Exclusion** | Contribution from holders of equity | Distribution to holders of equity |

# 6 Recognition Process

## 6.1 Meaning of Recognition

Recognition is the process of capturing for inclusion in the balance sheet or the statement of profit and loss an item that meets the definition of one of the elements of financial statements—an asset, a liability, equity, income or expenses.

### 6.2 Recognition Criteria

- Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet.
- Only items that meet the definition of income or expenses are recognised in the statement of profit and loss.
- An asset or liability is recognised only if recognition provides users of financial statements with information that is useful, i.e. with:
  - relevant information; and
  - a faithful representation
  - of the asset or liability and of any resulting income, expenses or changes in equity.

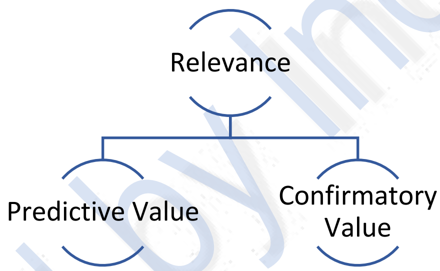
### 6.3 Derecognition

Derecognition is the removal of all or part of a recognised asset or liability from an entity's balance sheet. Derecognition normally occurs when that item no longer meets the definition of an asset or of a liability:

## 7 Qualitative Characteristics of Financial Statements

***If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.***

### 7.1 Relevance




- Financial information is relevant if it is capable of making a difference in decisions made by users.
- Financial information has predictive value if it can be used as an input to processes employed by users to predict future outcomes.
- Financial information with predictive value is employed by users in making their own predictions.
- Financial information has confirmatory value if it provides feedback about (confirms or changes) previous evaluations.
- The characteristic of 'relevance' also includes the concept of materiality. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity

### 7.2 Faithful Representation

The financial information must faithfully present the substance of the events and transactions.

**Fundamental Characterstics**

- Complete - A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations
- Neutral - A neutral depiction is without bias in the selection or presentation of financial information.
- Free from Error - Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects.

**Enhancing Qualitative Characterstics**

- **Comparability**: Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

- **Verifiability**: Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Verification can be direct or indirect.

- **Timeliness**: Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is.

- **Understandability**: Classifying, characterising and presenting information clearly and concisely makes it understandable. Excluding information about complex events from financial reports might make the information in those financial reports easier to understand.

## 8 The Cost Constraint on Useful Financial Information

Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.

Both the providers and users of financial information incur costs in reporting and analysing financial information.

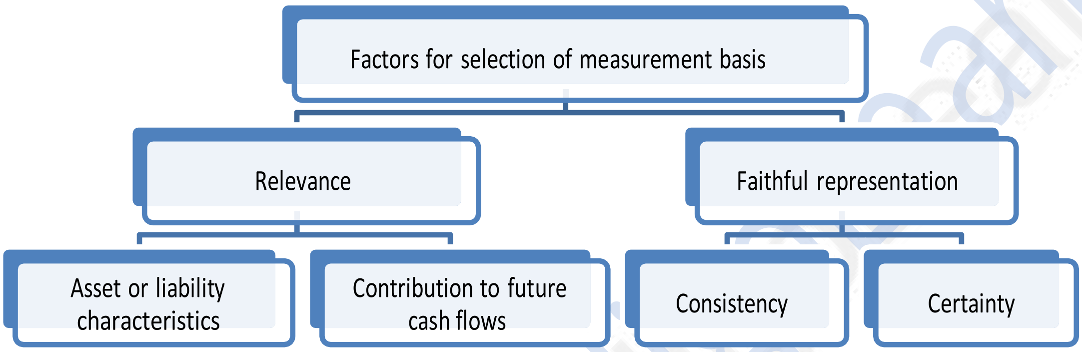
In applying the cost constraint, the ICAI assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information.

Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. ICAI seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities.

## 9 Measurement of Elements

Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss. The framework recognises four alternative measurement bases.

- **Historical Cost**
    - Asset – Consideration Paid + Transaction Price
    - Liability – Consideration Received – Transaction Cost
- **Current Value**
    - Entry Value – Current Cost
    - Exit Value
        - Fair value
        - Value in use for assets /Fulfilment value for liabilities




## 10 Capital Maintenance

Capital refers to net assets of a business.

$$P = (CA - CL) - (OA - OL) - C + D$$

Where: Profit = P

- Opening Assets = OA and Opening Liabilities = OL
- Closing Assets = CA and Closing Liabilities = CL
- Introduction of capital = C and Drawings / Dividends = D
- Retained Profit = P – D = (CA – CL) – (OA – OL) – C

A business should ensure that Retained Profit (RP) is not negative, i.e. closing equity should not be less than capital to be maintained, which is sum of opening equity and capital introduced.

## 1 Objective

- Prescribes the basis for presentation of general purpose financial statements to ensure comparability with the previous years of the entity and with other entities.
- Overall requirements for the presentation of financial statements
- Structure and minimum requirements for the content of financial statements

## 2 Scope

This Ind AS is applicable to

- All types of entities preparing and preparing and presenting general purpose financial statements. This includes both consolidated and separate financial statements. (but does not apply to structure and content of condensed interim financial statements prepared in accordance with Ind AS 34 except few points. )
- All types of entities including profit and non profit oriented and entities whose share capital is not considered as equity.
- This Standard uses terminology that is suitable for profit-oriented entities, including public sector business entities.
- If any non profit oriented entity is preparing Ind AS financial statements, it needs to modify the terminology as needed.

## 3 Definitions

### 3.1 General purpose financial statements

General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

### 3.2 Owners

Owners are holders of instruments classified as equity. It means a holder of redeemable preference share capital cannot be called as owner, as redeemable preference share capital is a liability but not equity.

### 3.3 Other Comprehensive Income

The other comprehensive income section should present line items for the amounts of other comprehensive income classified by nature and grouped into those that, in accordance with other Ind AS:

- Will not be reclassified subsequently to profit or loss; and
- Will be reclassified subsequently to profit or loss when specific conditions are met.

## 4 Complete set of financial statements

A complete set of financial statements comprises:

- a **balance sheet** as at the end of the period
- a **statement of profit and loss** for the period
- **statement of changes in equity** for the period
- a statement of **cash flows** for the period
- **notes**, comprising Material Accounting Policies and other explanatory information
- **comparative information** in respect of the preceding period
- **a balance sheet as at the beginning of the preceding period** when
  - an entity applies an accounting policy retrospectively or

- makes a retrospective restatements of items in its financial statements, or
- when it reclassifies items in its financial statements.

An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

Many entities present reports and statements (generally in annual reports) such as financial reviews by management, environmental reports, and value added statements that are outside the financial statements. Such reports and statements that are outside the financial statements are outside the scope of Ind AS.

## 5 General features of financial statements

### 5.1 Presentation of True and Fair view and compliance with Ind AS

Financial statements shall present a true and fair view of the financial position and financial performance and cash flows of the entity.

Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework.

The application of Ind AS, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.

Presentation of a true and fair view also requires an entity:

- To **select and apply accounting policies** in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Ind AS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an Ind AS that specifically applies to an item.
- To present information, including accounting policies, in a manner that **provides relevant, reliable, comparable and understandable information.**
- To provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.

#### 5.1.1 Departure from compliance of Ind AS

In the extremely rare circumstances in which management concludes that compliance of an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework. An entity shall depart from Ind AS requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it shall disclose:

(a) that the financial statements present a true and fair view as per management conclusion.
(b) that it has complied with applicable Ind AS, except the departure.
(c) Departed Ind AS information. Such as
  - The title of the Ind AS from which the entity has departed.

- The nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Conceptual Framework, and the treatment adopted; and

(d) For each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement

### 5.2 Going Concern

While preparing the financial statements, management is required to assess, the entity's ability to continue as a going concern, and this assessment should cover the entity's prospects for at least 12 months from the end of the reporting period.

In general, an entity is assumed to be a going concern unless there is significant information to the contrary or there is no realistic alternative.
In making such assessment, they should consider all material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The entity should disclose such uncertainties.

When an entity does not prepare financial statements on a going concern basis, disclose

- The fact that entity does not have going concern.
- Basis of preparation of the financial statements.
- The reason why the entity is not regarded as a going concern.

If the management believes that an entity may no longer be a going concern,

- The entity should account for all its assets at net realizable value or a liquidation basis but not on the historical cost basis.
- It should disclose the basis of preparation of financials.
- The difference between the carrying amount and net realizable value should be taken to P&L a/c.

### 5.3 Accrual basis of accounting

An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. It means to record the transaction whenever transaction occurs irrespective of flow of cash.

When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the framework.

### 5.4 Materiality and aggregation (Clubbing the items as one)

An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.

Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.

An entity need not provide a specific disclosure required by an Ind AS if the information is not material except when required by law.

### 5.5 Offsetting

- An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.
- An entity reports separately both assets and liabilities, and income and expenses. Measuring assets net of valuation allowances — for example, obsolescence allowances on inventories and doubtful debts allowances on receivables—is not offsetting.
- Ind AS 115, 'Revenue from Contracts with Customers', requires an entity to measure revenue from contracts with customers at the amount of consideration to which the entity expects to be entitled in exchange for transferring promised goods or services.
  **For example**:
  The amount of revenue recognized reflects any trade discounts and volume rebates the entity allows. An entity undertakes, in the course of its ordinary activities, other transactions that do not generate revenue but are incidental to the main revenue-generating activities. An entity presents the results of such transactions, when this presentation reflects the substance of the transaction or other event, by netting any income with related expenses arising on the same transaction.
- An entity presents on a net basis gains and losses arising from a group of similar transactions, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses separately if they are material.

### 5.6 Frequency of reporting

An entity shall present a complete set of financial statements (including comparative information) at least annually.
When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

- the reason for using a longer or shorter period, and
- the fact that amounts presented in the financial statements are not entirely comparable

### 5.7 Comparative information

**Minimum comparative information**

- An entity should present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements except when Ind AS permit or require otherwise.
- Comparative information for narrative and descriptive information should be included if it is relevant to understand the current period's financial statements.
- An entity shall present, as a minimum:
  - ✓ 2 Balance Sheets
  - ✓ 2 Statement of Profit and Loss
  - ✓ 2 Statement of Cash Flows
  - ✓ 2 Statement of Changes in Equity and
  - ✓ Related Notes

**Additional comparative information**

An entity may present comparative information in addition to the minimum comparative financial statements required by Ind ASs, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in 'Complete set of financial statements' but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

**Third Balance Sheet date**

If current year ended is 31-03-20X8, previous year comparative is 31-03-20X7 & opening balance sheet of previous year is 01-04-20X7.

An entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required if:

- It applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
- The retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

An entity shall reclassify the comparative amounts also unless it is impracticable. If it reclassifies, it should disclose the following

- The nature of reclassification
- The amount of each item or class of items that is reclassified
- The reason for reclassification

In case of impracticability, disclose the reason and nature of adjustments that would have been reclassifies.

### 5.8 Consistency of Presentation

An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

- it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or
- an Ind AS requires a change in presentation

## 6 Identification of Financial Statements

An entity shall clearly identify the financial statements and distinguish them from other information in the same published document. Ind AS apply only to financial statements, and not necessarily to other information presented in an annual report, a regulatory filing, or another document though they may be useful to users.

An entity shall display the following information prominently:

- the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period
- whether the financial statements are of an individual entity or a group of entities;
- reporting date or the reporting period
- the presentation currency
- the level of rounding used in presenting amounts in the financial statements.

Usage of any unit of the presentation currency is acceptable as long as the entity discloses the level of rounding and does not omit material information.

An entity meets above requirements by presenting appropriate headings for pages, statements, notes, columns and the like. Judgement is required in determining the best way of presenting such information.

An entity often makes financial statements more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the entity discloses the level of rounding and does not omit material information.

## 7 Balance Sheet

At a minimum, the balance sheet shall include following items:

a) Property, plant and equipment
b) Investment property
c) Intangible assets
d) Financial assets (excluding amounts shown under (e, h &i)
e) Investments accounted for using the equity method
f) Biological assets
g) Inventories
h) Trade and other receivables
i) Cash and cash equivalents
j) The total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105 Non-current Assets Held for Sale and Discontinued Operations
k) Trade and other payables
l) Provisions
m) Financial liabilities (excluding amounts shown under k and l)
n) Liabilities and assets for current tax, as defined in Ind AS 12 Income Taxes
o) Deferred tax liabilities and deferred tax assets, as defined in Ind AS 12
p) Liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105
q) Non-controlling interests, presented within equity
r) Issued capital and reserves attributable to owners of the parent

Additional line items, headings and subtotals in the balance sheet should be presented when such presentation is relevant to an understanding of the entity's financial position.

The descriptions of the line items, and the order in which they are shown, can be adapted according to the entity's nature and its transactions.

## 8 Current/Non-current distinction

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet.

### 8.1 Current Assets

An entity shall classify an asset as current when:

- It expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
- It holds the asset primarily for the purpose of trading;
- It expects to realise the asset within twelve months after the reporting period; or
- The asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

**Operating Cycle:**

The operating cycle of an entity is the time between the acquisition of assets (raw materials) for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading.

An entity shall classify all other assets as non-current.
This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

## 9 Current Liabilities

An entity shall classify a liability as current when:

- It expects to settle the liability in its normal operating cycle;
- It holds the liability primarily for the purpose of trading;
- The liability is due to be settled within twelve months after the reporting period; or
- It does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle.
An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.

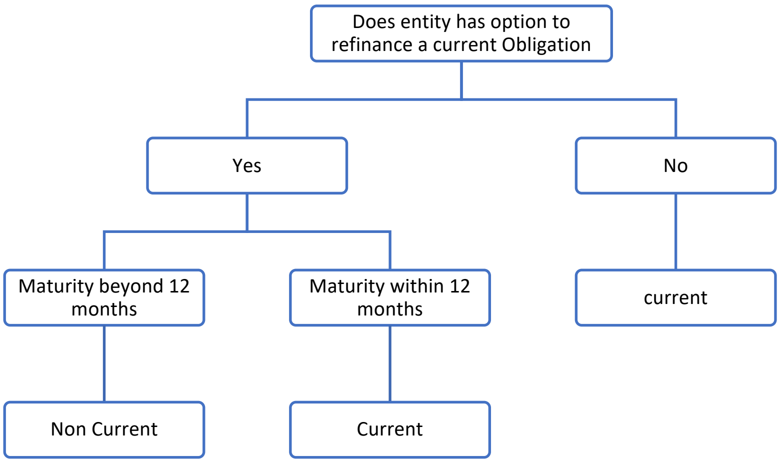
The same normal operating cycle applies to the classification of an entity's assets and liabilities.
When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

Other current liabilities which are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading

Financial liabilities that provide financing on a long-term basis (i.e. are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period **are non-current liabilities**.

An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

- the original term was for a period longer than twelve months, and
- an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.




If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, the entity does not classify the liability as current, even if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

However, an entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment

## 10 Information to be presented either in balance sheet or in notes

An entity shall disclose, either in the balance sheet or in the notes, further sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.
The detail provided in sub-classifications depends on the requirements of Ind AS and on the size, nature and function of the amounts involved.
An entity shall disclose the following, either in the balance sheet or in the statement of changes in equity which is part of the balance sheet, or in the notes:

- for each class of share capital:
    - ✓ the number of shares authorised;
    - ✓ the number of shares issued and fully paid, and issued but not fully paid;
    - ✓ par value per share, or that the shares have no par value;
    - ✓ a reconciliation of the number of shares
    - ✓ the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
    - ✓ shares in the entity held by the entity or by its subsidiaries or associates; and

- ✓ shares reserved for issue under options and contracts for the sale of shares, including terms and amounts; and
- a description of the nature and purpose of each reserve within equity.

An entity whose capital is not limited by shares e.g., a company limited by guarantee, shall disclose information, showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

## 11 Statement of Profit and Loss

The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:

(a) profit or loss;
(b) total other comprehensive income;
(c) Comprehensive income for the period, being the total of profit or loss and other comprehensive income.

An entity shall present (in case of consolidated statement of profit and loss) the following items as allocation of profit or loss and other comprehensive income for the period:

(a) profit or loss for the period attributable to:
- Non-controlling interests, and
- Owners of the parent.

(b) Comprehensive income for the period attributable to
- Non-controlling interests, and
- Owners of the parent.

## 12 Information to be presented in the profit or loss section of the statement of profit and loss

In addition to items required by other Ind AS, the profit or loss section of the statement of profit and loss should include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method
(b) gains and losses arising from the derecognition of financial assets measured at amortised cost
(c) finance costs
(d) impairment losses (including reversals of impairment losses or impairment gains)
(e) share of the profit or loss of associates and joint ventures accounted for using the equity method
(f) If financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date
(g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognized in other comprehensive income that is reclassified to profit or loss
(h) tax expense
(i) a single amount for the total discontinued operations

## 13 Information to be presented in Other Comprehensive Income Section

The other comprehensive income section should present line items for the amounts of other comprehensive income classified by nature and grouped into those that, in accordance with other Ind AS

- will not be reclassified subsequently to profit or loss; and
- will be reclassified subsequently to profit or loss when specific conditions are met.

An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.

When an entity presents subtotals, those subtotals shall:

- be comprised of line items made up of amounts recognised and measured in accordance with Ind AS;
- be presented and labelled in a manner that makes the line items that constitute the sub total clear and understandable;
- be consistent from period to period; and
- not be displayed with more prominence than the subtotals and totals required in Ind AS for the statement of profit and loss.

An entity shall present the line items in the statement of profit and loss that reconcile any sub totals presented with the subtotals or totals required in Ind AS for such statement.
An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes

## 14 Profit and Loss for the period

With regard to profit or loss for the period, the Standard requires the recognition of all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise.

## 15 Other Comprehensive income for the period

With regard to other comprehensive income for the period, the Standard requires to disclose the amount of income tax relating to each item of other comprehensive income, including reclassification adjustments, either in the statement of profit and loss or in the notes.
An entity may present items of other comprehensive income either:

(a) net of related tax effects, or
(b) before related tax effects with one amount shown for the aggregate amount of income tax relating to those items.

The Standard further prescribes that an entity should disclose reclassification adjustments relating to components of other comprehensive income.
Other Ind AS specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments.
A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss.

## 16 Information to be presented in the statement of Profit and Loss or in notes

When items of income or expense are material, an entity shall disclose their nature and amount separately.
Circumstances that would give rise to the separate disclosure of items of income and expense include:

- Write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs.
- restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- disposals of items of property, plant and equipment;
- disposals of investments;
- discontinued operations;
- litigation settlements; and

- Other reversals of provisions.

An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.

## 17 Statement of Changes in Equity

An entity shall present a statement of changes in equity which includes all changes in equity. It includes both - relating to performance and owner changes in equity (from transactions and events that increase or decrease equity but are not part of performance). The statement of changes in equity includes the following information:

a. total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests.
b. for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8.
c. for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing each change resulting from:
    - profit or loss
    - each item of other comprehensive income
    - Transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and
    - Any item recognised directly in equity such as amount recognised directly in equity as capital reserve with Ind AS 103.

## 18 Information to be presented in the statement of changes in equity or in the notes

An entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item.

An entity shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share.

Ind AS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transition provisions in another Ind AS require otherwise. Ind AS 8 also requires restatements to correct errors to be made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an Ind AS requires retrospective adjustment of another component of equity.

Disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

## 19 Statement of Cash Flows

Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

An entity should present a statement of cash flows in accordance with Ind AS 7, Statement of Cash Flows.

**Structure**

The notes shall:

a. Present information about the basis of preparation of the financial statements and the specific accounting policies used.
b. Disclose the information required by Ind AS that is not presented elsewhere in the financial statements; and
c. Provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them.

An entity shall present notes in a systematic manner. In determining a systematic manner, the entity shall consider the effect on the understandability and comparability of its financial statements.
An entity shall cross-reference each item in the balance sheet, in the statement of changes in equity, in the statement of profit and loss, and statement of cash flows to any related information in the notes.

## 20 Disclosures

### 20.1 Disclosure of accounting policies

An entity shall disclose its Material Accounting policies. Accounting policy information is material if it can reasonably be expected to influence decisions made by users of financial statements. Accounting policies related to immaterial transactions are not required to be disclosed.

Accounting policy information would be considered to be material if –

- The events related to material transactions, events or conditions
- Entity changed its accounting policy during the reporting period and this has resulted in a material change to the information in FS.
- Entity chose accounting policy from options permitted by Ind AS
- Accounting policy was developed in accordance with Ind AS in the absence of applicable Ind AS
- It relates to an area where entity is required to make significant judgement or assumptions
- Accounting required for the items is complex and would be difficult for the users to understand.

If a disclosure is required by a specific Ind AS it must be disclosed even if the management considers it to be immaterial

An entity must disclose along with its Material Accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

**Sources of estimation uncertainty:**
An entity must disclose, in the notes, information about the assumptions made concerning the future, and other important sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Disclosures about nature of such assets and their carrying amount as at the end of the reporting period should also be made.
**Capital**
An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

### 20.2 Puttable financial instruments classified as equity (You will understand this after learning Financial Instruments)

For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

a. Summary quantitative data about the amount classified as equity
b. Its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period.
c. The expected cash outflow on redemption or repurchase of that class of financial instruments; and
d. Information about how the expected cash outflow on redemption or repurchase was determined.

### 20.3 Other Disclosures

An entity must disclose the amount of dividends proposed or declared before the financial statements were approved for issue but not recognised as a distribution to owners during the period, and the related amount per share and the amount of any cumulative preference dividends not recognised.
Ind AS 1 requires certain other disclosures, if not disclosed elsewhere in information published with the financial statements:

a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office)
b) a description of the nature of the entity's operations and its principal activities
c) the name of the parent and the ultimate parent of the group; and
d) if it is a limited life entity, information regarding the length of its life.

## 21 Comparison with AS-1

The following are not covered in AS-1

- Complete set of financial statements
- Purpose and general features of FS
- Off-setting requirement (Specific AS prescribe requirement)
- Frequency of reporting
- Structure and content of FS
- Balance Sheet line items
- Statement of P&L line items
- Reclassification of items
- Statements of changes in equity
- Comparative information
- Classification of long-term loan arrangement
- Rectification of accounting policies (not covered by AS-1)
- Sources of estimation uncertainty

AS 1 requires disclosures if the fundamental accounting assumption of going concern, consistency and accrual are not followed in preparation of FS. Ind AS 1 does not have such requirement. Ind AS 1 requires entity to follow accrual basis of accounting and compliance with all Ind AS.

## 22 Carve Out from IAS1

IAS 1 required that in case of a loan liability, if any condition of the loan agreement which was classified as non-current is breached on or before the reporting date, such loan liability should be classified as current even if the breach is rectified after balance sheet date.

Ind AS 1 requires that where there is such breach and the lender agreed before the approval of financial statements for issue not to demand payment as a consequence of breach, the entity shall not classify such loan as current.

**Illustrations**

### 1. Illustration

Entity XYZ is a large manufacturer of plastic products for the local market. On 1st April, 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency Rs. appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products.

Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ went into losses. As at 31st March, 20X7, entity XYZ's equity was Rs. 1,000. During the second quarter of financial year ended 31 March 20X7, the management restructured entity's operations. That restructuring helped reduce losses for the third and fourth quarters to Rs. 400 and Rs. 380, respectively. During the year ended 31st March, 20X7, entity XYZ reported a loss of Rs. 4,000. In January 20X7, the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15th March, 20X7, the government announced that it would reintroduce limited plastic import tariffs at 10 percent in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term.
Management of the entity XYZ undertook a going concern assessment at 31st March, 20X7. Management projects / forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31st March, 20X7 annual financial statements?
*Hint: XYZ's liabilities could exceed its assets by the end of financial year 20X7-20X8. But entity XYZ is a going concern.*

### 2. Illustration

In 20X8 entity 'Superb' was acquired by entity 'Happy Go Luck'. To align its reporting date with that of its parent, Superb changed the end of its annual reporting period from 31stJanuary to 31st March. Consequently, entity Superb's reporting period for the year ended 31st March, 20X8 is 14 months.

On the basis of these facts, what disclosure would be appropriate?

*Hint: Comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.*

### 3. Illustration

An entity produces whisky from barley, water, and yeast in a 24-month distillation process. At the end of the reporting period the entity has one month's supply of barley and yeast raw materials, 800 barrels of partly distilled whisky and 200 barrels of distilled whisky. Determine whether they are current assets.

*Hint: Current Assets*

### 4. Illustration

An entity owns a machine with which it manufactures goods for sale. It also owns the building in which it carries out its commercial activities. Determine whether they are current assets.

*Hint: Non-Current Assets*

### 5. Illustration

On 31 December 20X2, an entity replaced a machine in its production line. The replaced machine was sold to a competitor for Rs,3,00,000. Payment is due 15 months after the end of the reporting period. Determine the nature of payment due.

*Hint: Receivable is a non-current asset*

### 6. Illustration

On 1st April, 20X2, XYZ Ltd invested Rs.15,00,000 surplus funds in corporate bonds that bear interest at 8 percent per year. Interest is payable on the corporate bonds on 1st April, of each year. The principal is repayable in three annual instalments of Rs.5,00,000 starting from 1st April, 20X3. Determine if it is a current liability?

*Hint: Rs.5,00,000 (repayable on 31/3/20X3)- Current assets & remaining Rs.10 lakhs non-current assets*

### 7. Illustration

On 1st April, 20X3, Charming Ltd issued 100,000 Rs. 10 bonds for Rs. 1,000,000. On 1st April, each year interest at the fixed rate of 8 percent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs. 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements?

*Hint: Rs.9,00,000 non-current liability & Rs.1,80,000 current liabilities*

## 8. Illustration

X Ltd provides you the following information:

- Raw material stock holding period: 3 months
- Work-in-progress holding period: 1 month
- Finished goods holding period: 5 months
- Debtor's collection period : 5 months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?

*Hint: Trade payables – Current Liabilities*

## 9. Illustration

Entity A has two different businesses, real estate and manufacturing of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

*Hint: Classification should be based the normal operating cycle that is relevant to that particular asset / liability.*

## 10. Illustration

An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

(a) Electricity Deposit

(b) Tender Deposit/Earnest Money Deposit [EMD]

(c) GST Deposit paid under dispute or GST payment under dispute.

*Hint: (a) Non-Current (b) EMD based on terms of deposit (c) GST Deposit depends on facts of case*

## 11. Illustration

Paragraph 69(a) of Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payment upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non- current?

*Hint: Current Liability*

## 12. Illustration

An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

(a) How should such loan be classified in the balance sheet of the entity?

(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?

(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?

(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

*Hint: (a)Non-Current (b) Current (c) Current Liability (d) Current*

## 13. Illustration

In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 20X5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable on demand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution. On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.

(a) As on March 31, 20X2, how should the entity classify the loan?

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 20X2, the entity approached the bank and got the compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case will the loan classification as on March 31, 20X2 be different from (a) above?

*Hint: (a) Current (b) Non-Current*

## 14. Illustration

OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd.

How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?

*Hint: Current*

## 15. Illustration

An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

(a) Will the inventory and the trade receivables be current in nature?

(b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

*Hint: (a) Current if realisable within normal operating cycle (b) No*

## 16. Illustration

Company A has taken a long term loan from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both the companies agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non-current.

*Hint: Liability to be classified as current as at March 31, 20X2.*

## 17. Illustration

Entity A has undertaken various transactions in the financial year ended March 31, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1.

| | |
|---|---|
| Remeasurement of defined benefit plans | 2,57,000 |
| Current service cost | 1,75,000 |
| Changes in revaluation surplus | 1,25,000 |
| Gains and losses arising from translating the monetary assets in foreign currency | 75,000 |
| Gains and losses arising from translating the financial statements of a foreign operation | 65,000 |
| Gains and losses from investments in equity instruments designated at fair value through other comprehensive income | 1,00,000 |
| Income tax expense | 35,000 |
| Share based payments cost | 3,35,000 |

*Hint: Items impacting (a) P&L – Service cost, translation gains/losses on forex, income tax, share based payments cost (b) OCI – Remeasurement, changes in surplus, translation gains / losses from foreign operations, gains / losses from investments.*

## 18. Illustration

XYZ Limited (the 'Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

| S. No. | Matters |
|---|---|
| (i) | There are qualifications in the audit report of the Company with reference to two Ind AS. |
| (ii) | Is it mandatory to add the word "standalone" before each of the components of financial statements? |
| (iii) | The Company is Indian Company and preparing and presenting its financial statements in Rs. Is it necessary to write in the financial statements that the financial statements has been presented in Rs. |
| (iv) | The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year. |

Evaluate the above matters with respect to preparation and presentation of general-purpose financial statement.

Hint: (i) Yes (ii) No (iii) Yes (iv) No

## 19. Illustration

A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. I t will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

(i) Can management present the third statement of profit and loss as additional comparative in the general-purpose financial statements?

(ii) If management present third statement of profit and loss in the general-purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?

(iii) Can management present third statement of profit and loss only as additional comparative in the general-purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

*Hint: (i) Yes (ii) Yes (iii) Yes*

## 20. Illustration

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of Rs. 10 Crore. The total revenue reported in FY 20X1-20X2 was Rs. 80 Crore. However, while preparing the financial statements for 20X2- 20X3, it discovered that excess revenue was booked in FY 20X1-20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

With regard to the above background, answer the following:

(i) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?

(ii) The Company wants to correct the error during FY 20X2-20X3 by giving impact in the figures of current year only. Is the contention of management correct?

*Hint: (i) No (ii) No*

## 21. Illustration

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

| S. No. | Items/transactions |
|---|---|
| (1) | The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle. |
| (2) | The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed. |
| (3) | The Company was awarded a contract of Rs. 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of Rs. 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract. |
| (4) | The Company has also given certain contracts to third parties and have received security deposits from them of Rs. 2 Crore on March 31, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract. |

Considering the above items/transactions answer the following:

(i) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

(ii) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?

(iii) Can the security deposit of Rs. 5 Crore made by the Company with the customers be presented as current?

(iv) Can the security deposit of Rs. 2 Crore taken by the Company from contractors be presented as non-current?

*Hint: (i) Yes (ii) No (iii) No (iv) No*

## 22. Illustration

Is offsetting permitted under the following circumstances?

(a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?

(b) Whether profit on sale of an asset against loss on sale of another asset can be offset?

(c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset?

*Hint: (a) Yes, if in substance is in nature of reimbursement (b) Yes unless material (c) Yes if entity has legal right*

## 1. Introduction

### 1.1 Objective

- Provides information about historical changes in cash and cash equivalents.
- Assess the ability to generate cash and cash equivalents.
- Understand timing and certainty of cash flow generation.

### 1.2 Benefits of cash flow information

- Provides information enabling evaluation of changes in net assets and financial structure.
- Assesses the ability to manage the cash.
- Assess and compare the present value of future cash flows.
- Compares the efficiency of different entities.

### 1.3 Scope

The standard requires all the entities to present a statement of cash flows.

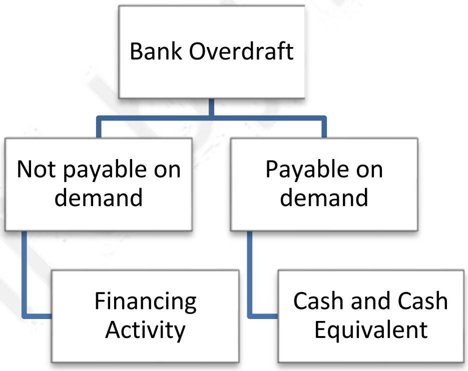
## 2. Definitions

### 2.1 Cash

Comprises cash on hand and demand deposits.

### 2.2 Cash equivalents

Short- term, high liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.






## 3. Classification of Cash Flows

Operating activities

Investing activities

Financing activities

### 3.1 Operating activities

Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity and other activities that are not investing or financing activities.

| **Operating Cash Inflows** | **Operating Cash Outflows** |
|---|---|

| | |
|---|---|
| • Cash receipts from sale of goods and rendering services<br>• Cash receipts from royalties, fee, commission and other revenue<br>• Cash receipts and cash payments of an insurance entity from premiums and claims, annuities and other policy benefits<br>• Cash receipts and payments from contracts held for dealing or trading purposes | • Cash payments to suppliers for goods and services<br>• Cash payments to and on behalf of employees<br>• Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities |

### 3.2 Investing activities

Activities that result in the acquisition and disposal of long-term assets and other investments that are not included under cash or cash equivalents.

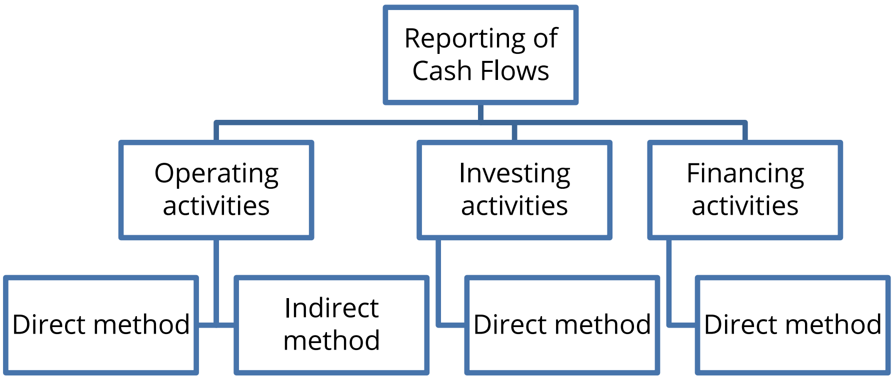
| Cash Inflow from Investing Activities | Cash Outflow from Investing Activities |
|---|---|
| • Cash receipts from sale of property, plant and equipment, intangibles and other long-term assets<br>• Cash receipts from sale of equity or debt instruments (other than those considered to be cash equivalents or those held for dealing or trading purposes)<br>• Cash receipts from repayment of advances and loans ( other than advances and loans of financial institution)<br>• Cash receipts from future contracts, forward contracts, option contracts and swap contracts ( except when held for dealing or trading purposes, or the receipts are classified as financing activities) | • Cash payments to acquire property, plant and equipment, intangibles and other long-term assets<br>• Cash payments to acquire equity or debt instruments (other than those considered to be cash equivalents or those held for dealing or trading purposes)<br>• Cash advances and loans made (other than advances and loans made by financial institution)<br>• Cash payments from future contracts, forward contracts, option contracts and swap contracts ( except when held for dealing or trading purposes, or the receipts are classified as financing activities) |

### 3.3 Financing activities

Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

| Cash Inflows from Financing Activity | Cash Outflows from Financing Activity |
|---|---|
| • Cash proceeds from issuing shares or other equity instruments<br>• Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long- term borrowings | • Cash payments owners to acquire or redeem the entity's shares<br>• Cash repayments of amount borrowed<br>• Cash payments by a lessee for the reduction of the outstanding liability relating to finance lease |

## 4. Reporting of Cash Flows




### 4.1 Reporting of cash flows from operating activities

**Direct Method**

- In the method major classes of gross cash receipts and gross cash payments are disclosed.
- Non-cash expenses , losses, gains not to be considered

**Indirect Method**

- Profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferals or accruals of past or future operating cash receipts or payments, and items of income or expenses associated with investing or financing cash flows

| | |
|---|---|
| Cash flow from operating activities | xxx |
| Cash flow from investing activities | xxx |
| Cash flow from financing activities | xxx |
| Increase or decrease in cash and cash equivalent | xxx |
| Add: opening cash and cash equivalent | xxx |
| Closing cash and cash equivalent | xxx |

| | |
|---|---|
| Profit after tax | xxx |
| Add/(less)- Adjustments | |
| a. Non-cash transactions | xxx |
| b. Items associated with investing and financing activities | xxx |
| c. Working capital adjustments | xxx |
| Cash generated from operating activities | xxx |

### 4.2 Reporting of cash flows from investing and financing activities

An entity is required to report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cashflows are permitted to be reported on a net basis.

### 4.3 Reporting of cash flows on gross basis

If nothing is specifically mentioned, then the cash flows will be presented on gross basis. Gross basis means the receipts would be shown separately and payments will be shown separately.

Example: If in the year 2021-2022, some machinery is purchased for Rs 8 crore and another machinery is sold for Rs 5 crore then while presenting the information, the entity shall show separately outflow of Rs 8 crore and inflow of Rs 5 crore.

## 4.4 Reporting of cash flows on net basis

4.4.1 Cash flows arising from the following operating, investing or financing activities may be reported on net basis:

a. Cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity

- Examples:
- the acceptance and repayment of demand deposits of a bank
- funds held for customers by an investment entity
- rents collected on behalf of, and paid over to, the owners of properties

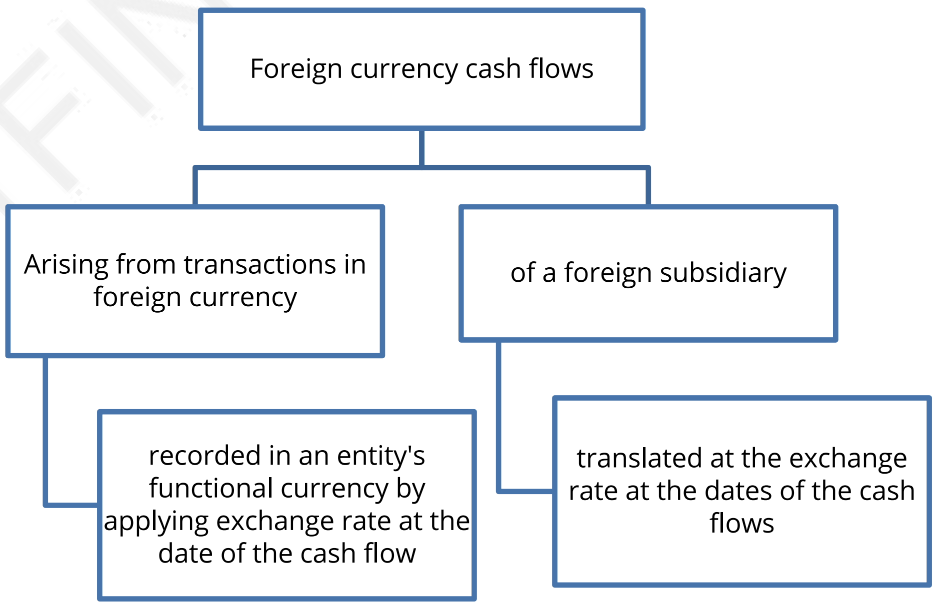
b. Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short

- Examples:
- principal amounts relating to credit card customers
- the purchase and sale of investments
- other short term borrowings( those which have maturity period of three months or less)

4.4.2 Cash flows arising from each of the following activities of a financial institutions may be reported on net basis:

- cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date
- the placement of deposits with and withdrawl of deposits from other financial institutions
- cash advances and loans made to customers and the repayment of those advances and loans.

## 5. Foreign currency cash flows



- Unrealized exchange gain or loss from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalent held or due in a foreign currecy is reported in the statement of cash flows in order to reconcile cash and cash equivalent at the beginning and at the end of the period.

**5.1 Treatment of foreign exchange differences arising from unsettled transactions relating to operating activities**

Under indirect method, the exchange differences that arise on translation at the balance sheet date, for monetary items that form part of operating activities, will require no adjustment in the reconciliation of profit to net cash flow from operating activities.

## 6. Interest and Dividends

| | Financing company | Other company |
|---|---|---|
| Interest paid | Cash flow from operating activity | Cash flow from financing activity |
| Interest received | Cash flow from operating activity | Cash flow from investing activity |
| Dividend received | Cash flow from operating activity | Cash flow from investing activity |
| Dividend paid | Cash flow from financing activity | Cash flow from financing activity |

## 7. Taxes on income

Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities in which case the tax cash flow is classified as an investing or financing activity.

Example:

| | |
|---|---|
| Capital gain tax | Investing activity |
| Tax on business income | Operating activity |
| Dividend distribution tax | Financing activity |

## 8. Non-Cash Transactions

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows.

Examples of non-cash transactions:

- Conversion of debt to equity
- Acquisition of assets either by assuming directly related liabilities or by means of a lease
- Acquisition of an entity by means of an equity issue

## 9. Investments in subsidiaries, associates and joint ventures

| Accounted for by use of the equity or cost method | Reporting its interest in an associate or a joint venture using the equity method |
|---|---|
| • an investor restricts its reporting in the statement of cash flows to the cashflows between itself and the investee, for example, dividends and advances. | • Includes in its statement of cash flows in respect of investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture. |

## 10. Changes in ownership interests in subsidiaries

### 10.1 Classification of cash flows as investing activity

- The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.
- An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:
  - ➢ The total consideration paid or received
  - ➢ The portion of the consideration consisting of cash and cash equivalents
  - ➢ The amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost
  - ➢ The amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

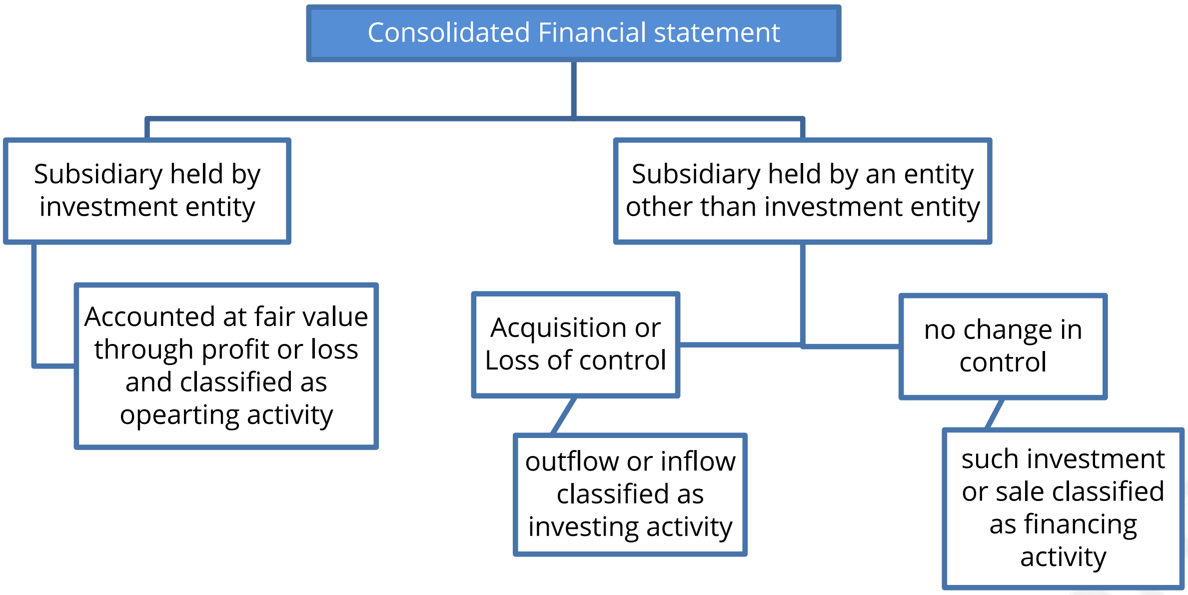
### 10.2 Classification of cash flows as financing activity

- Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss.

**Changes in ownership interests in subsidiaries and other businesses**

Separate financial statement

classified as investing activity (provided subsidiary not held by investment entity)




## 11. Changes in liabilities arising from financing activities

An entity shall disclose the following changes in liabilities arising from financing activities:

- Changes from financing cash flows
- Changes arising from obtaining or losing control of subsidiaries or other businesses
- The effect of changes in foreign exchange rates
- Changes in fair values
- Other changes

## 12. Disclosures

- An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in the statement of cash flows with the equivalent items reported in the balance sheet.
- An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.
- Additional information may be relevant to users in understanding the financial position and liquidity of an entity. It may include:
  - The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities.
  - The aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity it will help the stakeholders to know whether entity is paying proper attention for maintenance also.
  - The amount of the cash flows arising from the operating, investing, and financing activities of each reportable segment (Ind AS 108 Operating Segments).

## 13. Difference between Ind AS 7 and IAS 7

| Particulars | Ind As 7 | IAS 7 |
|---|---|---|
| Dividend paid | Classified as a part of financing activity only | Gives an option to classify the dividend paid as an item of operating activity |
| Dividend received | Financial Institutions- operating activity<br>Other entities-investing activity | Gives an option to classify the dividend received as an item of<br>operating activity |
| Interest paid | Financial Institutions- operating activity<br>Other entities-financing activity | Gives an option to classify the interest paid as an item of operating activity |
| Interest received | Financial Institutions- operating activity<br>Other entities-investing activity | Gives an option to classify the interest received as an item of<br>operating activity |

## 14. Difference between Ind AS 7 and AS 3

| Particulars | Ind AS 7 | AS 3 |
|---|---|---|
| Bank overdraft repayable on demand | Includes as a part of cash and cash equivalents | AS 3 is silent on this aspect |
| Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale in the ordinary course of business | Cash flow from operating activity | AS 3 does not contain such requirements |
| Profit or loss for the effects of undistributed profits of associates and non controlling interest | Adjustment while determining net cash flow from operating activities using indirect method | AS 3 does not contain such requirements |
| Cash flows relating to an investment in joint ventures, subsidiaries, and associates | Guidance available | No specific guidance |
| Cash flows associated with Extraordinary Activities | Does not contain this requirement | Separately classified as arising from operating, investing, and financing activities |

## ILLUSTRATIONS

### 1. Illustration

Company has provided the following information regarding the various assets held by company on 31st March 20X1. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provided in Ind AS 7

| Sr. No. | Name of the Security | Additional Information |
|---|---|---|
| 1. | Fixed deposit with SBI | 12%, 3 years maturity on 1st January 20X4 |

| | | |
|---|---|---|
| 2. | Fixed deposit with HDFC | 10%, original term was for 2 years, but due for maturity on 30th June 20X1 |
| 3. | Redeemable Preference shares in ABC ltd | Acquired on 31st January 20X1 and the redemption is due on 30th April 20X1 |
| 4. | Cash balances at various banks | All branches of all banks in India |
| 5. | Cash balances at various banks | All international branches of Indian banks |
| 6. | Cash balances at various banks | Branches of foreign banks outside India |
| 7. | Bank overdraft of SBI Fort branch | Temporary overdraft, which is payable on demand |
| 8. | Treasury Bills | 90 days maturity |

## 2. Illustration

From the following transactions, identify which transactions will be qualified for the calculation of operating cash flows, if company is into the business of trading of mobile phones.

| Sr. No. | Nature of Transaction |
|---|---|
| 1 | Receipt from sale of mobile phones |
| 2 | Purchases of mobile phones from various companies |
| 3 | Employees expenses paid |
| 4 | Advertisement expenses paid |
| 5 | Credit sales of mobile |
| 6 | Miscellaneous charges received from customers for repairs of mobiles |
| 7 | Loss due to decrease in market value of the closing stock of old mobile phones |
| 8 | Payment to suppliers of mobile phones |
| 9 | Depreciation on furniture of sales showrooms |
| 10 | Interest paid on cash credit facility of the bank |
| 11 | Profit on sale of old computers and printers, in exchange of new laptop and printer |
| 12 | Advance received from customers |
| 13 | Sales Tax and excise duty paid |

## 3. Illustration

From the following transactions taken from a private sector bank operating in India, identify which transactions will be classified as operating and which would be classified as Investing activity.

| S. No. | Nature of transaction paid |
|---|---|
| 1 | Interest received on loans |
| 2 | Interest paid on Deposits |
| 3 | Deposits accepted |
| 4 | Loans given to customers |
| 5 | Loans repaid by the customers |
| 6 | Deposits repaid |
| 7 | Commission received |
| 8 | Lease rentals paid for various branches |
| 9 | Service tax paid |
| 10 | Furniture purchased for new branches |

| | |
|---|---|
| 11 | Implementation of upgraded banking software |
| 12 | Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi |
| 13 | New cars purchased from Honda dealer, in exchange of old cars and remaining amount paid in cash |
| 14 | Provident fund paid for the employees |
| 15 | Issued employee stock options |

## 4. Illustration

From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transactions will be classified as Operating, Investing and Financing:

| S. No | Nature of Transaction |
|---|---|
| 1 | Issued preference shares |
| 2 | Purchased the shares of 100 % subsidiary company |
| 3 | Dividend received from shares of subsidiaries |
| 4 | Dividend received from other companies |
| 5 | Bonus shares issued |
| 6 | Purchased license for manufacturing of special drugs |
| 7 | Royalty received from the goods patented by the company |
| 8 | Rent received from let out of building (letting out is not main business) |
| 9 | Interest received from loans or advances given |
| 10 | Dividend paid |
| 11 | Interest paid on security deposits |
| 12 | Purchased Goodwill |
| 13 | Acquired assets by issuing equity shares |
| 14 | Interim dividends paid |
| 15 | Dissolved the 100% subsidiary and received the amount in final settlement |

## 5. Illustration

Find out the cash from operations by direct method and indirect method from the following information

**Operating statement of ABC Ltd. for the year ended 31.3.20X2**

| **Particulars** | **Amount in ₹** |
|---|---|
| Sales | 5,00,000.00 |
| Less: Cost of goods sold | 3,50,000.00 |
| Administration & Selling Overheads | 55,000.00 |
| Depreciation | 7,000.00 |

| | |
|---|---|
| Interest Paid | 3,000.00 |
| Loss on sale of asset | 2,000.00 |
| Profit before tax | 83,000.00 |
| Tax | (30,000.00) |
| **Profit After tax** | **53,000.00** |

**Balance Sheet as on 31st March**

| | **20X2** | **20X1** |
|---|---|---|
| **Assets** | | |
| Non-current Assets | | |
| Property, Plant and Equipment | 75,000.00 | 65,000.00 |
| Investment | 12,000.00 | 10,000.00 |
| **Current Assets** | | |
| Inventories | 12,000.00 | 13,000.00 |
| Trade receivables | 10,000.00 | 7,000.00 |
| Cash and cash equivalents | 6,000.00 | 5,000.00 |
| **Total** | **1,15,000.00** | **1,00,000.00** |
| **Equity and Liabilities** | | |
| Shareholders' Funds | 60,000.00 | 50,000.00 |
| Non-current Liabilities | 33,000.00 | 35,000.00 |
| **Current Liabilities** | | |
| Trade Payables | 12,000.00 | 8,000.00 |
| Payables for Expenses | 10,000.00 | 7,000.00 |
| **Total** | **1,15,000.00** | **1,00,000.00** |

## 6. Illustration

Use the following data of ABC Ltd. to construct a statement of cash flows using the direct and indirect methods:

| | 20X2 | 20X1 |
|---|---|---|
| Cash | 4,000 | 14,000 |
| Accounts Receivable | 25,000 | 32,500 |
| Prepaid Insurance | 5,000 | 7,000 |
| Inventory | 37,000 | 34,000 |
| Fixed Assets | 3,16,000 | 2,70,000 |
| Accumulated Depreciation | (45,000) | (30,000) |
| **Total Assets** | **3,42,000** | **3,27,500** |
| Accounts Payable | 18,000 | 16,000 |
| Wages Payable | 4,000 | 7,000 |
| Debentures | 1,73,000 | 1,60,000 |
| Equity Shares | 88,000 | 84,000 |
| Retained Earnings | 59,000 | 60,500 |
| **Total Liabilities & Equity** | **3,42,000** | **3,27,500** |
| | | |
| **Profit and Loss** | **20X2** | |
| Sales | 2,00,000 | |

| | |
|---|---|
| Cost of Goods Sold | (1,23,000) |
| Depreciation | (15,000) |
| Insurance Expense | (11,000) |
| Wages | (50,000) |
| Net Profit | 1,000 |

During the financial year 20X2 company ABC Ltd. declared and paid dividend of ₹ 2,500.
During 20X2, ABC Ltd. paid ₹ 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

## 7. Illustration

Following is the balance sheet of Kuber Limited for the year ended 31 March, 20X2

| | 20X2 ₹ in lakhs | 20X1 ₹ in lakhs |
|---|---|---|
| **Assets** | | |
| Non-Current assets | | |
| Property, plant and equipment | 13,000 | 12,500 |
| Intangible assets | 50 | 30 |
| Other financial assets | 145 | 170 |
| Deferred Tax Asset (net) | 855 | 750 |
| Other non-current assets | 800 | 770 |
| **Total non-current assets** | **14,850** | **14,220** |
| **Current assets** | | |
| **Financial assets** | | |
| Investments | 2,300 | 2,500 |
| Cash and cash equivalents | 220 | 460 |
| Other current assets | 195 | 85 |
| **Total current assets** | **2,715** | **3,045** |
| **Total assets** | **17,565** | **17,265** |
| **EQUITY AND LIABILITIES** | | |
| Equity | | |
| Equity share capital | 300 | 300 |
| Other equity | 12,000 | 8,000 |
| **Total equity** | **12,300** | **8,300** |
| Liabilities | | |
| Non-current liabilities | | |
| Financial liabilities | | |
| Long-term borrowings | 2,000 | 5,000 |
| Other non-current liabilities | 2,740 | 3,615 |
| **Total non-current liabilities** | **4,740** | **8,615** |
| Current liabilities | | |
| Financial liabilities | | |
| Trade payables | 150 | 90 |
| Bank overdraft | 75 | 60 |

| | | |
|---|---|---|
| Other current liabilities | 300 | 200 |
| **Total current liabilities** | 525 | 350 |
| **Total liabilities** | 5,265 | 8,965 |
| **Total equity and liabilities** | 17,565 | 17,265 |

Additional Information:

(1) Profit after tax for the year ended March 31, 20X2 - ₹ 4,450 lacs

(2) Interim dividend paid during the year - ₹ 450 lacs

(3) Depreciation and amortisation charged in the statement of profit and loss during the current year are as under

(a) Property, Plant and Equipment - ₹ 500 lacs

(b) Intangible Assets - ₹ 20 lacs

(4) During the year ended March 31, 20X2 two machineries were sold for ₹ 70 lacs. The carrying amount of these machineries as on March 31, 20X2 is ₹ 60 lacs.

(5) Income taxes paid during the year ₹ 105 lacs

(6) Other non-current / current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method.

## 8. Illustration

Z Ltd. has no foreign currency cash flow for the year 20X1. It holds some deposit in a bank in the USA. The balances as on 31.12.20X1 and 31.12.20X2 were US$ 100,000 and US$ 102,000 respectively. The exchange rate on December 31, 20X1 was US$1 = ₹ 45. The same on 31.12.20X2 was US$1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.20X2. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 20X1. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.20X2. How these transactions should be presented in cash flow for the year ended 31.12.20X2 as per Ind AS 7?

## 9. Illustration

During the financial year 2019-2020, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:

- Capital gain tax of ₹ 20 crore on sale of office premises at a sale consideration of ₹ 100 crore.
- Income Tax of ₹ 3 crore on Business profits amounting ₹ 30 crore (assume entire business profit as cash profit).
- Dividend Distribution Tax of ₹ 2 crore on payment of dividend amounting ₹ 20 crore to its shareholders.
- Income tax Refund of ₹ 1.5 crore (Refund on taxes paid in earlier periods for business profits).

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS.

## 10. Illustration

Entity A acquired a subsidiary, Entity B, during the year. Summarised information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information.

**Consolidated Statement of Profit and Loss**

| | Amount in ₹ |
|---|---:|
| Revenue | 3,80,000 |
| Cost of sales | (2,20,000) |
| Gross profit | 1,60,000 |
| Depreciation | (30,000) |
| Other operating expenses | (56,000) |
| Interest cost | (4,000) |
| Profit before taxation | 70,000 |
| Taxation | (15,000) |
| Profit after taxation | 55,000 |

**Consolidated Balance Sheet**

| | **20X2** | **20X1** |
|---|---:|---:|
| **Assets** | **Amount in ₹** | **Amount in ₹** |
| Cash and cash equivalents | 8,000 | 5,000 |
| Trade receivables | 54,000 | 50,000 |
| Inventories | 30,000 | 35,000 |
| Property, plant and equipment | 1,60,000 | 80,000 |
| Goodwill | 18,000 | — |
| **Total assets** | **2,70,000** | **1,70,000** |
| **Liabilities** | | |
| Trade payables | 68,000 | 60,000 |
| Income tax payable | 12,000 | 11,000 |
| Long term debt | 1,00,000 | 64,000 |
| Total liabilities | 1,80,000 | 1,35,000 |
| Shareholders' equity | 90,000 | 35,000 |
| **Total liabilities and shareholders'** | **2,70,000** | **1,70,000** |

**Other information**

All of the shares of entity B were acquired for ₹ 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

| **Particulars** | **Amount (₹)** |
|---|---:|
| Inventories | 4,000 |
| Trade receivables | 8,000 |
| Cash | 2,000 |
| Property, plant and equipment | 1,10,000 |
| Trade payables | (32,000) |
| Long term debt | (36,000) |
| Goodwill | 18,000 |
| **Cash consideration paid** | **74,000** |

Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

The relevant extracts of consolidated financial statements of A Ltd. are provided below:

**Consolidated Statement of cash flows**

| | For the year ended (₹ in Lakhs) | |
|---|---|---|
| | **31st March 20X2** | **31st March 20X1** |
| **Assets** | | |
| **Non-Current Assets** | | |
| Property, Plant and Equipment | 4,750 | 4,650 |
| Investment in Associate | 800 | - |
| Financial Assets | 2,150 | 1,800 |
| **Current Assets** | | |
| Inventories | 1,550 | 1,900 |
| Trade Receivables | 1,250 | 1,800 |
| Cash and Cash Equivalents | 4,650 | 3,550 |
| **Liabilities** | | |
| Current Liabilities | | |
| Trade Payables | 1,550 | 3,610 |

**Extracts from Consolidated Statement of Profit and Loss for the year ended 31st March 20X2**

| **Particulars** | **₹ in Lakhs** |
|---|---|
| Revenue | 12,380 |
| Cost of goods sold | (9,860) |
| Gross Profit | 2,520 |
| Other Income | 300 |
| Operating Expenses | (450) |
| Other expenses | (540) |
| Interest expenses | (110) |
| Share of Profit of Associate | 120 |
| Profit before Tax | 1,840 |

The below information is relevant for A Ltd Group.

1. A Ltd had spent ₹ 30 Lac on renovation of a building. A Ltd charged the entire renovation cost to profit and loss account.
2. On 1st April 20X1, A Ltd acquired 100% shares in S Ltd, for cash of ₹ 300 Lac. Fair value of the assets acquired and liabilities assumed under the acquisition are as under:

| | |
|---|---|
| Property, Plant and Equipment | 140 Lakhs |
| Inventories | 60 Lakhs |
| Trade receivables | 30 Lakhs |
| Cash and cash equivalents | 20 Lakhs |
| Total Assets | 250 Lakhs |
| **Less:** Trade Payables | (50 Lakhs) |
| **Net Assets on acquisition** | **200 Lakhs** |

3. A Ltd.'s property, plant and equipment comprise the following:

| | |
|---|---|
| Carrying amount on 1st April 20X1 | 4,650 Lakhs |
| Addition (at cost) including assets in S Ltd | 800 Lakhs |
| Revaluation Surplus | 80 Lakhs |
| Disposal (Sale) of Assets | (490 Lakhs) |
| Depreciation for the year | (290 Lakhs) |
| **Carrying Amount on 31st March 20X2** | **4,750 Lakhs** |

A Ltd constructed a machine that is a qualifying asset and incurred construction costs of ₹ 40 Lakhs that has been charged to other expenses. Of the interest cost of ₹ 110 Lakhs charged to profit or loss statement, ₹ 10 Lakhs includes interest cost on specific borrowings that need to be capitalized.

Property, plant and equipment was sold at 630 Lac. Gain on disposal is adjusted against operating expenses.

4. A Ltd. purchased 30% interest in an Associate (G Ltd) for cash on 1st April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.
5. Impairment test was conducted on 31st March 20X2. The following were impaired as under:

| | |
|---|---|
| Goodwill impairment loss | ₹ 265 Lakhs |
| Intangible Assets impairment loss | ₹ 900 Lakhs |

The goodwill impairment relates to 100% subsidiaries.

Assume that interest cost is all paid in cash.

You are required to determine cash generated from operations for group reporting purposes for the year ended 31st March 20X2.

## 12. Illustration

Company A acquires 70% of the equity stake in Company B on July 20, 20X1. The consideration paid for this transaction is as below:

(a) Cash consideration of ₹ 15,00,000

(b) 200,000 equity shares having face of ₹ 10 and fair value of ₹ 15 per share.

On the date of acquisition, Company B has cash and cash equivalent balance of ` 2,50,000 in its books of account.

On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of ₹ 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7.

## 13. Illustration

From the following data of Galaxy Ltd., prepare statement of cash flows showing cash generated from Operating Activities using direct method as per Ind AS 7:

| | 31.03.20X2 (amount in ₹) | 31.03.20X1 (amount in ₹) |
|---|---|---|
| Current Assets: | | |
| Inventory | 1,20,000 | 1,65,000 |

| | | |
|---|---|---|
| Trade receivables | 2,05,000 | 1,88,000 |
| Cash & cash equivalents | 35,000 | 20,500 |
| Current Liabilities: | | |
| Trade payable | 1,95,000 | 2,15,000 |
| Provision for tax | 48,000 | 65,000 |

| | | |
|---|---|---|
| Summary of Statement of Profit and Loss ` | | |
| Sales | 85,50,000 | |
| Less: Cost of sales | (56,00,000) | 29,50,000 |
| Other Income | | |
| Interest income | 20,000 | |
| Fire insurance claim received | 1,10,000 | 1,30,000 |
| 30,80,000 | | |
| Depreciation | (24,000) | |
| Administrative and selling expenses | (15,40,000) | |
| Interest expenses | (36,000) | |
| Foreign exchange loss | (18,000) | (16,18,000) |
| Net Profit before tax and extraordinary income | 14,62,000 | |
| Income Tax | (95,000) | |
| Net Profit | 13,67,000 | |

**Additional information:**

(i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.

(ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date.

## 1 Objective

- To establish the principles that an entity shall apply to report useful information about
    - Nature
    - Amount
    - Timing
    - Uncertainty

  of *revenue* and cashflows arising from *contract* with *customers* .
- Entity shall recognise revenue to depict
    - Transfer of goods and services to the customer
    - In an amount (consideration in exchange)

## 2 Five Step Model

An entity shall apply the five step model to recognise revenue.

| | |
|---|---|
| Identify the contract with customer | • Approved contract<br>• Identify each party rights<br>• Identify the payment terms<br>• Commercial Substance<br>• Collection of consideration - Probable |
| Identify Performance obligations | • Performance Obligation - Promise<br>• Each promise to transfer goods or services to the customer |
| Determine the transaction price | • amount of consideration which an entity expects to be entitled to receive in exchange of the goods or performance of services to a customer. |
| Allocate the transaction Price | • Allocate the transaction price to each performance obligation. |
| Recognise Revenue | • When the entity satisfies a performance obligation<br>• by transferring promised goods or services<br>• Customer obtains control of the asset |

## 3 Step 1 – Identify the *contract* with the *customer*

Customer - A party that has contracted with an entity to *obtain goods or services* that are an *output* of the *entity's ordinary activities* in exchange for consideration.

Contract - An *agreement* between two or more parties that creates *enforceable rights and obligations.* Contract can be oral, written or as per customary business practices.

Recognising a contract

An entity shall account for a contract with customer only if all the following conditions are satisfied (Paragraph 9)

> An entity shall not reassess Step 1 once the criteria under Para 9 are met. This is the case even if the ability of customer to pay the consideration deteriorates subsequently. *If collectability is uncertain subsequently, the entity will test receivable for impairment as per Ind AS 109. Revenue is not reversed in such a case.*

Contract is ***approved by parties*** (either orally, written or in accordance with customary business

Entity ***can identify each parties' rights*** regarding the goods or services to be transferred

Entity can ***identify the payment terms*** for the goods or services to be transferred

The transaction has ***commercial substance***, i.e., the risk, timing or amount of the future cash flows is expected to change

It is ***probable that the entity will collect the consideration*** to which it is entitled to

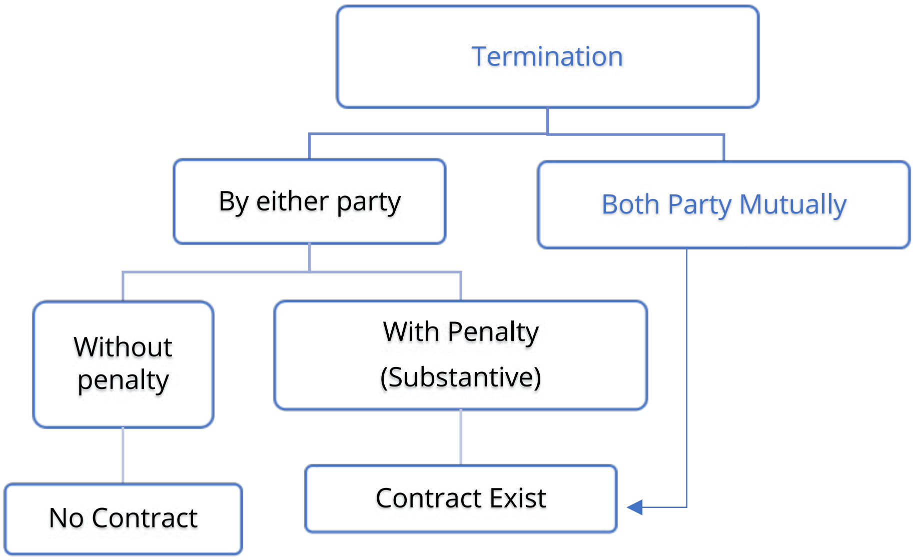
- *A contract does not exist if any of the party has a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other parties. If both parties can mutually agree and terminate the contract (even without penalty), a contract exists for the purpose of Ind AS 115.*

- A contract is wholly unperformed if
  - The entity has not yet transferred any promised goods or services and
  - The entity has not yet received or is entitled to receive any consideration in exchange for goods and services.

An entity shall apply Ind AS 115 to the duration of contract (contractual period) in which the parties have enforceable rights and obligations. Hence it is important to determine the duration of contract.

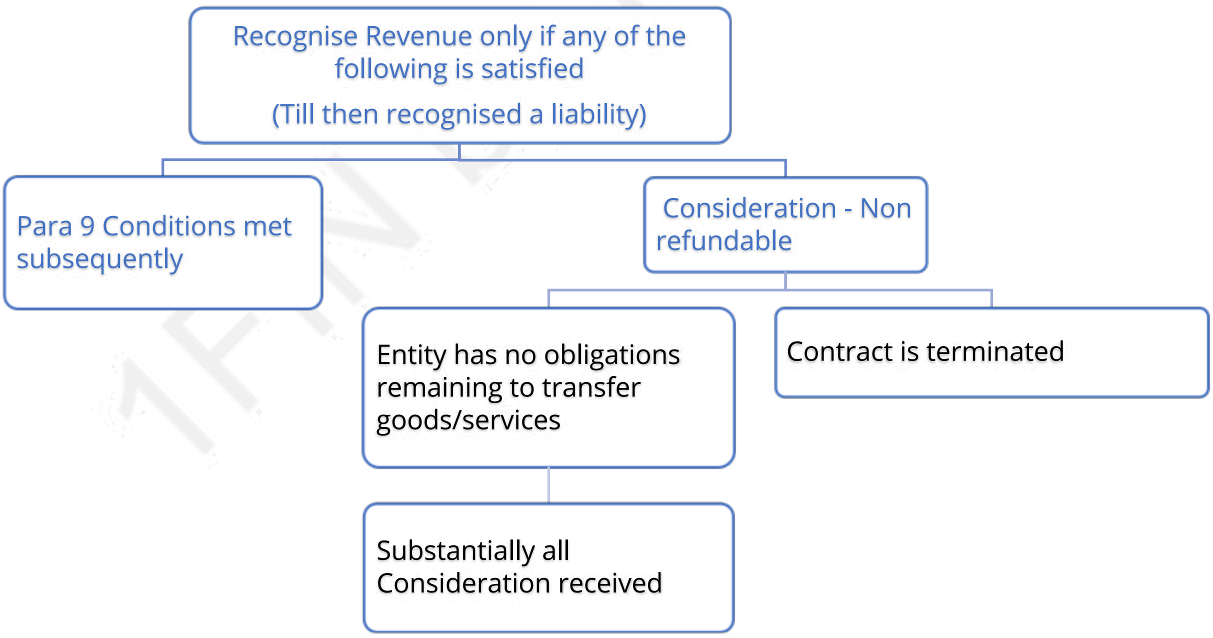
Examples – Whether a contract exists or not?

| Case | Answer |
|---|---|
| Either party can terminate the contract without penalty | *Contract does not exist* |
| Both parties can mutually agree and terminate the contract | *Contract exists* |
| Two parties have entered into a four year contract. Neither party can terminate the contract in the first year. Either party can terminate the contract after first year without penalty. | *Contract exists and is enforceable for the first year.* |
| Contract is for 4 year and customer can terminate at each year end with substantive penalty | *Contract exists for 4 years* |
| Contract can be terminated at each month end at option of customer without penalty | *Contract exists and is considered as a month on month contract [e.g. Netflix subscription]* |
| Contract is for 1 year and customer can terminate the contract with penalty in the first year. | *Contract exists for 1 year* |




**C** – Contract ✓
**R** – Rights ✓
**P** – Payment terms ✓
**C** – Commercial Substance ✓
**C** – Collectability ✓

### Consideration received from customer but Step 1 criteria not met




### Reassessment of Step 1

If a contract with a customer meets the criteria in paragraph 9 at contract inception, an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances.

Example - If a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

### Combination of contracts

Two or more contracts may need to be accounted for as a single contract if they are entered into at or near the same time with same customer if any of the following is satisfied:

- Contracts are negotiated as a package with a single commercial objective
- Amount of consideration in one contract depends on price or performance of another
- Goods and Services promised are single performance obligation

### Contract Modifications

A contract modification exists if three conditions are satisfied:

- There is a change in the scope, price, or both in a contract
- That change is approved by both the entity and the customer
- The change is enforceable

**Accounting for Contract Modification**

- **Separate contract**
  - Treated as a seperate contract if both the conditions are satisfied:
    - Increases the scope by adding **new goods or services.**
    - Increase in the contract price reflects the **stand-alone price** of the additional goods and services.
- **Not a Separate contract**
  - If goods or services to be provided after modification are distinct from goods or services that were already provided.
    - Account for the modifiction **prospectively**
  - Other cases
    - Account for the modification on a **cumulative catch-up basis** (retrospectively)



## 4 Step 2 – Identifying performance obligation

### Criteria for identifying performance obligation

At contract inception, an entity shall assess:

- The **goods and services promised** in a contract with a customer, and
- Shall **identify performance obligation** under each promise to be transferred to the customer.

- Promises under the contract can be
  - Explicit- which are promised to be provided in the future.

- Implicit- which are implied by the customary business practice.

**Performance obligation**

It is a promise to transfer either :

- A good or service or a (bundle of goods or services) that is distinct; or
- A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer

Performance Obligation

- Satisfied over a period of time
- Satisfied at point of time

### Distinct performance obligation

A good or service that is promised to a customer is distinct if both of the following criteria are met:

**Customer can benefit on its own or with other readily available resources**

A customer can benefit from a good or service if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits.

**Separately identifiable from other promises in the contract**

Factors to consider:

- No significant integration service
- No significant modification or customisation
- Goods or services are not highly interdependent or highly interrelated.

### Promise to transfer a series of distinct goods or services

There might be cases, where distinct goods or services are provided continuously over a period of time. For e.g. security services, or bookkeeping services.

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria to be a performance obligation satisfied over time; and
- the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

## 5. Step 3 – Determination of transaction price

Transaction price-

- is the amount of consideration
- to which an entity expects
- to be entitled
- in exchange for transferring promised goods or services to a customer,
- excluding amounts collected on behalf of third parties (for example, sales taxes).

Consideration promised in a contract may be fixed or variable or both.
When determining the transaction price, an entity shall consider the effects of all of the following:

Variable consideration

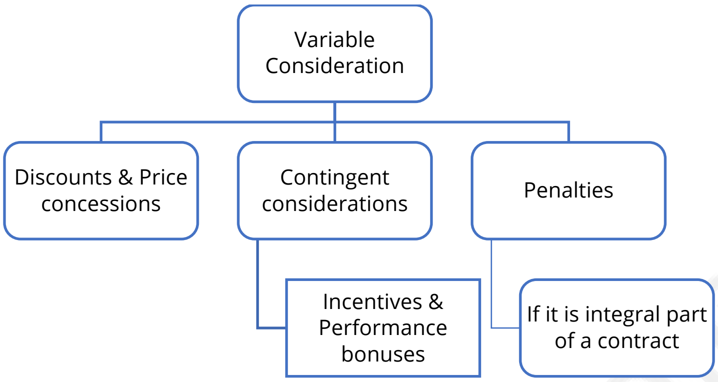
Constraining Estimates of Variable consideration

Significant financing component

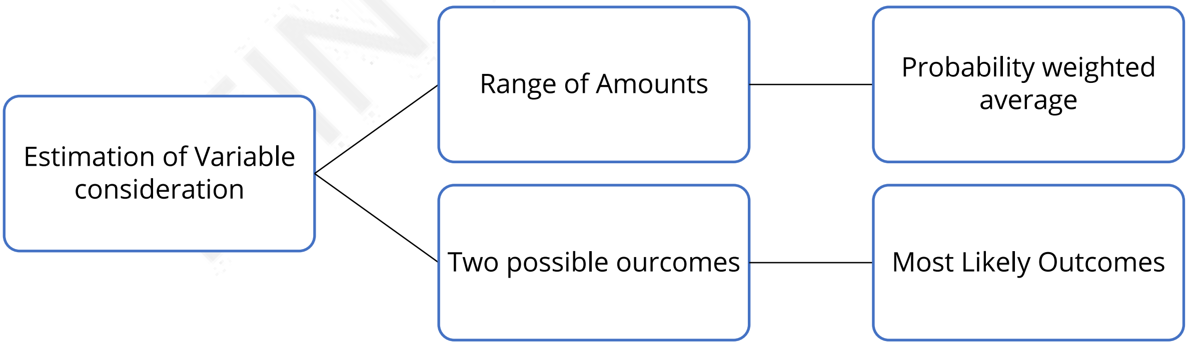
Consideration payable to customer

Non-cash consideration

## 5.1 Variable consideration




- An entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.
- An entity shall include in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is **highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur** when the uncertainty associated with the variable consideration is subsequently resolved




### 5.1.1 Penalties

Where the penalty is inherent in determination of transaction price, it **shall form part of variable consideration**.

### 5.1.2 Estimating the amount of variable consideration

An entity shall estimate an amount of variable consideration by using either of the following methods:

| *The Expected Value* | *The most likely amount* |
|---|---|
| •The expected value is the **sum of probability-weighted amounts** in a range of possible consideration amounts.<br>•This method is appropriate if an entity has large number of contracts with similar characteristics. | •It is the **single most likely amount** in a range of possible consideration amounts (ie the single most likely outcome of the contract)<br>•This method is appropriate if the contract has only two possible outcomes . |

An entity shall apply one method consistently throughout the contract when estimating the effect of an uncertainty on an amount of variable consideration to which the entity will be entitled.

### 5.1.3 Refund liabilities

An entity shall recognise a refund liability if

- the entity receives consideration from a customer and
- expects to refund some or all of that consideration to the customer.

A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled (i.e. amounts not included in the transaction price).

### 5.1.4 Constraining estimates of variable consideration

An entity shall include variable consideration, in the transaction price only to the extent that it is highly probable that a significant reversal will not occur.

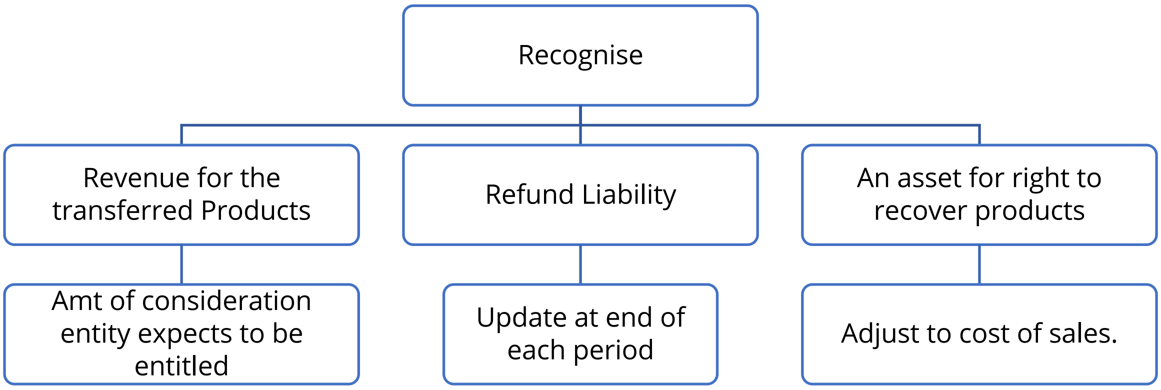
Factors that could increase the likelihood of a revenue reversal include –

- the amount of consideration is highly susceptible to factors outside the entity's influence.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time
- The entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value
- The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances
- The contract has a large number and broad range of possible consideration amounts

### 5.1.5 Reassessment of variable consideration

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

## 5.2 Sale with a right of return




- For the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise :
    - **revenue for the transferred products** in the amount of consideration to which the entity expects to be entitled;
    - **a refund liability**; and
    - **an asset** (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.
- Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one colour or size for another) are not considered returns for the purposes of applying this Standard.

### 5.3 Significant financing component

- If there is a significant component financing, time value of money is adjusted from the agreed amount of consideration.
- Either party may benefit from financing:
    - customer may pay before the entity performs its obligation (a customer loans to the entity)
    - customer may pay after the entity performs its obligation (a loan by the entity to the customer
- Recognise revenue at the expected cash price.
- Financing component is recognised separately from revenue.
- Factors to determine whether financing component is significant
    - The difference, if any, between the amount of promised consideration and the cash selling price; and
    - The combined effect of both of the following:
        - ➢ the expected length of time between when the entity transfers the promised goods or services and when the customer pays; and
        - ➢ the prevailing interest rates in the relevant market.
- Entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.
- After contract inception, an entity shall not update the discount rate for changes in interest rates or other circumstances.
- An entity need not adjust the the effects of a significant financing component if the entity expects, at contract inception, that the period between:
    - When the entity transfers a promised good or service to a customer and
    - When the customer pays for that good or service
    - will be one year or less.

A contract with a customer would not have a significant financing component if any of the following factors exist:

- customer paid for the goods or services in advance and the timing of the transfer ofthose goods or services is at the discretion of the customer.
- A substantial amount of consideration is variable based on future event that is not within the control of the customer or the entity.
- Difference between promised consideration and cash selling price arises for reasons other than the provision of finance.

Under AS-9, there is no specific requirement to identify and separate the significant financing component.

## 5.4 Non-cash consideration

- Sometimes a customer promises to pay for a good or service in a form other than cash, such as shares of common stock or other equity instruments, advertising, or equipment.
- To determine the transaction price, an entity shall:

  - In the first instance, measure the non-cash consideration at fair value
  - If it cannot estimate fair value , it shall measure at standalone selling price of goods or services given

### 5.4.1 Subsequent measurement of non-cash consideration

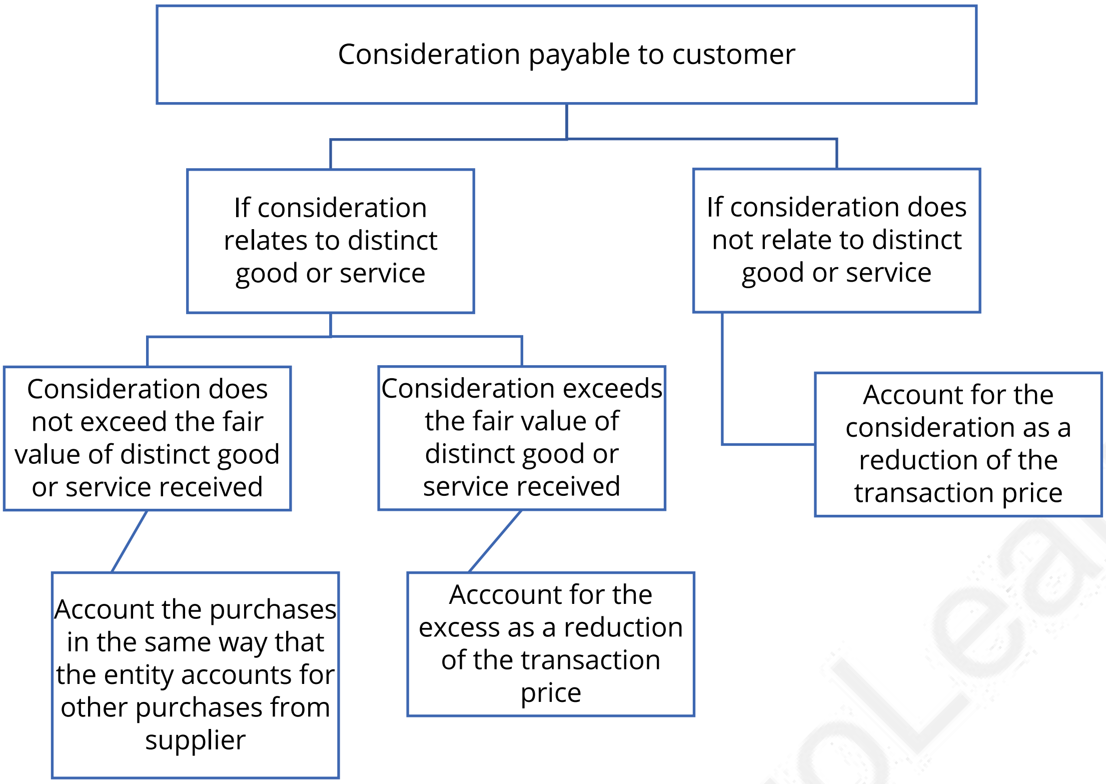
| If the fair value of the non-cash consideration varies after contract inception because of its form | If the fair value of the non-cash consideration varies for reasons other than only the form of consideration |
|---|---|
| • Entity does not not adjust transaction price for any such change. | • Entity shall apply the guidance on variable consideration and the constraint when determining the transaction price. |

### 5.4.2 Customer-provided goods or services

- If a customer contributes goods or services (for example, materials, equipment or labour) to facilitate an entity's fulfilment of the contract, the entity shall assess whether it obtains control of those contributed goods or services.
- If entity obtains control fair value of goods or services supplied by customer will be added to transaction price.

## 5. 5 Consideration payable to a customer

Consideration payable to a customer includes cash amounts, credit or other items that an entity pays, or expects to pay or that can be applied against amounts owed to the entity.




## 6. Step 4 – Allocating the transaction price to performance obligations

The entity shall allocate the transaction price to each performance obligation identified in the contract on a **relative stand-alone selling price** basis except-

- For allocating discounts
- For allocating variable consideration

### 6.1 Determining stand-alone selling price

- **Stand-alone selling price** - the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
- If **stand-alone selling price is not directly observable**, an entity shall consider all information (including market conditions, entity-specific factors and information about the customer or class of customer) that is reasonably available to the entity.
- An entity shall maximise the use of observable inputs and apply estimation methods consistently in similar circumstances.

Methods for estimating the stand-alone selling price of a good or service include the following:

**Methods**

**Adjusted market approach**

Take the market price in similar market and adjust those prices to reflect the entity's cost and margins.

**Expected cost plus margin approach**

-Forecast its expected costs for each performance obligation and then add an appropriate margin for that good or service.

-It may not be appropriate:

a. when direct fulfillment costs are not easily identifiable, or

b. when costs are not a significant input in setting the price.

**Residual approach**

-Total transaction price **less** sum of observable standalone selling prices of other goods or services in contract.

-This method is used only if :

a. entity sells the same good or service to differnet customers for a broad range of amounts.

b. entity has not yet established a price or such good or service has not previously been sold on a stand-alone basis.

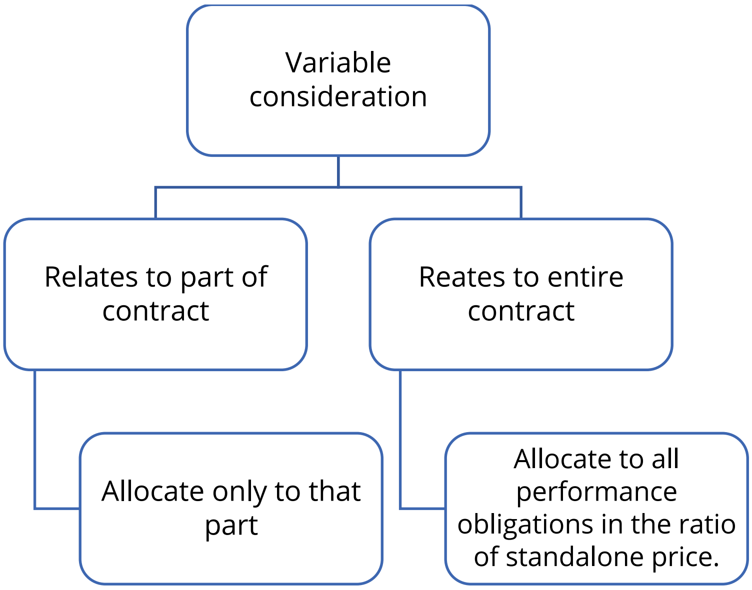
- An entity shall allocate the discount before using the residual approach to estimate the stand-alone selling price of a good or service where the discount is allocated entirely to one or more performance obligations in the contract.

### 6.1.1 Allocation of a discount

- Discount relates to all performance obligations – Proportionately based on stand alone selling price
- Discount relates to one or more (but not all) performance obligation – Allocate to only specific performance obligation
- When to allocate discount to 'less than all' performance obligations?
    - The entity regularly sells each distinct or each bundle of those distinct goods or services;
    - Entity also regularly sells a bundle (or bundles) of some of those distinct goods or services at a discount; and
    - Discount attributable to each bundle of goods or services is substantially the same as the discount in the contract and an analysis provides evidence of performance obligations to which the entire discount belongs.

### 6.1.2 Allocation of variable consideration

- Variable consideration may be attributable to
    - the entire contract or
    - a specific part of the contract
- How to allocate variable consideration?




- An entity shall allocate a variable amount entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation if both of the following criteria are met:
    - The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service.
    - allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective

### 6.2 Changes in transaction price

- An entity shall allocate to the performance obligations any subsequent changes in the transaction price on the same basis as at contract inception.
- An entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.
- Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.
- If the change in transaction price is the result of a contract modification, the entity should follow the contract modification guidance.

## 7. Step 5 – Satisfying performance obligation

- An entity shall recognise revenue as and when the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when the customer obtains control of that asset.
- Questions that need to be answered at contract inception to determine if the seller has satisfied its performance obligation are:

Establish what does **transfer of control mean** in the context of the arrangement between the parties?

Does the customer acquire **control over a period of time or at a point in time**?

### 7.1 What does transfer of control mean?

**Control of an asset** refers to the ability to direct the use and obtain substantially all of the benefits from the asset or ability to prevent other entities from directing the use of, and obtaining the benefits from an asset.

An entity shall consider indicators of the transfer of control which are as follows:

- The entity has a present right to payment for the asset;

- The customer has legal title to the asset;
- The entity has transferred physical possession of the asset;
- The customer has the significant risks and rewards of ownership of the asset;
- The customer has accepted the asset.

## 7.2 Does the customer acquire control over a period of time or at a point in time?

### 7.2.1 Transfer of control over a period of time

Transfer of control over a period of time

An entity transfers control of a good or service over time and satisfies a performance obligation and recognises revenue over time, if any of the following criteria is met

**Criteria (a)-**Customer simultaneously receives and consumes the benefits provided by entity's performance as the entity performs; or

**Criteria (b)-**Entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or

**Criteria (c)-**Entity's performance does not create an asset with an alternative use to the entity and entity has an enforceable right to payment for performance completed to date

- **Criteria (a)-** Applied in situations where benefit of seller's performance are immediately consumed by customer e.g security service.
- **Criteria (b)-** Applied in situations Where the customer ordinarily obtains control of the asset whose work is in progress – **construction done on customer's land**
- **Criteria (c)-** Applied in situations in which an asset is created at customer's discretion, which the seller is restricted from using for any other purpose and at the same time, the seller entity reserves a right to seek payment for work in process.

  **Conditions for (c)**
  - Asset does not have an alternative use to seller - This can arise due to contractual restrictions or practical limitations.
  - There is a Legally enforceable right to receive payment for performance completed to date. This payment should compensate the supplier for costs incurred plus a profit margin.

- Methods of measuring progress of a performance obligation satisfied over time:

**Output based method**

- Recognise revenue on the basis of fair value of goods or services transferred to date relative to remaining goods or services.
- Example: Surveys of performance completed to date,appraisals of results achieved etc.

**Input based method**

- Recognise revenue based on the entity's efforts or inputs to the satisfaction of a performance obligation.
- Example: Resources consumed labour hours expended, cost incurred, time elapsed or machine hours used

### 7.2.2 Transfer of control at a point in time

If none of the criteria of over a period of time is met, the performance obligation is considered to be discharged at a point in time.

Indicators to imply the point of time at which control of goods has been passed to the customer includes:

- A present obligation to pay
- Physical possession
- Legal title
- Risks and rewards of ownership
- Accepted the asset

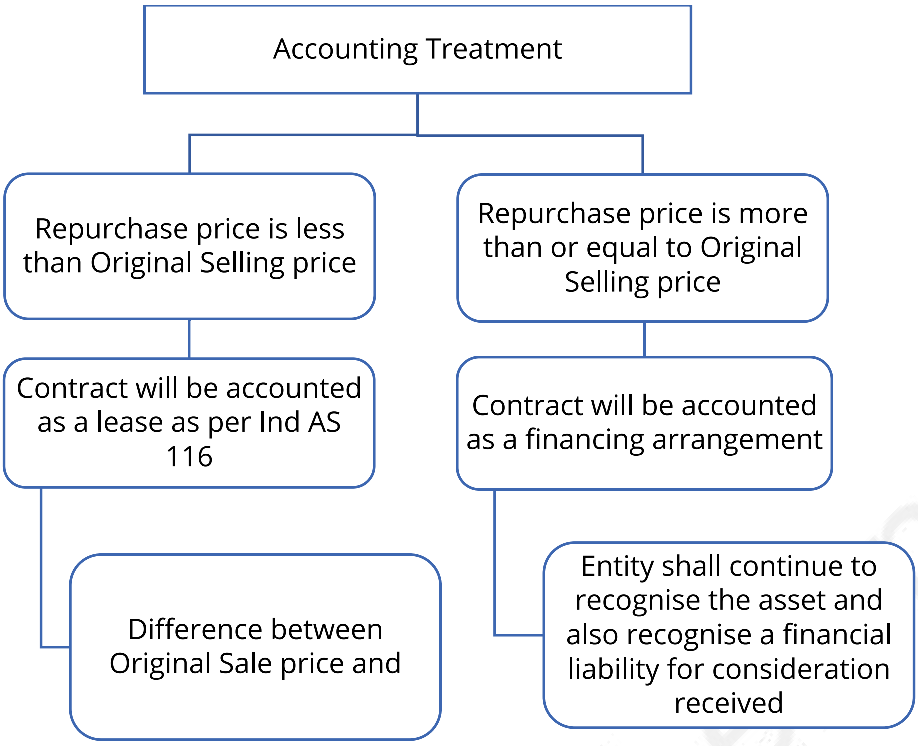
### 7.3 Repurchase agreements

A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option to repurchase the asset.

Repurchase agreements

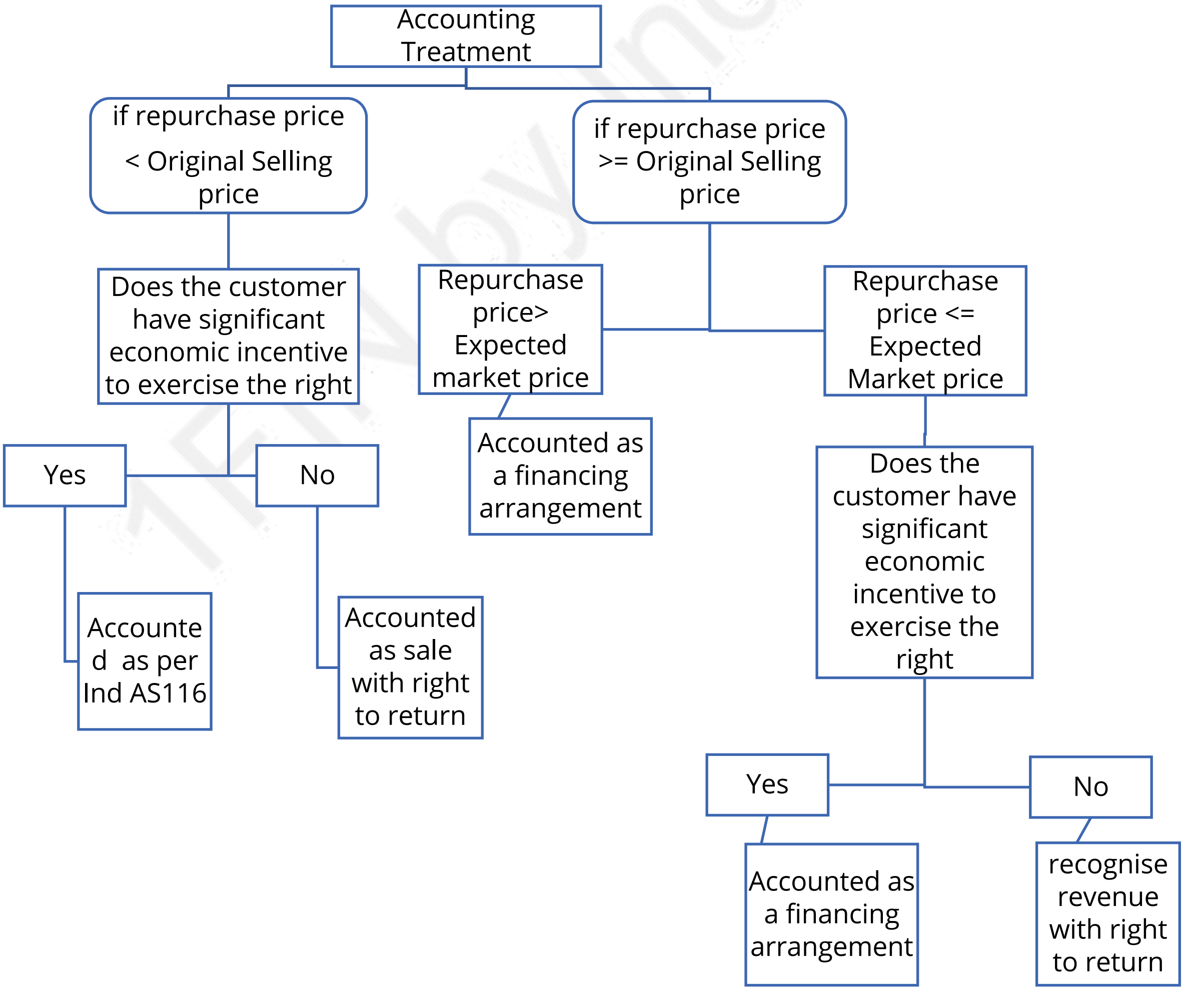
- Forward: An entity's obligation to repurchase the asset
- Call option: An entity's right to repurchase the asset
- Put option: An entity's obligation to repurchase the asset at the customer's request

### 7.3.1 Forward or call option:




- *A customer does not obtain control of the asset*
- *If the option lapses unexercised, an entity shall derecognise the liability and recognise revenue.*

### 7.3.2 Put option:



### 7.4 Bill-and-hold

- A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future.
- In such arrangement, the entity shall recognise revenue at the point of time when control is transferred to the customer.
- For few cases, a customer may obtain control of a product even though that product remains in an entity's physical possession if all the following criteria is met:

| |
|---|
| The reason for the bill-and-hold arrangement must be substantive; |
| The product must be identified separately as belonging to the customer; |
| The product currently must be ready for physical transfer to the customer; and |
| the entity cannot have the ability to use the product or to direct it to another customer. |

- Where an entity recognises revenue on bill-and-hold basis, the entity shall determine if it has any additional performance obligations and allocate a portion of transaction price to each performance obligation.

### 7.5 Licenses of intellectual property

Licences of intellectual property establish a customer's rights to the intellectual property of an entity and may include licences for any of the following: software and technology, media and entertainment (e.g. motion pictures and music), franchises, patents, trademarks and copyrights.

License of Intellectual property (IP)

Right to Access IP
(over time)

All criteria must be met

1.Entity is required/reasonable expected to undertake activities which can significantly affect the licensed Ip

2.License exposes the customer to any effects of entities activities

3.The activities of the entity are not performance obligatin under contract

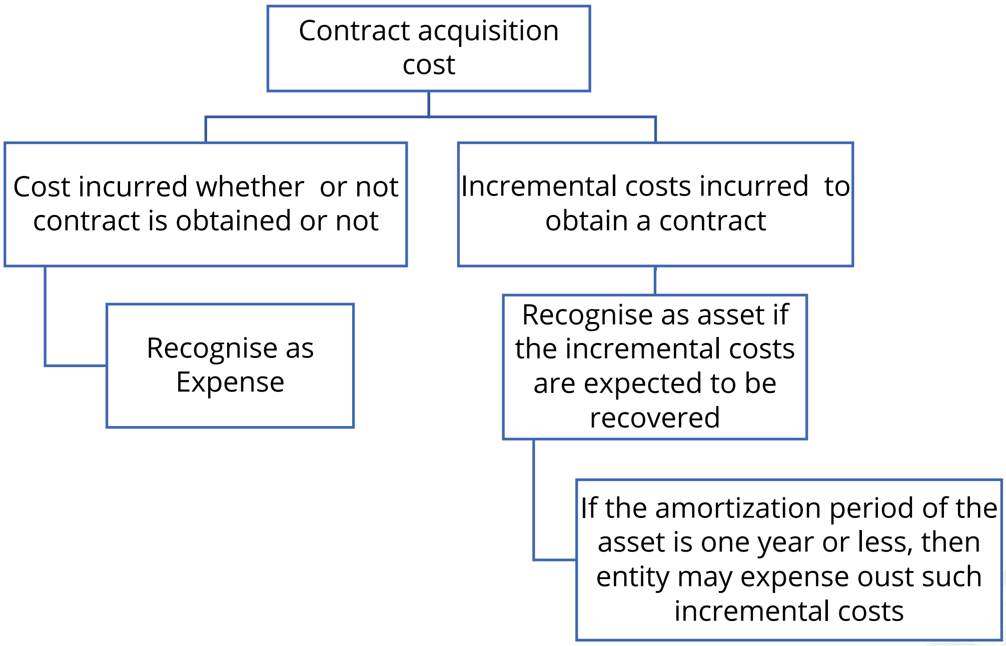
Right to use IP
(point of time)

If all the criteria for access over time are not met then right to use IP

(customer is able to direct the use of and obtain all remaining benefits from the licensed IP i.e static IP)

## 8. Contract Costs

### 8.1 Costs to obtain a contract (contract acquisition costs)




Examples of Contract Acquisition costs:

| **Cost** | **Capitalize Or Expense** | **Reason** |
|---|---|---|
| Commission paid only upon successful signing of a contract | Capitalize | Assuming the entity expects to recover the cost, the commission is incremental since it would not have been paid if the parties decided not to enter into the arrangement just before signing. |
| Travel expenses for sales persons pitching a new client contract | Expense | Because the costs are incurred regardless of whether the new contract is won or lost, the entity expenses the costs, unless they are expressly reimbursable. |
| Legal fees for drafting terms of arrangement for parties to approve and sign | Expense | If the parties walk away during negotiations, the costs would still be incurred and therefore are not incremental costs of obtaining the contract. |
| Salaries for sales people working exclusively on obtaining new clients | Expense | The salaries are incurred regardless of whether contracts are won or lost and therefore are not incremental costs to obtain the contract. |
| Bonus based on quarterly sales target | Capitalize | Bonuses based solely on sales are incremental costs to obtain a contract. |
| Commission paid to sales manager based on contracts obtained by the sales manager's local employees | Capitalize | The commissions are incremental costs that would not have been incurred had the entity not obtained the contract. Ind AS 115 does not differentiate costs based on the function or title of the employee that receives the commission. |

## 8.2 Costs to fulfil a contract (contract fulfilment costs)

**Contract fulfilment cost**

- Cost incurred in fulfiling a contract **covered under another standard**
  - Entity accounts those costs in accodance with the respective standards
- If cost incurred are **not covered under any Ind AS**
  - An entity shall recognise such costs as an asset if all the criteria be met:

    1. cost directly relate to contract (such as direct material, direct labour, other indirect cost of production, etc)

    2. cost generate or enhance resources of entity that will be used to satisfy performance obligation in future, and

    3. If entity expects to recover the cost.

Following costs should be expensed as incurred :

- general and administrative costs that are not explicitly chargeable to the customer
- costs of wasted materials, labour, or other resources that were not reflected in the contract price
- costs that relate to satisfied performance obligations
- costs related to remaining performance obligations that cannot be distinguished from costs related to satisfied performance obligations.

### 8.3 Amortisation and impairment

- Amortize capitalised contract costs on a systematic basis consistent with the pattern of transferring the goods or services. Any change in expected pattern, is accounted as a change in accounting estimate as per Ind AS 8.
- recognises an impairment loss in earnings if the carrying amount of an asset exceeds the remaining amount of consideration less any directly related contract costs yet to be recognised.
- Before recognising an impairment loss under the revenue recognition guidance, an entity recognises impairment losses associated with assets related to the contract that are accounted in accordance with another Standard (for example, Ind AS 2, Ind AS 16 and Ind AS 38)
- Reversal of impairment loss is allowed when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

## 9. Misc Matters

### 9.1 Warranties

**Warranties**

- **Customer has an option to purchase warranty separately**
  - warranty will be a distinct service and treated as a separate performance obligation and a portion of transaction price should be allocated to it.
- **Customer does not have option to purchase warranty separately**
  - warranty is not treated as seperate performance obligation and revenue to be attributable to the product.
  - Account for warranty in accordance with Ind AS 37.

In assessing whether a warranty is a separate performance obligation or not, an entity shall consider factors such as:

| Whether warranty is required by law | Length of warranty coverage period | Nature of task that entity promises to perform |
|---|---|---|
| •If required by law, it indicates that the promised warranty is not a performance obligation. | •The longer the coverage period, the more likely it is that the promised warranty is a performance obligation. | •Those tasks do not give rise to a performance obligation. |

### 9.2 Customer options for additional goods or services

- An entity may grant a customer the option to acquire additional goods or services in form of coupons, gift cards and customer award credits etc;
- Such option is treated as a separate performance obligation if it provides a material right to the customer.
- The right is material if it results in a discount that the customer would not receive without entering into the contract.
- If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.
- Entity shall allocate the transaction price to performance obligations on a relative stand-alone selling price basis.
- If the stand-alone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it.
- Estimate shall reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:

- any discount that the customer could receive without exercising the option; and
- the likelihood that the option will be exercised.

### 9.3 Long term arrangements

Entities enter into arrangements to provide services on a long-term basis it shall be accounted for its rights and obligations s for each period in which the contract cannot be cancelled by either party. In long-term service agreements when the consideration is fixed, the accounting generally will not change regardless of whether a single performance obligation or multiple performance obligations are identified.

### 9.4 Consignment arrangements

Consignment agreement – It is an agreement between a consignee and consignor for the storage, transfer, sale or resale and use of the goods.

**Indicators for evaluating the arrangement as a consignment arrangement**:

- The product is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer or until a specified period expires;
- The entity is able to require the return of the product or transfer the product to a third party; and
- The dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit)

### 9.5 Revenue is recognized when the entity has transferred control of the goods to the consignor or the end consumer.

A consignment sale differs from a sale with a right of return

- sale with right of return
  - customer has control of the goods
- consignment sales
  - consignee does not have the control

### Principal vs agent consideration

When entity is acting as

- Principal
  - Recognise revenue on **gross basis**
- Agent
  - Recognise revenue on **net basis**

**Indicators that an entity is a principal include the following:**

the entity is primarily responsible for fulfilling the contract.

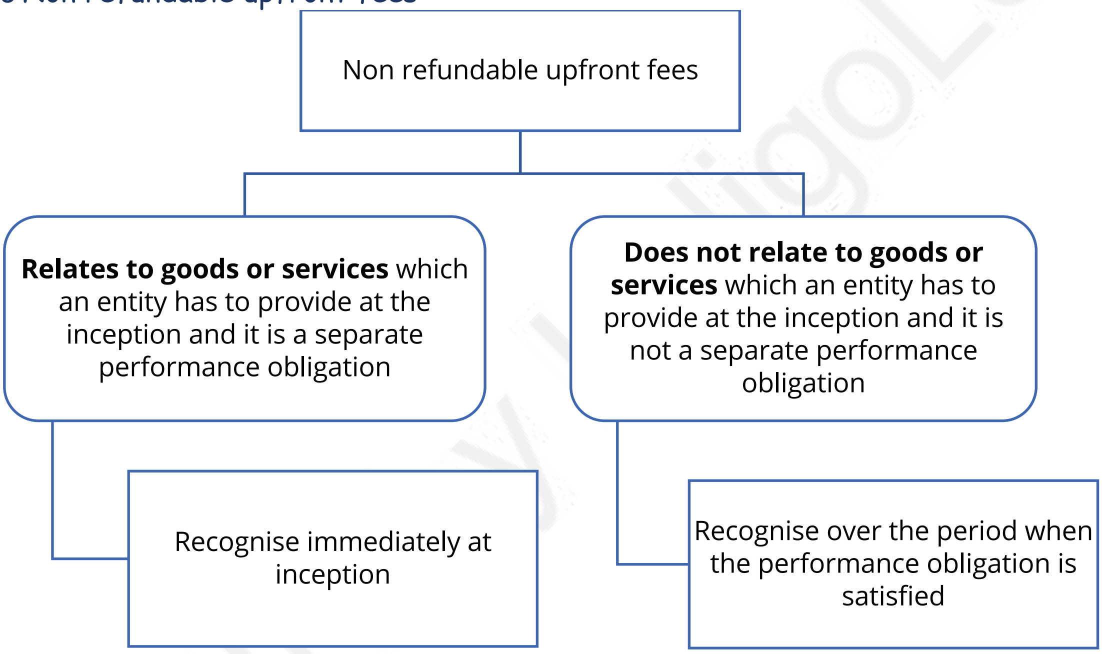
the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer.

the entity has discretion in establishing prices for the goods or services.

After an entity identifies its promise and determines whether it is the principal or the agent, the entity recognises revenue when it satisfies that performance obligation.

In some contracts in which the entity is the agent, control of the goods or services promised by the agent might transfer before the customer receives the goods or services from the principal.

### 9.6 Non refundable upfront fees




### 9.7 Sales-based or usage-based royalties

An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

- The subsequent sale or usage occurs; and
- The performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

## 10. Presentation

| | |
|---|---|
| **Balance Sheet** | As a contract liability, a contract asset or a receivable<br>- contract liability: If the customer has paid consideration, or if payment is due on reporting date but the entity has not yet satisfied a performance obligation. |

| | |
|---|---|
| | - contract asset or a receivable: If its right to consideration is conditioned on something other than the passage of time; otherwise, an entity recognises a receivable. |
| **Profit & Loss** | Recognise revenue |
| | |

## 11. Disclosure

| Disclosure area | Summary of requirements |
|---|---|
| General | • revenue recognised from contracts with customers, separately from its other sources of revenue.<br>• impairment losses on receivables or contract assets. |
| Disaggregation of revenue | • categories that depict the nature, amount, timing, and uncertainty of revenue and cash flows.<br>• sufficient information to enable users of financial statements to understand the relationship with revenue information disclosed for reportable segments under Ind AS 108. |
| Information about contract balances | • including opening and closing balances of contract assets, contract liabilities, and receivables (if not separately presented) |
| Information about performance obligations | • when the entity typically satisfies performance obligations<br>• significant payment terms<br>• nature of goods and services<br>• obligations for returns, refunds and similar obligations<br>• types of warranties and related obligations |
| Transaction price allocated to the remaining performance obligations | • that are unsatisfied and an explanation of when the entity expects to recognise such revenue. |
| Timing of satisfaction of performance | • performance obligations that an entity satisfies over time.<br>• performance obligations satisfied at a point in time. |
| Information about significant judgements | • judgements impacting the expected timing of satisfying performance obligations transaction price and amounts allocated to performance obligations. |
| Transaction price and the amount allocated to performance obligations | • determining the transaction price, estimating variable consideration, adjusting the consideration.<br>• estimate of variable consideration is constrained .<br>• measuring obligations for returns, refunds, and other similar obligations.<br>• allocating the transaction price, discounts, and variable consideration. |
| Assets recognised from the costs to | • judgments made in determining costs amount of the costs incurred to obtain or fulfil a contract with a customer. |

| | |
|---|---|
| obtain or fulfil a contract | • amortisation method used for closing balances by main category and amortisation expense. |
| Practical expedients | • existence of a significant financing component.<br>• incremental costs of obtaining a contract. |

## 12. Service Concession Arrangements

### 12.1 About Service Concession Arrangement

- Service Concession Arrangement involves a private sector entity (an operator) constructing the infrastructure used to provide the public service. It also involves operating and maintaining infrastructure for a specified period of time.
- It is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

**Operator**- An entity constructing and operating the infrastructure, the operator is responsible for the management of infrastructure and do not merely act as an agent. The operator is paid for its services over period of arrangement.

**Grantor**- It is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved .

### 12.2 Accounting Principles

### 12.3 Treatment of the operator's rights over the infrastructure

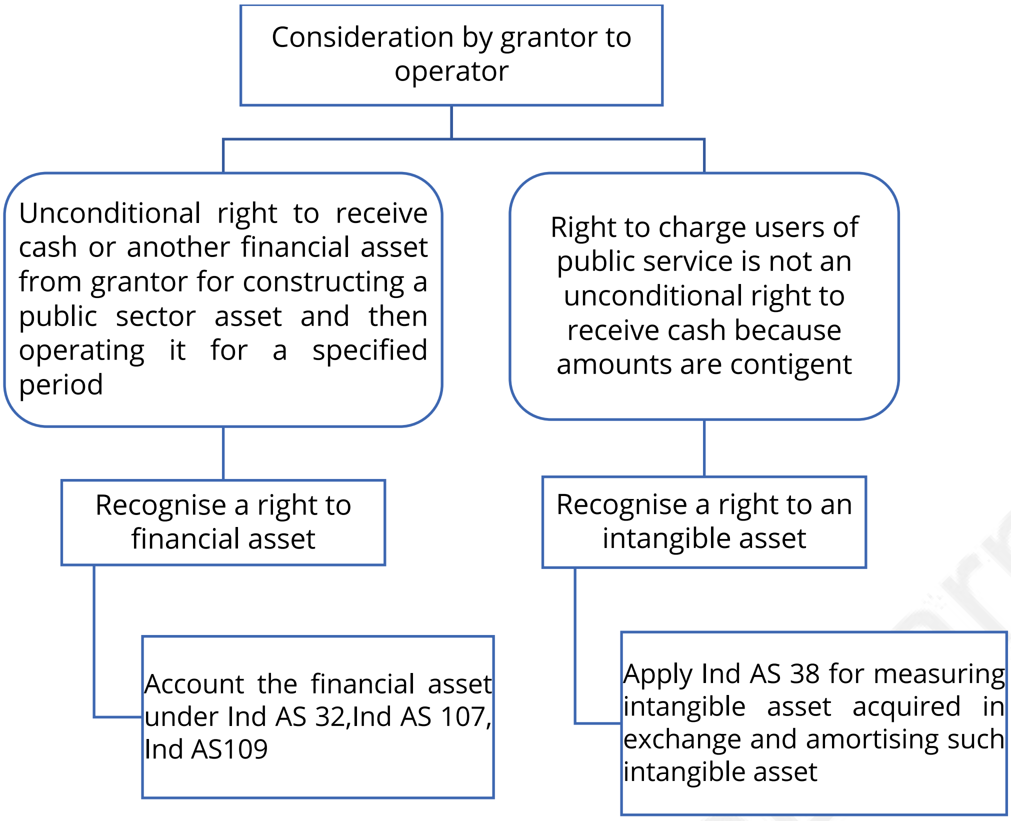
Infrastructure shall not be recognised as property, plant and equipment of the operator because the operator has no right to control the use of the public service infrastructure to the operator, however operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

### 12.4 Recognition and measurement

- Operator acting as a service provider, shall recognise and measure revenue in accordance with Ind AS 115.
- If the operator performing more than one service (i.e, construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated on the fair values of the services rendered.

### 12.5 Consideration given by the grantor to the operator

- If the operator provides construction or upgrade services, the consideration received or receivable by the operator shall be recognized at its fair value.




- If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of operator's consideration.

### 12.6 Contractual obligations to restore the infrastructure to a specified level of serviceability

The operator may have contractual obligations it must fulfil as a condition of its licence, like to maintain or restore infrastructure, except for any upgrade element, which shall be recognised and measured in accordance with Ind AS 37.

### 12.7 Borrowing costs incurred by the operator

- Operator has a contractual right to receive an intangible asset: recognise as an expense.
- Operator does not have a contractual right to receive an intangible asset: capitalise during the construction phase.

## Ind AS 115
## Revenue from Contracts with Customers
## ILLUSTRATIONS

### 1. Illustration (SM)

Company A has a customer P which is undergoing restructuring due to issues related to liquidity. Company A has decided not to do any further business with P. P has informed Company A that it will get Letter of Credit from a nationalised bank against which the Company A can despatch goods. Company A has manufactured the goods exclusively for P, but the Letter of Credit has not yet been arranged because it is in process. When should Company A recognise the revenue?

### 2. Illustration (SM)

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for Rs.20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry.

P Ltd. pays a non-refundable deposit of Rs.1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is Rs.12,00,000. P Ltd. obtains control of the machinery at contract inception.
When should G Ltd. recognise revenue from sale of machinery to P Ltd. in accordance with paragraph 9 of Ind AS 115?

## 3. Illustration (SM)

X Ltd. provides IT support services to its customers from a distant location. Customers call up the support team of X Ltd., who understand the client's requirement over the phone and provide necessary advice to the customer to resolve their issue. Before providing advice, the support team member will understand the client's problem and inform them about the price for the services to be provided. Once the problem is resolved, the customer will make the agreed payment to X Ltd. through online banking mode. X Ltd. considers that collection is probable and the oral contract is enforceable as per the laws applicable in the jurisdiction of X Ltd. In such a case, whether there is a valid contract in accordance with Ind AS 115?

## 4. Illustration (SM)

Company A, a manufacturer of specialised construction equipment enters into a contract with Customer B to manufacture and deliver a customised boom lift for Rs.95,000. The total cost to Company A of designing, manufacturing and delivering the boom lift is estimated to be Rs.70,000. Two days later, Company A enters into another contract with Customer B to deliver four boom lift tyres that Customer B will use on the customised boom lift in the future after the original tyres deteriorate. The contract price per tyre is Rs.800, however, the cost of each tyre is estimated at Rs.900. Whether these two contracts should be treated as a single contract?

## 5. Illustration (SM)

Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases.
Would these contracts be combined?

## 6. Illustration (SM)

Software Company S enters into a contract to license its customer relationship management software to Customer B. Three days later, in a separate contract, S agrees to provide consulting services to significantly customise the licensed software to function in B's IT environment. B is unable to use the software until the customisation services are complete.
Would these contracts be combined?

## 7. Illustration (SM)

Manufacturer M enters into a contract to manufacture and sell a cyber security system to Government-related Entity P. One week later, in a separate contract, M enters into a contract to sell the same system to Government-related Entity Q. Both entities are controlled by the same government. During the negotiations, M agrees to sell the systems at a deep discount if both P and Q purchases the security system.
Should these contracts be combined or separately accounted?

## 8. Illustration (SM)

An entity promises to sell 120 products to a customer for Rs. 120,000 (Rs. 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of Rs. 950 per product which is the standalone selling price for such additional products at the time of placing this additional order. The additional 30 products were not included in the initial contract.

It is assumed that additional products are contracted for a price that reflects the stand-alone selling price.
Determine the accounting for the modified contract?

## 9. Illustration (SM)

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal.
Based on its experience, Growth Ltd determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ₹ 150 per hour.
After incurring 100 hours of time, Growth Ltd and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of ₹ 100 per hour.
Determine how contract modification will be accounted as per Ind AS 115?

## 10. Illustration (SM)

XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is ₹ 2.5 crore, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31st March, 20X1 that the asset is incomplete, the promised consideration is reduced by ₹ 1 lakh. For each day before 31st March, 20X1 that the asset is complete, the promised consideration increases by ₹ 1 lakh.
In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of ₹ 15 lakh.
Determine the transaction price.

## 11. Illustration (SM)

AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.
Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of ₹ 25 crore.
The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)
- 10 percent bonus if completed by the 32nd month (40% likelihood)
- 5 percent bonus if completed by the 34th month (15% likelihood)

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of ₹ 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.
Determine the transaction price.

## 12. Illustration (SM)

A TV manufacturer sells TV sets to its dealers at the list price of Rs.10,000 per TV. If a dealer takes more than 8,000 sets during the contract period, then it is eligible for a discount of 5% on the list price retrospectively (i.e. for all sets purchased since the commencement of the agreement). The contract period starts in June and ends in May of each year. On the reporting date, i.e., March 31, 2018, a particular dealer has purchased 5,000 sets. Based on the past trends, it is expected that the total purchases to be made by dealer during the contract period up to May 2018 will be more than 8,000 sets. Should revenue be adjusted for the discount expected to be availed by such a dealer?

## 13. Illustration (SM)

HT Limited enters into a contract with a customer on 1st April, 20X1 to sell Product X for ₹ 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to ₹ 900 per unit. Consequently, the consideration in the contract is variable.
For the first quarter ended 30th June, 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).
Further, in May, 20X1, the customer acquires another company and in the second quarter ended 30th September, 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100 unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to ` 900.
Determine the amount of revenue to be recognise by HT Ltd. for the quarter ended 30th June, 20X1 and 30th September, 20X1.

## 14. Illustration (SM)

On 1st April, 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31st March, 20X2, the client's assets under management are ₹ 100 crore. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

Analyse the revenue to be recognised on 31st March, 20X2.

## 15. Illustration (SM)

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for ₹ 50 (1,000 total products × ₹ 50 = ₹ 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is ₹ 30.

The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.

Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the said contracts.

## 16. Illustration (SM)

Entity I sells a piece of machinery to the customer for ₹ 2 million, payable in 90 days. Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast ₹ 1.75 million, which is sufficient to cover entity I's cost of sales (₹ 1.5 million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts.

Entity I concludes that it is highly probable that it will collect ₹ 1.75 million, and such amount is not constrained under the variable consideration guidance.

What is the transaction price in this arrangement?

## 17. Illustration (SM)

On 1 January 20X8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

| Price per container | Cumulative sales volume |
|---|---|
| ₹ 100 | 1 - 1,000,000 containers |
| ₹ 90 | 1,000,001 - 3,000,000 containers |
| ₹ 85 | 3,000,001 containers and above |

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer.

Entity J sells 700,000 containers to the customer during the first quarter ended 31st March 20X8 for a contract price of ₹ 100 per container.
How should entity J determine the transaction price?

## 18. Illustration (SM)

A commercial airplane component supplier enters into a contract with a customer for promised consideration of ₹ 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 1,40,000 represented a insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.
State whether company needs to make any adjustment in determining the transaction price.
What if the advance payment was larger and received further in advance, such that the entity concluded that ₹ 14,00,000 represented the financing component based on an analysis of the facts and circumstances.

## 19. Illustration (SM)

NKT Limited sells a product to a customer for ₹ 1,21,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.
The cash selling price of the product is ₹ 1,00,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is ₹ 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 1,21,000 to the cash selling price of ₹ 1,00,000). Analyse the above transaction with respect to its financing component.

## 20. Illustration (SM)

VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed. The price stated in the contract is ₹ 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of ₹ 212,470.
Determine the discounting rate and the transaction price when
Case A—Contractual discount rate reflects the rate in a separate financing transaction
Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.

## 21. Illustration (SM)

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

1) Payment of ₹ 5,000 in two years when the customer obtains control of the asset or
2) Payment of ₹ 4,000 when the contract is signed. The customer elects to pay ₹ 4,000 when the contract is signed.

ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.
The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines

that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.
Pass journal entries showing how the entity would account for the significant financing component

## 22. Illustration (SM)

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid to the entity only when the building is complete.
Analyse whether the contract contains any financing component

## 23. Illustration (SM)

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional ₹ 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available).
Analyse whether there is any significant financing component in the contract or not.

## 24. Illustration (SM)

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time.
Analyse whether there is any significant financing component in the contract or not.

## 25. Illustration (SM)

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April, 20X1 and work begins immediately. The entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).
In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.
How should the entity decide the transaction price?

## 26. Illustration (SM)

RT Limited enters into a contract to build an office building for AT Limited over an 18-month period. AT Limited agrees to pay the construction entity ₹ 350 crore for the project. RT Limited will receive a bonus of 10 lakh equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.
Determine the transaction price.

## 27. Illustration (SM)

Production Company Y sells a television show to Television Company X. The consideration under the arrangement is a fixed amount of ₹ 1,000 and 100 advertising slots. Y determines that the stand-alone selling price of the show would be ₹ 1,500. Based on market rates, Y determines that the fair value of the advertising slots is ₹ 600.
Determine the transaction price.

## 28. Illustration (SM)

MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited. It also agrees to pay ₹ 25,000 per steering system and contributes tooling to be used in SK's production process.
The tooling has a fair value of ₹ 2 crore at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.
SK Limited may use the tooling for other projects and determines that it obtains control of the tooling.
Determine the transaction price?

## 29. Illustration (SM)

A producer entity sells energy drinks to a retailer, a convenience store. Producer also pays Retailer a fee to ensure that its products receive prominent placement on store shelves, to attract the customer's eyeballs so that chances of sales of it's products are higher. The fee is negotiated as part of the contract for sale of the energy drinks. In this case, Producer should reduce the transaction price for the sale of the energy drinks by the amount of slotting fees paid to Retailer. Producer does not receive a good or service that is distinct in exchange for the payment to Retailer.

## 30. Illustration (SM)

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least ₹ 15 crore of products during the year. The contract also requires the entity to make a non- refundable payment of ₹ 1.5 crore to the customer at the inception of the contract. The ₹ 1.5 crore payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.
Determine the transaction price

## 31. Illustration (SM)

An entity enters into a contract with a customer to sell Products A, B and C in exchange for Rs. 10,000.
The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.
To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C.
The entity estimates the stand-alone selling prices as follows:

| Product | Stand-alone selling price | Method |
|---|---|---|
| | Rs. | |
| Product A | 5,000 | Directly observable |
| Product B | 2,500 | Adjusted market assessment approach |
| Product C | 7,500 | Expected cost plus a margin approach |

| Total | 15,000 | |
|---|---|---|

Allocate the transaction price.

[**Ans:** Product A – Rs. 3,300; Product B – Rs. 2,500; Product C – Rs. 7,500]

## 32. Illustration (SM)

An entity regularly sells Products X, Y and Z individually, thereby establishing the following stand-alone selling prices:

| Product | Stand-alone selling price Rs. |
|---|---|
| Product X | 50,000 |
| Product Y | 25,000 |
| Product Z | 45,000 |
| Total | 1,20,000 |

In addition, the entity regularly sells Products Y and Z together for Rs. 50,000.

Case A—Allocating a discount to one or more performance obligations

The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for Rs. 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B—Residual approach is appropriate

The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is Rs. 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (Rs. 15,000 – Rs. 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs. 1,05,000 instead of Rs. 130,000.

**[Ans:]**

| | |
|---|---|
| Case A | • If entity transfers control of Products Y and Z at same point in time: Entity can account for transfer as single performance obligation and can allocate Rs. 50,000 to it<br>• If entity transfers control of Products Y and Z at different point in time: Allocated Transaction Price for Product Y and Z will be Rs. 17,857 and Rs. 32,143 respectively |
| Case B | Product X – Rs. 50,000; Product Y and Z Rs. 50,000; Product Alpha – Rs. 30,000 |
| Case C | Determine standalone selling price of Product Alpha using other method and then allocate transaction price for products based on relative stand-alone selling prices. |

## 33. Illustration (SM)

An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are Rs. 1,600,000 and Rs. 2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A – Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of Rs. 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be Rs. 2,000,000. Allocate the transaction price.

<u>Case B – Variable consideration allocated on the basis of stand-alone selling prices</u>
The price stated in the contract for Licence A is a fixed amount of Rs. 600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (i.e., the variable consideration) is Rs. 3,000,000. Here, Licence A is transferred 3 months later. The royalty due from the customer's first month of sale is Rs. 4,00,000.
Allocate the transaction price and determine the revenue to be recognised for each licence and the contract liability, if any.

**[Ans:]**

| | |
|---|---|
| Case A | Licence A – Rs. 1,600,000; Licence B – Rs. 2,000,000 |
| Case B | Allocation of fixed consideration: Licence A – Rs. 266,667; Licence B – Rs. 333,333.<br>First month – Revenue of Rs. 222,222 allocated to Licence B; Contract Liability of Rs. 177,178 allocated to Licence A. |

## 34. Illustration (SM)

On 1st April, 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for Rs. 2 crore. The consultant can earn Rs. 20 lakh bonus if it completes the software implementation by 30th September, 20X0 or Rs. 10 lakh bonus if it completes the software implementation by 31st December, 20X0.
The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

- Due diligence – Rs. 80 lakh
- Valuation – Rs. 20 lakh
- Software implementation – Rs. 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30th January, 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.
On 1st July, 20X0, the consultant notes that the project has progressed better than expected and believes that implementation will be completed by 30th September, 20X0 based on a revised forecast. As a result, the consultant updates its estimated transaction price to reflect a bonus of Rs. 20 lakh.
After reviewing its progress as of 1st July, 20X0, the consultant determines that it is 100 percent complete in satisfying its performance obligations for due diligence and valuation and 60 percent complete in satisfying its performance obligation for software implementation.
Determine the transaction price.

[**Ans:** On 1st July, 20X0, consultant shall consider total consideration for software implementation performance obligation as Rs. 1.2 crore and adjust the cumulative revenue to date to Rs. 72 lakh (60 percent of Rs. 1.2 crore).

## 35. Illustration (SM)

Telco G Ltd. grants a one-time credit of Rs. 50 to a customer in Month 14 of a two-year contract. The credit is discretionary and is granted as a commercial gesture, not in response to prior service issues (often referred to as a 'retention credit'). The contract includes a subsidised handset and a voice and data plan. G Ltd. does not regularly provide these credits and therefore customers do not expect them to be granted.

How this will be accounted for under Ind AS 115?

[**Ans:** Considered as contract modification and recognised over the remaining term of the contract]

## 36. Illustration (ICAI EM)

An entity, Moon Ltd. which manufactures auto components enters into a two year contract with a customer Venus Ltd., a car manufacturer. The total contract value is Rs.20,00,000. Additionally, Moon Ltd. agrees to pay Rs.4,00,000 to Venus Ltd. as compensation for storage facility which will require certain modifications to accommodate the components manufactured by Moon Ltd. The storage facility is controlled by Venus Ltd. and will be utilised exclusively to store goods received from Moon Ltd.

What will be the accounting treatment for the consideration payable to Venus Ltd.?

[**Ans**: Treated as reduction in revenue proportionately]

## 37. Illustration (ICAI EM)

Entity Y enters into an agreement to sell hardware, professional services and maintenance services for Rs. 2,00,000. Entity Y determines that each of the promised goods or services represents a separate performance obligation because the entity frequently sells professional services and maintenance services on a stand-alone basis. The stand-alone selling prices of professional services and maintenance services are Rs.25,000 and Rs.15,000 respectively. The Entity Y rarely sells the hardware on a stand- alone basis, so it estimates the stand-alone selling price at Rs.185,000 based on the hardware's underlying cost, the entity's targeted cost and the amount of margin the entity believes the market will bear (i.e., the expected cost plus a margin approach).

The contract price will include Rs.10,000 incentive, if professional services are provided within seven days of the delivery date of the hardware.

(a) How will the transaction price be allocated to performance obligations?

(b) What will be the accounting treatment for the incentive amount?

[**Ans:** (a) Allocated transaction price for hardware, professional services and maintenance services will be Rs. 1,64,444.44; Rs. 22,222.22; Rs. 13,333.33 respectively; (b) Incentive amount will be allocated to professional services]

## 38. Illustration (SM)

Minitek Ltd. is a payroll processing company. Minitek Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognise the revenue?

[**Ans:** Revenue shall be recognised over the period of time]

## 39. Illustration (SM)

T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horizon') enters into a contract with T&L for transportation of its

goods from India to Sri Lanka through sea. The voyage is expected to take 20 days from Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Colombo port.
Whether T&L's performance obligation is met over period of time?

## 40. Illustration (SM)

AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory firm for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.
Whether risk advisory firm's performance obligation is met over period of time?

## 41. Illustration (SM)

Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in this business for building such satellites for various customers across the world, however the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has right to enforce payment for work completed to date.
Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

## 42. Illustration (SM)

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.
Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

## 43. Illustration (SM)

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes.
Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?

## 44. Illustration (SM)

On 1st January, 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

| Particulars | Amount (₹) |
|---|---|
| Transaction price | 50,00,000 |
| Expected costs: | |
| (a) Elevators | 15,00,000 |
| (b) Other costs | 25,00,000 |
| Total | 40,00,000 |

The entity purchases the elevators and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of ₹ 500,000 by 31st March, 20X1.
How will the Company recognize revenue, if performance obligation is met over a period of time?
[**Ans:** Total revenue to be recognised for year ended 31 March, 20X1 = ₹22,00,000]

## 45. Illustration (SM)

An EPC contractor enters into a two-year contract to develop customized machine for a customer. The contractor concludes that the goods and services in this contract constitute a single performance obligation.
Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component.
Analyse whether there is any significant financing component in the contract or not.
[**Ans:** No. Holdback payment only to ensure successful completion of project]

## 46. Illustration (SM)

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms.
As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to Rs. 100 crore. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the Rs. 100 crore award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed.
The contract specifies Company Z will earn up to Rs. 100 crore based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy.
Partial award fees may be awarded based on a pre-determined scale based on their success.
Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of Rs. 80 crore in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize revenue over time for a single performance obligation using a cost-to-cost input method.
Analyse whether there is any significant financing component in the contract or not.
[**Ans:** No. Intention is to provide incentive to Company Z to produce high functioning missiles]

## 47. Illustration (SM)

An entity has a fixed fee contract for Rs. 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is Rs. 9,50,000. The entity will transfer control of the product over five years, and the entity uses the cost-to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

| Weight (kg) | Award % of fixed fee | Incentive fee |
|---|---|---|
| 951 or greater | 0% | — |

| | | |
|---|---|---|
| 701-950 | 10% | Rs. 100,000 |
| 700 or less | 25% | Rs. 250,000 |

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10 percent incentive and two that will achieve the 25 percent incentive. In this case, the entity determined that it has 95 percent confidence that it will achieve the 10 percent incentive and 20 percent confidence that it will achieve the 25 percent incentive.

Based on this analysis, the entity believes 10 percent to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10 percent award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 95 percent confidence in achieving the 10 percent award.

The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25 percent incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price.

Evaluate the impact of changes in variable consideration when cost incurred is as follows:

| Year | Rs. |
|---|---|
| 1 | 50,000 |
| 2 | 1,75,000 |
| 3 | 4,00,000 |
| 4 | 2,75,000 |
| 5 | 50,000 |

[**Ans:** Cumulative catchup adjustment – Rs. 98,684]

## 48. Illustration (SM)

An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty.

Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e., a service-type warranty). The total transaction price for the sale of a computer and the extended warranty is Rs. 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are Rs. 32,000 and Rs. 4,000, respectively. The inventory value of the computer is Rs. 14,400.

Furthermore, the entity estimates that, based on its experience, it will incur Rs. 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

**[Ans:]**

| | | |
|---|---|---|
| Cash/Trade Receivable Dr.<br>To Revenue<br>To Contract Liability (Service-type warranty) | Rs. 36,000 | <br>Rs. 32,000<br>Rs. 4,000 |
| Cost of Goods Sold Dr.<br>To Inventory | Rs. 14,000 | <br>Rs. 14,000 |
| Warranty Expense Dr.<br>To Accrued Warranty Costs | Rs. 2,000 | <br>Rs. 2,000 |

## 49. Illustration (SM)

Entity sells 100 ultra-life batteries for Rs. 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that years two through five represent a separate performance obligation.
The entity determines that Rs. 1,70,000 of the Rs. 2,00,000 transaction price should be allocated to the batteries and Rs. 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is Rs. 100 per battery.
Pass required journal entries.
**Ans:**

| | | |
|---|---|---|
| Cash/ Receivable Dr.<br>To Revenue<br>To Contract Liability (Service-type warranty) | Rs. 2,00,000 | <br>Rs. 1,70,000<br>Rs. 30,000 |
| Warranty Expense Dr.<br>To Accrued Warranty Costs | Rs. 10,000 | <br>Rs. 10,000 |

## 50. Illustration (SM)

An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are sold; therefore, there is no credit risk.
The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.
Determine whether the entity is a principal or an agent.
[**Ans:** Entity is principal – has inventory risk and determines ticket price]

## 51. Illustration

Company D Ltd. provides advertising services to customers. D Ltd. enters into a sub-contract with a multinational online video sharing company, F Ltd. Under the sub-contract, F Ltd. places all of D Ltd.'s customers' adverts.
D Ltd. notes the following:

- D Ltd. works directly with customers to understand their advertising needs before placing adverts.
- D Ltd. is responsible for ensuring that the advert meets the customer's needs after the advert is placed.
- D Ltd. directs F Ltd. over which advert to place and when to place it.
- D Ltd. does not bear inventory risk because there is no minimum purchase requirement with F Ltd.
- D Ltd. does not have discretion in setting the price because fees are charged based on F Ltd.'s scheduled rates.

D is Principal or an agent?
[**Ans:** Principal – It is primarily responsible for fulfilling promise to provide advertising services]

## 52. Illustration (SM)

An entity enters into a contract with a customer on 1st April, 20X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.
Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31st March, 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.
How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

## 53. Illustration (SM)

An entity, a music record label, licenses to a customer a 1975 recording of a classical symphony by a noted orchestra. The customer, a consumer products company, has the right to use the recorded symphony in all commercials, including television, radio and online advertisements for two years in Country A. In exchange for providing the licence, the entity receives fixed consideration of ₹ 50,000 per month. The contract does not include any other goods or services to be provided by the entity. The contract is non-cancellable.
Determine how the revenue will be recognised?

## 54. Illustration (SM)

Software Company X licenses its software application to Customer Y. Under the agreement, X will provide updates or upgrades on a when-and-if-available basis; Y can choose whether to install them. Y expects that X will undertake no other activities that will change the functionality of the software.
Determine the nature of license
**Ans:** The software licence provides a right to use the IP that is satisfied at a point in time

## 55. Illustration (SM)

Film Studio C grants a licence to Customer D to show a completed film. C plans to undertake significant marketing activities that it expects will affect box office receipts for the film. The marketing activities will not change the functionality of the film, but they could affect its value.
Determine the nature of license

**Ans:** Licence provides a right to use its IP

## 56. Illustration (SM)

Sports Team D enters into a three-year agreement to license its team name and logo to Apparel Maker M. The licence permits M to use the team name and logo on its products, including display products, and in its advertising or marketing materials.

(i) Determine the nature of license in the above case.

(ii) Modifying above facts that, Sports Team D has not played games in many years and the licensor is Brand Collector B, an entity that acquires IP such as old team or brand names and logos from defunct entities or those in financial distress. B's business model is to license the IP, or obtain settlements from entities that use the IP without permission, without undertaking any ongoing activities to promote or support the IP

Would the answer be different in this situation?

## 57. Illustration (SM)

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹ 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for ₹ 1.1 million on or before 31st December, 20X1.

How would the entity account for this transaction?

## 58. Illustration (SM)

An entity enters into a contract with a customer for the sale of a tangible asset on 1st January, 20X1 for ₹10,00,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before 31st December, 20X1. The market price for such goods is expected to be ₹ 7,50,000

How would the entity account for this transaction?

## 59. Illustration (SM)

An entity enters into a contract for the sale of Product A for ₹ 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to ₹ 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase ₹ 500 of additional products.

Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price?

## 60. Illustration (SM)

Entity sells gym memberships for ₹ 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at ₹ 6,000 per year. Entity estimates an annual attrition rate of 50% each year.

## 61. Illustration (ICAI EM)

A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every Rs.100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the stand alone price of each such point is Rs.5. Customer X spends Rs.10,000 in one of the resorts of A Ltd. and earns 100 points. What is the accounting treatment for the points granted by A Ltd.?

## 62. Illustration (ICAI EM)

A seller provides sales incentives to a customer when entering into a contract. Examples of such customer incentives include:

1. Cash incentives
2. Non-cash incentives in the three scenarios as described below:
    - Scenario 1: Loyalty points to purchase goods from the seller at a lower price;
    - Scenario 2: A coupon redeemable for free products from a third party; and

- Scenario 3: Free goods or services that the seller normally sells or provides as part of its business (e.g., On purchase of two products, third product is free).

How should an entity account for cash and non-cash based sales incentives when entering into a contract for supply of goods or services?

## 63. Illustration

For every ₹ 100 of sale, entity awards 10. If total sales are ₹ 1,00,000. Each point is worth ₹ 1. Entity expects that only 9,500 points would be redeemed.
At the end of year 1, 4500 points were redeemed.
At the end of year 2, 4000 points were redeemed.
At the end of year 2, entity expects that 9,700 points would be redeemed.

Determine the revenue to be recognised in each year.

## 64. Illustration (SM)

Customer outsources its information technology data centre
Term = 5 years plus two 1-yr renewal options
Average customer relationship is 7 years
Entity spends ₹ 400,000 designing and building the technology platform needed to accommodate out-sourcing contract:

| | |
|---|---|
| Design services | ₹ 50,000 |
| Hardware | ₹ 140,000 |
| Software | ₹ 100,000 |
| Migration and testing of data centre | ₹ 110,000 |
| TOTAL | ₹ 400,000 |

## 65. Illustration

| Year | Cost | Fair Value | Type of cost |
|---|---|---|---|
| 1 | 500 | 525 | Construction |
| 2 | 500 | 525 | Construction |
| 3 to 10 | 10 | 12 | Operations |
| 8 | 100 | 110 | Obligation to resurface |

Services being provided are Construction, operation and resurfacing.
Grantor pays consideration from year 3 to year 10. Determine how the revenue would be recognised.

## 66. Illustration

| Year | Cost | Fair Value | Type of cost |
|---|---|---|---|
| 1 | 500 | 525 | Construction |
| 2 | 500 | 525 | Construction |
| 3 to 10 | 10 | 12 | Operations |
| 8 | 100 | 110 | Obligation to resurface |

Services being provided are Construction, operation and resurfacing (as needed)
The entity expects that resurfacing should be done in $8^{th}$ year.
Entity has a right to collect the user fee from the users based on usage from Year 3 to 10. Entity expects to collect ₹ 200 crores from user each year.

## 67. Illustration

A Ltd. is in the business of the infrastructure and has two divisions under the same; (I) Toll Roads and (II) Wind Power.

The brief details of these business and underlying project details are as follows:

I. Bhilwara-Jabalpur Toll Project - The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to ₹ 50 crore as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:
   - Total Expenses estimated to be incurred on the project ₹ 100 crore;
   - Fair Value of the construction services is ₹ 110 crore;
   - Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crore;
   - Finance revenue over the period of operation phase is ₹ 15 crore:
   - Other income relates to the services provided during the operation phase.

II. Kolhapur- Nagpur Expressway - The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be ₹ 110 crore. The fair value of such construction cost is approximately ₹ 200 crore. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(ii) What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(iii) Also, suggest suitable accounting treatment for preparation of financial statements as per Ind AS for the above 2 projects.

## 68. Illustration

A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 2.5 per unit. How should revenue be measured in this case?

## 69. Illustration

Company X enters into an agreement on 1st January, 20X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of ₹ 50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are ₹ 40,00,000 including ₹ 10,00,000 for the air conditioners.

Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at 31st March, 20X1, other costs incurred excluding the air conditioners are ₹ 6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognised for the year ended March 20X1?

## 70. Illustration

Entity K sells electric razors to retailers for C 50 per unit. A rebate coupon is included inside the electric razor package that can be redeemed by the end consumers for C 10 per unit.
Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change.
How should entity K determine the transaction price?

## 71. Illustration

Electronics Manufacturer M sells 1,000 televisions to Retailer R for ₹ 50,00,000 (` 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

| Price reduction in next six months (₹ ) | Probability |
|---|---|
| 0 | 70% |
| ₹ 500 | 20% |
| ₹ 1,000 | 10% |

Determine the transaction price.

## 72. Illustration (Nov 19 – 12 Marks)

Nivaan Limited commenced work on two long-term contracts during the financial year ended on 31st March, 2019.
The first contract with A & Co. commences on 1st June, 2018 and had a total sales value of Rs. 40 lakh. It was envisaged that the contract would run for two years and that the total expected costs would be Rs. 32 lakh. On 31st March, 2019, Nivaan Limited revised its estimate of the total expected cost to Rs. 34 lakh on the basis of the additional rectification cost of Rs. 2 lakh incurred on the contract during the current financial year. An independent surveyor has estimated at 31st March, 2019 that the contract is 30% complete. Nivaan Limited has incurred costs up to 31st March, 2019 of Rs. 16 lakh and has received payments on account of Rs. 13 lakh.

The second contract with B & Co. commenced on 1st September, 2018 and was for 18 months. The total sales value of contract was Rs. 30 lakh and the total expected cost is Rs. 24 lakh. Payments on account already received were Rs. 9.50 lakh and total costs incurred to date were Rs. 8 lakh. Nivaan Limited has insisted on a large deposit from B & Co. because the companies had not traded together prior to the contract. The independent surveyor estimated that on 31st March, 2019 the contract was 20% complete.
The two contracts meet the requirement of Ind AS 115 'Revenue from Contracts with Customers' to recognize revenue over time as the performance obligations are satisfied over time.

The company also has several other contracts of between twelve and eighteen months in duration. Some of these contracts fall into two accounting periods and were not completed as at 31st March, 2019. In absence of any financial date relating to the other contracts, you are advised to ignore these other contracts while preparing the financial statements of the company for the year ended 31st March, 2019.
Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31st March, 2019.

## 73. Illustration (Jan 21 – 12 Marks)

A Ltd. is a company which is in the business of manufacturing engineering machines and providing after sales services. The company entered into a contract with Mr. Anik to supply and install a machine, namely 'model pi' on 1st April 2018 and to service this machine on 30th September 2018 and 1st April 2019. The cost of manufacturing the machine to A Ltd. was Rs. 1,60,000.
It is possible for a customer to purchase both the machine 'model pi' and the maintenance services separately. Mr. Anik is contractually obliged to pay A Ltd Rs. 4,00,000 on 1st April, 2019.
The prevailing rate for one-year credit granted to trade customers in the industry is 5 percent per six-month period. As per the experience, the servicing of the machine 'model pi' sold to Mr. Anik is expected to cost A Ltd. Rs. 30,000 to perform the first service and Rs. 50,000 to perform the second service. Assume actual costs equal expected costs. When A Ltd. provides machine services to customers in a separate transaction it earns a margin of 50 % on cost. On 1st April, 2018, the cash selling price of the machine 'model pi' sold to Mr. Anik is Rs. 2,51,927.

The promised supply of machine 'model pi' and maintenance service obligations are satisfactorily carried out in time by the company.
You are required to:

(i) Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115

(ii) Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction

(iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March·2019 and 31st March 2020; and

(iv) Draft an extract showing how revenue could be presented and disclosed in the financial statements of A Ltd. for the year ended 31st March 2019 and 31st March 2020.

# Ind AS 8
# Accounting Policies, changes in Accounting Estimates and Errors

## 1. Introduction

### 1.1 Objective

- To prescribe the criteria for selecting and changing accounting policies.
- To prescribe the accounting treatment and disclosure of
  - changes in accounting policies
  - changes in accounting estimates
  - corrections of errors.
- To provide better base for inter-firm and intra-firm comparison.

### 1.2 Scope

The standard shall be applied in

- selecting and applying accounting policies
- accounting for changes in accounting policies
- accounting changes in accounting estimates
- accounting for corrections of prior period errors.

The standard does not deal with the following

| | | |
|---|---|---|
| (a) | Tax effects of changes in accounting policy and correction of prior period errors | Dealt as per Ind AS 12 |
| (b) | Disclosure of accounting policies | Dealt as per Ind AS 1 |

## 2. Definitions

### 2.1 Accounting policies

Accounting policies are

-Specific principles
-Bases
-Conventions
-Rules
-Practices

applied by an entity in preparing and presenting financial statments

### 2.2 Accounting Estimate

Accounting estimates are monetary amounts in financial statements that are subject to material uncertainty.

### 2.3 Prior period errors

Are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

was available when financial statements for those periods were approved for issue, and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Errors include

| | | | |
|---|---|---|---|
| Effects of mathematical mistakes | Mistakes in applying accounting policies | Oversights or misrepresentations of facts | Fraud |

### 2.4 Retrospective application

Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

### 2.5 Retrospective restatement

Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

### 2.6 Prospective application

Change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

- applying the new accounting policy to transactions, other events, and conditions occurring after the date as at which the policy is changed; and
- recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

### 2.7 Impracticable

Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

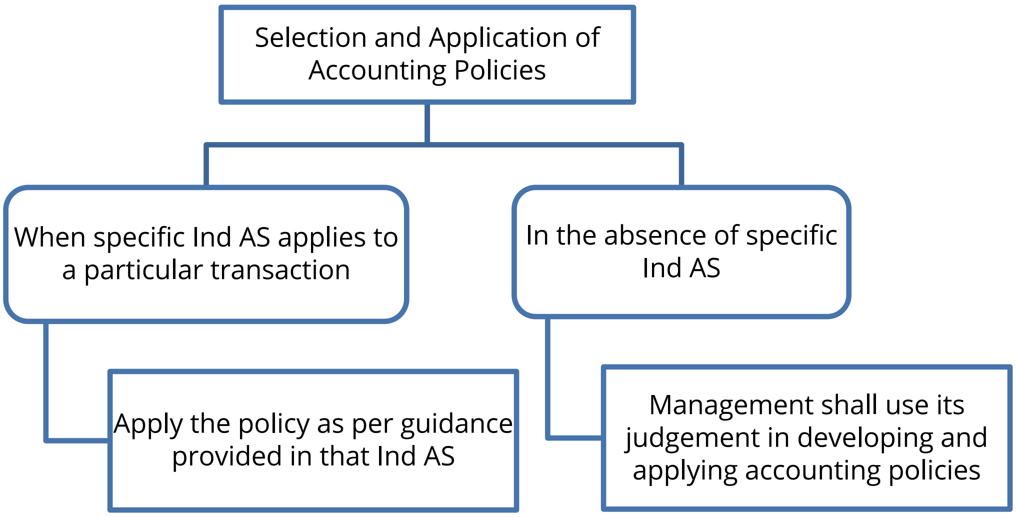
| | | |
|---|---|---|
| The effects of the retrospective application or retrospective restatement are not determinable | The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period | The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectivity information about those estimates that:<br>- provides evidence of circumstance that existed on the date as at which those amounts are to be recognised, measured or disclosed, and<br>- would have been available when the financial statements for that prior period were approved for issue from other information |

### 2.8 Material

- As per Ind AS 1 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements.
- Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.
- Information is obscured if it is communicated in a way that would have a similar effect for primary users of financial statements to omitting or misstating that information.
- The following are examples of circumstances that may result in material information being obscured:
  - information regarding a material item, transaction or other event is disclosed in the financial statements but the language used is vague or unclear,
  - information regarding a material item, transaction or other event is scattered throughout the financial statements,
  - dissimilar items, transactions or other events are inappropriately aggregated,
  - similar items, transactions or other events are inappropriately disaggregated, and
  - the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material.

## 3. Accounting Policies

### 3.1 Selection and Application of Accounting Policies




### 3.2 Selection and Application of Accounting Policies when specific Ind AS not available

Management shall use its judgement in developing and applying accounting policies that results in information that is:

- Relevant to the economic decision-making needs of users; and
- Reliable, in that the financial statements:
  - represent faithfully the financial position, financial performance and cash flows of the entity
  - reflect the economic substance of transactions, other events and conditions, and not merely the legal form
  - are neutral
  - are prudent
  - are complete in all material respects.

In making judgement, management shall refer and consider the applicability of the following sources in descending order:

- Any other Ind AS available which are dealing with related and similar issues
- Basic Framework of Ind AS, which provides the general principles
- Pronouncements of International Accounting Standards Board
- Pronouncements of other standard setting bodies having similar conceptual framework
- Accounting literature and accepted industry practices

### 3.3 Consistency of accounting policies

| | |
|---|---|
| Ind AS not specifically requires or not permits categorisation of items for which different policies are apropriate | •An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions |
| Ind AS specifically requires or permits categorisation of items for which different policies are apropriate | •An appropraiate accounting policy shall be selected and applied consistently to each category |

### 3.4 *Changes in accounting policies*

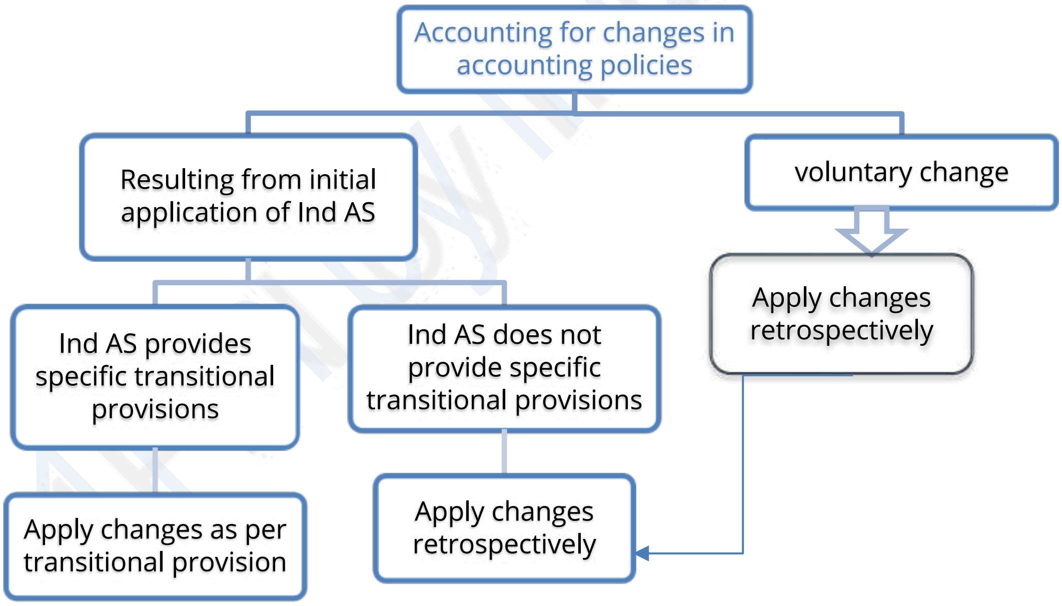
An entity shall change an accounting policy only if the change:

- Required by an Ind AS, or
- Results in the financial statements providing reliable and more relevant information.

Following are not changes in accounting policy:

- The application of an accounting policy for transactions, other events or conditions that-
  - Differ in substance
  - Did not previously occur
  - Are immaterial .

### 3.5 *Accounting for changes in accounting policies*




- Early application of Ind AS is not a voluntary change in accounting policy.
- In the absence of any specific Ind AS that specifically applies to a transaction, other event or condition, accounting policy applied from relevant IFRS, or the most recent pronouncements of International Accounting Standards Board, and subsequently there is an amendment in such IFRS or pronouncements, company may change its accounting policy, that change is considered as voluntary change and accordingly it shall apply the change retrospectively.

### 3.5.1 Retrospective application

- when a change in accounting policy is applied retrospectively, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.
- As per Ind AS1 present a third balance sheet as at the beginning of previous year if it applies accounting policy retrospectively.

### 3.5.2 Limitations of Retrospective application

Changes in accounting policy shall not be applied retrospective if it is impracticable to determine either the period specific effects or the cumulative effect of the change

↓

The entity shall apply the accounting policy as at the beginning of the earliest period for which retrospective application is practicable

## 3.6 Disclosure regarding the changes in Accounting Policies

**Initial application of Ind AS**

- Title of Ind As
- changes made in accordance with transitional provision
- Natue of change in accounting policy
- Transitional provision that may have effect on future periods
- Description of transitional provision
- Adjustments to each financial line item affected and Ind AS 33
- If retrospective application is impracticable the circumstances led to that condition and description from when changes applied

**Voluntary change in accounting policy**

- Nature of change
- Reasons for change and whether it is reliable and relevant
- Adjustments to each financial line item affected and Ind AS 33
- If retrospective application is impracticable the circumstances led to that condition and description from when changes applied

- When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:
  - This fact, and
  - Known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.

## 4. Accounting Estimate

### 4.1 Meaning

As a result of uncertainities inherent in business activities → Items in financial statements cannot be measured but can only be estimated → Estimation involves judgements based on latest available, reliable infomation

Accounting estimates are used when monetary amounts cannot be observed directly and must be estimated.

Examples:

- Loss allowance for expected credit losses as per Ind AS 109 (Bad debts),
- NRV of Inventory under Ind AS 2
- Fair value of financial assets or financial liabilities,
- Useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets,
- Depreciation expense
- Warranty obligations etc.

### 4.2 Change in accounting estimate

| | |
|---|---|
| change in accounting estimate results from | • new information<br>• more experience |
| Can change in estimate be related to prior periods? | • does not relate to prior periods and is not the correction of an error. |
| change in the measurement basis? | • change in an accounting policy, and it is not a change in an accounting estimate. |
| When it is difficult to distinguish a change in an accounting policy and accounting estimate | • change is treated as a change in an accounting estimate. |

### 4.3 Accounting treatment for a change in estimate

The effect of change in an accounting estimate shall be recognised prospectively by including it in profit or loss in:

- The period of the change, if the change affects that period only
- The period of the change and future periods, if the change affects both.

### 4.4 Disclosure of changes in estimates

- Effect of change in estimate on the current period
- If applicable and practicable, effect of change in estimate on future periods

- If applicable but impracticable, the fact it is impracticable to estimate the effect on future periods.

## 5. Errors

### 5.1 Meaning

omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

was available when financial statements for those periods were approved for issue, and

could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

### 5.2 Common types of Errors

| | |
|---|---|
| Mathematical Mistakes | • Errors are called as error of commission<br>• Examples: Wrong calculations, Carry forward of wrong balances, Errors in totals. |
| Mistakes in applying policies | • Assets and Liabilities and income and expenses should not be offset, unless otherwise specifically required or permitted in an Ind AS. |
| Misrepresentations of facts | • Whether the event is an adjusting event or a non-adjusting event if not dealt it properly may result into misrepresentation of fact. |
| Omissions | • The mistakes that happened due to omission to record a material transaction, perhaps, due to oversight. |
| Frauds | • Major theft undetected in the past. |

### 5.3 Accounting treatment for Errors

**Potential Errors of Current Period**

- corrected before the financial statements are approved for issue

**Prior period errors discovered subsequently**

- corrected in the comparative information presented in the financial statements for that subsequent period

| Error discovered relates to the comparative prior period presented | Error discoverd relates to period before the earliest comparative prior period presented |
|---|---|
| •Unless impracticable, correct material prior period errors retrospectively by restating the comparative amounts for the prior period presented in which the error occured. | •Unless impracticable, correct the same retrospectively by restating the opening balances of assets, liabilities and equity for the earliest prior period presented<br>•As per Ind AS 1 whenever there is a requirement of retrospective effect, an entity shall prepare previous year opening balancesheet . |

## 5.4 Limitations on retrospective restatement

A prior period error shall be corrected by retrospective restatement if it is practicable to determine both the period specific effects or the cumulative effect of the change

↓

The entity restates the comparative information prospectively from the earliest date practicable

## 5.5 Disclosure of prior period errors

- Nature of prior period error.
- Adjustments to each financial line item affected and Ind AS 33.
- If retrospective restatement is impracticable the circumstances, led to that condition and description from when errors has been corrected.

## 6. Difference between Ind AS 8 and AS 5

| Particulars | Ind AS 8 | AS 5 |
|---|---|---|
| Objective | To prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors | To prescribe the classification and disclosure of certain items in the statement of profit or loss for uniform preparation and presentation of financial statements |
| Extraordinary items | Does not deal with extraordinary items | Deals with extraordinary items |
| Definition of Accounting policies | Broadens the definition to include bases, conventions, rules and practices | Restricts the definition to specific accounting principles and methods of applying those |
| Change in accounting policies | Does not deal | Allows if required by statute |
| Accounting for changes in accounting policies | Retrospective effect with limited exceptions | Does not specify |
| Errors | States that errors include frauds | Silent |
| Rectification of material prior period errors | Retrospective effect with limited exceptions | Prospective effect |
| Disclosure requirements | More | Less |

## 1. Illustration

During 20X2, Delta Ltd., changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.

In years before 20X2, Delta Ltd.'s asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

Delta Ltd.'s management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta Ltd.'s new policy prospectively from the start of 20X2.

Additional information:

(i) Delta Ltd.'s tax rate is 30%

(ii) Property, plant and equipment at the end of 20X1:
- Cost Rs. 25,000
- Depreciation Rs. 14,000
- Net book value Rs. 11,000

(iii) Prospective depreciation expense for 20X2 (old basis) Rs. 1,500

(iv) Some results of the engineering survey:
- Valuation Rs. 17,000
- Estimated residual valueRs. 3,000
- Average remaining asset life 7 years
- Depreciation expense on existing property, plant and equipment
- for 20X2 (new basis) Rs. 2,000

You are required to prepare relevant note for disclosure in accordance with Ind AS 8.

*Hint: Adoption of the new policy has no effect on prior years. Current Year – PPE Increase Rs.6,000; Deferred tax increase 1,800; Revaluation surplus – 4,200; Depreciation increase 500; Tax expense reduction 150*

## 2. Illustration

An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X1). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts will be considered as correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

*Hint: No effect on the balance sheet at the beginning of the preceding period (1st April, 20X0). Hence, no requirement to present a third balance sheet.*

## 3. Illustration

While preparing the annual financial statements for the year ended 31st March, 20X3, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 20X2 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the error was material?

*Hint: Restate the comparative amounts (year ended 31st March, 20X2) in the statement of profit and loss; Present a third balance sheet as at 1st April, 20X1*

## 4. Illustration

ABC Ltd has an investment property with an original cost of Rs. 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil.

How should the error be corrected in the financial statements for the year ended 31st March, 20X4, assuming the impact of the same is considered material? For simplicity, ignore tax effects.

*Hint: Revaluation to be in accordance with Ind AS 16 or Ind AS 38. Change in amortisation method should be accounted for as a change in accounting estimate*

## 5. Illustration

ABC Ltd. changed its method adopted for inventory valuation in the year 20X2-20X3. Prior to the change, inventory was valued using the first in first out method (FIFO). However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable, a weighted average valuation model would be more appropriate.

The effect of the change in the method of valuation of inventory was as follows:

- 31st March, 20X1 - Increase of Rs. 10 million
- 31st March, 20X2 - Increase of Rs. 15 million
- 31st March, 20X3 - Increase of Rs. 20 million

Profit or loss under the FIFO valuation model are as follows:

| | 20X2-20X3 | 20X1-20X2 |
|---|---|---|
| Revenue | 324 | 296 |
| Cost of goods sold | (173) | (164) |

| | | |
|---|---|---|
| **Gross profit** | **151** | **132** |
| Expenses | (83) | (74) |
| **Profit** | **68** | **58** |

Retained earnings at 31st March, 20X1 were Rs. 423 million

Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.

*Hint: Change in accounting policy.*

*Retained earnings: 1st April 20X1- 433; 31st March 20X2 – 496; 31st March 20X3 - 569*

## 6. Illustration

During 20X4-X5, Cheery Limited discovered that some products that had been sold during 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at Rs. 6,500.

Cheery Limited's accounting records for 20X4-X5 show sales of Rs. 104,000, cost of goods sold of Rs. 86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.

In 20X3-X4, Cheery Limited reported:

| | **Rs.** |
|---|---|
| **Sales** | 73,500 |
| **Cost of goods sold** | (53,500) |
| **Profit before income taxes** | 20,000 |
| Income taxes | (6,000) |
| **Profit** | 14,000 |
| Basic and diluted EPS | 2.8 |

The 20X3-X4 opening retained earnings was Rs. 20,000 and closing retained earnings was Rs. 34,000. Cheery Limited's income tax rate was 30% for 20X4-X5 and 20X3-X4. It had no other income or expenses.

Cheery Limited had Rs. 50,000 (5,000 shares of Rs. 10 each) of share capital throughout, and no other components of equity except for retained earnings.

State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS.

*Hint: No effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3 i.e No Third balance sheet required.*

*Financial statements of 20X3-X4 restated :*

- *(Increase) in cost of goods sold (6,500) (Decrease) in inventory (6,500)*
- *Decrease in income tax expenses 1,950 Decrease in income tax payable 1,950*
- *(Decrease) in profit (4,550) (Decrease) in equity (4,550)*

- *(Decrease) in basic and diluted EPS (0.91)*

## 7. Illustration

In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred Rs. 100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional Rs. 20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, Rs. 5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost Rs. 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at Rs. 18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
Analyse the above situation in accordance with relevant Ind AS.

*Hint: Understatement of the warranty provision is not a prior period errors. Additional costs are expensed in calculating profit or loss for 20X3-20X4.*

# EVENTS AFTER THE REPORTING PERIOD

## 1 Objective

Objective of Ind AS 10 is to prescribe

- When to adjust FS for events after the reporting period
- Disclosures that an entity should give about
  - Date when the FS were approved for issue
  - Events after the reporting period
- Not to prepare FS on a going concern basis if going concern assumption is not appropriate

## 2 Scope

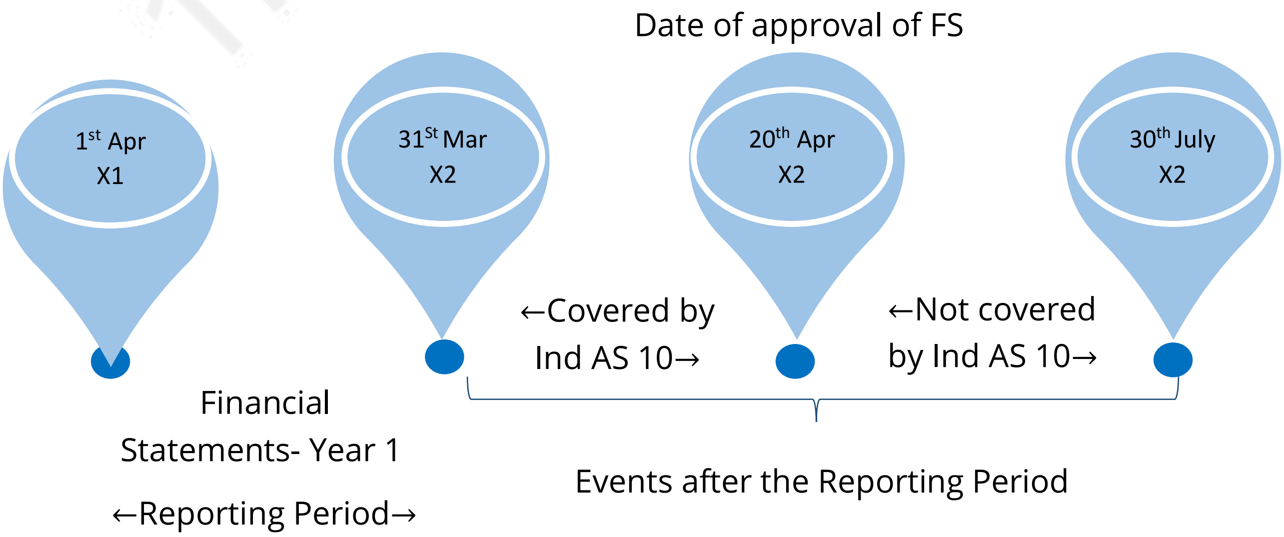
The Standard -shall be applied in,

- **Accounting** for events after reporting period and
- **Disclosure** of events after the reporting period.

## 3 Events after the Reporting Period

Those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved

- by the **Board of Directors** in case of a **company** and
- by the **corresponding approving authority** in case of any **other entity** for issue.



## 3.1 Date of approval Financial Statements

| | |
|---|---|
| In case of a company | • The FS will be treated as approved when board of directors approves the same. |
| In the case of any other entity | • The FS will be treated as approved when the corresponding approving authority approves the same. |

In some cases,

- ➢ the management of an entity is required to issue its financial statements to a **supervisory board** (made up solely of non-executives) for approval.
- ➢ in such cases, the financial statements are approved for issue when the **management approves** them for issue to the supervisory board.

# 4 Types of Events

**Events after the Reporting Period**

| **Adjusting Events** | **Non-adjusting events** |
|---|---|
| Those that provide evidence of conditions that existed at the end of the reporting period | Those that are indicative of conditions that arose after the reporting period |
| Entity to **adjust** amounts recognised in its FS | Entity to **Not adjust** amounts recognised in its FS |
| | If **material,** entity shall disclose<br>-nature of event<br>-estimate of its fianancial effect |

## 4.1 Examples

| | |
|---|---|
| *Adjusting Events* | ✓ Contingent liability becomes an actual liability<br>✓ The receipt of information after the reporting period indicating that an asset (for e.g an Account Receivable) was impaired at the end of the reporting period.<br>✓ The sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period. |

| | |
|---|---|
| | ✓ The determination after the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.<br>✓ The determination after the reporting period of the amount of **profit-sharing or bonus payments** |
| *Non-Adjusting Events* | ✓ Decline in fair value of investment<br>✓ Declaration of dividend after the end of reporting period |

# 5 Special Cases

## 5.1 Long-term Loan Arrangements

- Where there is a breach of a material provision of a long- term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date,
- The agreement by lender before the approval of the financial statements for issue, **to not demand payment** as a consequence of the breach,
- Shall be considered as an **adjusting event**.
- In such cases, the long term loans would be classified as non-current

Breach of a material provision of long- term loan arrangement → results into liability payable on demand on the reporting date → Agreement by lender before the approvel of FS ,to not demand payment as a consequence of the breach → **Adjusting event**

## 5.2 Going Concern

- An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period
    - either that it intends to liquidate the entity **or**
    - to cease trading **or**
    - that it has no realistic alternative but to do so.

- Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate.

# 6 Dividends

- If an entity declares dividends to holders of equity instruments after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.
- Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.

# 7 Disclosures

- Approvals,
    - Date of approval?
    - Who approved?
    - Do owners or others have power to amend the financial statements?

➢ Updating disclosure about conditions at the end of the reporting period
➢ Material Non-adjusting events,
  - Nature of the event.
  - An estimate of the financial effect or a disclosure that an estimate cannot be made.

**Examples of Material Non-adjusting events:**

1) A major business combination after the reporting period
2) Announcing a plan to discontinue an operation
3) Major purchases of assets, classification of assets as held for sale
4) The destruction of a major production plant by a fire after the reporting period
5) Announcing, or commencing the implementation of, a major restructuring
6) Major ordinary share transactions and potential ordinary share transactions after the reporting period
7) Abnormally large changes after the reporting period in asset prices or foreign exchange rates
8) Changes in tax rates or tax laws
9) Entering into significant commitments or contingent liabilities
10) Commencing major litigation arising solely out of events that occurred after the reporting period.

## 8 Distribution of Non-Cash Assets to Owners (Appendix A to Ind AS 10)

| | |
|---|---|
| Applicability of Ind AS 10 | • Distributions of non-cash assets<br>• Distributions that give owners a choice of receiving either non-cash assets or a cash alternative |
| Non-applicability of Ind AS 10 | • Does not apply to Distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. |

Non-Cash Dividend

- When to account?
  - When it is appropriately authorised & no longer at at decretion of entity
- At what value?
  - Fair value of asset to be distributed
- How to account for difference in the value of dividend & asset?
  - Transfer to profit or loss
    -When asset is transferred

### 8.1 Journal Entries

**a) On the date of declaration of dividend**

| Particulars | Debit | Credit |
|---|---|---|
| Retained Earnings Dr.<br>To Dividend Payable | XXXX* | <br>XXXX* |

*At the fair value of asset to be distributed

**b) On distribution of asset as dividend**

| Particulars | Debit | Credit |
|---|---|---|
| Dividend Payable Dr.<br>To PPE | XXXX | <br>XXXX |

At the end of each reporting period and on the date of settlement

- Entity to review and adjust carrying amount of dividend payable,
- with any changes in carrying amount of dividend payable recognised as adjustment to retained earnings.

### 8.2 Appendix A – Disclosures

➢ An entity shall disclose the following information, if applicable:

- carrying amount of the dividend payable at the beginning and end of the period;
- increase or decrease in the carrying amount recognised in the period as result of a change in the fair value of the assets to be distributed.

➢ If after the end of a reporting period but before the financial statements are approved for issue, an entity declares a dividend to distribute a non-cash asset, it shall disclose:

- the nature of the asset to be distributed;
- the carrying amount of the asset to be distributed as of the end of the reporting period and
- the fair value of the asset to be distributed as of the end of the reporting period, if it is different from its carrying amount.

## 9 Significant difference between Ind AS 10 and AS 4

| Basis of differences | IND AS 10: Events after the Reporting Period | AS 4- Contingencies and Events Occurring After the Balance Sheet Date |
|---|---|---|
| **Material non-Adjusting events** | To be disclosed in financial statements | To be disclosed in report of approving authority |
| **Breach of a material provision of a long-term loan arrangement** | Provide guidance under definition of "Events after the reporting period" | No guidance |
| **Distribution of non-cash assets to owners** | Includes Appendix A - Distribution of Non-cash Assets to owners | No guidance |

## 10 Carve Out in Ind AS 10 from IAS 10

### 10.1 Ind AS 10 Carve Out

- In case of breach of a material provision of a long-term loan arrangement on or before the end of the reporting period
- such liability becomes payable on demand on the reporting date
- if the lender, before the approval of the financial statements for issue, agrees to waive the breach,
- it shall be considered as an **adjusting event**.

Breach of a material provision of long- term loan arrangement → Results as liability that becomes payable on demand on the reporting date → Lender agrees to waive the breach before the approval of the financial statements → **Adjusting event**

### 10.2 IAS 10

- An agreement with the lender after the reporting period but before the approval of the financial statements for issue, not to demand payment
- is **not** considered as an **adjusting event**.

Agreement with lender after reporting period but before approval of FS, not to demand payment → **Non-adjusting event**

## ILLUSTRATIONS

### 1. Illustration

ABC Ltd. prepared interim financial report for the quarter ending 30th June, 20X1. The interim financial report was approved for issue by the Board of Directors on 15th July, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between 1st July, 20X1 and 15th July, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending 30th June, 20X1? (SM)

[Ans: Yes, they should be adjusted. Reporting period implies any term for which reporting is done by preparing financial statements]

### 2. Illustration

The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1-20X2 for issue on 15th June, 20X2. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on 30th June, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case? (SM)

[Ans: 30th June, 20X2]

## 3. Illustration

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 20X1-20X2. The court has issued the order on 15th April, 20X2 and rejected the claim of the company. Accordingly, the company is liable to pay the additional tax. The financial statements of the company for the year 20X1-20X2 have been approved on 15th May, 20X2. Should the company account for such tax in the year 20X1-20X2 or should it account for the same in the year 20X2-20X3? (SM)
[Ans: 20X1-20X2]

## 4. Illustration

While preparing its financial statements for the year ended 31st March, 20X1, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 20X1 a debtor for Rs. 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 20X1 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 20X1?

Would answer be different if earthquake had taken place after 31st March, 20X1, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors? (SM)

[Ans: Yes, it should provide for full loss. If earthquake had taken place after end of reporting period, it will be non-adjusting event – in that case, if it's material, disclosures may be required]

## 5. Illustration

A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of Rs. 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to
Rs. 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at Rs. 4,00,000 each or should it value at Rs. 3,00,000 each? Ignore estimated costs necessary to make the sale. (SM)
[Ans: Rs. 3,00,000 – Events after reporting period provide evidence about net realisable value of cars at end of reporting period]

## 6. Illustration

ABC Ltd. has purchased a new machinery during the year 20X1-20X2. The asset was finally installed and made ready for use on 15th March, 20X2. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same.
The supplier company sent the bills on 10th April, 20X2, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 20X1-20X2 or in the year 20X2-20X3? (SM)
[Ans: In year 20X1-20X2]

## 7. Illustration

Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 20X1- 20X2, 20X2-20X3, 20X3-20X4 and 20X4-20X5. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 20X5, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 20X5. The financial statements for the F.Y. 20X4-20X5 have been approved by Board of Directors on 10th July, 20X5. Whether it is appropriate to prepare financial statements on going concern basis? (SM)

[Ans: It may not be appropriate – entity's operations are expected to come to end by 31st Dec 20X5]

## 8. Illustration

In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of Rs. 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of Rs. 27,00,000 is expected. The financial statements for the year ending 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed? (SM)

[Ans: It's non-adjusting event; disclosures regarding material non-adjusting event should be made; company needs to determine whether it is appropriate to prepare the financial statements on going concern basis]

## 9. Illustration

ABC Ltd., has announced its interim results for Quarter 1, ending 30th June, 20X2 on 5th July, 20X2. However, till that time the AGM for the year 20X1-20X2 was not held. The financial statements for 20X1-20X2 were approved by the board of directors on 15th July, 20X2. What will be the 'after the reporting period' as per the definition given in Ind AS 10? (SM)

[Ans: Period between 31st Mar, 20X2 and 15th Jul, 20X2]

## 10. Illustration

ABC Ltd. is in a legal suit with the GST department. The company gets a court order in its favour on 15th April, 20X2, which resulted into reducing the tax liability as on 31st March, 20X2. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The management has not considered the effect of the transaction as the event is favourable to the company. The company's view is that favourable events after the reporting period should not be considered as it would hamper the realisation concept of accounting. Comment on the company's views in the light of Ind AS 10. (SM)

[Ans: Company's view is incorrect. Even favourable events need to be considered]

## 11. Illustration

ABC Ltd. is trading in laptops. On 31st March, 20X2, the company has 50 laptops which were purchased at Rs. 45,000 each. The company has considered the same price for calculation of closing inventory valuation. On 15th April, 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to Rs. 35,000 each. The financial statements for 20X1-20X2 were approved by the board of directors on 15th May, 20X2. The company does not want to value the stock at Rs. 35,000 less estimated costs necessary to make the sale as the event of reduction in selling price took place after 31st March, 20X2 and the reduced prices were not applicable as on 31st March, 20X2. Comment on the company's views. (SM)

[Ans:

## 12. Illustration

XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at Rs. 200 Crores. Execution of the project started during 20X1-20X2, and continued in the next financial year also. During the course of execution of the work on 29th May, 20X2, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra Rs. 50 crore, which would not be recoverable from the Contractee as per the terms of the contract. The Company's financial year ended on 31st March, 20X2, and the financial

statements were considered and approved by the Board of Directors on 15th June, 20X2. How will you treat the above in the financial statements for the year ended 31st March, 20X2? (SM)
[Ans: Cost of project and profit should be accounted considering extra Rs. 50 crore of cost]

## 13. Illustration

A Ltd. was required to pay penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 20X1-20X2, which were approved in July 20X2. The arbitrator, in June 20X2, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party. Now, whether A Ltd. is required to remeasure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 20X1-20X2? (SM)
[Ans: Required to remeasure provision; Recovery of cost should be recognised in financial year 20X2-20X3]

## 14. Illustration

A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on 20th April, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition.
Duty drawback has been credited by the Department on 28th June, 20X2 and financial statements have been approved by the Board of Directors of the company on 26th July, 20X2. Whether duty drawback credit should be treated as an adjusting event? (SM)
[Ans: No, it is not an adjusting event. Duty draw back credit which was contingent asset for F.Y. 20X1-20X2 should be recognised as asset and related income should be recognised in reporting period in which change occurs. i.e., F.Y. 20X2-20X3.]

## 15. Illustration

XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of Rs. 5 lakhs to ABC Ltd. between 17th March, 20X2 and 31st March, 20X2. ABC Ltd. paid the dues by 15th April, 20X2 with respect to sales made between 17th March, 20X2 and 31st March, 20X2. Financial statements were approved for issue by Board of Directors on 31st May, 20X2.
State whether discount will be adjusted from the sales at the end of the reporting period. (SM)
[Ans: Yes. Condition that sales have been made exists at end of the reporting period, Receipt of payment within 15 days' time confirms that discount is to be provided on those sales]

## 16. Illustration

Whether the fraud related to 20X1-20X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-20X4 is an adjusting event? (SM)
[Ans: Yes. Condition was existing which has been confirmed by detection of same]

## 17. Illustration

X Ltd. was having investment in form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 20X2. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 20X1-20X2? (SM)

[Ans: Yes – Value of investments in financial statements should be adjusted for fraudulent error in the computation]

## 18. Illustration

ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of Rs. 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of Rs. 28,00,000 and the company has expected that the demand would be settled at Rs. 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly. (SM)

[Ans: It is an adjusting event. Company should make a provision in the financial statements for the year 20X1-20X2.]

# Ind AS 113

# FAIR VALUE MEASURMENT

## 1 Scope

This standard will cover **requirements of all** other standards where fair value measurement and disclosure is needed.

### 1.1 Measurement exclusion

- ❖ Ind AS 102- Share based Payments
- ❖ Ind AS 116- Leases
- ❖ Ind AS 2- Inventories
- ❖ Ind AS 36- Impairment

### 1.2 Disclosure exclusion

- ❖ Ind AS 19- Employee benefits
- ❖ Ind AS 36- Impairment

## 2 What is fair value?

Fair value= market price

**Fair value**

- ✓ The price that would be received to sell an asset
- ✓ Paid to transfer a liability
- ✓ On an orderly transaction
- ✓ Between market participants
- ✓ At the measurement date

- ❖ Fair value is the value to **exit** the asset or liability
- ❖ But **not to buy** an asset or a liability

## 3 Assets or liability specific value

Fair value is **determined for asset / liability**

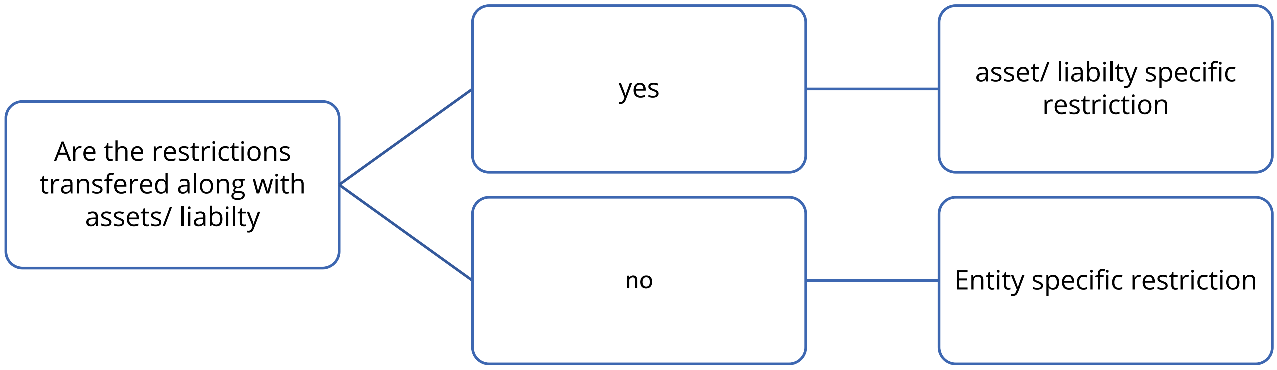
Fair vaue is **not entity specific**

**Restrictions/ conditions** attached to the asset will be considered to determine the fair value

**Points to remember**

- Entity specific restriction are not considered to determine fair value
- Assets / liability specific restrictions shall be considered to determine fair value

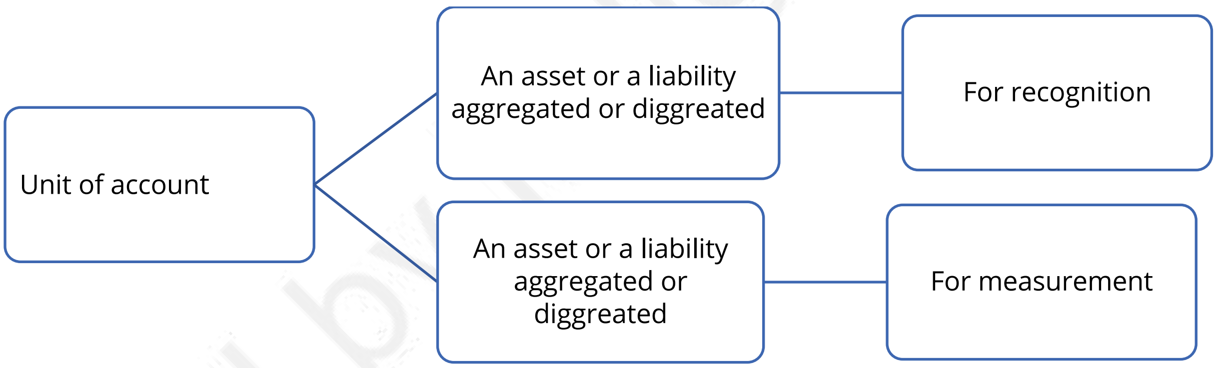
### 3.1 How to identify restrictions are entity specific or not?




## 4 Unit of Account

Means how to measure fair value-

a. Refer to respective Ind AS to measure such fair value
   Example-
   a) Securities – valued security by security at an individual level
   b) Cash generating unit-valued as per Ind AS 36 Impairment of assets after taking all the assets and liabilities
b. Aggregation or disaggregate the assets for valuation, observe and do as per other market participants.




## 5 Market

- ✓ Places where we buy and sell assets and liabilities
- ✓ Consider he **principal market** to determine the fair value
- ✓ In case of no principal market or multiple principle market, consider the **most advantageous market**
- ✓ Different entity can have different principal market for the same asset
- ✓ Entity may or may not sale in that market

### 5.1 Principal market

is a market having **highest volume** of trade with highest level of activities comparing with any other market available for similar transaction.

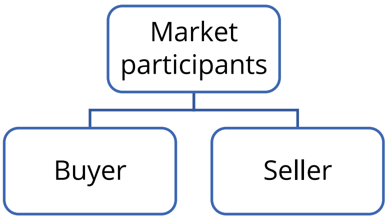
Example- Share of a company which is listed at BSE and NYSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

### 5.2 Most advantageous market

Is a market where entity realises the **highest sales proceeds** after deducting transaction cost if any, or cost to reach that market (transportation cost)

These markets are used in valuation only if principle market can't be identified

## 6 Market participants




- ✓ An entity measure the fair value of asset / liability using assumption that market participant would use if it is in their **best economic interest**
- ✓ Market participants should **not be related.** If related then transaction should be at **arm's length price**
- ✓ They are **aware of the information**, restrictions, usage and other details of assets/ liabilities
- ✓ The parties are **not under any stress** or force to enter into these transactions

## 7 Price

Fair value is the price that is

- received when an entity sells the asset
- paid when an entity transfers the liability
- in an orderly transaction in principal market (or most advantageous) market at
- Measurement date under current market conditions.

**Note- consider the price in most advantageous market**

### 7.1 Transaction cost

- Are not characteristics of assets or liability but characteristics of transactions.
- Hence, it would not appropriate to consider any transaction cost further while assessing fair value

**Note- transaction cost do not include transportation cost**

### 7.2 Transport cost

- Cost that would be incurred to transport the asset from its current location to principle (or most advantageous) market.

| | **Principal market** | **Most advantageous market** |
|---|---|---|
| **Transaction cost** | No | Yes |
| **Transport cost** | Yes | Yes |

## 8.1 Non-financial assets

### 8.1.1 Difference between financial and non-financial assets

| FINACIAL ASSETS | NON FINANCIAL ASSETS |
|---|---|
| 1)They have market and a structure to determine the fair value of the assets | 1)Standard address the procedure to assess the fair value of Non- Financial asset |
| 2)It does not change its characteristics | 2)Assets can changes its characteristics and have multiple uses |
| 3)Market is available readily | 3)Absence of active market |
| 4)Example-Investments, Receivables etc. | 4)Example-Property, land and equipment, machinery etc. |

### 8.1.2 Highest and best use

- Valuation concept used to value Non-Financial asset.
- The highest and best use of financial asset must be
    - Physically possible
    - Legally permissible
    - Financial feasible

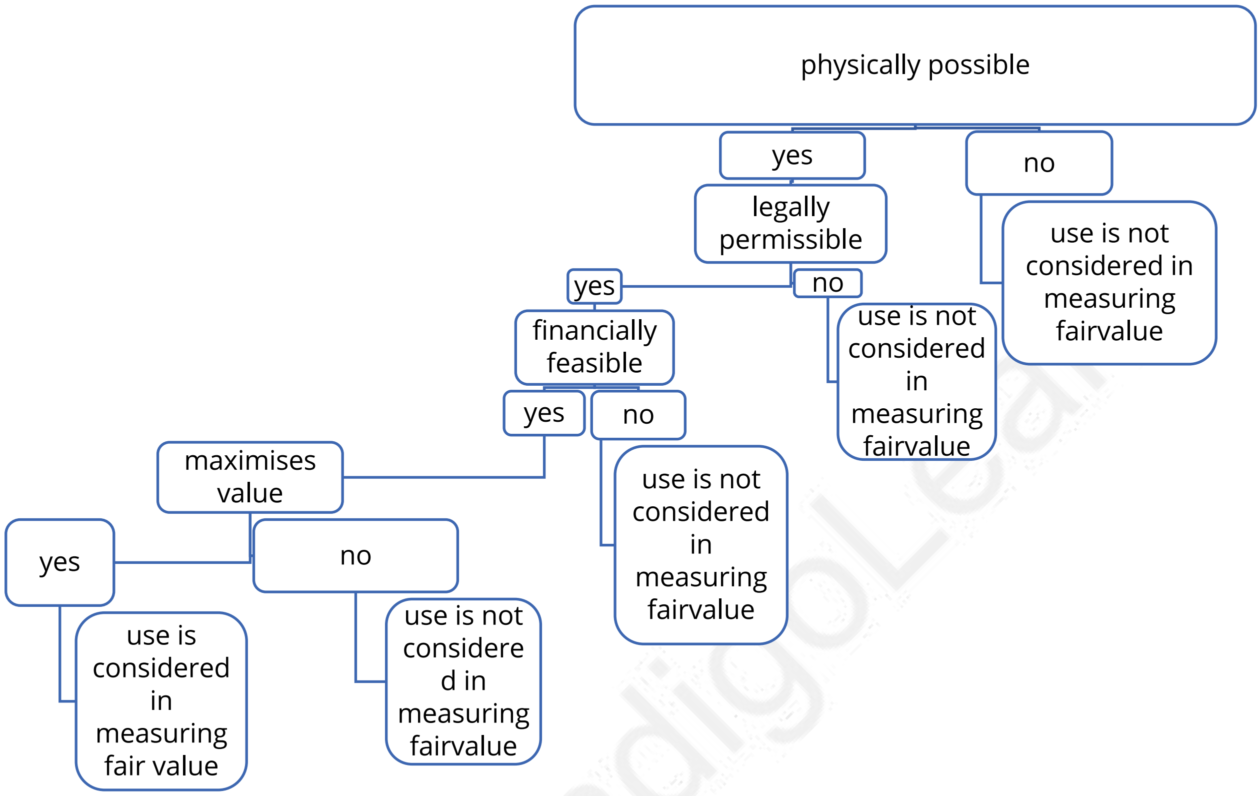
### 8.1.3 Valuation premise

Fair value measurement of non-financial assets would be based on either

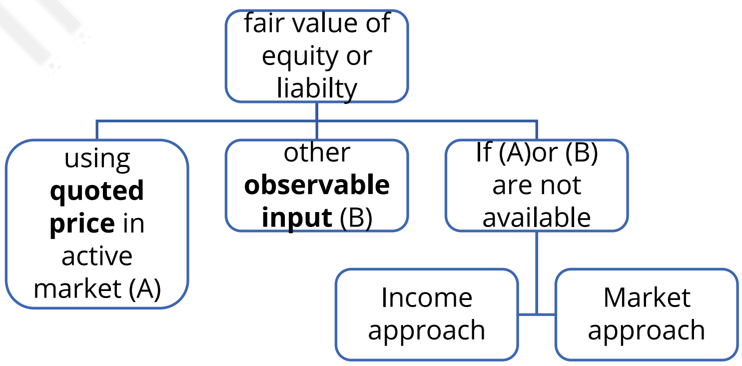
- In combination with other assets, or
- At stand-alone basis

Points to remember

- In case of no alternate use / best use is determined
    - Assume that current use is best and highest use



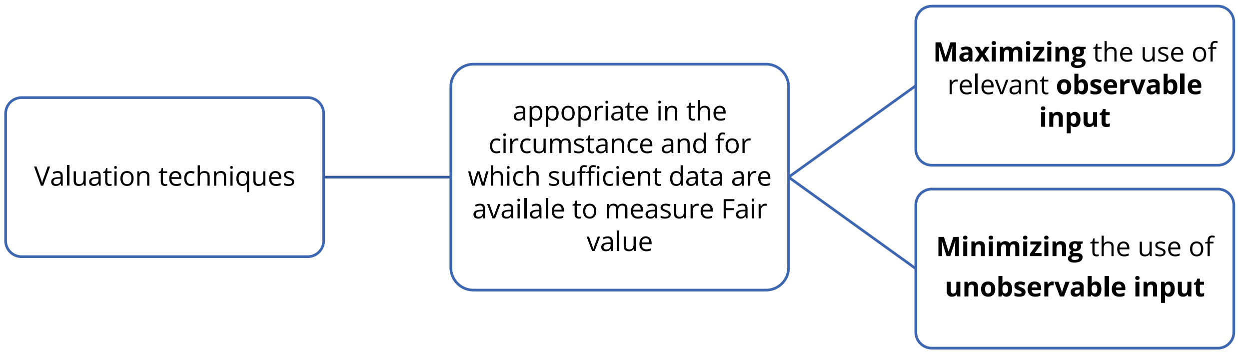

## 8.2 Applying fair value rules on liabilities and equity instruments



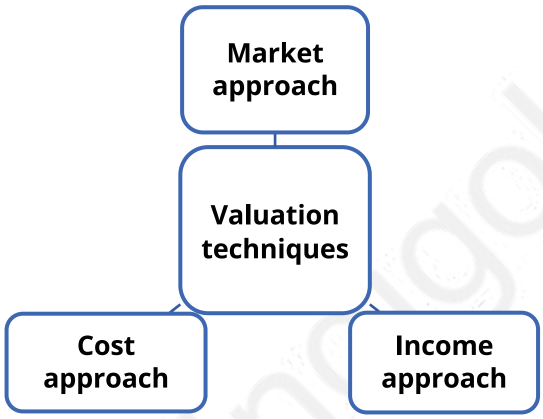

# 9 Valuation techniques for determining fair value

**Observable input:** inputs that are developed using market data such as publicly available information about actual events or transactions

**Unobservable input:** inputs for which market data are not available and they are developed using best information available

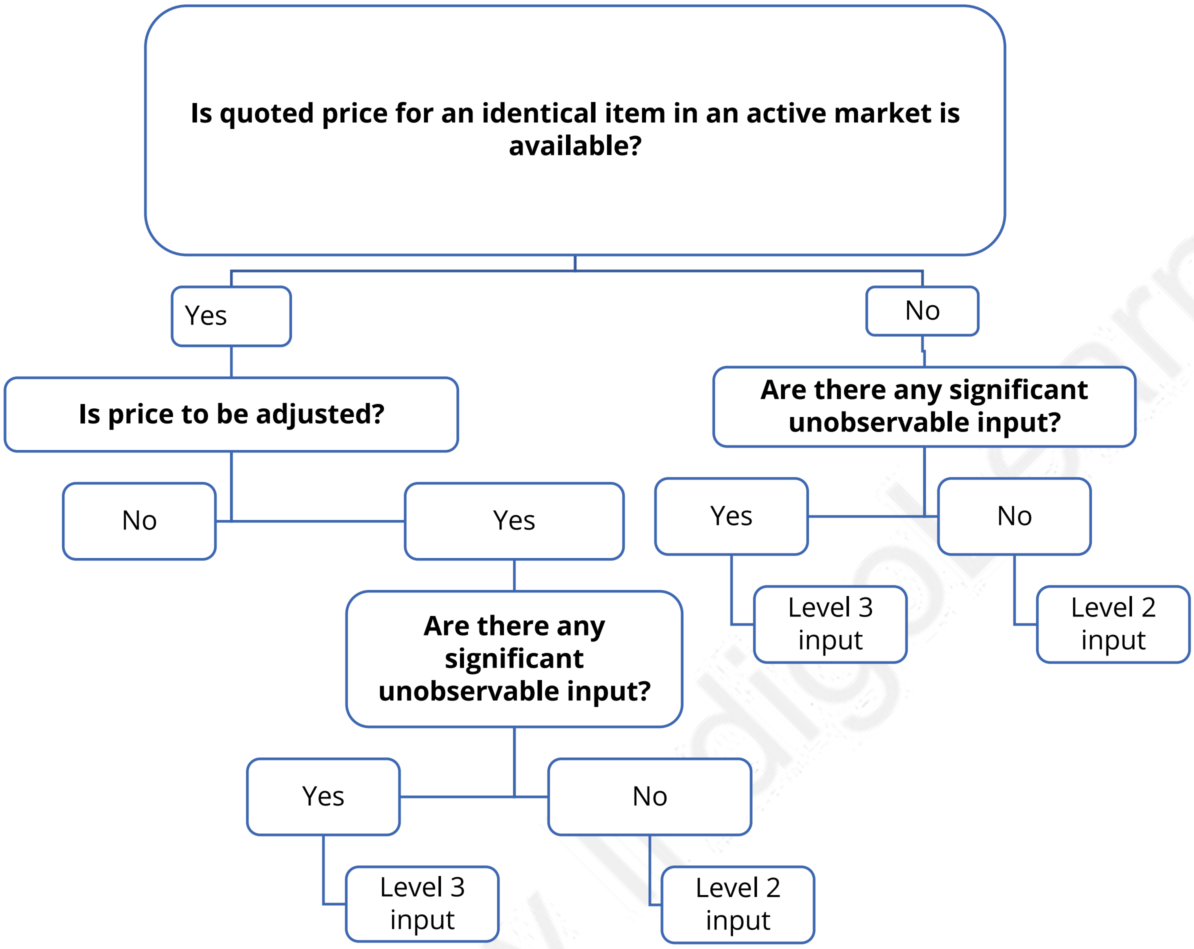



## 9.1 Approaches to measure fair value




| Market approach | Income approach | Cost approach |
|---|---|---|
| Use prices and other information generated by market | Converts future amounts (cash flows or incomes and expenses) to a single current amount. | Describes how much cost is required to replace existing asset/ liability in order to make it in a working condition |
| Quoted prices are indicative values of business if it exchanges in active market | Future cash flows to be discounted at current date to get fair value of the asset/ liability | All related cost will be fair value |
| Valuation technique specified by standard- **Matrix pricing** normally used to value debt securities | Valuation technique specified by standard-<br>➢ **Present value** techniques<br>➢ Option pricing modals e.g. **Black-Scholes Merton modal or Binomial modal**<br>➢ The multi period excess earning method. | |

## Inputs




## 11 Disclosure requirements

An entity shall disclose information that helps users of its financial statements assess both of the following

- for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurement
- for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

| | Fair Value Measurement | | | | | | Disclosure | | |
|---|---|---|---|---|---|---|---|---|---|
| | Recurring | | | Non-Recurring | | | | | |
| Level | 1 | 2 | 3 | 1 | 2 | 3 | 1 | 2 | 3 |
| Fair value at each reporting date | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | | |
| Reasons for measurement | | | | ✓ | ✓ | ✓ | | | |
| Level of hierarchy | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Transfers | ✓ | ✓ | ✓ | | | | | | |
| Valuation techniques | | ✓ | ✓ | | ✓ | ✓ | | ✓ | ✓ |
| If changes in valuation techniques | | ✓ | ✓ | | ✓ | ✓ | | ✓ | ✓ |
| Quantitative information about significant unobservable inputs | | | ✓ | | | ✓ | | | |
| Reconciliation of opening and closing | | | ✓ | | | | | | |
| Unrealized gains/losses from remeasurement | | | ✓ | | | | | | |
| Valuation process and policies | | | ✓ | | | ✓ | | | |
| Sensitivity to changes in unobservable inputs | | | ✓ | | | | | | |
| If highest and best use different from actual | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |

## 1. Illustration

ABC Ltd. acquired 5% equity shares of XYZ Ltd. for Rs. 10 crore in the year 20X1-20X2. The company is in process of preparing the financial statements for the year 20X2-20X3 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, the ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for Rs. 60 crore. The price of such transaction was determined on the basis of Comparable Companies Method (CCM)- Enterprise Value (EV) / EBITDA which was 8.

For the current year, the EBITDA of XYZ Ltd. is Rs. 40 crore. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.'s investment in XYZ Ltd. as on the balance sheet date?

*Hint: Fair Value Rs.14.40 Crores*

## 2. Illustration

UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flow of PT Ltd. for the next 5 years are as follows:

(Rs. in crore)

| Particulars | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|
| Cash flows | 187.1 | 187.6 | 121.8 | 269 | 278.8 |
| Terminal Value | | | | | 3,965 |

The weightage average cost of capital of PT Ltd. is 11%. The total debt as on measurement date is Rs. 1,465 crore and the surplus cash & cash equivalent is Rs. 106.14 crore.

The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd. as per Income Approach.

*Hint: Value per share Rs.205*

## 3. Illustration

You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

| Particulars | Rs. in crore |
|---|---|
| Valuation as per Market Approach | 5268.2 |
| Valuation as per Income Approach | 3235.2 |
| Debt obligation as on Measurement date | 1465.9 |
| Surplus cash & cash equivalent | 106.14 |
| Fair value of surplus assets and Liabilities | 312.4 |
| Number of shares of KK Ltd. | 8,52,84,223 shares |

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details.

*Hint: Value per share Rs.375.72*

## 4. Illustration

Comment on the following by quoting references from appropriate Ind AS.

(i) DS Limited holds some vacant land for which the use is not yet determined. The land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.
The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.
On what basis will the land be fair valued under Ind AS?
(ii)DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market.
Under which level of fair value hierarchy will the above inputs be classified?
What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares.
*Hint: (i) Highest best possibility of developing a commercial complex will be the basis. (ii) Level 3 (iii) If quoted price available then Level 2 inputs*

## 5. Illustration

On 1st January, 20X1, A Ltd assumes a decommissioning liability in a business combination. The reporting entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. The following information is relevant:

If A Ltd was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use all of the following inputs, probability weighted as appropriate, when estimating the price it would expect to receive:

a. Labour costs
Labour costs are developed based on current marketplace wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability to a range of cash flow estimates as follows:

| | | | |
|---|---|---|---|
| Cash Flow Estimates: | 100 Cr | 125 Cr | 175 Cr |
| Probability: | 25% | 50% | 25% |

b. Allocation of overhead costs: Assigned at 80% of labour cost

c. The compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset. Such compensation includes both of the following:

i. Profit on labour and overhead costs:
A profit mark-up of 20% is consistent with the rate that a market participant would require as compensation for undertaking the activity

ii. The risk that the actual cash outflows might differ from those expected, excluding inflation:

A Ltd. estimates the amount of that premium to be 5% of the expected cash flows. The expected cash flows are 'real cash flows' / 'cash flows in terms of monetary value today'.

d. Effect of inflation on estimated costs and profits

A Ltd. assumes a rate of inflation of 4 percent over the 10-year period based on available market data.

e. Time value of money, represented by the risk-free rate: 5%

f. Non-performance risk relating to the risk that Entity A will not fulfil the obligation, including A Ltd.'s own credit risk: 3.5%

A Ltd, concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability.

You are required to calculate the fair value of the asset retirement obligation.

*Hint: Fair value of decommissioning liability 194.88 Cr.*

## 6. Illustration

(i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of Rs. 10. Entity XYZ's after-tax maintainable profits are estimated at Rs. 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii)Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is Rs. 8,50,000. Determine the fair value of Entity A's investment in XYZ's shares.

*Hint: (i) Value of Investment 42,000 (ii) Value of investment Rs.42,500*

## 1. Introduction

When an entity procures goods or services, the entity can settle the transaction by

- Paying cash/ Bank payment
- Transfer of other asset (Exchange of assets)
- Assuming a liability (trade payable)
- Issuing its equity instruments or assets equivalent value of equity instruments [Share based payments]

When an entity issues shares or agrees to pay / transfer cash/asset equivalent of shares, it is called share based payment and is covered under Ind AS 102.

### 1.1 Share based payment arrangement

It is an agreement between the entity or another group (parent, subsidiary etc) entity (including shareholder) and another party (including an employee) that entitles the other party to receive -

- **cash or other assets** of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, **Or**
- **equity instruments** (including shares or share options) of the entity or another group entity, provided the specified **vesting conditions**, if any, are met.

### 1.2 Share based payment transaction

It is a transaction in which the entity –

- receives **goods or services** from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or
- incurs an obligation to **settle the transaction** with the supplier in a share-based payment arrangement when **another group entity receives those goods or services**.[E.g Parent agrees to settle the transaction for goods purchased by subsidiary]

### 1.3 Important Points

- Share based payment should be formed with an agreement between an entity & a party (includes employees)
- Share based payments should be made for goods/ services and should be with an external person e.g. supplier including employee.
- A transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. E.g. employee subscribing to rights issue.
- For receiving goods / services, an entity needs to settle the transaction either
  - by issuing its own equity shares / or group entity's shares (**equity settled**) or
  - by paying cash amount equivalent against such shares (**cash settled**) or

- a combination of these two where settlement option rests either with an entity or with the counterparty.

- Equity instruments, which means a residual interest in asset & liability of the company will include –
  - Ordinary shares
  - Redeemable preference shares
  - Written call option or warrants over such ordinary shares.
- Vesting conditions means the criteria which is to be fulfilled (if it is required as per the share based agreement) in order to get such Shared based payment

## 2. Scope

### 2.1 Applicability

An entity shall apply this Standard in accounting for all share-based payment transactions, whether or not the entity can identify specifically some or all of the goods or services received, including:

- equity-settled share-based payment transactions,
- cash-settled share-based payment transactions, and
- transactions where either party has choice of settling in equity or cash

### 2.2 Non Applicability

- Transaction with employee or suppliers in their capacity as shareholders
- Acquisition of goods as part of assets at the time of business combination.
- Transactions covered under Ind AS 32 - Financial Instruments

## 3. Recognition

An entity shall recognise

- the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received.
- increase in equity if the goods or services were received in an equity-settled share-based payment transaction,
- a liability if the goods or services were acquired in a cash-settled share based payment transaction.

| Particulars | Dr | Cr |
|---|---|---|
| **Inventory/Asset/Goods/Service/Expense Dr.** | XXXX | |
| **To Equity [Equity settled transaction]** | | XXX |
| **To Liability [cash settled transaction]** | | |

Recognising asset or an expense is covered by respective standard.

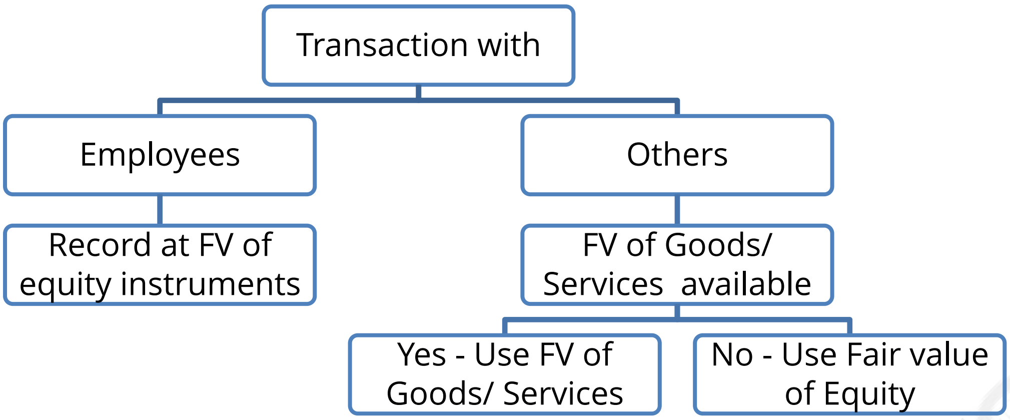
### 3.1 Equity Settled Share Based Payments

It is a share-based payment transaction in which the entity

- receives goods or services as consideration for its own equity instruments (including shares or share options), or
- receives goods or services but has no obligation to settle the transaction with the supplier.

(This happens in cases where another group entity settles the transaction

## Measurement




- In case of transactions with employees, it is difficult to estimate FV of employee servies received and hence FV of equity instruments granted is considered.
- In other cases, the first preference is the FV of Goods/Services received.

**Examples**

An entity has agreed to issue 100 shares to each of its 500 employees if they remain in service for next 3 years. In this case 3 years is a service period for which shares will be issued the entity, however, since this is share based payment plan with employees of the entity, hence the fair value of equity instruments issued will be used for calculating transaction value of the share based payments.

An entity agreed to issue 100 shares to a supplier for providing some consultancy services for next 2 years. There is similar contract in the market which has a value of Rs. 20,000. The similar value of the contract will be used as fair value of this share based payment transaction unless there is no reliable fair value is available.

| Counterparty | Measurement basis | Measurement date | Recognition date |
|---|---|---|---|
| Employee | Fair value of equity instruments awarded | Grant date | Date goods or services received |
| Non- employee | Fair value of goods or services received | Date goods or services received | Date goods or services received |

## 3.2 Equity settled SBP

**Vesting condition:** A condition that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement.

**Vesting period:** The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

**Grant date :** The date on which both the parties (entity and counterparty) agreed to the share based payment arrangement. If the agreement is subject to an approval process (e.g approval by shareholders), then the grant date is when the approval is obtained.

**Example**

A company grants Employee Stock Options to its employees. The employees have an option to subscribe to 1,000 shares of the company if they complete 3 years of service. In this case completion of 3 years of service is the service condition and the period of 3 years is the vesting period.

A company grants Employee Stock Options to its employees. The employees have an option to subscribe to 1,000 shares of the company if they achieve Rs. 50 lakhs of sales each year over a 3 year period. In this case achievement of sales target is the performance condition and the period of 3 years is the vesting period.

**Equity Instruments vest immediately**

**In this case there is on vesting condition and it is assumed that services have been received.**

**A company grants 1,000 share options to its employees which vest immediately. The employees can purchase shares of the company at an exercise price of Rs. 50 per share [face value of Rs.10]. The FV of options on grant date is Rs. 15 per share.**

**On Date of Grant**

| | | |
|---|---|---|
| Employee Benefit Expense Dr.<br>[FV = 15 x 1,000] | 15,000 | |
| To Share based payment reserve | | 15,000 |
| | | |
| | | |

**On subscription by Employees**

| | | |
|---|---|---|
| Share based payment Reserve Dr. | 15,000 | |
| Bank Dr. [Rs.50 x 1,000] | 50,000 | |
| To Share capital [10 x 1,000] | | 10,000 |
| To Securities Premium | | 55,000 |

***Employee received 1,000 shares by providing services worth 15,000 and paying cash of Rs. 50,000***

**Equity Instruments vest after completion of vesting period.**

- **Determine the value of services to be received which is the FV of equity instruments granted**
- **Recognise employee benefit expense over the vesting period**
- **Consider the expected vesting at the end of each period considering the employees expecte to leave.**
- **When employees subscribe to shares, account for issue of shares. The consideration is cash paid and services received.**

**A company grants 1,000 share options to its employees which carries a service condition of 2 years. The employees can purchase shares of the company at an exercise price of Rs. 50 per**

**share [face value of Rs.10]. The FV of options on grant date is Rs. 20 per share. The estimated vesting at the end of each year is given below :**
**Year 1 – 96%**
**At the end of Year 2 – 95% of shares are vested and are subscribed by the employees.**

**The FV of options granted is Rs. 20,000.**

**On Date of Grant – No entry is passed**

| | |
|---|---|
| **End of year 1** | |
| Expected Vesting | 96% |
| FV expected to Vest [96% x 20,000] | 19,200 |
| Vesting period | 2 Years |
| Expense to be recognised in Year 1[19,200 x1/2] | 9,600 |

**Accounting Entry**

| | | |
|---|---|---|
| Employee Benefit Expense Dr. | 9,600 | |
| To Share based payment reserve | | 9,600 |

| | |
|---|---|
| **End of year 2** | |
| Actual vesting | 95% |
| FV Vested [95% x 20,000] | 19,000 |
| Vesting period | 2 Years |
| Cumulative Expense to be recognised at end of Year2 [19,000 x 2/2] | 19,000 |
| Less: Expense already recognised | 9,600 |
| Expense to be recognised in Year 2 | 9,400 |

**Accounting Entry**

| | | |
|---|---|---|
| Employee Benefit Expense Dr. | 9,400 | |
| To Share based payment reserve | | 9,400 |

**No of shares vested = 950 [95% of 1,000]**
**Total amount to be paid by employees = 950 x 50 = 47,500**

| | | |
|---|---|---|
| Share based payment Reserve Dr. | 19,000 | |
| Bank Dr. [Rs.50 x 1,000] | 47,500 | |
| To Share capital [10 x 1,000] | | 10,000 |
| To Securities Premium | | 56,500 |

***Employee received 950 shares by providing services worth 19,000 and paying cash of Rs. 47,500***

Summary –

- Recognise 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
- Revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates.

- On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested.
- Fair value of grant date is considered and is not revised.

### 3.3 Cash settled – Share based payments

For cash-settled share-based payment transactions,

- the entity shall measure the goods or services acquired and
- the liability incurred at the fair value of the liability.
- the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement,
- any changes in fair value recognized in profit or loss for the period
- It can also take form of share appreciation rights.

  [In case of equity settled transactions, there is no remeasurement. This means that the amount recognised under equity is based on FV on the grant date]

**Journal Entries – in case of immediate vesting**

**On Date of Grant**

| | | |
|---|---|---|
| Expense | Xxx | |
| To Share based payment liability | | Xxx |
| | | |
| | | |

**End of each year**

| | | |
|---|---|---|
| **In case of loss** | | |
| Expense Dr. | Xxx | |
| To Share based payment liability | | Xxxx |
| **In case of gain** | | |
| Share based payment liability | Xxx | |
| To expense | | Xxxx |

### 3.4 Share based payment with cash alternative

In this case either the entity or the other party has the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

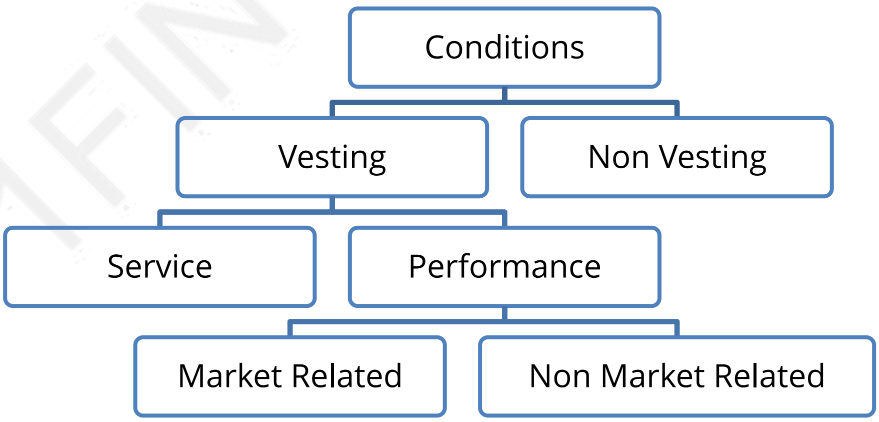
| |
|---|
| **Choice with counter-party** |
| Treated as compound financial instrument [debt + equity] (Refer Ind AS 109) |
| **FV of goods/services measured directly**<br>- Difference between FV of goods/services and FV value of debt component is considered as equity component. |

| |
|---|
| **If FV of Goods/Services not available or in case of employees**<br>**FV of Compound Financial Instrument is used to measure the value of goods and services.**<br>- Measure FV of debt<br>- Measure FV of equity assuming cash alternative is surrendered<br>FV of Compound Financial Instrument = FV of debt + FV of equity. |
| Liability component is fair valued |
| **On Settlement**<br>Cash Paid – Dr. Liability & Cr. Cash. The equity component is not impacted.<br><br>Equity issued – Dr. Liability & Cr. Equity |

| |
|---|
| **Choice is with the entity** |
| Accounted as Cash settled or Equity Settled |
| **Entity checks whether it has present obligation**<br>- Intention to settle<br>- Past practice<br>- Ability to settle in equity instruments [ If restriction to issue equity, it is considered to be a cash settled] |
| **Settlement**<br>- Accounted as equity and settled by issuing shares : Account for issue of shares<br>- Accoutned as Equity settled but settled in cash : Treated as buy back of equity interest<br>- Accounted as liability & Settled in cash – Dr. Liability & Cr. Cash<br>- Accounted as liability but settled in equity : Transfer liability to equity<br>- Settled at higher value – Differential portion is treated as additional expense. |

## 4. Type of Conditions

Conditions in SBP can be vesting and non-vesting. A vesting condition is either a service condition or a performance condition.




Only Market based condition & Non vesting conditions will be considered to determine the fair value of SBP.

Remaining conditions are adjusted while estimating number of equity instruments which would vest. For e.g service condition is considered to estimate % of employees who would complete the number of years of service requirement.

**Service condition:** A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failed to satisfy the condition. A service condition does not require a performance target to be met.

An entity has issued 100 shares each to its 1,000 employees under share based payment if they remain in the organization for next 3 years. This would be considered to be a service condition; 3 years being the period over which employee would be required to be in service as a condition.

Service condition does not impact the FV of SBP.

**Performance condition**: A vesting condition that requires:

- the counterparty to complete a specified period of service (ie a service condition); the service requirement can be explicit or implicit; and
- specified performance target(s) to be met while the counterparty is rendering the service required above. Performance targets could be profit target, sales target, market price of shares etc.

**Market related condition**

When one of the conditions is to achieve target price/ value of the share by an entity, it is called as market-related performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised.

An entity issues stock options to its employees who will serve the organization for next 2 years and till the time the share price reaches to Rs. 100. The target price to reach Rs. 100 is one of the market related condition.

If the options vest earlier than expected due to market condition, expenses will be recognised immediately. If options vest later than expected due to market condition, it is ignored.

**Non-market related condition**

When the condition is not market driven but linked with some internal performance/ operations or activities of the entity, it will be considered as non-market related conditions. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates.

An entity issued some stock options to employees with a condition that they have to remain in the organisation for next 2 years and EBITA of the entity should rise to Rs. 10 lakhs. Here, the EBITA target is non-market related condition.

**Non vesting Condition**

In case of non-vesting condition, the condition does not impact vesting.

## 5. Reload Feature

Reload feature: A feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

Reload option: A new share option granted when a share is used to satisfy the exercise price of a previous share option.

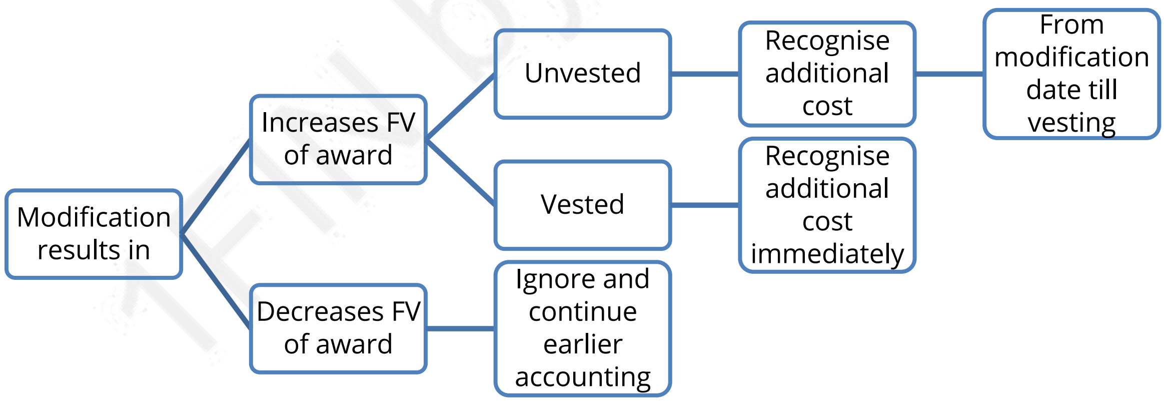
**Treatment of a reload feature**

For options with a reload feature, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a reload option shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

## 6. Modification, Cancellation & Settlements

An entity might modify the terms and conditions on which the equity instruments were granted. For example, it might reduce the exercise price of options granted to employees (i.e. reprice the options), which increases the fair value of those options.

### 6.1 Modification




- If the modification results in increase in number of shares, recognise additional cost from date of modification till date of vesting.

### 6.2 Cancellation

- recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period [acceleration of vesting]
- any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest. If amount paid is in excess of FV of equity instrument, the excess is treated as expense.

### 6.3 Grant of new equity instruments & cancellation of existing instruments

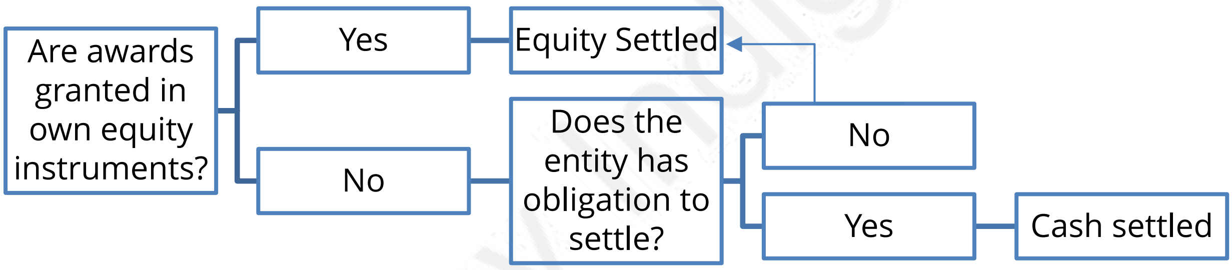
- Treated as replacement for cancelled instruments
- Consider as modification of the original grant and account as per above.

| | | | |
|---|---|---|---|
| **A** | **FV of the replaced equity instruments** | | XXXX |
| | | | |
| **B** | **(-)Net FV of cancelled instruments [C-D]** | | |
| C | FV of cancelled instruments | xxxx | |
| D | (-) Amount paid to the employee on cancellation | xxxx | XXXX |
| **A-B** | **Incremental FV Granted** | | **xxx** |

## 7. Group Share based payment plans

There are instances where goods or services are received by one group entity and another group entity has the obligation to settle the share based payment transaction. For e.g. Reliance Industries Limited grants stock options on its shares to the employees of Reliance Jio (Subsidiary).

Check the following for entity receiving goods and services to determine whether the plan is cash settled or equity settled.




| Scenario | I | II |
|---|---|---|
| Who receives goods/ services? | Subsidiary | Parent |
| Who settles? | Parent | Subsidiary |
| Settlement by | Issuing shares of parent | Issuing shares of subsidiary |
| Type | Equity<br>(Since subsidiary does not have obligation to settle) | Equity<br>(Since parent does not have obligation to settle) |
| Accounting – Parent | Dr. Investment in subsidiary<br>Cr. Equity | Dr. Expenses<br>Cr. Dividend Income |
| Accounting Subsidiary | Dr. Expenses<br>Cr. Equity | Dr. Retained Earnings<br>Cr. Equity |

## 8. Calculation of FV

The fair value of options can be determined using models like binomial model, Black Scholes Model etc. All option pricing models take into account the following factors:

- the exercise price of the option;
- the life of the option;
- the current price of the underlying shares;
- the expected volatility of the share price;
- the dividends expected on the shares (if appropriate); and
- the risk-free interest rate for the life of the option

If FV of options is not determinable, intrinsic value can be taken. Intrinsic value = Market Price – Exercise price.

## 9. Disclosures

Standard requires an entity to disclose the following-

- Type and scope of agreement existing during the reporting period.
- Describing general terms & conditions of each type of share-based payment plans.
- The number of weighted average price of share option as outstanding with a movement of granted, vested, expired, exercised, cancelled and closing balance of share-based payment plans.
- The average share price of exercised options.
- The range of exercise prices and weighted average remaining contractual life of options outstanding at the end of reporting period.
- The valuation method used to estimate the fair value of the awards.
- The impact on Statement of Profit and Loss and Balance Sheet for such share-based payments.

## ILLUSTRATIONS

### 1. Illustration

ABC Limited granted to its employees, share options with a fair value of Rs. 5,00,000 on 1st April, 20X0, if they remain in the organization up to 31st March, 20X3. On 31st March, 20X1, ABC Limited expects only 91% of the employees to remain in the employment. On 31st March, 20X2, company expects only 89% of the employees to remain in the employment. However, only 82% of the employees remained in the organisation at the end of March, 20X3 and all of them exercised their options. Pass the Journal entries? (SM)

### 2. Illustration

An entity issued 100 shares each to its 1,000 employees subject to service condition of next 2 years. Grant date fair value of the share is Rs. 195 each. There is an expectation 97% of the employees will remain in service at the end of 1st year. However, at the end of 2nd year the expected employees to remain in service would be 91% of the total employees. Calculate expense for the year 1 & 2? (SM)

### 3. Illustration

Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-

- To remain in service for 3 years & entity's profit after tax (PAT) shall reach to Rs. 100 million.
- It is expected that PAT should reach to Rs. 100 million by the end of 3 years.
- Fair value at grant date is Rs. 100.

- Employees expected for vesting right by 1st year 97%, then it revises to 95% by 2nd year and finally to 93% by 3rd year.

Calculate expenses for next 3 years in respect of share-based payment. (SM)

### 4. Illustration

XYZ issued 10,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1st April, 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is Rs. 95. SAR can be exercised any time up to 31st March, 20X3. At the end of period on 31st March, 20X1 it is expected that 95% of total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% were exercised at the end of the 3rd year.

Fair Values at the end of each period have been given below:

| Fair value of SAR | Rs. |
|---|---|
| 31st March, 20X1 | 112 |
| 31st March, 20X2 | 109 |
| 31st March, 20X3 | 114 |

Pass the Journal entries? (SM)

### 5. Illustration

On 1st January, 20X1, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

Fair values (Rs.) of the shares are as follows:

| | |
|---|---|
| Share alternative fair value (with restrictions) | 102 |
| Grant date fair value on 1st January, 20X1 | 113 |
| Fair value on 31st December, 20X1 | 120 |
| Fair Value on 31st December, 20X2 | 132 |

The employees exercise their cash option at the end of 20X2. Pass the journal entries.

### 6. Illustration

Tata Industries issued share-based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

| **<u>Option I</u>** | **Period** | **Rs.** |
|---|---|---|
| No of cash settled shares | | 74,000 |
| Service condition | 3 years | |
| **<u>Option II</u>** | | |
| No of equity settled shares of face value of Rs. 100 each | | 90,000 |
| **Conditions:** | | |
| Service | 3 years | |
| Restriction to sell | 2 years | |
| **<u>Fair values</u>** | | |

| | | |
|---|---|---|
| Equity price with a restriction of sale for 2 years | | 115 |
| Fair value at grant date | | 135 |
| Fair value | 20X0 | 138 |
| | 20X1 | 140 |
| | 20X2 | 147 |

Pass the Journal Entries. (SM)

### 7. Illustration

Indian Inc. issued 995 shares in exchange for purchase of an office building. The title was transferred in the name of Indian Inc. on February, 20X1 and shares were issued. Fair value of the office building was Rs. 2,00,000 and face value of each share of Indian Inc was Rs. 100.

Pass the journal entries. (SM)

### 8. Illustration

Reliance limited hired a maintenance company for its oil fields. The services will be settled by issuing 1,000 shares of Reliance. Period for which the service is to be provided is 1st April, 20X1 to 1st July, 20X1 and fair value of the service was estimated using market value of similar contracts for Rs. 1,00,000. Nominal value per share is Rs. 10.

Record the transactions. (SM)

### 9. Illustration

Ankita Holding Inc. grants 100 shares to each of its 500 employees on 1st January, 20X1. The employees should remain in service during the vesting period. The shares will vest at the end of the First year if the company's earnings increase by 12%;
Second year if the company's earnings increase by more than 20% over the two-year period;
Third year if the entity's earnings increase by more than 22% over the three-year period.

The fair value per share at the grant date is Rs. 122. In 20X1, earnings increased by 10%, and 29 employees left the organisation. The company expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2.

At the end of 20X2, company's earnings increased by 18%. Therefore, the shares did not vest. Only 29 employees left the organization during 20X2. Company believes that additional 23 employees will leave in 20X3 and earnings will further increase so that the performance target will be achieved in 20X3. At the end of the year 20X3, only 21 employees have left the organization. Assume that the company's earnings increased to desired level and the performance target has been met.

Determine the expense for each year and pass appropriate journal entries. (SM)

### 10. Illustration

ACC limited granted 10,000 share options to one of its managers. In order to get the options, the manager has to work for next 3 years in the organization and reduce the cost of production by 10% over the next 3 years.

Fair value of the option at grant date was Rs. 95

Cost reduction achieved-

| | |
|---|---|
| Year 1 12% | Achieved |
| Year 2 8% | Not expected to vest in future |
| Year 3 10% | Achieved |

How the expenses would be recorded? (SM)

## 11. Illustration

Apple Limited has granted 10,000 share options to one of its directors for which he must work for next 3 years and the price of the share should increase by 20% over next 3 years.

The share price has moved as per below details -
Year 1 22%
Year 2 19%
Year 3 25%

At the grant date, the fair value of the option was Rs. 120. How should we recognize the transaction? (SM)

## 12. Illustration

An entity P issues share-based payment plan to its employees based on the below details:

| | | |
|---|---|---|
| Number of employees | 100 | |
| Fair value at grant date | Rs. 25 | |
| Market condition | Share price to reach at | Rs. 30 |
| Service condition | To remain in service until market condition is fulfilled | |
| Expected completion of market condition | 4 years | |

Define expenses related to such share-based payment plan in each year subject to the below scenarios-

a) Market condition if fulfilled in year 3, or
b) Market condition is fulfilled in year 5. (SM)

## 13. Illustration

Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-

- To remain in service for 3 years & entity's profit after tax (PAT) shall reach to Rs. 100 million.
- It is expected that PAT should reach to Rs. 100 million by the end of 3 years.
- Fair value at grant date is Rs. 100.
- Employees expected for vesting right by 1st year 97%, then it revises to 95% by 2nd year and finally to 93% by 3rd year.

Calculate expenses for next 3 years in respect of share-based payment? (SM)

## 14. Illustration

Marathon Inc. issued 150 share options to each of its 1,000 employees subject to the service condition of 3 years. Fair value of the option given was calculated at Rs. 129. Below are the details and activities related to the SBP plan-

Year 1: 35 employees left and further 60 employees are expected to leave. Share options re-priced (as MV of shares has fallen) as the FV fell to Rs. 50. After the re-pricing they are now worth Rs. 80, hence expense is expected to increase by Rs. 30.
Year 2: 30 employees left and further 36 employees are expected to leave
Year 3: 39 employees left

How the modification/ re-pricing will be accounted? (SM)

### 15. Illustration

QA Ltd. had on 1st April, 20X1 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 20X4 provided the employee remains in employment till 31st March, 20X4.

On 1st April, 20X1, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 20X4. This estimate was amended to 1,850 employees on 31st March, 20X2 and further amended to 1,840 employees on 31st March, 20X3.

On 1st April, 20X1, the fair value of an option was Rs. 1.20. The fair value increased to Rs. 1.30 as on 31st March, 20X2 but due to challenging business conditions, the fair value declined thereafter. In September, 20X2, when the fair value of an option was Rs. 0.90, the Directors repriced the option and this caused the fair value to increase to Rs. 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was Rs. 1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 20X2 should be spread over the remaining vesting period from 30th September, 20X2 to 31st March, 20X4.

The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 20X3. (SM)

### 16. Illustration

Anara Fertilisers Limited issued 2000 share options to its 10 directors for an exercise price of Rs. 100.The directors are required to stay with the company for next 3 years.

| | |
|---|---|
| Fair value of the option estimated | Rs. 130 |
| Expected number of directors to vest the option | 8 |

During the year 2, there was a crisis in the company and Management decided to cancel the scheme immediately. It was estimated further as below -

| | |
|---|---|
| Fair value of option at the time of cancellation was | Rs. 90 |
| Market price of the share at the cancellation date was | Rs. 99 |

There was a compensation which was paid to directors and only 9 directors were currently in employment. At the time of cancellation of such scheme, it was agreed to pay an amount of Rs. 95 per option to each of 9 directors.

How the cancellation would be recorded? (SM)

### 17. Illustration

P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value Rs. 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

| | |
|---|---|
| 31st March 20X2 | Rs. 210 |
| 31st March 20X3 | Rs. 220 |
| 31st March 20X4 | Rs. 215 |
| 31st March 20X5 | Rs. 218 |

What would be the difference if at the end of the second year of service (i.e. at 31st March 20X3), P Ltd. modifies the terms of the award to require only three years of service? (SM)

## 18. Illustration

A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is Rs. 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options.

Pass the necessary journal entries for giving effect to the above arrangement. (SM)

## 19. Illustration

A parent, Company P, grants 30 shares to 100 employees each of its subsidiary, Company S, on condition that the employees remain employed by Company S for three years. Assume that at the outset, and at the end of Years 1 and 2, it is expected that all the employees will remain employed for all the three years. At the end of Year 3, none of the employees have left. The fair value of the shares on grant date is Rs. 5 per share.

Company S agrees to reimburse Company P over the term of the arrangement for 75 percent of the final expense recognised by Company S. What would be the accounting treatment in the books of Company P and Company S? (SM)

## 20. Illustration

Entity X acquired entity Y in a business combination as per Ind AS 103. There is an existing share-based plan in entity Y with a vesting condition for 3 years in which 2 years have already lapsed at the date of such business acquisition. Entity X agrees to replace the existing award for the employees of combined entity.

The details are as below –

| | |
|---|---|
| Acquisition date fair value of share-based payment plan | Rs. 300 |
| Number of years to vest after acquisition | 1 year |
| Fair Value of award which replaces existing plan | Rs. 400 |

Calculate the share-based payment values as per Ind AS 102? (SM)

## 21. Illustration

At 1st January, 20X0, Ambani Limited grants its CEO an option to take either cash amount equivalent to 800 shares or 990 shares. The minimum service requirement is 2 years. There is a condition to keep the shares for 3 years if shares are opted.

| Fair values of the shares | Rs. | |
|---|---|---|
| Share alternative fair value (with restrictions) | | 212 |
| Grant date fair value on 1st January, 20X0 | | 213 |
| Fair value on 31st December, 20X0 | 220 | |
| Fair value on 31st December, 20X1 | 232 | |

The key management exercises his cash option at the end of 20X2. Pass journal entries. (SM)

## 22. Illustration

An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to the appreciation in the entity's share price since the grant date. All of the rights vest on 31st December 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is Rs. 11; and it estimates that overall 10% of the employees will leave during the two-year period.

The fair values of the SARs at each year end are shown below:

| Year | Fair value at year end |
|---|---|
| 31 December 20X5 | 12 |
| 31 December 20X6 | 8 |
| 31 December 20X7 | 13 |
| 31 December 20X8 | 12 |

10% of employees left before the end of 20X6. On 31st December 20X7 (when the intrinsic value of each SAR was Rs. 10), six employees exercised their options; and the remaining 30 employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of Rs. 12).

How much expense and liability is to be recognized at the end of each year? Pass Journal entries. (SM)

## 1. Introduction

### 1.1 Objective

- To prescribe accounting for agricultural activity
- This standard requires biological assets (living animal or plant) to be measured at fair value less costs to sell.

### 1.2 Scope

1.2.1 This standard shall be applied for the following when they relate to agricultural activity:

a. Biological assets;

b. Agricultural produce at the point of harvest;

c. Government grants

1.2.2 Ind AS 41 does not apply to:

| Exclusions | Covered by |
|---|---|
| Land relating to agricultural activity:<br>(e.g the land on which biological assets grow, regenerate and/or degenerate) | Ind AS 16, Ind AS 40 |
| Bearer plants related to agricultural activity<br>(this standard applies to produce on those bearer plants) | Ind AS 16 |
| Government grants related to bearer plants. | Ind AS 20 |
| Intangible assets associated with agricultural activity<br>(e.g licences & rights) | Ind AS 38 |

1.2.3 Examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

| **Biological assets** | **Agricultural produce** | **Products that are the result of processing after harvest** |
|---|---|---|
| Sheep | Wool | Yarn, carpet |
| Trees in timber plantation | Felled Trees | Logs, lumber |
| Dairy Cattle | Milk | Cheese |
| Pigs | Carcass | Sausages, cured hams |
| Cotton plants | Harvested cotton | Thread, clothing |
| Sugarcane | Harvested cane | Sugar |
| Tobacco plants | Picked leaves | Cured tobacco |
| Tea bushes | Picked leaves | Tea |
| Grape vines | Picked grapes | Wine |
| Fruit trees | Picked fruit | Processed fruit |
| Rubber trees | Harvested latex | Rubber products |

Some plants, for example, tea bushes, grape vines, oil palms and rubber trees, usually meet the definition of a bearer plant and are outside the scope of Ind AS 41 and these are covered under Ind AS 16.

## 2. Definitions

### 2.1 Agricultural activity

Agricultural activity is

management of biological transformation and harvest of biological assets

- for sale
- for conversion into agricultural produce/additional biological assets

### 2.2 Biological Asset

Biological Asset is defined as living animal or plant.

### 2.3 Biological transformation

Biological transformation comprises the process of-

| Growth | Degeneration | Production | procreation |
|---|---|---|---|
| Increase in quantity/improvement in quality of an animal or plant | Decrease in quantity or deterioration in quality of an animal or plant | Of agricultural produce such as milk, latex,wool, and tea leaf etc | Creation of additional living animals or plants |

### 2.4 Agricultural produce

Agricultural produce is the harvested product of the entity's biological assets.

### 2.5 Harvest

Harvest is

- detachment of produce from a biological asset
- cessation of a biological asset's life processes

### 2.6 Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### 2.7 Cost to sell

Cost to sell are incremental costs directly attributable to disposal of asset. Finance cost and income tax expenses are not considered to be costs to sell.

### 2.8 Bearer plant

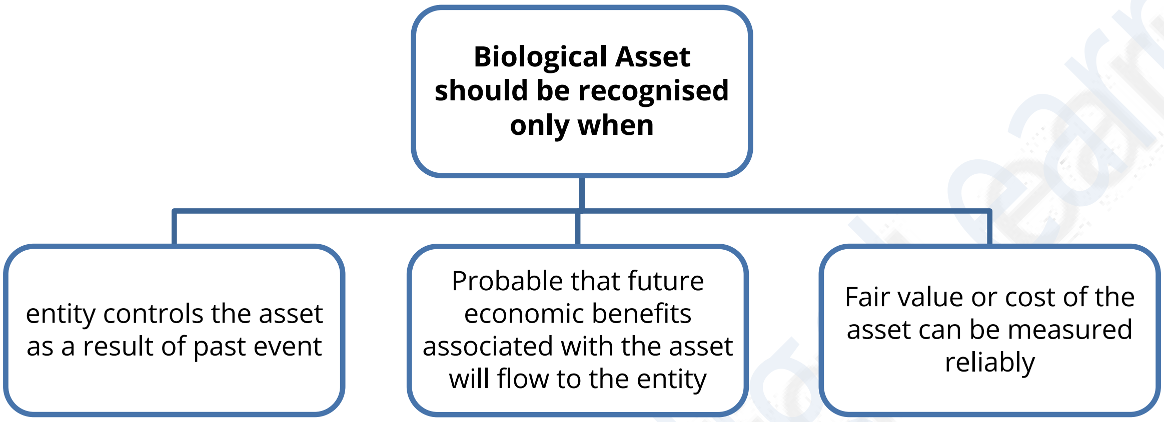
Bearer plant is defined as living plant that:

- is used in the production or supply of agricultural produce;
- is expected to bear produce for more than one period; and
- has a remote likelihood of being sold as agricultural produce, expect for incidental scrap sales.

(Bearer plants are covered by Ind As 16)

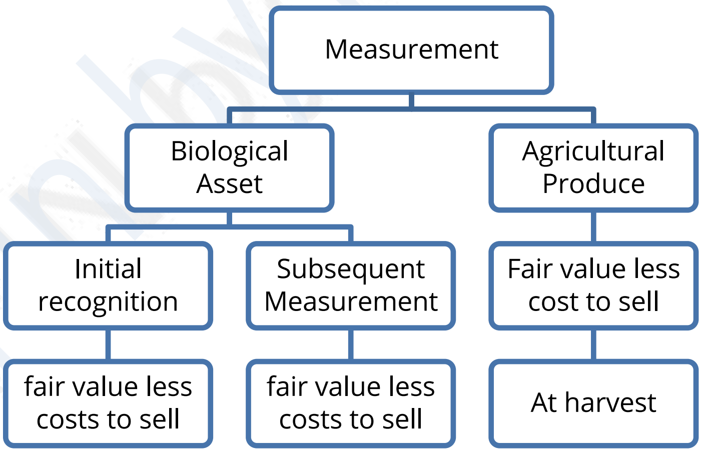
## 3 Recognition

### 3.1 Criteria for recognition




### 3.2 Measurement

**I. Biological Asset**




**Exception:**
Biological assets measured at Cost less accumulated depreciation/impairment when

- quoted market prices are not available for the biological assets
- alterntive fair value measurements are determined to be clearly unreliable.

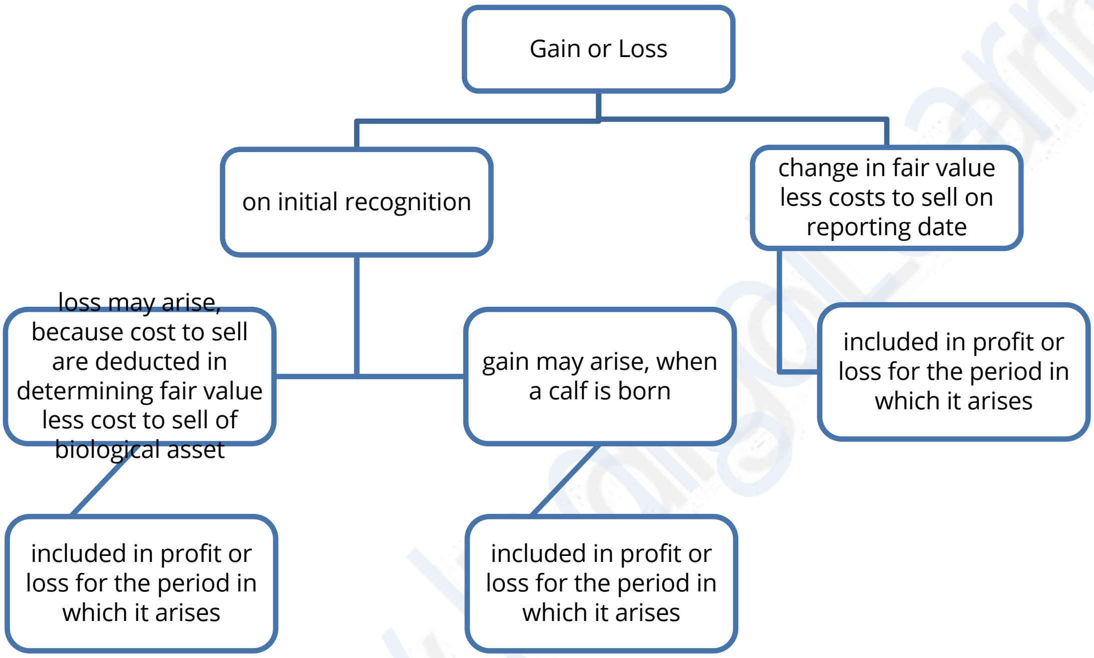
**II. Agricultural produce**

Agricultural produce harvested from an entity's biological assets should be measured at its fair value less cost to sell at the point of harvest.

- Fair value is not adjusted even if there are contract to sell the agricultural produce in future.
- When fair value is available for a biological assets along with another asset (say land), then in such cases, the fair value of another asset (land) is deducted from the combined fair value to arrive at fair value of agricultural produce.

## 4 Gains and Losses

### I. Biological Asset




### II. Agricultural produce

Gain or loss on initial recognition is recognised in P&L in the period in which it arises.

## 5 Government Grants

**Biological Asset measured at fair value less cost to sell:**

| Unconditional Grant | Conditional Grant |
|---|---|
| An unconditional government grant related to a biological asset measured at its fair value less costs to sell<br>**Recogntion**: In profit or loss when, and only when, the government grant becomes receivable. | A conditional government grant related to a biological asset measured at its fair value less costs to sell<br>**Recogntion**: In profit or loss when, and only when, the conditions attaching to the government grant are met. |

*Terms and conditions of government grants vary

### I. Biological Asset measured at its cost:

In case of inability to measure fair value reliably, then a government grant which relates to Biological Asset is measured at its cost less any accumulated depreciation and any accumulated impairment loss, i.e. Ind AS 20 is applied.

## 6 Disclosure

- Description of Biological Assets and activities.
- Gains and losses recognised during the period.
- Reconciliation of changes in biological assets
    - Gain or loss from changes in fair value less costs to sell;
    - Increases arising from purchases;
    - Decreases attributable to sales and biological assets classified as held for sale in accordance with Ind AS105;
    - Decreases due to harvest;
    - Increases resulting from business combinations;
    - Net exchange differences ;
    - Other changes.
- Restricted assets, commitments and risk management strategies.
- Additional disclosureswhen fair value cannot be measured reliably:
    - A description of the Biological Assets;
    - An explanation of why fair value cannot be measured reliably;
    - The range of estimates within which fair value is highly likely to lie;
    - The depreciation method used;
    - The useful lives or the depreciation rates used;
    - The gross carrying amount and the accumulated depreciation and impairment losses at the beginning and end of the period.
- Government grants
    - Nature and extent of government grants recognised;
    - Unfulfilled conditions and other contingencies attaching to government grants; and
    - Significant decreases expected in the level of government grants.

## Illustration

### 1. Illustration

A farmer owned a dairy herd, of three years old cattle as at 1st April, 20X1 with a fair value of Rs. 13,750 and the number of cattle in the herd was 250.
The fair value of three year cattle as at 31st March, 20X2 was Rs. 60 per cattle. The fair value of four year cattle as at 31st March, 20X2 is Rs. 75 per cattle.
Calculate the measurement of group of cattle as at 31st March, 20X2 stating price and physical change separately.
*Hint: Fair Value on 31/3/X2 Rs.18,750*

### 2. Illustration

XYZ Ltd., on 1st December, 20X3, purchased 100 sheep from a market for Rs. 5,00,000. The transaction cost of 2% on the market price of the sheep was incurred which was paid by the seller.

Sheep's fair value increased from Rs. 500,000 to Rs. 600,000 on 31st March, 20X4. Transaction cost of 2% would have to be incurred by the seller to get the sheep to the relevant market.
Determine the fair value on the date of purchase and the reporting date and pass necessary journal entries thereon.
*Hint: Loss on initial recognition – Rs.10,000; Gain – Change in fair value Rs.98,000*

## 3. Illustration

Entity A purchased cattle at an auction on 30th June 20X1

| | |
|---|---|
| Purchase price at 30th June 20X1 | Rs. 1,00,000 |
| Costs of transporting the cattle back to the entity's farm | Rs. 1,000 |
| Sales price of the cattle at 31st March, 20X2 | Rs. 1,10,000 |

The company would have to incur similar transportation costs if it were to sell the cattle at auction, in addition to an auctioneer's fee of 2% of sales price. The auctioneer charges 2% of the selling price, from both, the buyer as well as the seller.
Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March, 20X2.
*Hint: Fair value less costs to sell Rs.1,06,800*

## 4. Illustration

XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. had a herd of 500 cows which were all three years old.
During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows from the market for Rs. 21,000 each. These 20 cows were all one year old when they were purchased.
On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was Rs. 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of Rs. 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.
Information relating to fair value and costs to sell is given below:

| Date | Fair value of a dairy cow (aged) | | | | Costs to sell a cow |
|---|---|---|---|---|---|
| | 1 year | 1.5 years | 3 years | 4 years | |
| 1st April 20X1 | 20,000 | 22,000 | 27,000 | 25,000 | 1,000 |
| 1st October 20X1 | 21,000 | 23,000 | 28,000 | 26,000 | 1,000 |
| 31st March 20X2 | 21,500 | 23,500 | 29,000 | 26,500 | 1,100 |

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is Rs. 27,000.

Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.
*Hint: Loss on death of 20 cows – Rs.5,20,000 ; Loss on initial recognition of 20 new cows – Rs.20,000; loss on remeasurement of old cows – 2,88,000; Biological Asset on 31st Mar 20X2 – 480 4years : Rs.1,21,92,000 and 20 1.5 years : Rs.4,48,000.*

## 5. Illustration

Company X purchased 100 goats at an auction for Rs. 1,00,000 on 30 September 20X1. Subsequent transportation costs were Rs. 1,000 that is similar to the cost X would have to incur to sell the

goat at the auction. Additionally, there would be a 2% selling fee on the market price of the goat to be incurred by the seller.
On 31 March 20X2, the market value of the goat in the most relevant market increases to Rs. 1,10,000. Transportation costs of Rs. 1,000 would have to be incurred by the seller to get the goat to the relevant market. An auctioneer's fee of 2% on the market price of the goat would be payable by the seller.

On 1 June 20X2, X sold 18 goats for Rs. 20,000 and incurred transportation charges of Rs. 150. In addition, there was a 2% auctioneer's fee on the market price of the goat paid by the seller.

On 15 September 20X2, the fair value of the remaining goat was Rs. 82,820. 42 goats were slaughtered on that day, with a total slaughter cost of Rs. 4,200. The total market price of the carcasses on that day was Rs. 48,300, and the expected transportation cost to sell the carcasses is Rs. 420. No other costs are expected.

On 30 September 20X2, the market price of the remaining 40 goat was Rs. 44,800. The expected transportation cost is Rs. 400. Also, there would be a 2% auctioneer's fee on the market price of the goat payable by the seller.

Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.

*Hint: Fair value of goat on 30/9/X1 – Rs.97,000; Loss on initial recognition Rs.4,000; Gain on sale on 31/3/X2 – Rs.9,800; Gain on sale of goat on 1/6/X2 - Rs.226; Biological asset goats on 15/9/X2 – Rs.44,856; Fair value of goat on 30/9/X2 – Rs.43,504*

## 6. Illustration

Moon Ltd prepares financial statements to 31st March, each year. On 1st April 20X1 the company carried out the following transactions:
-- Purchased a land for Rs. 50 Lakhs.
-- Purchased 200 dairy cows (average age at 1st April, 20X1 is 2 years) for Rs. 10 Lakhs.
-- Received a grant of Rs. 1 million towards the acquisition of the cows. This grant was non- refundable.
For the year ending 31st March, 20X2, the company has incurred following costs:
-- Rs. 6 Lakh to maintain the condition of the animals (food and protection).
-- Rs. 4 Lakh as breeding fee to a local farmer.
On 1st October, 20X1, 100 calves were born. There were no other changes in the number of animals during the year ended 31st March, 20X2. As of 31st March, 20X2, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.
Information regarding fair values is as follows:

| Item | Fair Value less cost to sell | | |
|---|---|---|---|
| | 1st April, 20X1 | 1st October, 20X1 | 31st March, 20X2 |
| | Rs. | Rs. | Rs. |
| Land | 50 Lakhs | 60 Lakhs | 70 Lakhs |

| | | | |
|---|---|---|---|
| New born calves (per calf) | 1,000 | 1,100 | 1,200 |
| Six month old calves (per calf) | 1,100 | 1,200 | 1,300 |
| Two year old cows (per cow) | 5,000 | 5,100 | 5,200 |
| Three year old cows (per cow) | 5,200 | 5,300 | 5,500 |
| Milk (per litre) | 20 | 22 | 24 |

Prepare extracts from the Balance Sheet and Statement of Profit & Loss that would be reflected in the financial statements of the entity for the year ended 31st March, 20X2.

*Hint: Net Income Rs.3,02,000; Assets : Dairy Cow – Rs.11,00,000 ; Calves – Rs.1,30,000; Milk – Rs.72,000*

## 7. Illustration

Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming

- Development of living organisms such as cells, bacteria and viruses
- Growing of plants to be used in the production of drugs
- Purchase of 25 dogs for security purpose of the company's premises.

*Hint: Ind AS 41 – (i) No (ii) No (iii) Yes (iv) Analysis required (v)Yes (vi) No*

# Ind AS 12

# Income Taxes

## 1. Introduction

### 1.1 Objective

The objective of this Standard is to prescribe the accounting treatment for income taxes. Income taxes for the purpose of this Standard includes:

- all domestic and foreign taxes which are based on taxable profits;
- taxes, such as withholding taxes (Tax Deducted at Source), which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity

### 1.2 Key Terms

- **Accounting profit** is profit or loss for a period before deducting tax expense.
- **The tax base** of an asset or liability is the amount attributed to that asset or liability for tax purposes.
- **Taxable profit (tax loss)** is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).
- **Tax expense (tax income**) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.
- **Current tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.
- **Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.
- **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:
    - deductible temporary differences;
    - the carry forward of unused tax losses; and
    - the carry forward of unused tax credits.

## 2. Recognition

### 2.1 Current Tax Liability

- Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability.
- The liability is estimated at the time of preparation of financial statement and actual liability is known once the assessment is completed.
- Any excess of this liability over the prepaid taxes (advance tax) and withhold taxes (TDS) is to be treated as current liability.
- This liability may be for the current reporting period or may relate to earlier reporting periods.

### 2.2 Current Tax Asset

If the amount paid for taxes by way of advance taxes and withholding taxes (tds), the excess is recognised as an asset.

### 2.3 Measurement

Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantially enacted (e.g budget approved)

## 3. Deferred Taxes

**A deferred tax liability** shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which:
  - is not a business combination; and
  - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
  - At the time of the transaction does not give rise to equal taxable and deductible temporary differences.

**A deferred tax asset** shall be recognised for all deductible temporary differences to the extent that it is **probable that taxable profit will be available** against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- is not a business combination; and
- at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
- At the time of the transaction, does not give rise to equal taxable and deductible temporary differences

Deferred Tax is not recognised for permanent differences.

## 4. Carrying Amount & Tax Base

### 4.1 Computation of carrying amount

Carrying amount is the amount as computed in the books i.e ledger account balance. All adjustments like depreciation, impairment, revaluation must be given effect to.

### 4.2 Computation of Tax Base of an asset

- Tax base is the amount attributed to the asset or liability as per income tax for tax purposes.
- The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

  **Example**
  - WDV of a capital asset would be the tax base which would be deductible subsequently as depreciation. If an asset is sold, the WDV would be deductible while computing capital gains.
  - Carrying amount of an inventory is deductible as cost of goods sold when inventory is sold.

- If economic benefit from an asset is not taxable then the tax base is equal to the carrying amount. Hence in such cases difference would be zero and there would not be any deferred tax.

### 4.3 Computation of Tax Base of a liability

- The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods.
  **Example**
  - Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense will be deducted for tax purposes on a cash basis.
    The tax base of the accrued expenses is nil.
  - Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense has already been deducted for tax purposes.The tax base of the accrued expenses is Rs. 100.
- If liabilities are not deductible, the tax base of liability is equal to carrying amount.

### 4.4 Computation of Tax base where carrying amount is Nil

In such cases the tax base is the amount that would be allowed as deduction in future. Preliminary expenses are expensed fully in accounts but are allowed over a period of 5 years under Income Tax Act, 1961. So the carrying amount would be Nil and the tax base at end of first year would be $4/5^{th}$ of the amount.

## 5. Temporary Differences

**Temporary differences** are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

| **Taxable** | **Deductible** |
|---|---|
| that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; | that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled |
| Carrying Amount of Asset > Tax Base | Carrying Amount of Asset < Tax Base |
| Carrying Amount of Liability < Tax Base | Carry Amount of Liability > Tax Base |
| Deferred Tax Liability | Deferred Tax Asset |

Differences may arise due to –

- Difference in depreciation calculation
- Expenses being allowed differently under tax provisions
- Revaluation of assets in books but the income tax reporting is done using historical cost
- Income being taxed on cash basis or expenses being allowed on cash basis.
- Fair valuation during business combination (Refer Ind AS 103)

- Goodwill arising due to business combination

## 5.1 Exceptions

### 5.1.1 Goodwill arising on business combination

- No deferred Tax Liability is recognised on taxable temporary differences which arises on Goodwill which is not tax deductible
- If Goodwill is tax deductible, deferred tax liability or asset is recognised.

### 5.1.2 Initial recognition of asset or liability

Deferred Tax Asset/Liability is not recognised in case of

- A transaction which is not a business combination &
- It does not affect accounting profit or taxable profit.

Example - Entity A acquires a foreign made vehicle for Rs. 1,00,000 directly from the vehicle manufacturer. The transaction is not a part of any business combination. The tax laws do not permit any depreciation thereon. Also, any profits at the time of sale are not taxable or losses are not tax deductible. This vehicle thus has a tax base of Nil. There is a taxable temporary difference of Rs. 1,00,000. Assuming a tax rate of 30%, the entity should create a deferred tax liability of Rs. 30,000. But the Standard does not permit recognition of DTA/DTL in such cases.

### 5.1.3 Temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures

Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest.

| No DTL recognised if | DTA is recognised if |
|---|---|
| the parent, investor or venturer is able to control the timing of the reversal of the temporary difference | the temporary difference will reverse in the foreseeable future; |
| it is probable that the temporary difference will not reverse in the foreseeable future. | Taxable profit will be available against which the temporary difference would be utilised. |

## 5.2 Assessment of future profits for DTA

An entity should recognise deferred tax assets only when it is probable (> 50% chance) that sufficient taxable profits will be available against which the deductible temporary differences can be utilised. This is based on the principle of prudence and conservatism.

## 5.3 Unused Tax Losses and Tax Credits

- A deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

- The reason for recognising deferred tax asset is that the tax liability would be lesser in future
- the existence of unused tax losses is strong evidence that future taxable profit may not be available.
- If the entity has history of losses, deferred tax asset should be recognised only to the extent of amount that the entity has as taxable temporary differences or strong evidence that there would be taxable profits in future.
- At the end of each reporting period, the entity should reassess unrecognised deferred tax assets. It may need to recognise a previously unrecognised deferred tax asset to the extent it has now become probable that future taxable profits will be available for deferred tax assets to be recovered

## 6. Tax Rates

Deferred tax assets and liabilities shall be measured:

- at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled;
- based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.
- Enacted – Already in force
- Substantively enacted – Formalities are completed but not yet enacted. Like budget presented and passed but president has not yet assented.
- If different tax rates are applicable for different types/slabs of income, use the appropriate tax rates at which recovery would be done.

## 7. Accounting Entries

| | |
|---|---|
| Current Tax | Dr. Income Tax expense – Current<br>Cr. Income Tax Payable |
| Deferred Tax Asset | Dr. Deferred Tax Asset<br>Cr. Income tax benefit – Deferred |
| Deferred Tax Liability | Dr. Income Tax expense – Deferred<br>Cr. Deferred Tax Liability |
| Tax Expense (PL) | Current Tax + Deferred Tax Expense – Deferred Tax Benefit |
| Deferred Tax (BS) | Shown at Net Amount |

- Deferred Taxes are not discounted.
- Deferred Taxes are always shown as non current
- Deferred Tax expense/benefit are reported in P&L or OCI depending upon the items which have resulted the deferred tax.

## 8. Offsetting Deferred Tax Asset & Liabilities

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

- the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously.

## 9. Practical Application

### 9.1 Business Combination

- an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date.
- an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill (because of circular computation)
  [Recognising DTL will reduce net assets which will again increase goodwill]
- As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination.
- The potential benefit of the acquiree's income tax loss carry forwards or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently.
  - If the new information is obtained in the measurement period (refer IndAS 103), adjustments would be made in assets/liabilities and goodwill/bargain purchase capital reserve.
  - All other adjustments are recognised in P&L or OCI subsequently.

### 9.2 Share Based Payments

- Share based payments are recognised as expense as per Ind AS 102.
- The deduction for the purpose of taxation would be available when employees exercise the share options.
- The amount that would be available as deduction in the future would be the tax base and carrying amount would be Nil.
- An entity recognises deferred tax asset for the temporary difference.
- If the deductible amount is greater than the expense recognised in P&L, the balance reprsents amount attributable to equity. Deferred tax should be recognised in P&L and Equity accordingly.

### 9.3 Change in Tax Status

- A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss.

- The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period,
    - unless those consequences relate to transactions and events that result,in the same or a different period,
    - in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income.
- Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity.
- Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income

## 10. Presentation

### 10.1 Presentation - Offset

An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:

- has a legally enforceable right to set off the recognised amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

- the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
    - the same taxable entity; or
    - different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

### 10.2 Tax expense

- The tax expense (income) related to profit or loss from ordinary activities shall be presented as part of profit or loss in the statement of profit and loss
- the aggregate current and deferred tax relating to items that are charged or credited directly to equity
- the amount of income tax relating to each component of other comprehensive income

## 11. Disclosures

The major components of tax expense (income) shall be disclosed separately.

(a) current tax expense (income);
(b) any adjustments recognised in the period for current tax of prior periods;
(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
(f) the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56; and
(h) the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Ind AS 8, because they cannot be accounted for retrospectively

**Relationship between tax expense (income) and accounting profit in either or both of the following forms:**

- a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s)
- a numerical reconciliation between the average effective tax rate and the applicable tax rate

**Other Disclosures**

- an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;
- the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;
- the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint arrangements, for which deferred tax liabilities have not been recognised
- in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:
- the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;
- the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the balance sheet;
- in respect of discontinued operations, the tax expense relating to:
- the gain or loss on discontinuance; and
- the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented;
- the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were approved for issue, but are not recognised as a liability in the financial statements;
- if a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre- acquisition deferred tax asset, the amount of that change; and
- if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date, a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.

**An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:**

(a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(b) the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

## 12. Ind AS 12 vs AS 22

| | |
|---|---|
| Ind AS 12 is based on balance sheet approach.<br>It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base. | AS 22 is based on income statement approach.<br><br>It requires recognition of tax consequences of differences between taxable income and accounting income.<br><br>For this purpose, differences between taxable income and accounting income are classified into permanent and timing differences. |
| As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate. | AS 22 does not specifically deal with this aspect. |
| Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. | AS 22 does not deal with this aspect. |
| Since the concept of virtual certainty does not exist in Ind AS 12, this explanation is not included. | AS 22 explains virtual certainty supported by convincing evidence. |
| Ind AS 12 does not provide guidance on tax holiday | AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday |

## 1. Illustration

Given,

- Cost of Machine – Rs.1,00,000
- Useful life – 5 years
- Deprecation for Tax – 25% on SLM
- Tax Rate – 30%

Based on the above, compute

(i) Carrying amount as per books

(ii) Tax base

(iii)Check if there is any deferred tax asset or liability and compute deferred tax impact.

## 2. Illustration

An entity has a deductible temporary difference of Rs. 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to Rs. 60,000. The cost of implementing this tax planning strategy is Rs. 12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

## 3. Illustration

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of Rs. 10,000 and the tax rate was 25%. On 28th February, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on 21st May, 20X2. Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is 31st December, 20X1 and these are approved for issued on 31st May, 20X2.

## 4. Illustration

B Limited is a newly incorporated entity. Its first financial period ends on 31st March, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of Rs. 9,000. These are expected to reverse equally over next 3 years.

Rs.(b) Deductible temporary differences relating to preliminary expenses of Rs. 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on 31st March, 20X1.

## 5. Illustration

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is Rs. 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease rentals are Rs. 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent. Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2 .

## 6. Illustration

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of Rs. 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of a B Ltd. share was Rs. 2.00.

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at Rs. 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1. The following matters emerged:

- Property having a carrying value of Rs. 15 Cr at 1 April 20X1 had an estimated market value of Rs. 18 Cr at that date.
- Plant and equipment having a carrying value of Rs. 11 Cr at 1 April 20X1 had an estimated market value of Rs. 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of Rs. 2.50 Cr. The fair value of the inventory on the acquisition date is Rs. 3 Cr.

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.

## 7. Illustration

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for Rs. 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of Rs. 5 crore, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

## 8. Illustration

A Ltd. acquired B Ltd. The following assets and liabilities are acquired in a business combination:

'000

| | Fair Value | Carrying amount | Temporary Difference |
|---|---|---|---|
| Plant and Equipment | 250 | 260 | (10) |
| Inventory | 120 | 125 | (5) |
| Debtors | 200 | 210 | (10) |
| | **570** | **595** | **(25)** |
| 9% Debentures | (100) | (100) | |
| | **470** | **495** | |

| | | | |
|---|---|---|---|
| Consideration paid | 500 | 500 | |
| **Goodwill** | **30** | **5** | **(25)** |

Calculate Deferred Tax Asset.

## 9. Illustration

X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, the following events affected the tax position of the group:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of Rs. 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income- tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of Rs. 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than Rs. 20,00,000.

(iii) During the year ended 31st March, 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was Rs. 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

(iv) On 1st April, 2017, X Ltd. borrowed Rs. 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1st April, 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March, 2020 will be Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

## 10. Illustration

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs.15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

| **Acquisitions** | **Book values Rs.'000** | **Tax base Rs.'000** | **Fair values Rs.'000** |
|---|---|---|---|
| Land and buildings | 600 | 500 | 700 |
| Property, plant and equipment | 250 | 200 | 270 |

| | | | |
|---|---|---|---|
| Inventory | 100 | 100 | 80 |
| Accounts receivable | 150 | 150 | 150 |
| Cash and cash equivalents | 130 | 130 | 130 |
| Accounts payable | (160) | (160) | (160) |
| Retirement benefit obligations | (100) | - | (100) |

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition.

## 11. Illustration

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of Rs. 1,500 (20X1: Rs. 2,000) and in country B of Rs. 1,500 (20X1: Rs. 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of Rs. 100 (20X1: Rs. 200) are not deductible for tax purposes.
Compute the tax expense combined under both the jurisdictions.

Hint: 20X2 - 780 & 20X1 - 760

## 12. Illustration

A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is Rs. 100 thousand and taxable profit for year 20X1-20X2 is Rs. 104 thousand. The difference between these amounts arose as follows:

1. On 1st February, 20X2, it acquired a machine for Rs. 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.
2. In the year 20X1-20X2, expenses of Rs. 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

Prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation.

## 13. Illustration

A Ltd prepares financial statements to 31 March each year. The rate of income tax applicable to A Ltd is 20%. The following information relates to transactions, assets and liabilities of A Ltd during the year ended 31 March 20X2:

(i) A Ltd has a 40% shareholding in L Ltd. A Ltd purchased this shareholding for Rs. 45 Cr. The shareholding gives A Ltd significant influence over L Ltd but not control and therefore A Ltd. accounts for its interest in L Ltd using the equity method. The equity method carrying value of A Ltd's investment in L Ltd was Rs. 70 Cr on 31 March 20X1 and Rs. 75 Cr on 31 March 20X2. In the tax jurisdiction in which A Ltd operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.

(ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31 March. On 31 March 20X1, carrying value of the building (after revaluation) was Rs. 40 Cr and its tax base was Rs. 22 Cr. During the year ended 31 March 20X2, A Ltd charged depreciation in its statement of profit or loss of Rs. 2 Cr and claimed a tax

deduction for tax depreciation of Rs. 1.25 Cr. On 31 March 20X2, the building was revalued to Rs. 45 Cr. In the tax jurisdiction in which A Ltd operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.
Basis the above information, you are required to compute:
(a) The deferred tax liability of A Ltd at 31 March 20X2
(b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X2

## 14. Illustration

K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March 20X2, K Ltd entered into the following transactions:
(a) On 1st April 20X1, K Ltd purchased an equity investment for Rs. 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March 20X2, the fair value of the investment was Rs. 2,40,000. In the tax jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.
(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for Rs. 80,000. The goods had cost to K Ltd for Rs. 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.
(c) On 31st October 20X1, K Ltd received Rs. 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November 20X1 to 31st July 20X2. K Ltd recognised revenue of Rs. 1,20,000 in respect of this transaction in the year ended 31st March 20X2 and will recognise the remainder in the year ended 31st March 20X3. Under the tax jurisdiction in which K Ltd operates, Rs. 2,00,000 received on 31st October 20X1 was included in the taxable profits of K Ltd for the year ended 31st March 20X2.

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March 20X2. Assume tax rate to be 25%.

## 15. Illustration

An entity is finalising its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30th June, 20X2.
The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

| | |
|---|---|
| Deferred tax asset | Rs. 80,000 |
| Deferred tax liability | Rs. 60,000 |

Of the deferred tax asset balance, Rs. 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.
Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries.

## 16. Illustration – Nov 22 [8 Marks]

Following is the summarized Statement of Profit and Loss of New Age Ltd. as per Ind AS for the year ended 31.3.2022:

| Particulars | Rs. in lakhs |
|---|---|
| Revenue from operations | 1,450.00 |
| Other income | 70.00 |
| (A) Total income | 1,520.00 |
| Purchase of stock in trade | 50.00 |
| Changes in inventories of stock in trade | 20.00 |
| Employee benefit expenses | 145.00 |
| Finance costs | 180.00 |
| Other expenses | 375.00 |
| (B) Total expenses | 770.00 |
| (C) Profit before tax (A - B) | 750.00 |
| (D) Current tax expense | 211.65 |
| (E) Profit after tax (C - D) | 538.35 |

Additional information:
(1) Consider that Income tax rate applicable to New Age Ltd. in India is 30%.
(2) 'Other expenses' include the following expenses which are not deductible for income tax purposes:
(i) Penalties Rs. 1.50 lakh
(ii) Donations Rs. 55.00 lakhs
(iii) Impairment of goodwill Rs. 7.00 lakhs
(3) 'Other expenses' also include expenditure on Scientific Research amounting to Rs. 10 lakhs in respect of which a 150% weighted deduction is available under income tax laws.
(4) 'Other income' includes:
(i) Dividends of Rs. 5 lakhs, which is exempt from tax.
(ii) Long term capital gains of Rs. 12 lakhs which are taxable at the rate of 10%.
(5) 'Profit before tax of Rs. 750 lakhs' includes:
(i) Agriculture income of Rs. 65 lakhs which is exempt from tax; and
(ii) Profit of Rs. 75 lakhs earned in USA on which New Age Ltd. has paid tax at the rate of 20%.

During review of financial statements of New Age Ltd., the CFO multiplied profit before tax by the income tax rate and arrived at Rs. 225 lakhs as the tax expenses. However, the actual income tax expenses appearing in the summarized Statement of Profit and Loss is Rs. 211.65 lakhs.
You are required to help the CFO of the company in reconciling the difference between the tax expense amount.

**Indian Accounting Standard 21**
**THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES**

# 1 Introduction

Ind AS 21 deals with accounting for change in foreign currency of transactions or foreign operations.

Ind AS 21 corresponding to AS 11, but there is Fundamental difference. There is a concept of Functional Currency under in Ind AS 21.

# 2 Presentation vs Functional vs Foreign currency

## 2.1 Preparation Currency

**Presentation Currency** is the currency in which financial statements are presented

For Eg: Amazon in USA is Holding company of Amazon in India, So Amazon in India is required to prepare F.S in $. Here $ is the Presentation Currency.

## 2.2 Functional Currency

**Functional Currency** is the currency of primary economic environment in which entity operates

For Eg: Amazon in India has 95% of business in UK based. Here £ is the functional currency.

Note: Generally, Presentation/ reporting currency = Functional Currency. But It can differ. In above example Presentation currency is ₹, but Functional currency is £.

## 2.3 Foreign Currency

**Foreign Currency** is a Currency other than functional currency of the entity

# 3 Scope of Ind As 21

## 3.1 Applicability of Ind AS 21

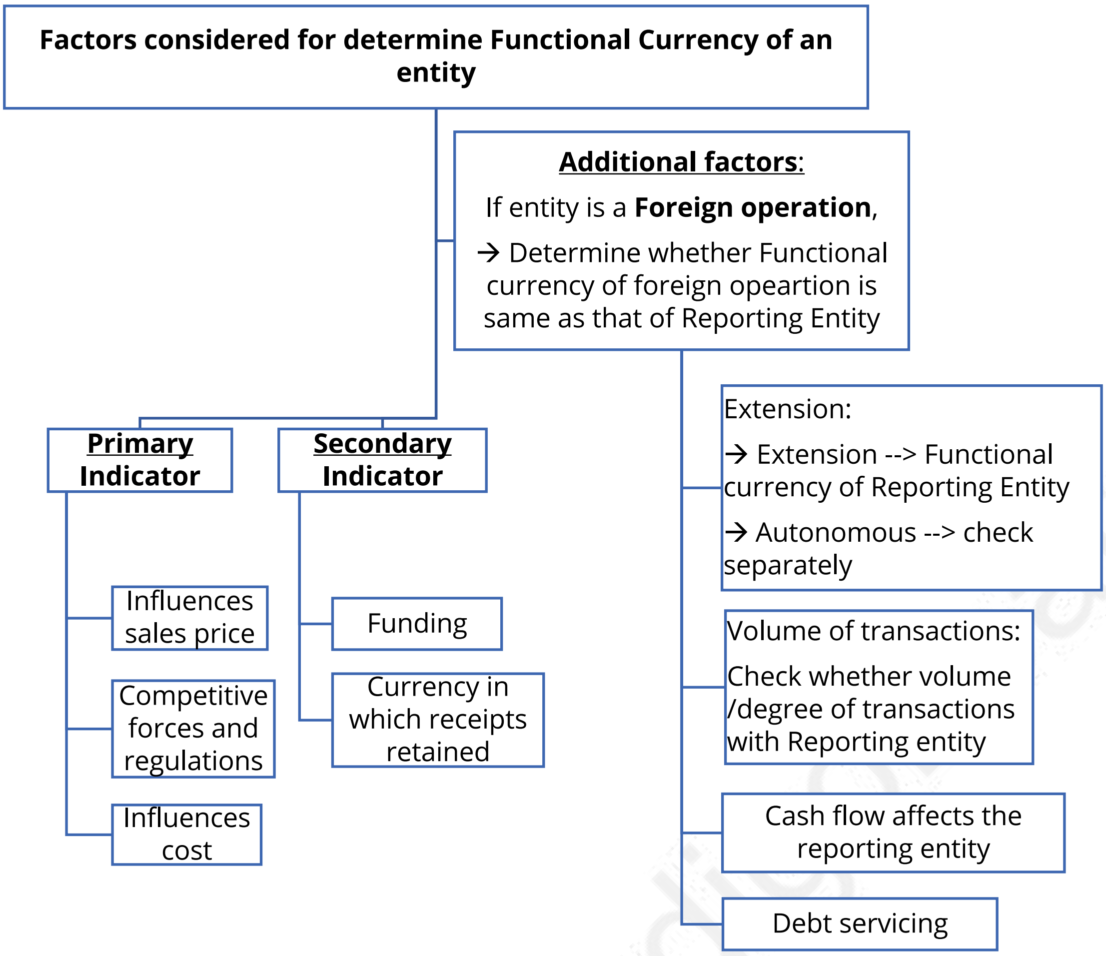
- Accounting for transactions and balances in foreign currencies, except for derivatives transactions and balances covered by Ind AS 109
- Translating the results and financial position of foreign operations that are included in the financial statement of the entity.
- Translating an entity's results and financial position into a presentation currency

## 3.2 Non-Applicability of Ind AS 21

- Hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. Applicable Ind AS 109
- Presentation of cash flows from transactions in a foreign currency or a to translations of cash flows of a foreign operation. Applicable Ind AS 7
- Long term foreign currency items for which an entity has opted for the exemption as per Ind AS 101

# 4 Functional Currency

Ind As 21 requires each entity to determine its functional currency. All the transactions must be recorded in Functional currency




Note:

- Primary indicators/ factors are in one currency (For eg: USD), but the settlement can be in another currency (Eg: local currency – INR). We have to consider the primary factors indicating currency for deciding functional currency.
- As there may be a chance of conflicting between one factor to another, those factors are not conclusive rules to decide the functional currency.
- Deciding Functional currency based on Judgement considering all the above factors.

Important Points

1. A currency used for pricing purpose may not always represent functional currency.
2. To check whether functional currency is local currency or other → check Primary & Secondary factors
3. Importing products from foreign and payment for the same in foreign currency does not imply foreign currency is functional currency
4. When functional currency is not obvious, management uses its judgement to determine functional currency that most faithfully represents economic effects of underlying transactions, events and conditions.

## 5 Foreign Currency transaction

### 5.1 Meaning

Foreign currency transaction → Transaction which is

| Denominated or | | | | requires settlement | in Foriegn currency |
|---|---|---|---|---|---|
| buys or sells goods or services whose price is denominated in foreign currency | borrows or lends funds with amount denominated in foreign currency | otherwise acquires or disposes of assets, or incurs or dettles liabilities denominated of assets, or incurs or settles liabilities, denominated in foreign currency | | Invoiced in local currency, but settlement made in foreign currency | |

### 5.2 Initial measurement

A Foreign currency transaction shall be recorded

- <u>On initial recognition</u>
- <u>In the functional currency</u>
- By applying to the foreign currency amount
- The spot exchange rate between the functional currency and the foreign currency
- At the date of the transaction

Foreign currency transaction is initially recorded by translating in entity's functional currency at exchange rate on transaction date.

➢ <u>Determine Functional currency</u>

For eg:

If Reporting currency – INR
Functional currency – USD
Transaction currency – GBP/INR
Then initial recognition will be done at Functional currency – USD (Even though the presentation currency is INR)
Later convert into Presentation currency (INR) for Reporting/ presentation purpose.

➢ <u>Identify Exchange rate on transaction date</u>

- Average rate for day, week or month might be used for all transactions in each foreign currency occurring during that period (Only if exchange rate fluctuation is insignificantly)
- If exchange rate fluctuates significantly, the use of average rate for the a period is inappropriate.
- Mostly Company uses reference rate (published by an association) or some pre-defined rates (Closing or Average exchange rates) as per their policies.

## 5.3 Subsequent measurement

- Subsequent measurement (Can be at the end of reporting period or at the time of settlement)
  - Monetary
    - Closing rate
  - Non Monetary
    - Historical Cost
      - Exchange rate at date of transaction
    - Fair value
      - Exchange rate on the date for value was arrived

For Eg:
Foreign branch purchased PPE $ 10,000 & Fair value on Reporting date is $ 11,000
Exchange rate: On Purchase date is 1 USD = INR 85 & Reporting date is 1 USD = INR 83

| PPE measured at | Cost Model | Fair value model |
|---|---|---|
| Value (A) [As per IND AS 16] | Historical cost = $ 10,000 | Fair/Revalued value = $ 11,000 |
| Exchange rate (B) [As per IND AS 21] | On date of purchase = Rs.85 | On date of revaluation = Rs.83 |
| Value of PPE (A×B) | Rs.8,50,000 ($ 10,000 * Rs.85) | Rs.9,13,000 ($ 11,000 * Rs.83) |

Foreign branch purchased Inventory $ 20,000 & Fair value on Reporting date is $ 20,500
Exchange rate: On Purchase date is 1 USD = INR 85 & Reporting date is 1 USD = INR 82

| Inventory measured at | Lower of Cost or NRV | |
|---|---|---|
| Value (A) [As per IND AS 2] | Cost = $ 20,000 | NRV = $20,500 |
| Exchange rate (B) [As per IND AS 21] | On date of purchase = Rs.85 | On date of revaluation = Rs.82 |
| (A×B) | Rs.17,00,000<br>($ 20,000 * Rs.85) | Rs.16,81,000<br>($ 20,500 * Rs.82) |
| Value of Inventory | Rs. 16,81,000 | |

Note:
Ind As 21 explains only in which currency Foreign currency transaction to be recognised, not how to measure.

## Monetary items vs Non-Monetary items

**Monetary Items**

Units of currency held and assets & liabilities to be received paid are in fixed or determinable number of units of currency

**Non-Monetary items**

There is no fixed or determinable number of units of currency

Examples of monetary items:

> Pension and other employee benefits to be paid in cash

> Provision that are to be settled in cash

> lease liabilities

> Cash dividends that are recognised as a liability

> Debt security

> Contract to receive/deliver variable no.of entity's own equity instruments/ assets in which fair value equals fixed or determinable no.of units of currency

> Sundry Debtors & Accounts receivables, Cash & cash Equavalent, Fixed Deposits, Creditors & Loans

Examples of Non-monetary items:

> Inventory

> Fixed Assets

> Equity

> Investments in shares

> Goodwill, Intangible assets, Inventory, property, plant & equipment, right-of-use assets, provisions to be settled by delivery of non- monetart asset, amounts prepaid for goods & services and income received in advance

**Example:**

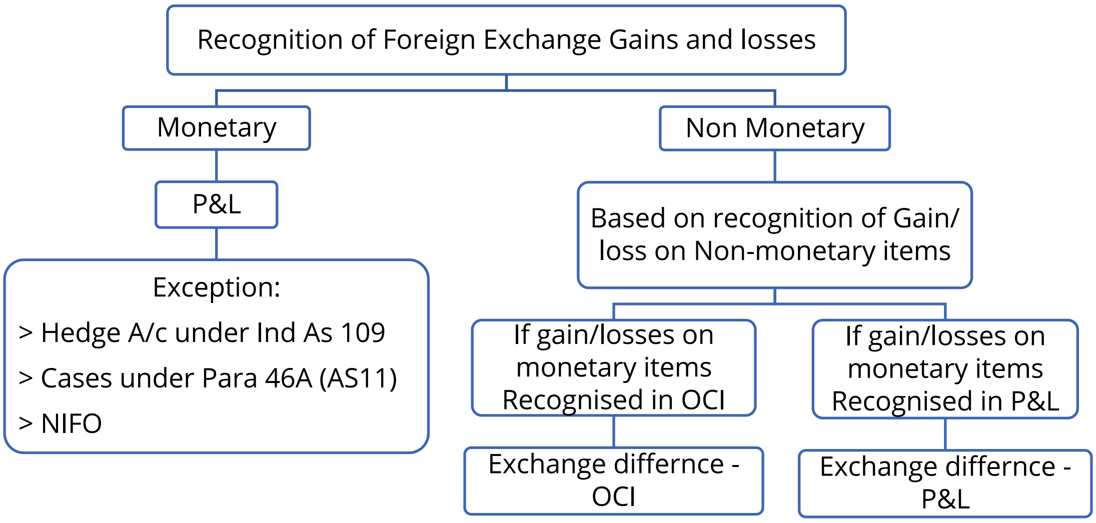
Infosys exports a Service for $ 10,000 on 01-01-X1

Functional Currency – INR

Foreign Currency – USD

| **Initial Measurement:** | | | | | |
|---|---|---|---|---|---|
| Date | Particulars | Debit | Credit | Currency | Exchange rate |
| 01-01-X1 | Receivables/customers A/c Dr<br>To Revenue/Sales A/c | 9,00,000 | 9,00,000 | Functional Currency - INR | 1 USD = INR 90 |
| **Subsequent Measurement:** (As it is monetary item – Closing rate) | | | | | |
| Date | Particulars | Debit | Credit | Currency | Exchange rate |
| 31-03-X1 | Foreign Exchange loss A/c Dr<br>To Receivables/customers A/c | 20,000 | 20,000 | Functional Currency - INR | 1 USD = INR 88 |
| **If It is settled on 31-03-X1:**<br>**(Loss or Gain are recognised based on the exchange rate on date of settlement)** | | | | | |
| Date | Particulars | Debit | Credit | Currency | Exchange rate |
| 31-03-X1 | Bank A/c Dr<br>Foreign Exchange loss A/c Dr<br>To Receivables/customers A/c | 8,80,000<br>20,000 | 9,00,000 | Functional Currency - INR | 1 USD = INR 88 |

### 5.4 Recognition of Foreign Exchange Gains and losses




**Exception:**

- If Exchange differences arises out of an item, which qualifies for <u>Hedge accounting under IND AS 109</u>, then IND AS 109 will apply for recognition instead of IND AS 21.
- <u>IND AS 101</u> allows an entity to apply Para 46A under AS 11, (Optional)
  Exchange difference on Foreign currency of Long term monetary Item
  - If it is Depreciable asset → Add/Less from carrying amount
  - If it is Non-depreciable asset → Transferred to Foreign Currency Monetary Item Translation Difference Account (FCMITDA - Component of equity) → Amortise over the remaining life

  Example: Long term loan in foreign currency - $ 100,000 to acquire PPE. Exchange rate on that day 1 USD = INR 80. Closing Exchange rate → 1USD = INR 85

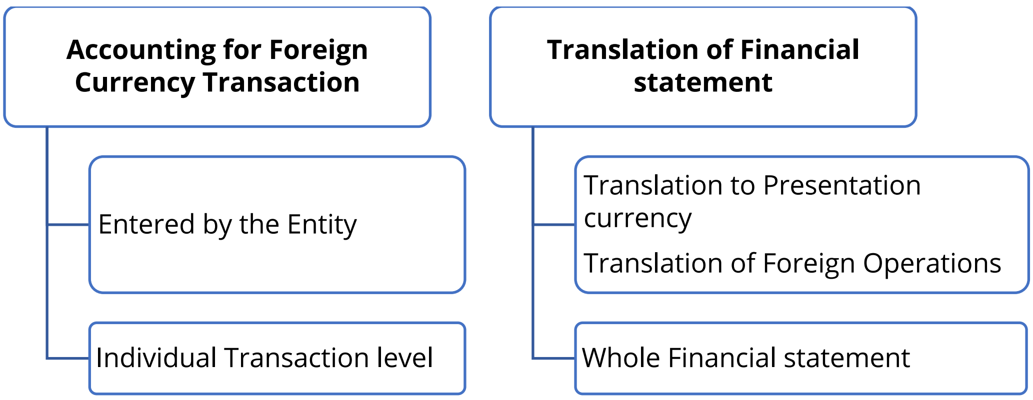
| Particulars | PPE | Long-term Loan |
|---|---|---|
| Cost | Rs.80,00,000<br>($ 100,000 × Rs.80) | Rs.80,00,000<br>($ 100,000 × Rs.80) |
| Item | Non-Monetary Item | Monetary Item |
| Closing balance | Rs.80,00,000 | Rs.85,00,000<br>($ 100,000 × Rs.85) |

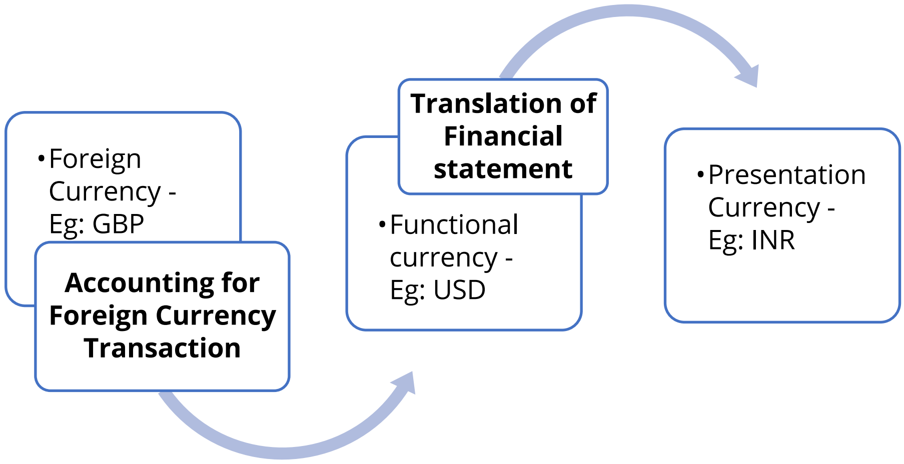
Difference between loan balance (Rs.85,00,000 – Rs.80,00,000 = Rs.5,00,000) will be Transferred to Foreign Currency Monetary Item Translation Difference Account (FCMITDA - Component of equity) → Amortise over the remaining life

## 6 Translation of Financial statement

Translation of Financial Statement from one currency to another currency

### 6.1 Distinguish between Accounting for Foreign Currency Transaction vs. Translation of Financial statement






## 6.2 Foreign Operation

Foreign Operation

Subsidiary | Associate | Joint venture | Branch

of reporting entity,

activity of which are based/conducted in a country/currency other that those of reporting entity

Note:

- Branch/ Subsidiary/ Associate/ Joint venture having different functional currency from the functional currency of reporting entity will be considered as Foreign Operation. Even though Both reporting entity & its associate company is in same country.

**<u>Translation of Foreign Operations:</u>**

Functional currency Foreign Operations → To → Functional Curreny of Parent Company → To → Presentation Currency

## 6.3 Translation to Presentation currency

| **Particulars** | **Exchange rate** | **Date** |
|---|---|---|
| Assets & Liabilities | Closing Rate | Balance sheet |
| Profit & loss items | Individual rate or Average rate (If there exist Insignificant Fluctuation) | Transaction date |
| Equity | Historical Cost/ Historical Value | |

Note:

- All resulting exchange difference recognised in Other Comprehensive Income (OCI) → FCTR (Foreign Currency Translation Reserve)
- In CFS, Goodwill raised from the acquiring shares of Subsidiary company will be treated as Asset i.e., Goodwill of the Foreign Operation and should follow the translation principle @ Closing rate.

# 7 Net Investment in a foreign operation

NIFO is

- The amount of the reporting entity's interest
- in the net assets of that operation

- An item (Long term Monetary item) for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation.

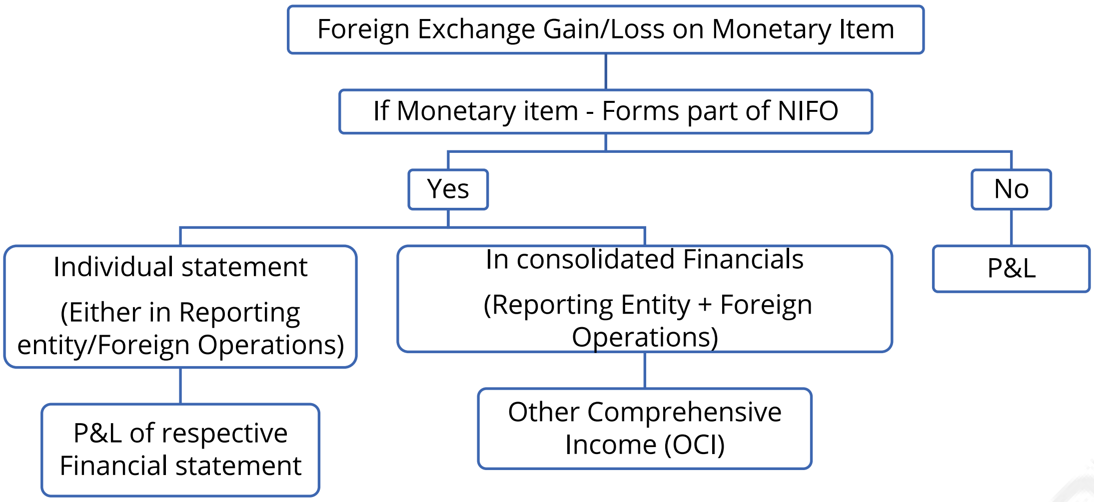



Illustration Summary:

- Gain or loss on monetary item is generally recognised in P&L. If monetary item forms part of NIFO, then in CFS it is recognised in OCI.
- Trade receivables & Trade payable will not be form part of NIFO, While Long term loans, receivables & payables will form part of NIFO.
- If Subsidiary company of reporting entity gives loan to another Subsidiary of reporting entity
  - If the given loan forms part of NIFO, then it should be recognised in OCI of Consolidated Financial statement of group companies.

## 8 Intra group transactions

Effect of Intra group transactions in Consolidated Financial Statement

- Intra group balances - Eliminate
- Unrealised gain - Eliminate
- Exchange gain/ loss recognised in standalone statements - Recognise in CFS

Exchange Gain/Loss on Monetary item

- Forming part of NIFO → OCI of CFS
- Not forming part of NIFO → Consolidated P&L

**Example 1:**

Exchange rate: Opening 1 USD = INR 50 & Closing 1 USD = INR 55

| **Year** | **Holding Company** | | **Subsidiary Company** | |
|---|---|---|---|---|
| | **Asset** | **Amount (INR)** | **Liability** | **Amount (USD)** |
| Beginning | Loan given to Subsidiary | 1,00,000.00 | Received Loan | 2,000.00 |
| | | | | |
| End | Loan given to Subsidiary | 1,00,000.00 | Received Loan | 1,818.18 |
| | | | | |
| | | | Exchange Gain | 181.82 |

- In Consolidated Financial statement, Loan given & received will set off &
- Exchange Gain = Rs.10,000 (181.82 × 55) recognised

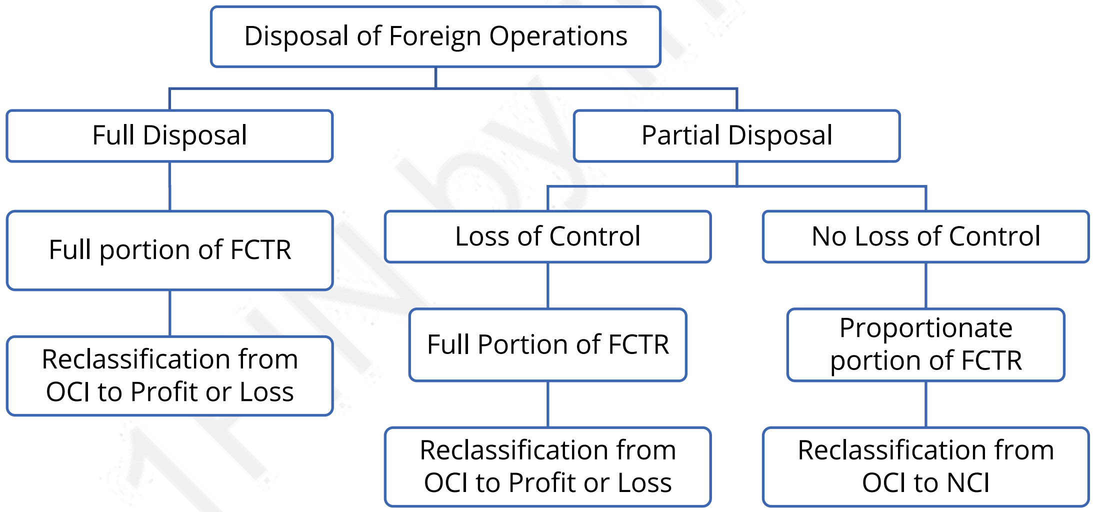
**Example 2:**

Holding company sold goods to Subsidiary worth $ 1,000. Profit element in sale = Rs.10,000
Inventory not sold & transaction not settled by Subsidiary.
Exchange rate: Opening 1 USD = INR 80 & Closing 1 USD = INR 85.

| **Holding Company:** | | | |
|---|---|---|---|
| **Date** | **Particulars** | **Debit** | **Credit** |
| 01-01-X1 | Account Receivable - Subsidiary A/c Dr<br>To Sales A/c | 80,000 | <br>80,000 |
| 31-03-X1 | Account Receivable - Subsidiary A/c Dr<br>To Exchange Gain A/c | 5,000 | <br>5,000 |
| **Subsidiary Company:** | | | |
| **Date** | **Particulars** | **Debit** | **Credit** |
| 01-01-X1 | Inventory A/c Dr<br>To Account Payable – Holding Company A/c | 80,000 | <br>80,000 |

- Exchange Gain on Account receivable = Rs.5,000 (Rs.85,000 - Rs.80,000) (This gain is recognised in Separate Financial Statement when restatement of Monetary items at closing rate). This will be offset by Account payable in Subsidiary.
- Inventory is a non-monetary item and it would not be restated in subsidiary financial statements. However, in CFS, inventory will be recognised at cost to holding company by eliminating unrealised gain.
- Subsidiary will recognise loss on account payable due to change in exchange rate.

## 9 Disposal of Foreign Operations.




## 10 Change in Functional Currency

Change in Functional Currency

↓

Can be changed unless there is a change in the relevant underlying transactions, events and conditions

↓

The change is accounted for prospectively from the date of the change

↓

All the items are translated into the new functional currency using the exchange rate of the date of the change

↓

Exchange difference arising previously recognised in the other comprehensive income are not reclassified from equity to profit or loss until the disposal

- Non-Monetary items measured @ historical cost → Exchange rate at the date of change of functional currency will be used for arriving historical value in new functional currency.

## 11 Currency of a Hyperinflationary Economy as a Functional Currency

When an entity's Functional currency is currency of a hyperinflationary economy, the entity shall restate its financial statement in accordance with Ind As 29 before applying the translation method as explained below:

- If both the Functional and Reporting currencies are Hyperinflationary, translate using the closing rate at the end of reporting period.
  Example:

| | | |
|---|---|---|
| Year | 20X3 | 20X2 |
| Exchange Rate | 31-03-20X3 | 31-03-20X3 |

- If Functional currency is Hyperinflationary & Reporting currencies is Non-hyperinflationary, then translate using closing rate at the end of respective period of Financial statement.
  Example:

| | | |
|---|---|---|
| Year | 20X3 | 20X2 |
| Exchange Rate | 31-03-20X3 | 31-03-20X2 |

## 12 Disclosure

Ind AS 21 requires following disclosures:

- amount of exchange differences recognised in profit or loss
  - except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109;
- net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity,
  - along with the reconciliation of the amount at the beginning and end of the period
- when the presentation currency is different from the functional currency –
  - that fact shall be stated, together with disclosure of the
    - functional currency and
    - the reason for using a different presentation currency;

- in case of change in functional currency of either the reporting entity or a significant foreign operation:
  - (i) fact of such change;
  - (ii) reason for the change and;
  - (iii) date of change in functional currency;
- if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with.

  However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:
  - the information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;
  - the currency in which the supplementary information is displayed should be disclosed; and
  - the entity's functional currency and the method of translation used to determine the supplementary information should be disclosed.

## 13 AS 11 vs Ind AS 21

| S.No | Particulars | AS 11 | Ind AS 21 |
|---|---|---|---|
| 1 | Functional Currency | Not exist | Exist |
| 2 | Foreign currency | Currency other than Reporting currency | Currency other than Functional currency |
| 3 | Presentation currency | Silent | It can be different from local currency, functional currency |
| 4 | Approach for Translation – Foreign Operation | Based on<br>→Integral foreign operation and<br>→ Non-integral foreign operation (NIFO) | Based on Functional currency approach<br>→ Determining an entity's functional currency similar to indicators to determine Non-Integral FO in AS 11<br>→ Despite of difference in terms there is no substantive difference in respect of accounting of a foreign operation. |
| 5 | NIFO | Non-integral foreign operation | Net Investment in foreign operation |
| 6 | Long term monetary items | → No exemption given under Ind AS 21<br>→ Ind AS 101 gives an exemption of Para 46A under Ind AS 11 - | AS 11 itself explains about accounting LTMI |

| | | | |
|---|---|---|---|
| | | either recognise in P&L or adjust the carrying amount of asset | |
| 7 | Exclusion of Forward exchange contract and other similar financial instrument | No specific mention | Excludes from its scope |

## ILLUSTRATIONS

### 1. Illustration

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$. What is the functional currency of Future Ltd.? (SM) [Ans: Local Currency (L$)]

### 2. Illustration

Small India Private Limited (Small), a subsidiary of Big Inc., takes orders from Indian customers for Big Inc's merchandise and then bills and collects for the sale of the merchandise in Rupees. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. Big Inc is based out of US and has its functional currency as USD. What is Small's functional currency? (SM) [Ans: USD]

### 3. Illustration

A is an Oman based company having a foreign operation, B, in India. The foreign operation was primarily set up to execute a construction project in India. The functional currency of A is OMR.
78% of entity B's finances have been raised in USD by way of contribution from A. B's bank accounts are maintained in USD as well as INR. Cash flows generated by B are transferred to A on a monthly basis in USD in respect of repayment of finance received from A.
Revenues of B are in USD. Its competitors are globally based. Tendering for the construction project happened in USD.
B incurs 70% of the cost in INR and remaining 30% costs in USD.
Since B is located in India can it presume its functional currency to be INR? (SM)
[Ans: No. USD should be considered as the functional currency of B]

### 4. Illustration

S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 20X1. Since then the company's operations have increased considerably. The company was engaged in the business of trading of motor cycles. The company only deals in imported Motor cycles. These motor cycles are imported from US.

After importing the motor cycles, these are sold across India through its various distribution channels. The company had only private customers earlier but the company also started corporate tie-up and increased its customer base to corporates also. The purchase of motor cycles are in USD because the vendor(s) from whom these motor cycles are purchased those are all located in US.

All other operating expenses of the company are incurred in India only because of its location and they generally happen to be in INR. Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motor cycles in India are different from those in other countries.

The company is also expecting that in the coming years, its customers base will increase significantly in India and the current proportion may also change.
Currently, the invoices are raised to the corporate customers in USD for the purpose of hedging. However, private customers don't accept the same arrangement and hence invoices are raised to them in INR.
What would be the functional currency of this company? (SM)
[Ans: INR]

## 5. Illustration

On 30th January, 20X1, A Ltd. purchased a machinery for \$ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 \$ = Rs. 60. The fair value of the machinery determined on 31st March, 20X1 is \$ 5,500. The exchange rate on 31st March, 20X1 is 1\$ = Rs. 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1\$ = Rs. 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%. A Ltd. follows Revaluation method in respect of Plant & Machinery. (SM)

## 6. Illustration

On 1st January, 2018, P Ltd. purchased a machine for \$ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was \$1= Rs. 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the \$ in the three months following purchase and by 31st March, 2018 the exchange rate was \$1 = Rs. 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.
Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. (SM}

## 7. Illustration

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.
State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are Rs. 72 per USD and Rs. 75 per USD respectively. (SM)
[Ans: Amount of revenue to be recognised on date of revenue (31$^{st}$ March 2018) – ₹ 3,690 million)

## 8. Illustration

On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = Rs. 2.50.
- 31st March, 20X2 – FCY 1 = Rs. 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = Rs. 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. (SM)

[Ans: Initial measurement amount – ₹ 1,45,00,000; Finance cost for year – ₹ 16,84,320; Closing balance – ₹ 1,62,14,000; Exchange loss – ₹ 16,79,860]

## 9. Illustration

Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following balances appear in the books of Infotech Global Ltd. at the year-end prior to translation:

| | USD | L$ |
|---|---|---|
| Property, plant and equipment | 50,000 | |
| Receivables | 9,35,000 | |
| **Total assets** | **9,85,000** | |
| Issued capital | 50,000 | 30,055 |
| Opening retained earnings | 28,000 | 15,274 |
| Profit & Loss A/c (Profit for the year) | 20,000 | |
| Accounts payable | 8,40,000 | |
| Accrued liabilities | 47,000 | |
| **Total equity and liabilities** | **9,85,000** | |

Translate the above balances of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

**Additional information:**

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13 (SM)

## 10. Illustration

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S and a transaction for the same was made for USD 300 during the year. At the year end, a balance of the same amount is outstanding as receivable from S. It has been observed that such balance amount has been continuing as receivable from S year on year and even though the payments in respect of these balances are expected to be received in the foreseeable future but if we look at the year-end then we see this balance as outstanding every year.

In addition to the trading balances between P and S, P has lent an amount of USD 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference, if any, be recognised in the profit and loss? (SM)

[Ans: Recognised in Profit or Loss as it is in nature of Trade Balance]
Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding (i.e. loan amount) extended to S is made via another entity in group, T, rather than from P directly. That is, on directions of P, T gives loan to S. T is also a subsidiary of P. Where should exchange difference, if any, be recognised? (SM)
[Ans: Profit or loss in P's separate financial statements and in OCI in its consolidated financial statements]

## 11. Illustration

M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.
M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 20X1. The cost of these bottles was Rs. 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 20X1, all these bottles were lying as closing stock and payable with G Ltd.
Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd. Following additional information is available:

| | |
|---|---|
| Exchange rate on 1st February, 20X1 | 1 Euro = Rs. 83 |
| Exchange rate on 31st March, 20X1 | 1 Euro = Rs. 85 |

Provide the accounting treatment for the above in books of M Ltd. and G Ltd. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of M Ltd. (SM)

## 12. Illustration

Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1.
The exchange rates as at 30th September, 20X1 was Rs. 82 / EURO and at 31st March, 20X2 was Rs. 84 / EURO.
What is the value at which the goodwill has to be recognised in the financial statements of Global Limited as on 31st March, 20X2?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was Rs. 83 / EURO and on 31st March, 20X2 was Rs. 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements. (SM)

[Ans: (i) Rs. 117.6 million; (ii) Rs. 149.40 million]

## 13. Illustration

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for Rs. 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is Rs. 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of Rs. 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of Rs. 180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is Rs. 20 lakhs
Calculate P's gain on disposal in its consolidated financial statements. (SM)[Ans – Rs. 780 lakhs]

# Indian Accounting Standard 24
# RELATED PARTY DISCLOSURE

## 1 Introduction

Ind AS 24 → Disclosure based transaction

**Ind AS 24 deals with Identifying & disclosure of:**

Related party relationships → Related party transactions → Outstanding balances → Disclosure requirements

## 2 Related party

### 2.1 Related party

**A Related party** is

i. A Person or
ii. An entity

that is related to the reporting entity

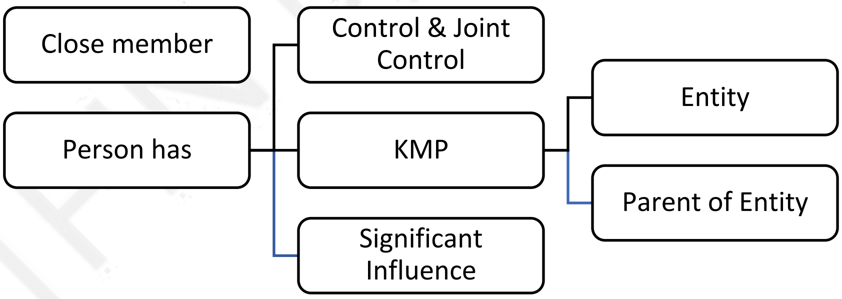
### 2.2 Person related to Reporting Entity

**A person or a close member of that person's family** is related to a **reporting entity** if the person

a) Has control or joint control over the reporting entity → Control referred
b) Is a member of the key managerial personnel of
   - The reporting entity or
   - A parent of the reporting entity
c) Has significant influence over the reporting entity

For Eg:

- In Indigo learn, Suraj owns 51% of shares OR is Director of Indigo learn → then Mr.Suraj & Mrs. Suraj are related parties to Indigo learn
- If Mr.A is director of Parent Company → He will be Related party of Subsidiary company.
- If Mr.A is director of Subsidiary → He cannot be Related party of Parent company.




As per Ind AS 110 – Consolidated Financial statement, Investor **Controls** over an investee if –

a) Power over the investee
b) Exposure, or rights to variable returns from its involvement with the investee and
c) Ability to use its power over the investee to affect the amount of the investor's returns

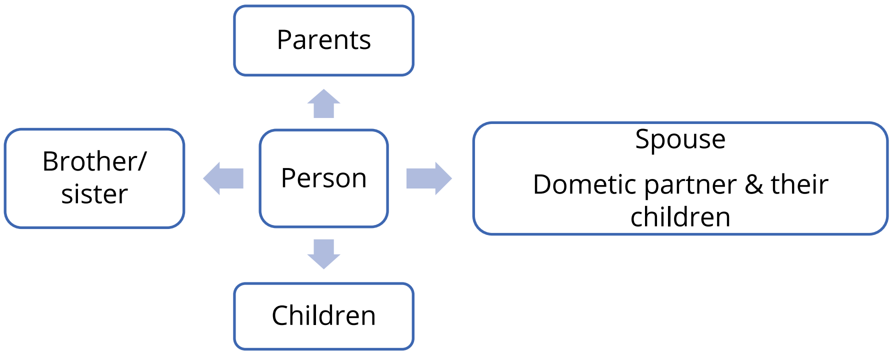
**Joint control** is the contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control

**Significant influence over the reporting entity**

- power to participate in the financial statement and operating policy decisions of the investee

➢ but is not control of those policies

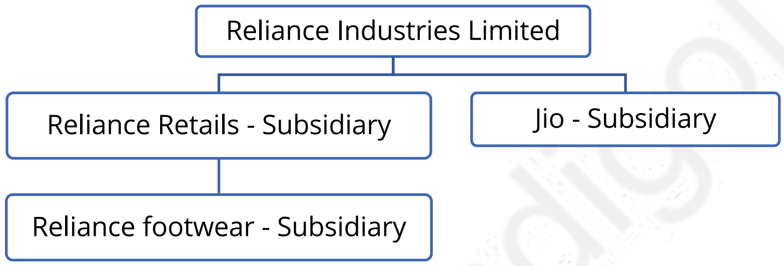
**<u>Close members of the family:</u>**



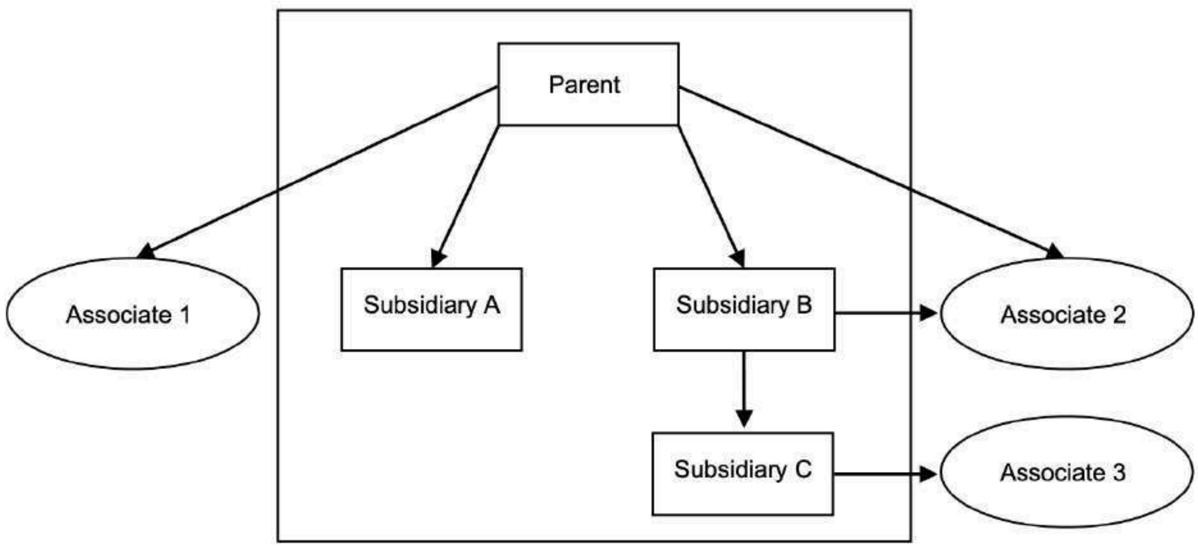

## 2.3 Entity related to Reporting Entity

**An entity is related to a reporting entity if:**

a) The entity and the reporting entity are **members of the same group** (which means that each parent, subsidiary and fellow subsidiary are related to the others)
Eg: All companies in the below group are Related to each other



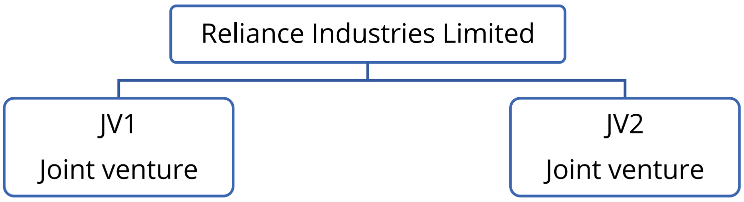

b) **One entity is an associate or joint venture of the other entity** (or an associate or joint venture of a member of a group of which the other entity is a member)



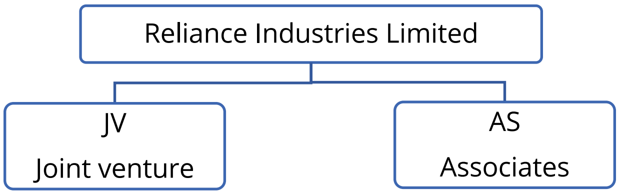

| Financial Statements of | Related Parties |
|---|---|
| Parent | Subsidary A, B, C & Associate 1,2,3 |
| Subsidiary A | Parent, Subsidiary B&C, Associate 1,2,3 |
| Subsidiary B | Parent, Subsidiary A&C, Associate 1,2,3 |
| Subsidiary C | Parent, Subsidiary A&B, Associate 1,2,3 |
| Associates 1,2,3 | Parent, Subsidiary A,B,C |

Associates 1,2,3 are not related to one another.

c) Both entities are joint ventures of the same third party
Eg: In the below table, JV1 & JV2 are related parties to each other



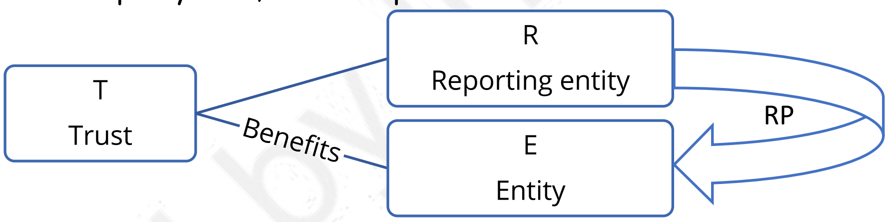

d) One entity is a joint venture of a third entity and the other entity is an associate of the third entity
Eg: JV & AS are Related parties to each other




**Note:**

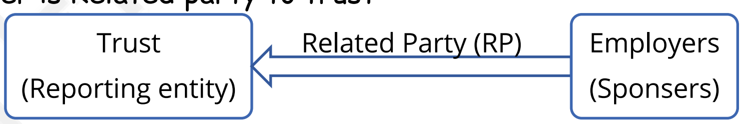
- If Both are associates, then they are not related party, as there is no control element in associates.
- Either both should be joint venture or one is Joint venture & other should be associate, then only they can be related parties.

e) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity.
Eg: T are Related party to R, where T provides benefits to E




If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity

Eg: Employer is Related party to trust

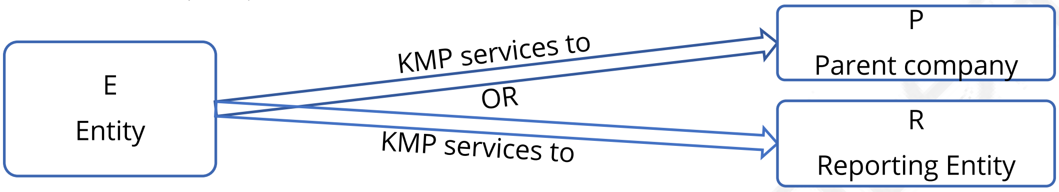



f) The entity is controlled or jointly controlled by a person who is a related party to entity (by control, significant influence or KMP)
Eg:

g) A person who is related party to the entity has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)
Eg:

| Person (Eg: Suraj) | | Entity/ Joint venture (Eg: 1Fin) | | |
|---|---|---|---|---|
| | | **Control/Joint control** | **Key Managerial Personnel** | **Significant Influence** |
| **Reporting Entity (Eg: Indigo learn)** | **Control/Joint control** | Related parties | Related parties | Related parties |
| | **KMP** | Related parties | Not RP | Not RP |
| | **Significant Influence** | Related parties | Not RP | Not RP |

h) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.
Eg: E is related party to R




**Note:**

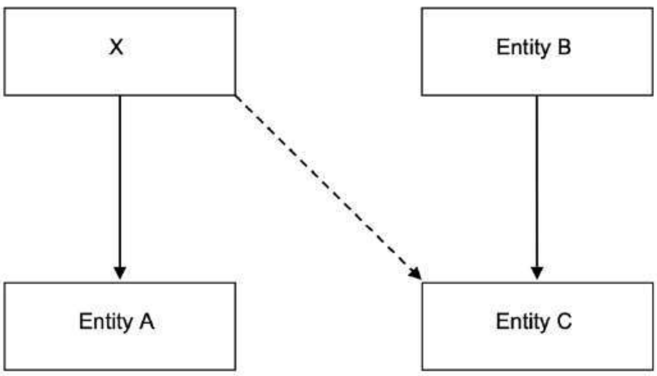
- ➢ The aforesaid definition is wide and exhaustive.
- ➢ The standard lays emphasis on the substance of the relationship rather than legal form

**Example:** Mukesh Ambani controls Reliance Industries and Anil Dhiru bhai Ambani control Reliance Capital. Here We cannot conclude that Reliance Industries and Reliance Capital are Related party, because the persons who control are brothers.

We have to look into

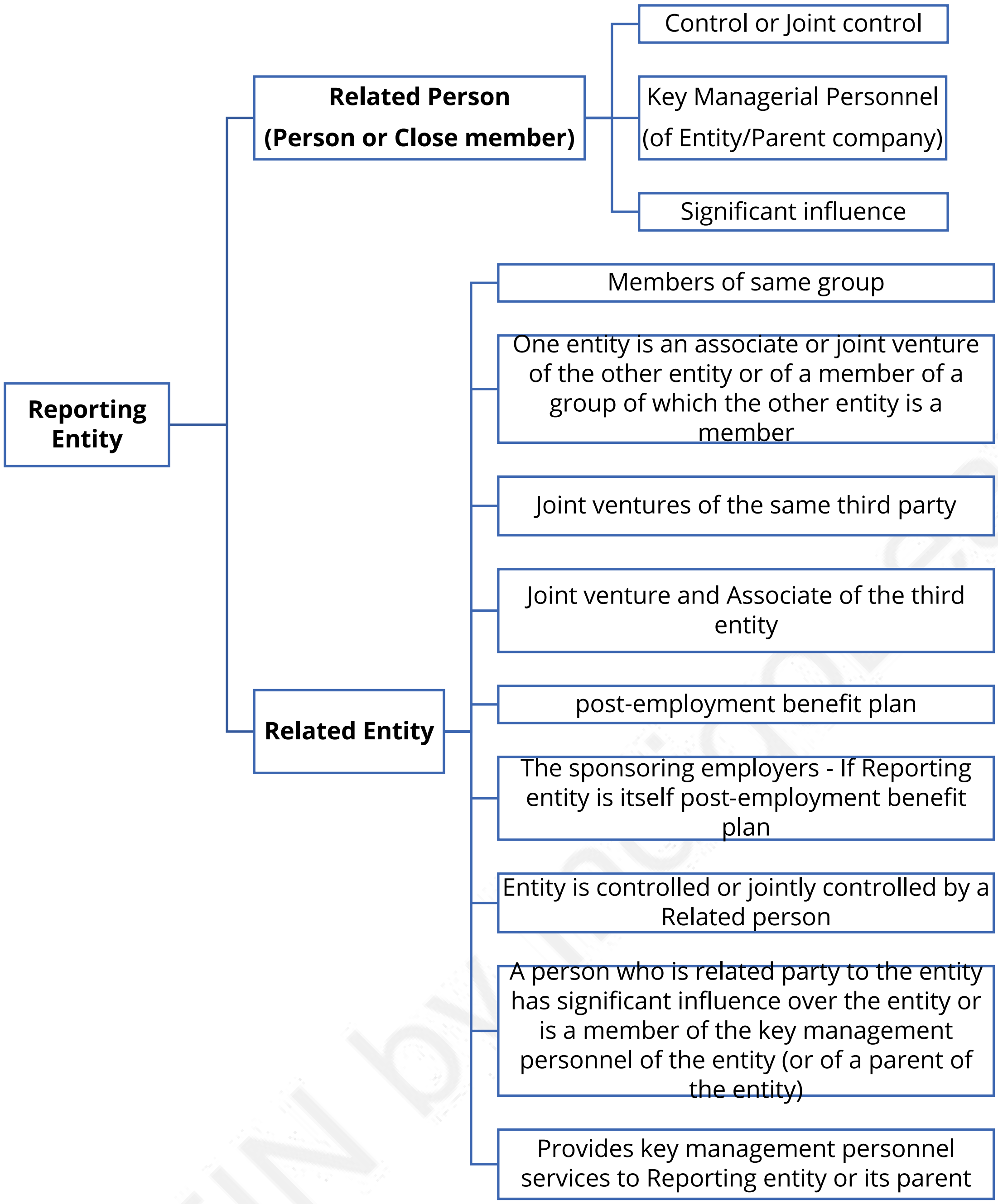
- o Substance of the relationship → neither of their decisions are dependent with each other nor influencing each other.
- o Not just a legal form of Relationship → Brothers

**Example**




In the example X holds 100% of share capital of Entity A and hence controls it. X is also the KMP in Entity C. Entity B owns 100% of Entity C

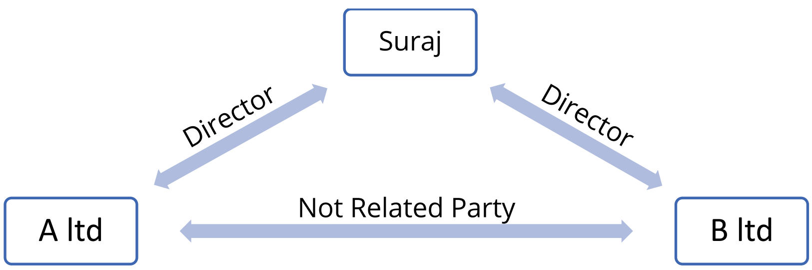
| Financial Statements of | Related Party |
|---|---|
| Entity C | Entity B(Parent)<br>X (KMP)<br>Entity A (Controlled by KMP) |
| Entity A | X (Control)<br>C (X controls A and is KMP of C) |
| Entity B | Entity C |



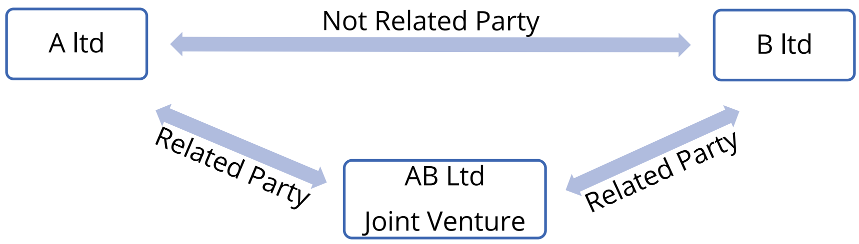

## 3 Who are Not Related party ?

The Following are not Related parties:

1. Two Entities → because they have a **common director or other member of Key management personnel**.
   **Example:**




2. Two Joint venturers → because they **share joint control of a joint venture**.
   **Example:**




3. **Stakeholders** like
    i. Provider of Finance
    Eg: Kingfisher Airlines depends on State Bank of India for funds. SBI → Not RP
    ii. Trade unions
    Eg: Maruti – Suzuki workers struggle for trade union rights

    iii. Public Utilities
    Eg: Electricity Supply board, Water board. Pollution control board

    iv. Department and Agencies of a government
    Eg: Company works with government like Road contracts, Liquor business

that does not control, joint control or significant influence the reporting entity, simply by virtue of their normal dealings with an entity

4. Customer, supplier, franchisor, distributor or general agent → with whom an entity transacts a **significant volume of business** → simply by virtue of the resulting **economic dependence**.

## 4 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 of Related party transactions:**

- purchases or sales of goods (finished or unfinished);
- purchases or sales of property and other assets;
- rendering or receiving of services;
- leases;
- transfers of research and development;
- transfers under licence agreements;
- transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- provision of guarantees or collateral;
- commitments to do something if a particular event occurs or does not occur in the future, including executory contracts1 (recognised and unrecognised);
- settlement of liabilities on behalf of the entity or by the entity on behalf of that related party; and

- management contracts including for deputation of employees.

## 5 Disclosure

### 5.1 The following are Categories of disclosure as per Ind AS 24:

- **Category 1:** Disclosure of Related parties with their Relationship
- **Category 2:** Disclosure of Related party transactions

Note: Additional Disclosure can be done if required by the company or other regulations like companies act, SEBI act etc

### 5.2 Category 1:

**Category 1:** Disclosure of **Relationship** irrespective of the fact whether there have been Related party transactions by the entity.

Example: Parent – Subsidiary relationship

- Relationship between a Parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them.
- An entity is required to disclose the name of its parent and, if different, the ultimate controlling party.
  **Example:** Reliance Retail should disclose both Reliance Industries and Mukesh Ambani with their Relationship

Mukesh Ambani (Ultimate controlling) → Reliance Industries (Parent) → Reliance Retail (Subsidiary)

- If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.
  **Example:**
  - If All Tata Electric Vehicles, Tata Motors, Tata Mobility and Tata Sons provides Consolidated Financial statement, then Tata Electric Vehicles should disclose Tata Motors, and Tata Sons with their Relationship.
  - If Only Tata Mobility provides Consolidated Financial statement, then Tata Electric Vehicles should disclose Tata Motors, Tata Mobility and Tata Sons with their Relationship.

Tata Sons (Parent to Tata Mobility)
↓
Tata Mobility (Parent to Tata Motors)
↓
Tata Motors (Parent to Tata Electric Vehicles)
↓
Tata Electric Vehicles (Subsidiary to Tata Motors)

## 5.3 Category 2:

**Category 2:** Disclosure of Transaction and Relationship only when there have been **Related party transactions**

**Related Party Transactions:**

- Nature of Relationship
- Information about
  - Transactions
  - Outstanding balances
  - Commitments
- Necessary for users to understand the potential effect of the relationship on the financial statements

**Minimum Disclosures:**

- The amount of the transactions
- The amount of outstanding balances, including commitments,
  - Their terms their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
  - details of any guarantees given or received;
- provisions for doubtful debts related to the amount of outstanding balances; and
- the expense recognized during the period in respect of bad or doubtful debts due from related parties.

**Disclosure bifurication:**

a) the parent;
b) entities with joint control or significant influence over the entity;
c) subsidiaries;
d) associates;
e) joint ventures in which the entity is a joint venturer;
f) key management personnel of the entity or its parent; and
g) other related parties.

## 5.4 Compensation to Key Managerial Personnel:

**Key Managerial 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.

An entity is required to disclose

i. Total compensation to Key managerial personnel and
ii. Compensation for each of the following categories:
   a. Short-term employee benefits
   b. Post-employment benefits
   c. Other long-term benefits
   d. Termination benefits
   e. Share-based payments

## 6 Exemption from Disclosure

**Exemption to Government – Related entities**

A reporting entity is exempt from the disclosure requirements in relation to (i) related party transactions (ii) outstanding balances and (iii) commitments with:

- a government → that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party → because the same government has control, joint – control or significant influence over both the reporting entity and the other entity.

In case the reporting entity opts to apply the exemption, it **shall disclose**:

a) the name of the government;

b) the nature of the government's relationship with the entity (whether the government has control, joint control or significant influence over the entity);

**Significant transaction to be disclosed:**

- the nature and amount of each individually significant transaction;
- for other transactions that are not significant individually but are significant when aggregated, either a qualitative or quantitative indication of their extent.

Consider following while applying judgment to determine the level of details required to be disclosed:

i. Size of transaction

ii. Transactions carried out on non-market terms

iii. One-time transactions

**Illustration summary:**

- When transaction done at off-market (Not @ Market rate). Hence Separate disclosure is required for the difference amount between Market rate and transaction amount as Government grant not as profit.
- When transaction done @ market term, but the size of transaction is huge or significant individually or in aggregate → disclosure of Government assistance by Ind As 20, Accounting for government Grants and disclosure of Government assistance is required.

## 7 Ind AS 24 vs AS 18

| Difference | Ind AS 24 | AS 18 |
|---|---|---|
| Domestic partner | Definition of "Close member of the family of a person" includes domestic person | No scope for domestic partner in definition |
| State-controlled enterprises | Government refers to government, government agencies and similar bodies whether local, national or international | Defines state-controlled enterprises as "an enterprise which is under the control of the central government and/ or any state governments" |
| Key managerial personnel | Covers KMP of the parent | Cover Key managerial personnel of the entity only |
| Co-venturers or co-associates | Related parties | Not related parties to each other |
| Entities that are post-employment benefit plans | Related parties | Not covered |

| Difference | Ind AS 24 | AS 18 |
|---|---|---|
| Disclosure of next most senior parent | Additional Disclosure as to the name of the next most senior parent which produces consolidated financial statement for public use | No requirement |
| KMP Compensation | Disclosure requirement for KMP compensation | No Disclosure requirement for KMP compensation |
| Disclosure of 'amount of transaction vs Volume of the transaction' | Amount of the transaction need to be disclose | Gives an option to disclose the "Volume of the transactions either as an amount or as an appropriate proportion" |
| Government related entities | Requires Disclosure of certain information by the government related entities | Presently exempts the disclosure of such information |

## ILLUSTRATIONS

### 1. Illustration

On 15 January, 20X1 Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, sold a 10-hectare piece of land to another government-related utility company for Rs. 5 million. On 31, December 20X0 a plot of land in a similar location, of a similar size and with similar characteristics, was sold for Rs. 3 million. There had not been any appreciation or depreciation of the land in the intervening period. See note X [of the financial statements] for disclosure of government assistance as required by Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance,* and notes Y and Z [of the financial statements] for compliance with other relevant Indian Accounting Standards

### 2. Illustration

In the year ended December 20X1 Government G provided Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, with a loan equivalent to 50 percent of its funding requirement, repayable in quarterly instalments over the next five years. Interest is charged on the loan at a rate of 3 per cent, which is comparable to that charged on Entity A's bank loans.∗ See notes Y and Z [of the financial statements] for compliance with other relevant Indian Accounting Standards

### 3. Illustration

Government G, indirectly, owns 75 per cent of Entity A's outstanding shares. Entity A's significant transactions with Government G and other entities controlled, jointly controlled or significantly influenced by Government G are [a large portion of its sales of goods and purchases of raw materials] or [about 50 per cent of its sales of goods and about 35 per cent of its purchases of raw materials]. The company also benefits from guarantees by Government G of the company's bank borrowing. See note X [of the financial statements] for disclosure of government assistance as required by Ind AS

20, Accounting for Government Grants and Disclosure of Government Assistance, and notes Y and Z [of the financial statements] for compliance with other relevant Indian Accounting Standards.

## 4. Illustration

ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 20X1. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 20X1 to 31st May 20X1 totalled Rs. 8,00,000. Following the share purchase by Mrs. P,XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 20X1 to 31st March 20X2 totalled Rs. 60,00,000. On 31st March 20X2, the trade receivables of XYZ Ltd. included Rs. 18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show (where possible by quantifying amounts) how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31st March 20X2 as per Ind AS. You are required to mention the disclosure requirements as well.

## 5. Illustration

Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the Management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of Rs. 2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged Rs. 1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

## 6. Illustration

Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 20X2 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period 20X1-20X2. Mr. Y owns 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

Provide answers to the query raised by the Managing Director Mr. Y as per Ind AS.

## 7. Illustration

S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd. Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?

## 1. Introduction

### 1.1 Objective

- To prescribe principles for the determination and presentation of earning per share.
- To facilitate performance comparisions between different entities in the same reporting period and between different reporting periods for the same entity.

Earnings per share data, may have limitations because of different accounting policies that companies might have used for determining 'earnings'.

### 1.2 Scope

- This standard requires that if an entity computes earnings per share then it must calculate and disclose the same as per this standard.
- EPS related information to be disclosed both in consolidated financial statements and separate financial statements.

| Type of Financial statements | EPS disclosure | EPS computation should be based on |
|---|---|---|
| Consolidated | Yes | Information given in consolidated financial statements only (Consolidated EPS) |
| Separate | Yes | Information given in separate financial statements only (Separate EPS) |

## 2. Definitions

### 2.1 Ordinary share (Referred to as equity shares in India)

An ordinary share is an equity instrument that is subordinate to all other classes of equity instruments.

- An entity may have more than one class of ordinary shares.
- Ordinary shares of the same class have the same rights to receive dividends.

### 2.2 Potential ordinary share

A potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares.

**Examples of potential ordinary shares are:**

a. Financial liabilities or equity instruments, including preference shares, that are convertible into ordinary shares;
b. Options and warrants;
c. Shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.

### 2.3 Options, warrants and their equivalents

Options, warrants and their equivalents are financial instruments that give the holder the right to purchase ordinary shares.

### 2.4 Put options

Put options on ordinary shares are contracts that give the holder the right to sell ordinary shares at a specified price for a given period.

### 2.5 Dilution

Dilution is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

### 2.6 Antidilution

Antidilution is an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

### 2.7 Contingent share agreement

A contingent share agreement is an agreement to issue shares that is dependent on the satisfaction of specified conditions.

### 2.8 Contingently issuable ordinary shares

Contingently issuable ordinary shares are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of specified conditions in a contingent share agreement.

## 3. Measurement of Basic Earnings Per Share

### 3.1 Meaning

Entity shall calculate basic earning per share for

- profit or loss attributable to ordinary equity holders of parent entity.
- profit or loss from continuing operations attributable to those equity share holders.

### 3.2 Formula

Computation of Basic earnings per share =

$$\frac{\text{Profit/Loss attributable to Equity share holders}}{\text{Weighted average number of Equity shares outstanding during the period}}$$

### 3.3 Calculation of Profit attributable to Equity Share Holders

| | |
|---|---|
| **Earnings Before Interest & Taxes** | **xxx** |
| Less: Finance cost (including dividend on Preference shares classified as Liability) [You will understand this after Ind AS 109] | xxx |
| **Earnings before Taxes** | **xxx** |
| Less: Taxes | xxx |
| **Profit after tax** | **xxx** |
| Less: Dividend on Cumulative Preference shares whether or not declared | xxx |
| Less: Dividend on Non-cumulative Preference shares only if declared | xxx |
| Less: Deemed dividend on increasing rate preference shares | xxx |
| Less: Redemption/Repurchase of Preference shares at premium | xxx |
| Less: Early conversion of Preference shares at premium | xxx |
| **Profit attributable to Equity share holders** | **xxx** |

### 3.3.1 Treatment of certain items in computation of profit attributable to equity share holders

#### 1. Increasing rate Preference shares

| Meaning | Treatment |
|---|---|
| Preference shares that provide for:<br>- Low initial dividend to compensate an entity for selling the preference shares at a discount, or<br>- An above-market dividend in later periods to compensate investors for purchasing Preference shares at a premium. | An original issue discount or premium on increasing rate preference shares is:<br>- Amortised to retained earnings using the effective interest method, and<br>- Treated as a preference dividend for the purposes of calculating earnings per share. |

#### 2. Redemption of Preference shares at premium

| Amount | Treatment |
|---|---|
| The excess of the fair value of the consideration paid to the preference shareholders over the carrying amount of the preference shares represents:<br>- A return to the holders of the preference shares, and<br>- A charge to retained earnings for the entity. | This amount is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity. |

#### 3. Early conversion Of Preference shares at premium

| Amount | Treatment |
|---|---|
| The excess of the fair value of the ordinary shares or other consideration paid over the fair value of the ordinary shares issuable under the original conversion terms is a return to the preference shareholders. | This amount is deducted in calculating profit or loss attributable to ordinary equity holders of the parent entity. |

#### 4. Excess payment to Preference share holders

Excess of the carrying amount of preference shares over the fair value of the consideration paid to settle them is added in calculating profit or loss attributable to ordinary equity holders of the parent entity.

#### 5. After tax amounts of Preference dividends

| Includes | Excludes |
|---|---|
| - After-tax preference dividend declared in respect of the period, on Non-cumulative preference shares.<br><br>- After-tax preference dividend required for current period on Cumulative preference shares, whether or not dividends have been provided for. | Dividends on Cumulative preference shares paid or declared during the current period, in respect of previous periods. |

### 3.4 Shares

### 3.4.1 Calculation of Weighted Average Number of Shares

| | |
|---|---|
| Ordinary shares outstanding at the beginning of the period | xxx |
| Add: Ordinary shares issued during year (weighted) | xxx |
| Add: Bonus issue (no time weightage factor) | xxx |
| Add: Right issue (time weighted) | xxx |
| Less: Ordinary shares bought back during the year (weighted) | xxx |
| **Weighted average number of shares** | **xxx** |

**Bonus shares are assumed to have been issued at the beginning of earliest period reported or date of issue of original shares during the year.**

### 3.4.2 Deciding the date for issue of shares

Shares are usually included in the weighted average number of shares from the date consideration is receivable (which is generally the date of their issue),

| When ordinary shares are issued | Timing effective from the date |
|---|---|
| In exchange for cash | When cash is receivable |
| On voluntary reinvestment of dividends on ordinary or preference shares | When dividends are reinvested |
| As a result of conversion of a debt instrument to ordinary shares | When Interest ceases to accrue |
| In place of interest or principal on other financial instruments | When Interest ceases to accrue |
| In exchange for the settlement of a liability | On settlement date |
| As consideration for the acquisition of an asset other than cash | When the acquired asset is recognised |
| For rendering of services to the entity | When the services are rendered |
| As a part of the consideration transferred in a business combination | From the date of the acquisition |
| Upon the conversion of a mandatorily convertible instrument | From the date of entering into the contract |

### 3.4.3 Contingently issuable shares

- Treated as outstanding and included in the calculation of basic earnings per share only from the date when all necessary conditions are satisfied.
- Shares that are issuable solely after the passage of time are not contingently issuable shares, because the passage of time is a certainty.

### 3.4.4 Contingently returnable shares

Outstanding ordinary shares that are contingently returnable are not treated as outstanding and are excluded from the calculation of basic earnings per share until the date the shares are no longer subject to recall.

### 3.4.5 Change in the number of shares without change in value of capital

| Example | Treatment |
|---|---|
| - A capitalisation or bonus issue<br>- A share split | - The number of ordinary shares outstanding is increased without an increase in resources.<br>- The number of shares outstanding shall be adjusted as if the event occurred at the beginning of the earliest period presented. |
| - A reverse share split | - The number of ordinary shares outstanding is reduced without a reduction in resources.<br>- The number of shares outstanding shall be adjusted as if the event occurred at the beginning of the earliest period presented. |

### 3.4.6 Right issues

- Entities might raise additional capital by issuing shares to existing shareholders, on a pro rata basis to their existing holdings, in the form of a rights issue.
- The right shares can either be offered at the current market price or at a price that is below the current market price.
- A right issue usually includes a bonus element.

**EPS Computation in case of Right shares:**

**Theoretical ex-rights (TERP) fair value per share=**

$$\frac{\boldsymbol{FV\ of\ all\ outstanding\ shares\ before\ rights + Total\ amount\ received\ from\ rights}}{\boldsymbol{No\ of\ original\ shares + rights\ shares}}$$

**Adjustment factor=**

Fair value before rights issue
Theoretical ex-rights price

*Adjusting factor should be applied to adjust the shares outstanding before the right issue, both for the current and previous year.

Example
Rights issue 1:5 (1 shares for 5 issued)
Rights issue price – Rs. 15
Cum Rights Price – Rs. 20 [FV before rights]

TERP = (20x5)+(1x15)/(5+1)

$$\frac{(20x5) + (1x15)}{5 + 1} = 19.16$$

## 4. Measurement of Diluted Earnings Per Share

### 4.1 Meaning

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.

## 4.2 Formula

Computation of Diluted earnings per share =

$$\frac{\text{Profit/Loss attributable to Equity share holders when dilutive potential shares are converted into ordinary shares}}{\text{Weighted average number of Equity shares+ Weighted average number of dilutive potential ordinary shares}}$$

## 4.3 Calculation

- Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares **at the beginning of the period or the date of issue of the potential ordinary shares, whichever is later.**
- Potential ordinary shares that are canceled or lapsed during the period are included in the calculation of diluted earnings per share for the portion of the period during which they are outstanding.
- Potential ordinary shares that are converted into ordinary shares during the period are included in the calculation of diluted earnings per share from the beginning of the period till the date of conversion.

  From the date of conversion, the resulting ordinary shares are included in both basic and diluted earnings per share.

- The conversion of the potential ordinary shares into ordinary shares should assume the most advantageous conversion rate or exercise price from the standpoint of the holder.
- Only potential ordinary shares that are dilutive are considered in the calculation of diluted earnings per share.

## 4.4 Steps for computing Diluted EPS

| Step1 | Compute Incremental EPS for each potential Ordinary share |
|---|---|

- Incremental EPS=$\frac{\text{Effect of potential share on earnings to equity holders}}{\text{Effect of potential share on weighted average number of shares}}$

| Step2 | Ranking |
|---|---|

- Rank the various types of potential ordinary shares based on step1 above.First rank is given for least earning per incremental ordinary share and so on, in ascending order.

| Step3 | Compute Diluted EPS |
|---|---|

- compute Basic EPS
- Add net profit and additional shares for each type of potential ordinary share, in ascending order.
- calculate Diluted EPS at each stage
- Select least Diluted EPS, which to be reported.If Diluted EPS increases at any point it will be considered Anti-Dilutive.

### 4.5 Shares of subsidiary, joint venture or associate

If the potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share.

### 4.6 Options, warrants and their equivalents

- The difference between the number of ordinary shares issued and the number of ordinary shares that would have been issued at the average market price of ordinary shares during the period shall be treated as an issue of ordinary shares for no consideration and should be included in the calculation of diluted earning per share.
- when the average market price of ordinary shares during the period exceeds the exercise price, Options and warrants have a dilutive effect, and Previously reported earnings per share are not retroactively adjusted to reflect changes in prices of ordinary shares.

### 4.7 Employee Stock Options

- Employee share options with fixed or determinable terms and non-vested ordinary shares are treated as options in the calculation of diluted earnings per share, even though they may be contingent on vesting. They are treated as outstanding on the grant date.
- Performance-based employee share options are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.
- Dilutive effect on ESOP:
  In case of vested ESOPs, potential equity shares will be calculated as:
  Total ESOP - (exercise price x Number of options/average fair value)

### 4.8 Contingently issuable shares

Contingency involves some amount of uncertainty, it depends on happening or not happening of a particular event. If all the conditions which were uncertain become certain, one can include contingently issued shares in the calculation of Basic and diluted EPS.

| If conditions are not satisfied by the end of reporting period | If conditions are satisfied but shares not issued | If conditions are satisfied but compliance date is in future | If conditions are satisfied and shares issued |
|---|---|---|---|
| no treatment | consider in Basic and Diluted EPS | Consider in Diluted EPS | consider in BasicEPS |

### 4.9 Entity with discontinued operations

An entity that reports a discontinued operation should use income from continuing operations, adjusted for preferred dividends and similar adjustments, if any, as the "control number" in determining whether potential common shares are dilutive. That is, the same number of potential common shares used in computing the diluted per-share amount of income from continuing operations should be used in computing all other reported diluted per-share amounts even if the effect will be anti-dilutive compared to their respective basic per-share amounts.

### 4.10 Convertible instruments

| Convertible preference shares | Convertible debt |
|---|---|
| - The dilutive effect of convertible preference shares shall be reflected in diluted EPS.<br>- Convertible preference shares are anti-dilutive when the amount of the dividend on such shares obtainable on conversion exceeds basic earnings per share (Incremental EPS>Basic EPS) | - The dilutive effect of convertible debt shall be reflected in diluted EPS.<br>- Convertible debt is anti-dilutive whenever its interest (net of tax) per ordinary share obtainable on conversion exceeds basic earnings per share. |

### 4.11 Contracts that may be settled in ordinary shares or cash

- When an entity has issued a contract that may be settled in ordinary shares or cash at the entity's option, the entity shall presume that the contract will be settled in ordinary shares, and the resulting potential ordinary shares shall be included in diluted earnings per share if the effect is dilutive.
- If contracts may be settled in ordinary shares or cash at the holder's option, the more dilutive cash settlement and share settlement shall be used in calculating diluted earnings per share.

### 4.12 Purchased options

Contracts such as purchased put options and purchased call options are not included in the calculation of diluted earnings per share because including them would be antidilutive.

### 4.13 Written put options

- Contracts that require the entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive.
- If the exercise price is above the average market price, then-
  - It shall be assumed that at the beginning of the period sufficient ordinary shares will be issued and the proceeds from the issue are used to satisfy the contract.
  - Incremental ordinary shares shall be included in the calculation of diluted earnings per share.

## 5. Retrospective Adjustments

- If the number of ordinary or potential ordinary shares outstanding increases due to capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the basic and diluted earnings per share for all periods presented shall be adjusted retrospectively.
- If the changes occur after the reporting period but before the financial statements are approved for the issue, the per-share calculation for those and any prior period shall be based on the new number of shares.
- Basic and diluted earnings per share of all periods presented shall be adjusted for the effects of errors and adjustments resulting from changes in accounting policies accounted for retrospectively.

## 6. Participating equity instruments and two-class ordinary shares

1. The equity of some entities includes:
    - Instruments that participate in dividend with ordinary shares according to a predetermined with, at times, an upper limit on the extent of participation.
    - a class of ordinary shares with a different dividend rate from that of another class of ordinary shares but without prior or senior rights.

2. Profit or loss for the period is allocated to the different classes of shares and participating equity instruments in accordance with their dividend rights or other rights:
    - profit or loss attributable to ordinary equity holders of the parent entity is adjusted by the amount of dividend for each class of shares.
    - the remaining profit or loss is allocated to ordinary shares and participating equity instruments to the extent that each instrument shares in earnings as if all of the profit or loss for the period had been distributed.
    - The total amount of profit or loss allocated to each class of equity instrument is divided by the number of outstanding instruments to which the earnings are allocated to determine the earnings per share for the instrument.

## 7. Presentation

- An entity shall present in the statement of profit and loss basic and diluted earnings per share.
- An entity shall present basic and diluted earnings per share with equal prominence for all periods.
- An entity shall present basic and diluted earnings per share even if it is negative.
- If the company does not have any potential ordinary shares, the company need not mention basic earnings per share and diluted earnings per share separately on two different lines. It can just mention on one line.
- One should not misunderstand that earnings per share have to be presented only when the company has profits.

## 8. Disclosure

- The amounts used as the numerators in calculating basic and diluted earnings per share and a reconciliation to the profit or loss.
- The weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share and a reconciliation of the denominators to each other.
- Instruments (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, but not included in the calculation of diluted earnings per share.
- Description of ordinary share transactions or potential ordinary share transactions.

**Ind AS 33**
**Earnings per Share**

## 1. Illustration

ABC Ltd. issues 9% preference shares of fair value of Rs. 10 each on 1.4.20X1. Total value of the issue is Rs. 10,00,000. The shares are issued for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at Rs. 11 each. At the end of the year 3, i.e.

on 31.3.20X4, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at Rs. 12 each instead of original agreement of Rs. 11. Comment on the impact of early conversion of preference shares at a premium on earnings for the year 20X3- 20X4 attributable to ordinary equity holders of ABC Ltd. for basic EPS. Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.

## 2. Illustration

An entity has following preference shares in issue at the end of 20X4:

- 5% redeemable, non-cumulative preference shares: These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – Rs. 100,000.
- Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%: The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, Rs. 18,000. These shares are classified as equity – Rs. 200,000.
- 8% non-redeemable, non-cumulative preference shares: At the beginning of the year, the entity had Rs. 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased Rs. 50,000 of these at a discount of Rs. 1,000 – Rs. 50,000.
- 7% cumulative, convertible preference shares (converted in the year): These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of Rs. 300 – Nil.

The profit after tax for the year 20X4 is Rs. 150,000.
Determine the adjustments for the purpose of calculating EPS.

## 3. Illustration

On 31 March, 20X2, the issued share capital of a company consisted of Rs. 100,000,000 in ordinary shares of Rs. 25 each and Rs. 500,000 in 10% cumulative non-redeemable preference shares (classified as equity) of Re 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalisation of reserves in the proportion 1:4 for the year ended 31 March, 20X3.
Profit for 20X1-20X2 and 20X2-20X3 is Rs. 450,000 and Rs. 550,000 respectively.
Calculate the basic EPS for 20X1-20X2 and 20X2-20X3..

## 4. Illustration

| | |
|---|---|
| 1st January | 1,000,000 shares in issue |
| 28th February | Issued 200,000 shares at fair value |
| 31st August | Bonus issue 1 shares for 3 shares held |
| 30th November | Issued 250,000 shares at fair value. |

Calculate the number of shares which would be used in basic EPS calculation if the reporting date is 31st December.

## 5. Illustration

At 31 December 20X1, the issued share capital of a company consisted of 1.8 million ordinary shares of Rs. 10 each, fully paid. The profits for the year ended 31 December 20X1 and 20X2 amounted to Rs. 630,000 and Rs. 875,000 respectively. On 31 March 20X2, the company made a rights issue on a 1 for 4 basis at Rs. 30. The market price of the shares immediately before the rights issue was Rs. 60.

Calculate EPS..

## 6. Illustration

ABC Ltd
1 January 20X1 Shares in issue 1,000,000

31 March 20X1
(a) Rights issue 1 for 5 at Rs. 90
(b) Fair value of shares Rs. 100 (cum-rights price)

Calculate the number of shares for use in the EPS calculation for the calendar year..

## 7. Illustration

Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.
Entity A's results for 20X2 showed a profit before tax of Rs. 80,000 and a profit after tax of Rs. 64,000 (for simplicity, a tax rate of 20% is assumed in this question).

Calculate Earnings for the purpose of diluted EPS..

## 8. Illustration

ABC Ltd. has 1,000,000 Rs. 1 ordinary shares and 1,000 Rs. 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period.
ABC Ltd.'s share price is Rs. 4.50 per share and earnings for the period are Rs. 500,000. The tax rate applicable to the entity is 21%.
Calculate basic EPS, earnings per incremental share for the convertible bonds and diluted EPS.

## 9. Illustration

At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of Rs. 1 each. On 1 October 20X1, the entity issued Rs. 1,250,000 of 8% convertible loan stock for cash at par. Each Rs. 100 nominal value of the loan stock may be converted, at any time during the years ended 20X6 to 20X9, into the number of ordinary shares set out below:
30 June 20X6: 135 ordinary shares;
30 June 20X7: 130 ordinary shares;
30 June 20X8: 125 ordinary shares; and
30 June 20X9: 120 ordinary shares.
If the loan stocks are not converted by 20X9, they would be redeemed at par.

It is assumed that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of Rs. 2,500 and Rs. 2,650 respectively. It is assumed that there are no tax consequences arising from these losses.
The profit before interest, fair value movements and taxation for the year ended 30 June 20X2 and 20X3 amounted to Rs. 825,000 and Rs. 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.
Calculate Basic and Diluted EPS.

## 10. Illustration

At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of Rs. 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at Rs. 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to Rs. 500,000 and Rs. 600,000 respectively (wholly relating to continuing operations).

Average market price of share:
Year ended 31 December 20X7 = Rs. 120
Year ended 31 December 20X8 = Rs. 160

Calculate basic and diluted EPS.

## 11. Illustration

Ordinary shares outstanding during 20X1 - 1,000,000 (there were no options, warrants or convertible instruments outstanding during the period)

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

- 5,000 additional ordinary shares for each new retail site opened during 20X1
- 1,000 additional ordinary shares for each Rs. 1,000 of consolidated profit more than Rs. 2,000,000 for the year ended 31 December 20X1

Retail sites opened during the year:

- one on 1 May 20X1
- one on 1 September 20X1

Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:

- Rs. 1,100,000 as of 31 March 20X1
- Rs. 2,300,000 as of 30 June 20X1
- Rs. 1,900,000 as of 30 September 20X1 (including Rs. 450,000 loss from a discontinued operation)
- Rs. 2,900,000 as of 31 December 20X1

Calculate basic and diluted EPS.

## 12. Illustration

Assume the following facts for Company XY:

- Income from continuing operations: 30,00,000
- Loss from discontinued operations: (36,00,000)
- Net loss: (6,00,000)
- Weighted average Number of shares outstanding – 10,00,000
- Incremental common shares outstanding relating to stock options – 2,00,000

Calculate Basic and Diluted EPS

Assume, if in above case, Loss from continued operations is Rs. 10,00,000 and income from discontinued operations is Rs. 36,00,000 calculate the diluted EPS..

## 13. Illustration

An entity issues 2,000 convertible bonds at the beginning of Year1. The bonds have a three- year term and are issued at par with a face value of Rs. 1,000 per bond, giving total proceeds Rs. 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.
When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is Rs. 3. Income tax is ignored.

Calculate basic and diluted EPS when Profit attributable to ordinary equity holders of the parent entity Year 1 Rs. 1,000,000

| | |
|---|---|
| Ordinary shares outstanding | 1,200,000 |
| Convertible bonds outstanding | 2,000 |

## 14. Illustration

1 January Shares in issue 1,000,000
5% Convertible bonds Rs. 100,000
(Terms of conversion 120 ordinary shares for Rs. 100)

On 31 March Holders of Rs. 25,000 bonds converted to ordinary shares.

Profit for the year ended 31 December Rs. 200,000
Tax rate 30%.

Calculate basic and diluted EPS.
Ignore the need to split the convertible bonds into liability and equity elements.

## 15. Illustration

An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares
- 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of Rs. 5 per share before any dividends are paid on the ordinary shares.

Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above Rs. 2 at a rate of 50% of any additional dividend payable on an ordinary share.
The entity's profit for the year is Rs. 100,000, and dividends of Rs. 2 per share are declared on the ordinary shares.
Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

## 16. Illustration

Profit attributable to equity holders of the parent entity Rs. 100,000
Ordinary shares outstanding 10,000
Non-convertible preference shares 6,000

Non-cumulative annual dividend on preference shares (before any dividend is paid on ordinary shares) Rs. 5.50 per share

After ordinary shares have been paid a dividend of Rs. 2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares.

## 17. Illustration

| | 20X0 | 20X1 | 20X2 |
|---|---|---|---|
| Profit attributable to ordinary equity holders of theparent entity | Rs. 1,100 | Rs. 1,500 | Rs. 1,800 |

| | |
|---|---|
| Shares outstanding before rights issue | 500 shares |
| Rights issue | One new share for each fiveoutstanding shares |
| Exercise price | Rs. 5.00 |
| Date of rights issue | 1 January 20X1 |
| Last date to exercise rights | 1 March 20X1 |
| Market price of one ordinary share immediately before exercise on 1st March 20X1: | Rs. 11.00 |
| Reporting date | 31 December |

Compute the EPS.

## 18. Illustration

**Parent:**

| | |
|---|---|
| Profit attributable to ordinary equity holders of the parent entity | Rs. 12,000 (excluding any earnings of, or dividends paid by, the subsidiary) |
| Ordinary shares outstanding | 10,000 |

| | |
|---|---|
| Instruments of subsidiary owned by the parent | 800 ordinary shares<br>30 warrants exercisable to purchase ordinary shares of subsidiary<br>300 convertible preference shares |
| **Subsidiary:** | |
| Profit | Rs. 5,400 |
| Ordinary shares outstanding | 1,000 |
| Warrants | 150, exercisable to purchase ordinary shares of the subsidiary |
| Exercise price | Rs. 10 |
| Average market price of one ordinary share | Rs. 20 |
| Convertible preference shares | 400, each convertible into one ordinary share |
| Dividends on preference shares | Rs. 1 per share |

No inter-company eliminations or adjustments were necessary except for dividends.

Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.

## 19. Illustration

CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

| Particulars | Attributable to CAB Limited | Non-controlling interest | Total (Rs. in '000) |
|---|---|---|---|
| Profit for the year | 39,000 | 3,000 | 42,000 |
| Other Comprehensive Income | 5,000 | Nil | 5,000 |
| Total Comprehensive Income | 44,000 | 3,000 | 47,000 |

The long-term finance of the company comprises of the following:

(i) 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value

(ii) 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.

(iii) Rs. 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of Rs. 1 payable in four years is 0.74 and the cumulative present value of Rs. 1 payable at the end of years one to four is 3.31.

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:

- the finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.
- the basic and diluted earnings per share for the year ended 31st March, 20X3.
- Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%.

# Indian Accounting Standard 34
# INTERIM FINANCIAL REPORTING

## 1 Introduction

**Ind AS 34**

- Is largely Disclosure based standard
- Deals with how and what should be presented in Interim Financial statement

**The objective of Ind AS 34:**

- The minimum content of an interim financial report
- The principles for recognition and measurement in complete or condensed financial statements for an interim period.

## 2 Definition

### 2.1 Interim Financial Report

**Interim Financial Report** is a Financial report containing

- Complete set of Financial statement as per Ind AS 1 or
- Condensed set of Financial statement as described in Ind AS 34 for an Interim Period

### 2.2 Interim Period

**Interim Period** is a financial reporting period shorter than full financial year

$$Interim\ period\ \neq complete\ period\ (12\ months)$$
$$Interim\ period\ < Yearly\ Reporting\ Period$$

As per Clause 41 of Listing agreement → Listed company required to submit quarterly unaudited Financial statement.

**Example:** Listed company - Interim Financial Report

| 1st Quarter (Q1) | 2nd Quarter (Q2) | 3rd Quarter (Q3) | 4th Quarter (Q4) | Annual Financial Report |
|---|---|---|---|---|
| Apr, May & June | July, Aug & Sep | Oct, Nov & Dec | Jan, Feb & Mar | Apr to mar |

**Note:**

- Ind AS 34 does not provide the Interim Period, it is determined by the listed agreement or any other statutory requirement.
- If an entity's interim financial report is described as complying with Ind AS, it must comply with all of the requirements of this Standard.

## 3 Complete set of Financial statement vs Condensed set of Financial statement

| **Content of Interim Financial Report can be either in** | |
|---|---|
| **Complete set of Financial statement** | **Condensed set of Financial statement** |
| Balance sheet | Condensed balance sheet |
| Statement of Profit and loss | Condensed Profit and loss |
| Statement of Cash Flows | Condensed Cash flow statement |
| Statement of changes in equity | Condensed Statement of changes in equity |
| Full explanatory notes and other information | Selected noted and explanatory information |

| Content of Interim Financial Report can be either in | |
|---|---|
| **Complete set of Financial statement** | **Condensed set of Financial statement** |
| | |
| As per Ind AS 1 | As per Ind AS 34<br>- Use headings from the latest annual financial statement<br>- Present EPS<br>- Include items whose omission would make the report misleading |

**Note:**

- Ind AS 34 does not discourage or prohibit to provide Interim Financial statement in complete set.
- It intends that Interim FS has minimum disclosure/requirement as per Condensed set - Minimum requirement of Interim Financial statement

## 4 Period of Interim Financial statement

**Period for which Interim Financial statement are required to be presented**

| Interim Financial Statement | | Example: Interim Financial Statement for | |
|---|---|---|---|
| | | **Q2 ended 30-Sep-X2** | **Q3 ended 31-Dec-X2** |
| **Statement of P&L** | For the Interim period | For July to Sep X2 (3Ms) | For Oct to Dec X2 (3Ms) |
| | On a Year to Date basis | For Apr to Sep X2 (6Ms) | For Apr to Dec X2 (9Ms) |
| | Comparative Information for both period | Comparative for Interim:<br>For July to Sep X1 (3Ms) | Comparative for Interim:<br>For Oct to Dec X1 (3Ms) |
| | | Comparative for YTD:<br>For Apr to Sep X1 (6Ms) | Comparative for YTD:<br>For Apr to Dec X1 (9Ms) |
| **Balance Sheet** | At end of Interim period and comparative end of Previous Financial Year | As on 30-Sep-X2 | As on 31-Dec-X2 |
| | | Comparative:<br>As on 31-Mar-X2 | Comparative:<br>As on 31-Mar-X2 |
| **Cash Flow Statement** | Cumulative YTD basis till end of Interim period & comparatives | For Apr to Sep-X2 (6Ms) | For Apr to Dec-X2 (9Ms) |
| | | Comparative:<br>For Apr to Sep-X1 (6Ms) | Comparative:<br>For Apr to Dec-X1 (9Ms) |
| **Statement of change in Equity** | Cumulative YTD basis till end of Interim period & comparatives | For Apr to Sep-X2 (6Ms) | For Apr to Dec-X2 (9Ms) |
| | | Comparative:<br>For Apr to Sep-X1 (6Ms) | Comparative:<br>For Apr to Dec-X1 (9Ms) |

## 5 Significant Event and transaction occurred in the Interim Period

Significant Event and transaction occurred in the Interim Period

- Explain significant events and transaction
- Events and transaction having impact on Financial performance are only reported

| The following is a list of events and transactions for which disclosures would be required if they are significant: the list is not exhaustive |
|---|
| • The write-down of inventories to net realisable value and the reversal of such write-down; <br> • Recognition of a loss from the impairment of financial assets, property, plant and Equipment, intangible assets, assets arising from contracts with customers, or other assets, and the reversal of such an impairment loss; <br> • The reversal of any provisions for the costs of restructuring; <br> • Acquisitions and disposals of items of property, plant and equipment; <br> • Commitments for the purchase of property, plant and equipment; <br> • Litigation settlements <br> • Corrections of prior period errors; <br> • Changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost; <br> • Any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period; <br> • Related party transactions; <br> • Transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments; <br> • Changes in the classification of financial assets as a result of a change in the purpose or use of those assets; and <br> • Changes in contingent liabilities or contingent assets. |

## 6 Recognition and Measurement

### 6.1 Recognition and measurement

- **Accounting policy:**
- **Valuation of specific head:**
  - Revenue, Cost and expense
  - Tax Expense Recognition
  - Allocation of Fixed Overhead

Note:
In deciding how to recognise, measure, classify, or disclose an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data.

### 6.2 Accounting policy to prepare Interim Financial statement

- Same accounting policy has to apply same as applied in its annual financial statement.
- Policy can be changed provided the policy for interim and annual period is same.
- Change in estimate can be done.
- Measurement principal for Annual period should not be impacted by measurements in Interim reports.

Same Accounting Policy

Year 1
01-04-X0 to 31-03-X1

Interim Report Year 2 - Q1
Apr, May & June X1

### 6.3 Revenue, cost and Expense

- Take each Interim period as annual reporting period and account Revenue, Cost and expense incurred in respective period accordingly
- Revenue (received cyclically, occasionally or seasonally) → cannot be deferred or anticipated in advance.
- Cost and Expenses (Incurred unevenly during the financial year) → cannot be deferred or anticipated in advance.

**Example:**

| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Revenue | 110 | 50 | 45 | 55 |
| Less: Expense | 40 | 40 | 90 | 40 |
| Profit/loss | 70 | 10 | (35) | 15 |

In the above example,

- Revenue for Q1 is high due to seasonal revenue and it cannot be deferred to Q2, Q3 & Q4. It should be accounted in Q1 only.
- Expense for Q3 is high due to advertisement and it cannot be deferred to Q1, Q2 & Q4. It should be accounted in Q1 only.

### 6.4 Tax Expense Recognition

- Income tax expense is recognised in each interim period based on the best estimate of weighted average annual income tax rate expected for the full financial year.
- Amount accrued for income tax expenses in one interim period may have to be adjusted in the subsequent interim period of that financial year, if the estimate of annual income tax rate changes.

**Example 1:**

| Quarters | Profit | Tax @ 20% | PAT |
|---|---|---|---|
| Q1 | 60 | -12 | 48 |
| Q2 | -15 | 3 | -12 |
| Q3 | -15 | 3 | -12 |
| Q4 | -15 | 3 | -12 |
| Expected annual profit | 15 | | |
| Tax rate | 20% | | |
| Income Tax | 3 | | |
| Effective annual tax rate | 3/15 = 20% | | |

**Example 2:**

| | |
|---|---|
| Brought forward loss | 600 |
| Quarterly | 900 |
| Total Expected profit | 3600 (900 X 4) |
| Less: Brought forward loss | -600 |
| Taxable Income | 3000 |
| Tax Rate @ 40% | 1200 |
| Effective tax rate | 33.33 % (1200/3600) |

| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Profit | 900 | 900 | 900 | 900 |
| Tax @ 33.33% | -300 | -300 | -300 | -300 |
| PAT | 600 | 600 | 600 | 600 |

Assumption: There is no Deferred Tax Asset for the losses of previous period.
The Standard follows an <u>Integral approach</u> for Tax purpose → As we calculate Effective annual tax rate, considering overall annual period. Not discrete approach, Where each quarter independently. Hence Brought forward loss deducted from Total expected annual profit.

**<u>Case: Different Tax rate for different category of income</u>**

**Example 1:**

| **QUESTION:** | | |
|---|---|---|
| Estimated Taxable income (Includes capital gain of 8,00,000) | | 33,00,000 |
| Capital gain | | 8,00,000 |
| Other Income | | 25,00,000 |
| | | |
| | **Other Income** | **Capital Gain** |
| Q1 | 7,00,000 | - |
| Q2 | 8,00,000 | - |
| Q3 | 4,00,000 | 8,00,000 |
| Q4 | 6,00,000 | - |
| **Total** | **25,00,000** | **8,00,000** |
| **Tax rates** | | |
| Capital gain | 12% | |
| Others up to 5,00,000 | 30% | |
| Above 5,00,000 | 40% | |

| **ANSWER:** | | |
|---|---|---|
| **Tax payable** | | |
| Upto 5,00,000 | 5,00,000 X 30% | 1,50,000 |
| Balance 20,00,000 | 20,00,000 X 40% | 8,00,000 |
| Total Tax | | 9,50,000 |
| Total of Income (Excluding capital gain) | | 25,00,000 |
| Effective Tax rate | 9,50,000/25,00,000 | 38% |
| **Tax Expense on** | **Other income @ 38%** | **Capital gain @ 12%** |
| Q1 | 2,66,000 | |
| Q2 | 3,04,000 | |
| Q3 | 4,00,000 | 96,000 |
| Q4 | 2,28,000 | |
| Total | 9,50,000 | 96,000 |
| | | |

**Example 2:**

| | **Profit** | **Tax expense** |
|---|---|---|
| Q1 | 1,50,000 | 45,000 |
| Q2 | (50,000) | (15,000) |
| Q3 | (50,000) | (15,000) |
| Q4 | (50,000) | (15,000) |
| Total | 0 | 0 |
| Effective tax rate/ Prevailing tax rate | | 30% |

**Note:**

- We have to calculate tax expense for Interim period by applying Effective tax rate/ Prevailing tax rate/ Estimate tax rate, even though tax expense for the whole annual period is zero.

**Case: Financial period is different from the tax period → Different effective rate will be used for respective tax periods.**

**Example:**

Financial year end: 31st Dec X1

Tax year end: 31st Mar X1

| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| End | 31st Mar X1 | 30th June X1 | 30th Sep X1 | 31st Dec X1 |
| Profit | 10,000 | 10,000 | 10,000 | 10,000 |
| Effective tax rate | 25% | 30% | 30% | 30% |
| Tax expense | 2,500 | 3,000 | 3,000 | 3,000 |

### 6.5 Allocation of Overhead:

- Over Absorption of allocated Fixed Overhead → will be charged/debited to P&L
- Under Absorption of allocated Fixed overhead → will be credit to P&L

### 6.6 Restatement of previously reported interim periods

A change in accounting policy, other than one for which the transition is specified by a new Ind AS, shall be reflected by:

- Restating
  - The financial statements of prior interim periods of the current financial year and
  - the comparable interim periods of any prior financial years

  that will be restated in the annual financial statements in accordance with Ind AS 8; or
- If it is impracticable → Apply the new accounting policy prospectively from the earliest date practicable.

## 7 Disclosure

### 7.1 Disclosure of compliance with Ind AS

- If an entity's interim financial report is in compliance with this Standard, that fact shall be disclosed.
- An interim financial report shall not be described as complying with Ind ASs unless it complies with all of the requirements of Ind ASs.

### 7.2 Disclosure in Annual Financial Statements

- If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year
- but a separate financial report is not published for that final interim period
- the nature and amount of that change in estimate shall be disclosed
- in a note to the annual financial statements for that financial year.

### 7.3 Other Disclosures

The following should be disclosed either in

- Interim FS or

- Incorporated by cross-reference from the interim FS to other statement → that is available to users of FS
  On the same terms as the Interim FS and at the same time.

If Users of FS doesn't access to that cross-reference → then the Interim FS is incomplete

a. A statement that the same accounting policies and methods of computation are followed in the interim financial statements. If those recently used policies or methods have been changed, a description of the nature and effect of the change should also be given.
b. Explanatory comments about the seasonality or cyclicality of interim operations.
c. 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.
d. The nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial year
e. Issues, repurchases and repayments of debt and equity securities.
f. Dividends paid (aggregate or per share) separately for ordinary shares and other shares.
g. The following segment information (disclosure of segment information is required in an entity's interim financial report only if Ind AS 108, Operating Segments, requires that entity to disclose segment information in its annual financial statements):
    - Revenues from external customers,
    - Inter segment revenues,
    - Measure of segment profit or loss.
    - Measure of total assets and liabilities for a particular reportable segment
    - Description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss.
    - Reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations.
h. Events after the interim period that have not been reflected in the financial statements for the interim period.
i. The effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. Ind AS 34 1Fin by IndigoLearn 6 In the case of business combinations, the entity shall disclose the information required by Ind AS 103, Business Combinations.
j. For financial instruments, the disclosures about fair value of Ind AS 113, Fair Value Measurement, and Ind AS 107, Financial Instruments: Disclosures
k. For entities becoming, or ceasing to be, investment entities, as defined in Ind AS 110, Consolidated Financial Statements, the disclosures in Ind AS 112, Disclosure of Interests in Other Entities
l. The disaggregation of revenue from contracts with customers required by Ind AS 115.

## ILLUSTRATIONS

### 1. Illustration

Company A has reported Rs. 60,000 as pre tax profit in first quarter and expects a loss of Rs. 15,000 each in the subsequent quarters. It has a corporate tax slab of 20 percent on the first Rs. 20,000 of annual earnings and 40 per cent on all additional earnings. Calculate the amount of tax to be shown in each quarter.

## 2. Illustration

ABC Ltd. presents interim financial report quarterly. On 1.4.20X1, ABC Ltd. has carried forward loss of Rs. 600 lakhs for income-tax purpose for which deferred tax asset has not been recognized. ABC Ltd. earns Rs. 900 lakhs in each quarter ending on 30.6.20X1, 30.9.20X1, 31.12.20X1 and 31.3.20X2 excluding the carried forward loss. Income-tax rate is expected to be 40%. Calculate the amount of tax expense to be reported in each quarter.

## 3. Illustration

Innovative Corporation Private Limited (or "ICPL") is dealing in seasonal product and the sales pattern of the product, quarter wise is as under during the financial year 20X1-20X2:

| Qtr. I | Qtr. II | Qtr. III | Qtr. IV |
|---|---|---|---|
| ending 30 June | ending 30 September | ending 31 December | ending 31 March |
| 10% | 10% | 60% | 20% |

For the first quarter ending on 30 June, 20X1, ICPL has provided the following information :

| **Particulars** | **Amounts (in crore)** |
|---|---|
| Sales | 70 |
| Employees benefits expenses | 25 |
| Administrative and other expenses | 12 |
| Finance cost | 4 |

ICPL while preparing interim financial report for first quarter wants to defer Rs. 16 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and that the expenditures are uniform throughout all quarters.

Calculate the result of first quarter as per Ind AS 34 and comment on the company's view.

## 4. Illustration

Fixed production overheads for the financial year is Rs. 10,000. Normal expected production for the year, after considering planned maintenance and normal breakdown, also considering the future demand of the product is 2,000 MT. It is considered that there are no quarterly / seasonal variations. Therefore, the normal expected production for each quarter is 500 MT and the fixed production overheads for the quarter are Rs. 2,500.

| **Actual production achieved** | **Quantity (In MT)** |
|---|---|
| First quarter | 400 |
| Second quarter | 600 |
| Third quarter | 500 |
| Fourth quarter | 400 |
| Total | 1,900 |

Presuming that there are no quarterly / seasonal variation, calculate the allocation of fixed production overheads for all the four quarters as per Ind AS 34 read with Ind AS 2. Will the quarterly results affect the annual results?

## 5. Illustration

ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of Rs. 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

(i) Bad debts of Rs. 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Additional depreciation of Rs. 4,50,000 resulting from the change in the method of depreciation.

(iii) Exceptional loss of Rs. 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.

(iv) Rs. 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quarter will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

Analysis and ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors.

## 6. Illustration

Company A expects to earn Rs. 15,000 pre-tax profit each quarters and has a corporate tax slab of 20 percent on the first Rs. 20,000 of annual earnings and 40 per cent on all additional earnings. Actual earnings match expectations. Calculate the amount of income tax to be shown in each quarter.

## 7. Illustration

Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income:

Estimated Gross Annual Income 33,00,000

(inclusive of Estimated Capital Gains of Rs. 8,00,000)

Estimated Income of Quarter I is Rs. 7,00,000, Quarter II is Rs. 8,00,000, Quarter III (including Estimated Capital Gains of Rs. 8,00,000) is Rs. 12,00,000 and Quarter IV is Rs. 6,00,000.

Tax Rates: On Capital Gains 12%

On Other Income: First Rs. 5,00,000 30%

Balance Income· 40%

## 8. Illustration

An entity reports quarterly, earns Rs. 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs. 50,000 in each of the three remaining quarter The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

## 9. Illustration

An entity reports quarterly, earns Rs. 1,50,000 pre-tax profit in the first quarter but expects to incur losses of Rs. 50,000 in each of the three remaining quarter The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct or not? If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

## 10. Illustration

Due to decline in market price in second quarter, Happy India Ltd. incurred an inventory loss. The Market price is expected to return to previous levels by the end of the year. At the end of year, the decline had not reversed. When should the loss be reported in interim statement of profit and loss of Happy India Ltd.?

An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at Rs. 10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31st March, 2019 and 30% for the year ended 31st March, 2020.

How the related tax charge would be calculated for the year 2019 and its quarters.

## Ind AS 108
## OPERATING SEGMENTS

### 1 Core principle

An entity shall disclose information

- ✓ to users of financial statements to evaluate
  a) The nature and
  b) Financial effects of business activities in which
    - it engages
    - the economic environment in which its operates

### 2 Scope

Ind AS 108 applies to –

- ✓ Companies to which Ind AS is applicable
- ✓ If an entity is not required to apply with Ind AS 108 -
  - ✓ Chooses to disclose information about segments that does not comply with Ind AS 108
  - ✓ Shall not describe information as segment information.
- ✓ If Financial report contains -
  - ✓ both consolidated financial statement as well as parent's separate financial statements
  - ✓ segment information is required only in consolidated financial statements

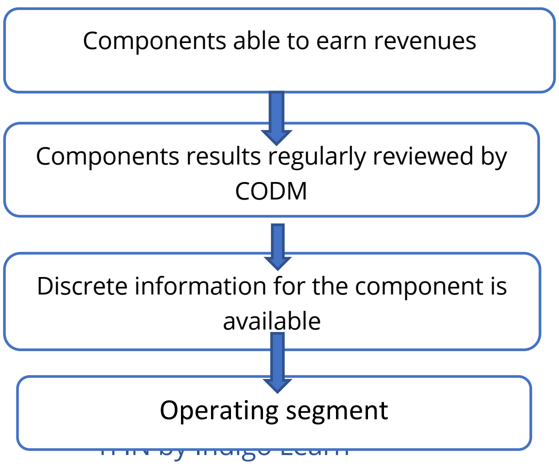
### 3 Operating segments

1. Not every part of an entity is necessarily an operating segment or
2. part of an operating segment.

#### 3.1 Identification of operating segments

An operating segment is **component of entity**

- That engages in business activities
- from which it may earn revenues and incur expenses (including from transactions with other components of the entity)
- may engage in business activities for which it has yet to earn revenues
- Whose operating results are regularly reviewed by the entity's chief operating decision maker (CEO, COO, Group of Directors of operations/production/ geographical area)
- to make decisions about resources to be allocated to the segment and assess its performance
- For which **discrete** financial information is available



## 3.2 Identification of Reporting segments

Identify CODM

Identify operating segment

Determine Reportable segment

Disclose information about each segment

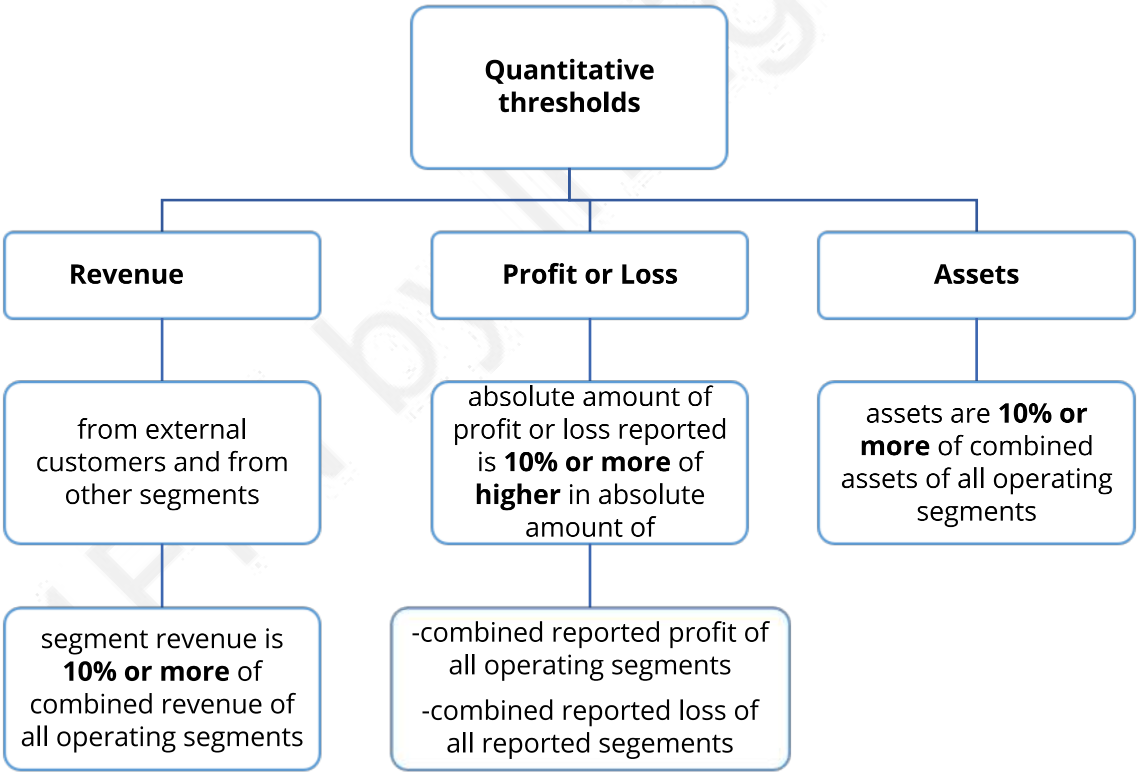
## 3.3 Aggregation Criteria

Two or more operating segments may be aggregated into single operating segment if aggregation is consistent with the **core principle** of Ind AS 108

Segments are similar in each of following respects-

a) Nature of product and services
b) Nature of production process
c) Type or class of customer for their product and services
d) Method use to distribute their products and services
e) If applicable, nature of regulatory requirement

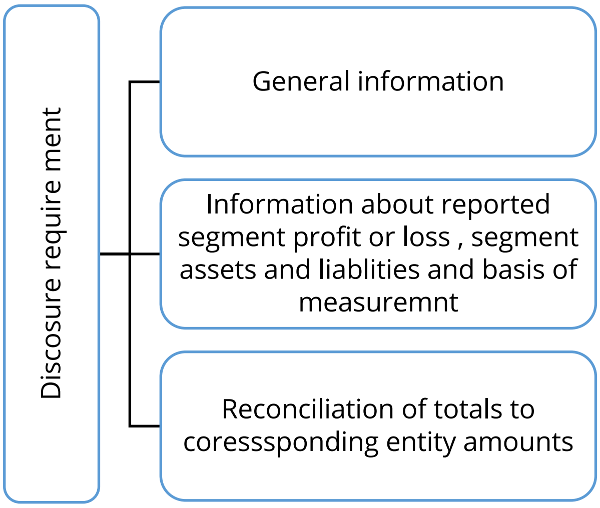
## 3.4 Quantitative threshold




Points to Remember

✓ If above quantitative threshold criteria are satisfied, then such segment has to be reported separately.

Even if a segment does not satisfy the criteria but management believes that information about segment would be useful to users of financial statements, such segment should be reported separately.




## 4.1 General information

- Factors used to identify the entity's reportable segments, including the basis of organisation

a) Product and services
b) Geographical areas
c) Regulatory requirement
d) A combination of factors and whether operating segments have been aggregated

- Judgments made by management in applying aggregation criteria

- Types of products and service from which each reportable segment derives its revenue

## 4.2 Information about profit or loss

- Revenues from external customer
- Revenues from transaction with operating segments of the same entity
- Interest revenue
- Interest expense
- Depreciation and amortisation
- Material items of income an d expenses disclose in accordance with Ins AS 1 presentation and disclosure
- The entity's interest in profit or loss of associate and joint venture accounted by equity method
- Income tax expense or income
- Material non-cash items other than depreciation and amortisation

## 4.3 Information about assets and liabilities

- The amount of investment in associates and joint venture accounted for by the equity method.
- The amounts of addition to on-current assets other than financial instrument, deferred tax assets, net defined benefit assets and rights arising under insurance contracts.

## 4.4 Measurement- Segment information

An entity should provide an explanation of the measurement of segment profit or loss, segment assets and liabilities for each reportable segment.

At a minimum, an entity should disclose following

- ✓ **Basis of accounting** for any transactions between reportable segments
- ✓ Nature of any difference between the measurements of the reportable segments , **profit or losses** and the entity's profit or loss before income tax expense or income and discontinued operation
- ✓ Nature of any difference between measurement of reportable segments **assets and liabilities** and the entity's assets and liabilities
- ✓ Nature of any changes from **prior period** in the measurement methods used to determine reported segment profit or loss and effect, if any of those changes on the measurement of segment profit or loss
- ✓ Nature and effect of any **asymmetrical allocation** to reportable segment

## ILLUSTRATIONS

### 1. Illustration

X Ltd. has identified 4 operating segments for which revenue data is given below:

| | External Revenue | Internal Revenue (₹) | Total (₹) |
|---|---|---|---|
| Segment A | 30,00,000 | Nil | 30,00,000 |
| Segment B | 6,50,000 | Nil | 6,50,000 |
| Segment C | 8,50,000 | 1,00,000 | 9,50,000 |
| Segment D | 5,00,000 | 49,00,000 | 54,00,000 |
| **Total Revenue** | **50,00,000** | **50,00,000** | **1,00,00,000** |

Additional information:
Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108? (SM)

### 2. Illustration

ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages products B & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by the CODM. Identify reportable segments of ABC Ltd. (SM)

### 3. Illustration

The CEO along with other Board members do a review of financial information about various business segments and take decisions on the basis of discrete information available for these segments and are correctly identified as Chief Operating Decision Maker (CODM). Review of only revenue information is done for decision making about those segments by the CODM. As per CODM, many segments require minimal costs due to centralization of costs. Whether review of only the revenue related information is sufficient for these segments to be considered as operating segments for the purposes of Ind AS 108 'Operating Segments'? (SM)

### 4. Illustration

X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per the geographical location of the company. The CODM regularly reviews the operating results of both sets of components. How should X Ltd. identify its operating segments? (SM)

## 5. Illustration

XY Ltd. has operations in France, Italy, Germany, UK and India. It wishes to apply aggregation criteria on geographical basis. How will the aggregation criteria apply for reporting segments in the given scenario? (SM)

## 6. Illustration

T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:

- Segment 1: Local Route
- Segment 2: Inter-city Route
- Segment 3: Contract Hiring

The characteristics of each segment are as under:
**Segment 1:** The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.
**Segment 2:** T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).
**Segment 3:** T Ltd also leases buses to schools under a long-term arrangement.
While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under 'Operating Segment'

**Required:**
Whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'? and
Discuss, in the above context, whether disclosure of segment information is relevant to an investor's appraisal of financial statements? (SM)

## 7. Illustration

X Ltd. is operating in coating industry. Its business segments comprise Coating and Others (consisting of chemicals, polymers and related activities). Certain information for financial year 20X1-20X2 is given below:

(Rs. in lakhs)

| Segments | External Revenue (including GST) | GST | Other operating income | Result | Asset | Liabilities |
|---|---|---|---|---|---|---|
| Coating | 2,00,000 | 5,000 | 40,000 | 10,000 | 50,000 | 30,000 |
| Others | 70,000 | 3,000 | 15,000 | 4,000 | 30,000 | 10,000 |

Additional information:

1. Unallocated income net of expenses is Rs. 30,00,00,000

2. Interest and bank charges is Rs. 20,00,00,000
3. Income tax expenses is Rs. 20,00,00,000 (current tax Rs. 19,50,00,000 and deferred tax Rs. 50,00,000)
4. Unallocated Investments are Rs. 1,00,00,00,000 and other assets are Rs. 1,00,00,00,000.
5. Unallocated liabilities, Reserves & surplus and share capital are Rs. 2,00,00,00,000, Rs. 3,00,00,00,000 & Rs. 1,00,00,00,000 respectively.
6. Depreciation amounts for coating & others are Rs. 10,00,00,000 and Rs. 3,00,00,000 respectively.
7. Capital expenditure for coating and others are Rs. 50,00,00,000 and Rs. 20,00,00,000 respectively.
8. Revenue from outside India is Rs. 6,20,00,00,000 and segment asset outside India Rs. 1,00,00,00,000.

Based on the above information, how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 20X1-20X2? (SM)

## IND AS 101

## FIRST TIME ADOPTION OF INDIAN ACCOUNTING STANDARDS

## 1 Objective

The purpose of this Ind AS 101 is

- To explain the process of transition to Ind AS from different GAAP's (Indian GAAP)
- To remove the difficulties of retrospective applications as specified under each Ind AS
- This standard also provides guidance to prepare the opening balance sheet to get suitable starting point for accounting as per Ind AS.

The objective of this Ind AS 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
- Can be generated at a cost that does not exceed the benefits

## 2 Scope

An entity shall apply this Ind AS in:

- Its first Ind AS financial statements; and
- Each interim financial report, if any, that it presents in accordance with Ind AS 34, Interim Financial Reporting, for part of the period covered by its first Ind AS financial statements.

## 3 Definitions

### 3.1 First time adopter

An entity that presents its first Ind-AS financial statements, that entity is known as first time adopter.

### 3.2 Date of Transition

The beginning of the earliest period for which an entity presents full comparative information under Ind AS in first Ind AS financial statements.

### 3.3 Opening Ind AS Balance Sheet

The entity's balance sheet at the date of transition to Ind AS

## 4 Recognition and Measurement

### 4.1 Opening Ind AS Balance Sheet

An entity shall prepare and present an opening Ind AS balance sheet at the date of transition to Ind AS. This is the starting point for its accounting in accordance with Ind AS.

### 4.2 Accounting policies

Entity uses the same accounting policies in its opening Ind AS Balance Sheet and through all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, subject to:

- Mandatory exceptions and
- Optional exemptions.

An entity shall, in its opening Ind AS balance sheet:

- Recognise all assets and liabilities whose recognition by Ind AS

- Not recognise as assets or liabilities if Ind AS does not permit such recognition
- Reclassify items that it recognised in accordance with previous GAAP as one tupe of assets, liability or component of equity, but are different type of asset, liability or component of equity in accordance with Ind AS
- Apply Ind AS in measuring all recognised assets and liabilities

It means, we have to prepare First Ind AS financial statements as if we were following Ind AS from the date of incorporation. i.e., retrospective application except the exemptions provided and additional guidance given in the standard. There will be few differences due to difference in accounting policies followed in previous GAAP and under Ind AS. Those differences related to a period till the date of transition to Ind AS should be recognised directly in retained earnings (or if appropriate, another category of equity) at the date of transition to Ind AS

## 5 Comparative Information

The first Ind AS financial statements of any entity shall include atleast

- Three Balance Sheets. (i.e., Current Year, Previous Year and Opening balance sheet of Previous year)
- Two statements of profit and loss
- Two statements of cash flows
- Two statements of changes in equity
- Related notes, including comparative information

## 6 Historical summaries and comparative information

Any financial statements containing historical summaries or comparative information in accordance with previous GAAP – Actually these are not required by Ind AS. If the entity is presenting, it shall:

- Label the previous GAAP information prominently as not being prepared in accordance with Ind AS and
- Disclose the nature of the main adjustments that would make it to comply with Ind AS. An entity need not to quantify those adjustments

## 7 Explanation of transition of Ind AS

An entity shall explain how the transition from previous GAAP to Ind AS affected its reported Balance sheet, financial performance and cash flows.
As part of explanation of transition, it should provide the following:

- Sufficient detail to understand adjustment to each line item
- Present reconciliation of Equity
    - ✓ Date of transition to Ind AS and
    - ✓ Latest period presented financials in with previous GAAP
- If an entity presented a statement of cash flows under its previous GAAP, it shall also explain the material adjustments to the statement of cash flows.
- If the entity recognised or reversed any impairment losses for the first time in preparing its opening Ind AS Balance Sheet, the disclosures that Ind AS 34- Impairment of Assets, would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to Ind AS.

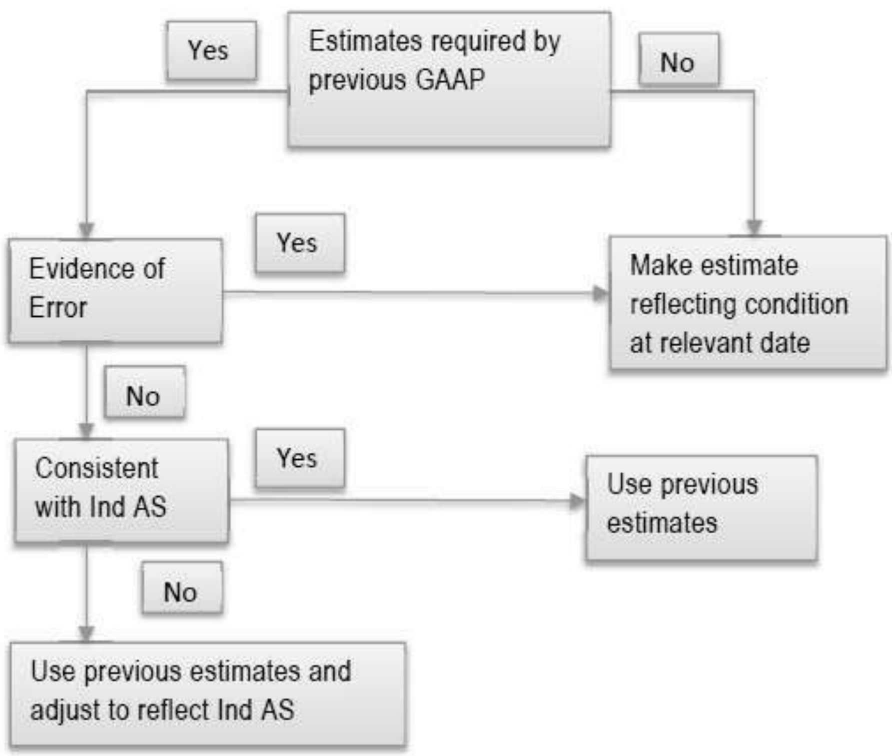
- If an entity changes its accounting policies or its use of the exemptions contained in this Ind AS, it shall explain the changes in each such interim financial report and update the reconciliations required.
- If adopted first time exemption option, disclose the fact and accounting policy until such time those PPE, intangible asset, investment properties or intangible assets significantly depreciated/impaired/derecognised.

## 8 Estimates

An entity 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.
The entity should consider the information as on date of transition. Any information received subsequently should be considered as non-adjusting and it should not be considered for estimation.

**For Example:**
Date of transition is 1st April 2015 and entity received new information on 15th July 2015, which required the revision of an estimate made in accordance with previous GAAP at 31st March, 2015. The entity shall not consider the new information in its opening Ind-AS Balance Sheet, unless the estimate made in error on 31st March 2015 or the estimates need adjustment for any differences in accounting policies.

If under previous GAAP, few estimates are not required but these may be required in Ind AS – Such estimates should reflect the conditions that existed at the date of transition to Ind AS.
**For Example:**
Market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.



## 9 Mandatory Exemptions

First Ind AS financials should be prepared as if Ind AS followed from the date of incorporation. It leads to retrospective restatement but there are some exemptions.

- Mandatory exemptions to retrospective application and
- Optional exemptions i.e., an entity may elect to use one or more of the exemptions given.

An entity shall not apply these exemptions by analogy (similar) to other items.

The following are the **mandatory exceptions** to retrospective application i.e., follow prospectively the accounting treatment mentioned in the respective standards.

### 9.1 De-recognition of financial assets and financial liabilities

A first-time adopter shall apply the de-recognition requirements in Ind AS 109 **prospectively** for transactions occurring on or after the date of transition to Ind AS.

An entity may apply the de-recognition requirements in Ind AS 109 **retrospectively** from a date of the entity's choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions

### 9.2 Hedge accounting

At the date of transition to Ind AS an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

If the hedge relationship:

(a)is of a type that qualifies for hedge accounting and

(b) is designated under Indian GAAP

then:

(i) the hedge relationship is required to be reflected in the opening Ind AS Balance Sheet, irrespective of whether other conditions for applying hedge accounting (i.e. documentation and effectiveness) are met; and

(ii) If those conditions are not met, requirements of Ind AS 109 with respect to discontinuance of hedge accounting are applied subsequently.

### 9.3 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, and the related requirements of Ind AS 105, Non-current Assets Held for Sale and Discontinued operations i.e. classification of all the assets and liabilities of that subsidiary as held for sale.

However, if a first-time adopter elects to apply Ind AS 103 retrospectively to past business combinations, it shall also apply Ind AS 110 from that date.

### 9.4 Classification and measurement of financial assets

Ind AS 109 requires assessment of classification of financial asset as on date of its initial recognition. Ind AS 101 provides an exception to this general principle by requiring that such assessment should be done on the date of transition to Ind AS.

Ind AS 101 further provides that if it is impracticable to assess the below mentioned features of a financial asset as at the date of transition to Ind AS, the "contractual cash flow characteristics test" shall be done without taking into account those features:

(i) Modified time value of money element

(ii) Significance of the fair value of a prepayment feature

An entity shall disclose the carrying amount of such financial assets until those financial assets are derecognized.

### 9.5 Impairment of financial assets

At the date of transition to Ind AS, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised

An entity is not required to undertake an exhaustive search for information when determining, at the date of transition to Ind AS, whether there have been significant increases in credit risk since initial recognition.

If, at the date of transition to Ind ASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognised, unless that financial instrument is low credit risk at a reporting date.

### 9.6 Embedded derivatives

A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of (a) the date it first became a party to the contract and (b) the date a reassessment is required by Ind AS 109 i.e. when there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract.

### 9.7 Government loans

A first-time adopter shall apply 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 AS and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

## 10 Optional Exemptions

The following are the optional exemptions from retrospective application of other Ind AS

### 10.1 Exemptions for business combinations – Ind AS 103

If one business combination is restated to comply with Ind AS 103, all subsequent business combinations are restated.

If an asset acquired or liability assumed was not recognized in previous GAAP but would have been recognised in Ind AS, it shall not have a deemed cost of zero and shall be measured at the amount at which Ind AS would require it to be measured. The resulting change is recognised in retained earnings.

If an asset acquired or liability assumed was recognized in previous GAAP but Ind AS would require its subsequent measurement at other than original cost (for example, investments in certain equity instruments as per Ind AS 109), it shall be measured at such basis and not its original cost. The resulting change is recognised in retained earnings.

### 10.2 Share based payments – Ind AS 102

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.

However, a first-time adopter may apply Ind AS 102 to equity instruments, if it has disclosed publicly the fair value of those equity instruments, determined at the measurement date.

It is encouraged to apply Ind AS 102 to liabilities arising from share-based payment transactions that were settled before the date of transition to Ind AS.

### 10.3 Deemed cost for PPE, intangible assets and right of use assets – Ind AS 16, Ind AS 38, Ind AS 116

Measurement basis as per the respective standards applied retrospectively. This measurement option can be applied on an item-by-item basis.

Fair value at the date of transition to Ind AS. This measurement option can be applied on an item-by-item basis

Previous GAAP revaluation, if such revaluation was, at the date of revaluation, broadly comparable to (a) fair value or (b) cost or depreciated cost in accordance with other Ind AS adjusted to reflect changes in general or specific price index. This measurement option can be applied on an item-by-item basis in similar fashion.

Previous GAAP carrying amounts (provided there is no change in functional currency). This measurement option can be applied only if applied to "all" of the assets classes and items therein. In addition, this measurement option can be applied to investment property (Ind AS 40) as well.

### 10.4 Cumulative translation differences – Ind AS 21

There is no need to

- Recognise some translation differences in other comprehensive income.
- Reclassify cumulative translation differences for foreign operation from entity to profit or loss as part of gain or loss on its disposal

If first time adopter uses this exemption

- Cumulative translation differences set to zero for all foreign operations.

- Gain / loss on subsequent disposal of a foreign operation shall exclude these differences that arose before transition

### 10.5 Other Optional Exemptions

- Investments in subsidiaries, joint ventures & associates – Ind AS 27
- Compound financial instruments – Ind AS 109
- Designation of previously recognised financial instruments – Ind AS 109
- Fair value measurement of financial assets or financial liabilities at initial recognition – Ind AS 109
- Decommissioning liabilities included in the cost of PPE – Ind AS 16
- Extinguishing financial liabilities with equity instruments – Ind AS 109
- Joint arrangements – Ind AS 28
- Non current assets held for sale and discontinued operations – Ind AS 105
- Foreign currency transactions and advance consideration - Ind AS 21
- Stripping cost – Ind AS 16.

## 11 Presentation and Disclosure

### 11.1 Comparative Information

Ind AS does not require historical summaries to comply with the recognition and measurement requirement of Ind AS.
In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:

- Label the previous GAAP information prominently as not being prepared in accordance with Ind AS; and
- Disclose the nature of the main adjustments that would make it comply with Ind AS. An entity need not quantify those adjustments

### 11.2 Explanation of transition to Ind AS

- Reconciliation of
  (a) Equity from previous GAAP to Ind AS at transition and last year end;
  (b) Last year's total comprehensive income under previous GAAP to Ind AS.
- Sufficient detail to understand adjustments to each line item.
- Reconciliation to distinguish correction of errors identified during transition from change in accounting policy.
- Fair value as deemed cost and the amount of the adjustment.
- Ind AS 36 disclosures for impairment during transition.
- If adopted first time exemption option, to disclose the fact and accounting policy until such time those PPE, Intangible Assets, investment properties or intangible assets significantly depreciated/impaired/derecognized.
- Interim financial reports to include reconciliation with equity and profit or loss under previous GAAP.
- Further information to comply with Ind AS 34.
-

## 12 Carve outs in Ind AS 101 from IFRS 1

### 12.1 Definition of previous GAAP under Ind AS 101

**As per IFRS**

- IFRS 1 defines previous GAAP as the basis of accounting that a first - time adopter used immediately before adopting IFRS.

**Carve out**

Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its reporting requirement in India immediately before adopting Ind AS. The change made it mandatory for Indian entities to consider the financial statements prepared in accordance with notified Accounting Standards as was applicable to them as previous GAAP when it transitions to Ind AS.

**Reason**

The change makes it mandatory for Indian companies to consider the financial statements prepared in accordance with Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 as previous GAAP when it transitions to Ind AS as the law prevailing in India recognises only the financial statements prepared in accordance with the Companies Act, 2013.

### 12.2 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 or a previous GAAP revaluation, subject to certain requirements.

**Carve out**

Paragraph D7AA of 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.

### 12.3 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 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 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 Ind AS reporting period.

### 12.4 Intangible assets arising from service concession arrangements related to toll roads accounted for in accordance with Appendix D, Service Concession Arrangements to Ind AS 115, Revenue from Contracts with Customers

**As per IFRS**

No provision in IFRS 1.

**Carve Out**

Ind AS 101 permits a first-time adopter to continue with the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads 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.

As a consequence to the above, paragraph 7AA has been inserted in Ind AS 38 to scope out the entity, to apply amortisation method, that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in Ind AS 101.

**Reason:**

Schedule II to the Companies Act, 2013, allows companies to use revenue based amortisation of intangible assets arising from service concession arrangements related to toll roads while Ind AS 38, Intangible Assets, allows revenue based amortisation only in the circumstances in which the predominant limiting factor that is inherent in an intangible asset is the achievement of revenue threshold. In order to provide relief to such entities, Ind AS 38 and Ind AS 101 have been amended to allow the entities to continue to use the accounting policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial statements. In other words, Ind AS 38 would be applicable to the amortisation of intangible assets arising from service concession arrangements related to toll roads entered into after the implementation of Ind AS.

### 12.5 Land and building element in lease contracts

**As per IFRS**

No provisions under IFRS 1.

**Carve Out**

An entity which is a lessor can use the transition date facts and circumstances for lease arrangements which includes both land and building elements to assess the classification of each element as finance or an operating lease at the transition date to Ind AS. Also, if there is any land lease newly classified as finance lease then the first time adopter may recognise assets and liability at fair value on that date; any difference between those fair values is recognised in retained earnings.

**Reason**

This aspect is quite common in the Indian environment and it was felt that the first time adopters may face hardship if they were to retrospectively assess the two elements of the contract.

## ILLUSTRATIONS

### 1. Illustration

On April 1, 20X1, Sigma Ltd. issued 30,000; 6% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31 March 20X5 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%. The date of transition to Ind AS is 1 April 20X3. Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition. (SM)

[Ans: Derecognise debenture liability in previous GAAP of Rs. 31,50,000; Recognise liability component at Rs. 30,39,669, equity component at Rs. 1,75,480 and debit Rs. 65,149 to Retained Earnings; Note – Answers based on 4 decimal pts present value calculations]

### 2. Illustration

H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

| Particulars | Notes | Amount (Rs. ) |
|---|---|---|
| Property, Plant & Equipment | 1 | 1,34,50,000 |
| Investments in S. Ltd. | 2 | 48,00,000 |
| Trade Receivables | | 2,00,000 |
| Advances for purchase of inventory | | 50,00,000 |
| Inventory | | 8,00,000 |
| Cash | | 49,000 |
| **Total assets** | | **2,42,99,000** |
| VAT deferral loan | 3 | 60,00,000 |
| Creditors | | 30,00,000 |
| Short term borrowing | | 8,00,000 |
| Provisions | | 12,00,000 |
| **Total liabilities** | | **1,10,00,000** |
| Share capital | | 1,30,00,000 |
| Reserves: | | 2,99,000 |
| Cumulative translation difference | 4 | 1,00,000 |
| ESOP reserve | 4 | 20,000 |
| Retained Earnings | | 1,79,000 |
| **Total Equity** | | **1,32,99,000** |
| **Total Equity and Liabilities** | | **2,42,99,000** |

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 20X1:

1. In relation to property, plant and equipment, the following adjustments were identified:
   - Property, plant and equipment comprise land held for capital appreciation purposes costing Rs. 4,50,000 and was classified as investment property as per Ind AS 40.

- Exchange differences of Rs. 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of Rs. 40,000 was recognised.
- There were no asset retirement obligations.
- The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.

2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for Rs. 48,00,000 that carried a fair value of Rs. 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. Financial instruments:
   - **VAT deferral loan Rs. 60,00,000 :**
     The VAT deferral loan of Rs. 60,00,000 was obtained on March 31, 20X1, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 20X1, is Rs. 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan

4. The retained earnings of the Company contained the following:
   - **ESOP reserve of Rs. 20,000:**
     The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised Rs. 12,000 towards the vested options and Rs. 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been Rs. 15,000 and Rs. 9,000 for the vested and unvested shares respectively. The Company intends to avail Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

   - **Cumulative translation difference :**
     The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of Rs. 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero.

Prepare transition date Ind AS balance sheet of Company H showing adjustments to the values of assets and liabilities. (SM)

### 3. Illustration

Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of Shaurya Limited's shares are held by the Government of India and rest by other investors.
This is the first time that Shaurya limited would be applying Ind AS for the preparation of its financials for the current financial year 2019-2020. Following balance sheet is prepared as per earlier GAAP as at the beginning of the preceding period (1st April 2018) along with the additional information.

| Particulars | Amount |
|---|---|
| EQUITY AND LIABILITIES | |
| (1) Shareholders' Funds | |
| (a) Share Capital | 10,00,000 |
| (b) Reserves & Surplus | 25,00,000 |
| (2) Non-Current Liabilities | |
| (a) Long Term Borrowings | 4,50,000 |
| (b) Long Term Provisions | 3,50,000 |
| (c) Deferred tax liabilities | 3,50,000 |
| (3) Current Liabilities | |
| (a) Trade Payables | 22,00,000 |
| (b) Other Current Liabilities | 4,50,000 |
| (c) Short Term Provisions | 12,00,000 |
| TOTAL | 85,00,000 |
| ASSETS | |
| (1) Non-Current Assets | |
| (a) Property, Plant & Equipment (net) | 20,00,000 |
| (b) Intangible assets | 2,00,000 |
| (c) Goodwill | 1,00,000 |
| (d) Non-current Investments | 5,00,000 |
| (e) Long Term Loans and Advances | 1,50,000 |
| (f) Other Non-Current Assets | 2,00,000 |
| (2) Current Assets | |
| (a) Current Investments | 18,00,000 |
| (b) Inventories | 12,50,000 |
| (c) Trade Receivables | 9,00,000 |
| (d) Cash and Bank Balances | 10,00,000 |
| (e) Other Current Assets | 4,00,000 |
| TOTAL | 85,00,000 |

Additional Information (All figures are in '000) :

1. Other current liabilities include Rs. 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and Rs. 60,000 are statutory government dues.
2. Long term loans and advances include Rs. 40,000 loan and the remaining amount consists Advance to staff of Rs. 1,10,000.
3. Other non-current assets of Rs. 2,00,000 consists Capital advances to suppliers.
4. Other current assets include Rs. 3,50,000 current assets receivable in cash and Prepaid expenses of Rs. 50,000.
5. Short term provisions include Dividend payable of Rs. 2,00,000. The dividend payable had been as a result of board meeting wherein the declaration of dividend for financial year 2017-2018 was made. However, it is subject to approval of shareholders in the annual general meeting.

Chief financial officer of Shaurya Limited has also presented the following information against corresponding relevant items in the balance sheet:

a) Property, Plant & Equipment consists a class of assets as office buildings whose carrying amount is Rs. 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be Rs. 15,00,000. Company wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements.
b) The fair value of Intangible assets as on the date of transition is estimated to be Rs. 2,50,000. However, the management is reluctant to incorporate the fair value changes in books of account.
c) Shaurya Ltd. had acquired 80% shares in a company, Excel private limited few years ago thereby acquiring the control upon it at that time. Shaurya Ltd. recognised goodwill as per erstwhile accounting standards by accounting the excess of consideration paid over the net assets acquired at the date of acquisition. Fair value exercise was not done at the time of acquisition.
d) Trade receivables include an amount of Rs. 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates using hindsight, the provision needs to be revised to Rs. 25,000.
e) Company had given a loan of Rs. 1,00,000 to an entity for the term of 10 years six years ago. Transaction costs were incurred separately for this loan. The loan carries an interest rate of 7%. The principal amount is to be repaid in equal instalments over the period of ten years at the year end. Interest is also payable at each year end. The fair value of loan as on the date of transition is Rs. 50,000 as against the carrying amount of loan which at present amounts to Rs. 40,000. However, Ind AS 109 mandates to recognise the interest income as per effective interest method after the adjustment of transaction costs. Management says it is tedious task in the given case to apply the effective interest rate changes with retrospective effect and hence is reluctant to apply the same retrospectively in its first time adoption.
f) In the long-term borrowings, Rs. 4,50,000 of component is due towards the State Government. Interest is payable on the government loan at 4%, however the prevailing rate in the market at present is 8%. The fair market value of loan stands at Rs. 4,20,000 as on the relevant date.
g) Under Previous GAAP, the mutual funds were measured at cost or market value, whichever is lower. Under Ind AS, the Company has designated these investments at fair value through profit or loss. The value of mutual funds as per previous GAAP is Rs. 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is Rs. 2,30,000.
h) Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be Rs. 50,000 on account of Ind AS transition adjustments.
Requirements:

- Prepare transition date balance sheet of Shaurya Limited as per Indian Accounting Standards
- Show necessary explanation for each of the items presented by chief financial officer in the form of notes, which may or may not require the adjustment as on the date of transition. (SM)

## 4. Illustration

Company A intends to restate its past business combinations with effect from 30 June 20X0 (being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for property, plant and equipment (PPE), can be adopted? (SM)

[Ans: Entity may adopt deemed cost exemption for its PPE other than those acquired through business combinations]

## 5. Illustration

X Ltd. was using cost model for its property, plant and equipment till March 31, 20X2 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 20X2. On April 1, 20X1, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS financial statements would amount to a change in accounting policy? (SM)

[Ans: No change in accounting policy]

## 6. Illustration

Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X5. On April 1, 20X0, it obtained a 7 year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21 with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so? (SM)

[Ans: Yes, Y Ltd. may opt for discontinuation]

## 7. Illustration

A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101. However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to property, plant and equipment i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of property, plant and equipment under previous GAAP? (SM)

[Ans: Entity continues to recognize PPE at deemed cost. Past Exchange fluctuation already capitalised can be ignored. Any future exchange fluctuation will be recognised in Statement of Profit & Loss]

## 8. Illustration

Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31st March, 20X3. The transition date is 1st April, 20X1.

The following adjustments were made upon transition to Ind AS:

(a) The Company opted to fair value its land as on the date on transition.
The fair value of the land as on 1st April, 20X1 was Rs. 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was Rs. 4.5 crores.

(b) The Company has recognised a provision for proposed dividend of Rs. 60 lacs and related dividend distribution tax of Rs. 18 lacs during the year ended 31st March, 20X1. It was written back as on opening balance sheet date.

(c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is Rs. 75 lacs.

(d) The Company has an Equity Share Capital of Rs. 80 crores and Redeemable Preference Share Capital of Rs. 25 crores.

(e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was Rs. 95 crores representing Rs. 40 crores of general reserve and Rs. 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.

(f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards) and as per

Ind AS to be presented in the opening balance sheet as on 1st April, 20X1. Ignore deferred tax impact. (SM)

[Ans: Balance of Total Equity after Transition – Rs. 182.03 crores]

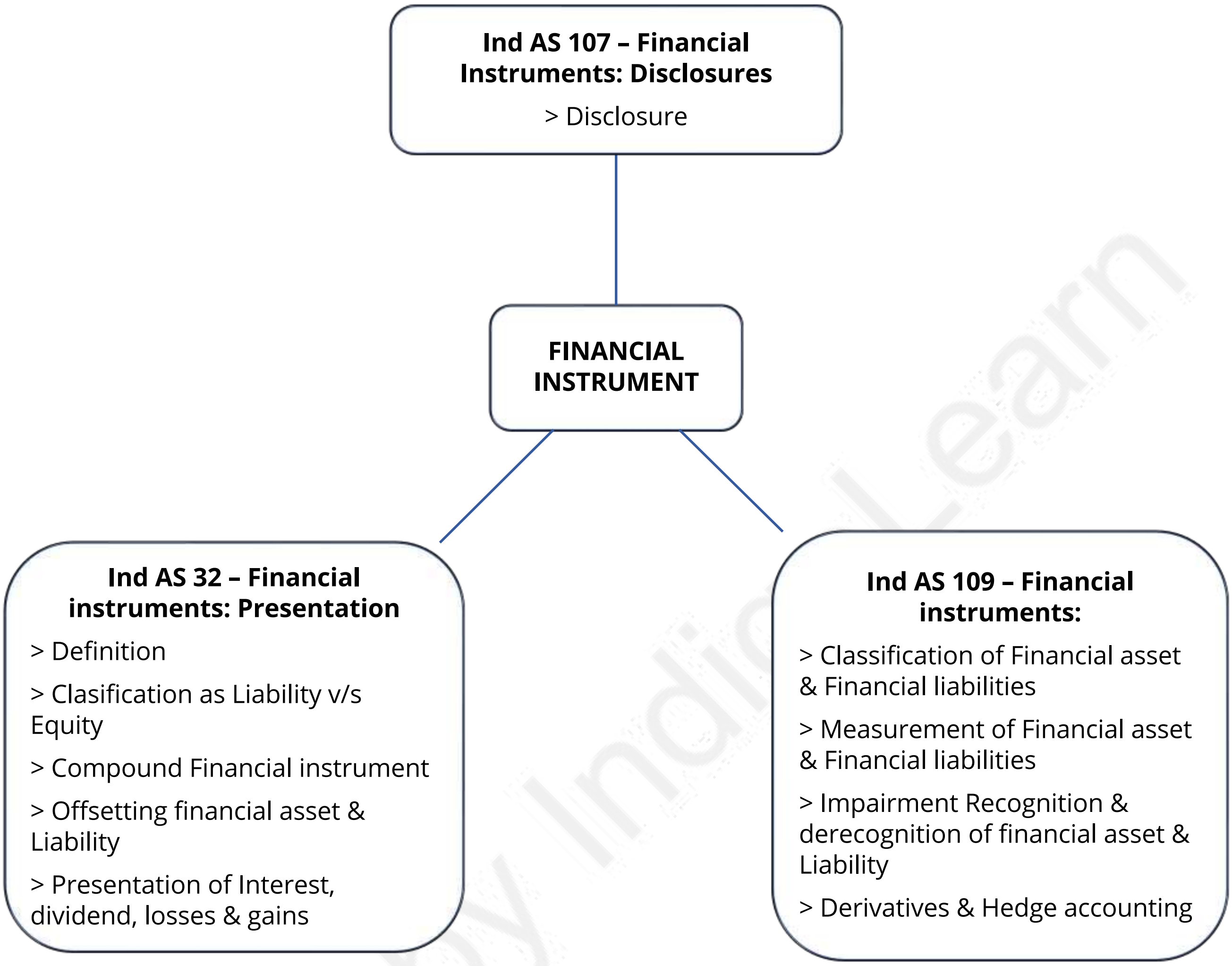
## 9. Illustration

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS. (SM)

[Ans: No. Capital Reserve should be transferred to appropriate category under 'Other Equity]

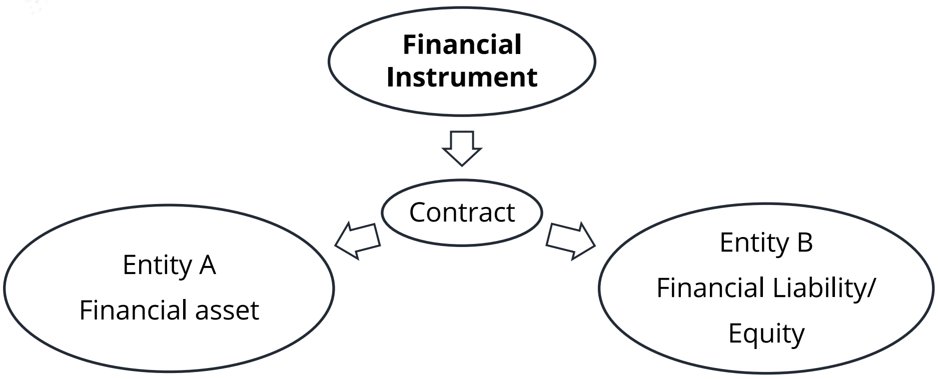
## 1 Introduction




## 2 Important Terms

### 2.1 Financial Instrument

A financial instrument is any **contract** that gives rise to a **financial asset** of one entity and a **financial liability or equity instrument** of another entity




**Note:**

- Contract can be Oral/Written/Implied and may take a variety of forms.

- Not contractual Assets/Liabilities ⟹ Not financial liabilities or financial assets
  Eg: Income taxes (Statutory obligation), Deferred tax asset, Constructive Obligation as defined in Ind as 37.

Financial Instruments →
- Primary instruments (such as Receivables, payables, and equity instruments)
- Derivative financial instruments (such as financial options, futures and forwards, interest rate swaps, and currency swaps)

## 2.2 Financial Asset

| | | |
|---|---|---|
| **Financial Asset:** | Cash | • Currency<br>• Deposit of cash with Bank/ other financial institution. |
| | Equity Instrument | • Invested in Equity shares of another Entity |
| | Contractual Right. | • To **receive cash or another financial asset** from another entity; or<br>• To **exchange financial assets or financial liabilities** with another entity under conditions that are potential **favourable** to the entity; or |
| | Contract that will or may be settled in entity's own equity instrument and is | • a non-derivative - receive a **variable number of entity's own** equity instruments; or<br>• a derivative - settled **other than** by exchange of fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments. |

**Note:**

- Contract settled in Own equity, can either be
  - ➔ Non-derivative (receive variable no of entity's own equity instrument) or
  - ➔ Derivative – which is not a fixed to fixed contract.
  - ➔ If a contract involves exchange of fixed number of equity instruments against fixed consideration – it is classified as equity.
  - ➔ In case of a derivative asset, the entity gains in the contract.

- Examples for Contractual Right in definition are Trade receivable, Loans & notes receivable, Deposits made & Investment in bonds, Financial guarantees on behalf of borrower etc.
- In case of a derivative financial asset, an entity gains from the contract.

**Following are examples to evaluate Financial Asset:**

| S.No | Particulars | Whether FA or not | Remarks |
|---|---|---|---|
| 1 | Investment in bonds/ debentures | FA | Contractual right to receive cash. |
| 2 | Loans and receivables | | |
| 3 | Deposits given | | |
| 4 | Trade & other receivables | | |
| 5 | Bank balance | | |
| 6 | Security Deposit paid | | |
| 7 | Cash and cash equivalents | | Specifically covered in the definition. |
| 8 | Investments in equity shares | | Equity instrument of another entity |
| 9 | Perpetual debt instruments<br>Eg. perpetual bonds, debentures and capital notes. | | contractual right<br>• to receive interest for indefinite future or<br>• to return of principal |
| 10 | Physical assets<br>Eg. inventories, property, plant and equipment etc. | No | Control of such assets does not create a present right to receive cash or another financial asset. |
| 11 | Right to use assets<br>Eg. Lease vehicle etc. | | |
| 12 | Intangibles<br>Eg. Patents, trademark etc. | | |
| 13 | Gold | | |
| 14 | Prepaid expenses<br>Eg. Prepaid insurance, prepaid rent etc. | | Future economic benefit in the form of goods or services, rather than the right to receive cash |
| 15 | Advance given for goods and services | | |

## 2.3 Financial liability

**Financial Liability:**

**Any liability that is**

Contractual Obligation

- To deliver cash or other financial asset to another entity; or
- To exchange financial assets or financial liabilities with another entity under conditions that are potential unfavourable to the entity; or

Contract that will or may be settled in entity's own equity instrument and is

- a non-derivative - obliged to deliver a variable number of entity's own equity instruments; or
- a derivative - settled **other than** by exchange of fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments.

**Note:**

- Contract settled in Own equity, either be
  - ➔ Non-derivative (variable no of entity's own equity instrument) or
  - ➔ Derivative – Not a fixed to fixed contract.
- In case of a derivative liability, the entity loses in the contract.

**Following are examples to evaluate Financial Liability:**

<table>
<tr><th>S.No</th><th>Particulars</th><th>Whether FL or not</th><th>Remarks</th></tr>
<tr><td>1</td><td>Loans payable or bank loan</td><td rowspan="8">FL</td><td rowspan="6">Contractual obligation to pay cash/bank.</td></tr>
<tr><td>2</td><td>Trade and other payables</td></tr>
<tr><td>3</td><td>Bills payable /acceptance</td></tr>
<tr><td>4</td><td>Deposits received</td></tr>
<tr><td>5</td><td>Redeemable preferences shares</td></tr>
<tr><td>6</td><td>Financial guarantee given</td></tr>
<tr><td>7</td><td>Call option (Writer/seller)</td><td rowspan="2">Contractual obligation that are unfavorable to the entity</td></tr>
<tr><td>8</td><td>Future/Forward</td></tr>
</table>

## 2.4 Equity Instrument

**Equity instrument:**

Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities and also both conditions to be met

No Contractual Obligation

- To deliver cash or other financial asset to another entity; or
- To exchange financial assets or financial liabilities with another entity under conditions that are potential unfavourable to the entity; or

Contract that will or may be settled in entity's own equity instrument and is

- a non-derivative - no contractual obligation for the issuer to deliver a variable number of entity's own equity instruments; or
- a derivative - settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of entity's own equity instruments.

| Equity |
|---|
| • Equity instrument issued<br>• Derivative: Warrants to issue fixed number of shares at fixed price against each warrant<br>• Non-derivative: Other instrument convertible into fixed number of equity shares, etc<br>• Derivative - Fixed for fixed settlement. |

**Exception: FL treated as Equity**

1. Puttable Financial Instrument with conditions
   - For Eg: Mutual Funds, Units of trust, Puttable instrument of Venture capital Funds

2.Obligation to deliver pro-rata shares in Net asset at the time of liquidation subject to conditions (When Redemption/liquidation time is known)
   - A business - Construction of Bridge (Liquidate in 2yrs) , Obligation to pay back the capital to the investor

Puttable Instrument is a Financial Instrument that gives the holder:

- the right to put the instrument back to the issuer for cash or another FA, 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.

**Puttable Instrument classified as Equity instrument, If it satisfies following conditions:**

In case of liquidation, Holder is entitled to a pro rata share of the entity's net assets

Subordinate to all other classes of instruments (last priority) on liquidation

All financial instruments in the most subordinate class have identical features

Only contractual obigation for the issuer to repurchase or redeem the instrument for cash or another FA.

No other contractual obligations: to deliver cash or another FA, or
to settle in variable number of entity's own equity instrument

Total expected cash flows are based substantially on the:

a) Profit or loss; b) Change in recognised net assets or c) Change in fair value of recognised and unrecognised net assets of the entity

Issuer must have no other Financial instrument or contract that has:

a) total cash flows on same terms as above, with

b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

**Preference Shares**

- Irredeemable
  - Equity
- Redeemable
  - Mandatory
    - Financial Liability
  - Optional at
    - Entity
      - Equity
    - Holder
      - Financial Liability

**Distribution on Preference shares (Dividend)**

- Compulsory (Contractual obligation exists)
  - Financial Liability
- Optional at entity (No Contractual obligation to pay)
  - Equity Instrument

**Convertible Preference Shares**

- Compulsory
  - Equity
- Optional at
  - Holder
    - Financial Liability
  - Entity / Issuer
    - Equity

## 3 Comparison of Financial Asset, Financial Liability and Equity

| Item | Financial Asset | Financial Liability | Equity |
|---|---|---|---|
| Cash | Cash | - | Residual Int. |
| Equity Instrument of another entity | Yes | - | - |
| **Contractual** | **Right** | **Obligation** | |
| - Cash/FA | Receive | Deliver | Not Equity |
| - Exchange FA/FL | Favorable Terms | Unfavorable Terms | Not Equity |
| **Own Equity Instrument** | | | |
| ND – Variable no of Equity | Receive | Deliver | - |
| ND – Fixed no of Equity | - | - | Delivers |
| **Derivative** | | | |
| - Cash/FA | Variable | Variable | Fixed |
| - Own Equity | Fixed | Fixed | Fixed |

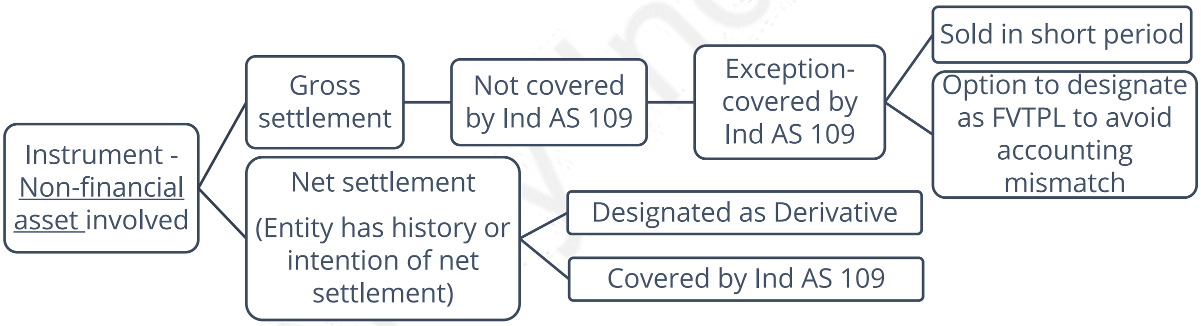
Note:

- Rights, Warrants, Options are issued -> Fixed Equity instrument to Fixed Consideration (can be any Currency) -> treated as Equity.
  Eg: Right Issue for Foreign Investor – Pay $20 per Share for subscription, Here Consideration ($20) is fixed – Currency doesn't matter
- Right issue must be made pro-rata based on existing share holding
- When No of Equity instrument varies (Conversion ratio changes):
  - Corresponding to underlying variable (Eg: based on Market value, Valuation), classified as Financial Liability.
  - in response to passage of time (which is a certain event), classified as Equity.
  - To protect right of convertible instrument holders (eg: bonus shares), classified as Equity
  - If issuer subsequently issues shares to others at a lower price, classified as Financial liability.
  - In a narrow range (eg: convertible at fair value not going below 15% & not going above 40%), classified as Financial Liability.

## 4 Scope of Financial Instrument

| S.No | Particulars | Covered under Ind As 109 | Covered under Ind As 32 | Applicable Ind As |
|---|---|---|---|---|
| 1 | Interest in Subsidiaries (At Cost) | No | No | Ind As 27 |
| 2 | Interest in Associates (At Cost) | No | No | Ind As 28 |
| 3 | Interest in Joint ventures (At Costs) | No | No | Ind As 110 |
| 4 | Rights and obligations under leases | No | No | Ind As 116 |
| 5 | Employers rights and obligations under employee benefit plans | No | No | Ind As 19 |
| 6 | Rights and Obligations under an insurance contract | No | No | Ind As 104 |
| 7 | Forward contract arising in case of business combination | No | No | Ind As 103 |
| 8 | Loan commitment other than covered under Ind as 109 and Ind As 32 | No | No | Ind As 37 |
| 9 | Share-based payments | No | No | Ind As 102 |
| 10 | Reimbursement right in respect of provision | No | No | Ind As 37 |
| 11 | Rights and obligations under revenue for contracts with customers | No | No | Ind as 115 |

**Own Use Exemption:** Derivate - Contracts to buy or sell non-financial items for own use (Not for subsequent sale)




Example: Forward contract entered on 01-01-2022 to buy 1000 tons of oil on 30-06-2022 @$100/ton. On 30-06-2022, Oil price per ton increased to $110.

- On 30-06-2022, If Fully physically settlement (1000 tons of oil),
  - ➔ If it is sale in short time or designated as FVTPL to avoid accounting mismatch - covered under Financial Instrument (Exemption to Gross settlement)
  - ➔ Otherwise - not covered under Financial Instrument. [Gross settlement]
- On 30-06-2022, If (1000 tons* $(110-100) = $1000) net settlement either by cash/ exchanging Financial instrument - then Financial Instrument [Net settlement]

## 5 Classification and Measurement of Financial asset

### 5.1 Initial measurement and subsequent measurement

- Initial recognition at Fair value.
- Subsequent measurement depends on how we classify of Financial instrument.

Classification of Financial asset

- Amortized Cost
- Fair value through Other comprehensive income (FVTOCI)
- Fair value through profit or loss (FVTPL)

## 5.2 Test for classification of Financial Asset

**Business Model:** How Financial Assets are managed

**Factors to determine Business model are:**

- How the performance of business model & Financial assets evaluated & reported to Entity's KMP
- Risk that affects BM & FA and, way in which those risks are managed
- How Managers are compensated (compensation based on profit, Fair Value of asset managed)

**Example for business model:**

Business Model: Lend money and collect interest and loan at the end of tenure

Cases of Loan default (Risk): Entity may try to sell these receivables to ARCs (Risk managed)

Business model Type: Hold the asset till its maturity.


Business Model: Buy loans from Bajaj Finserv like companies and Recovery/sell it subsequently

Business model Type: Sell by taking advantage of Market Volatility.

**Business Model Test**

**Test for Classification of Financial Asset**

**Contractual cash flow Test**

Collect **<u>Contractual Cashflow</u>** (Hold-to-collect)

**<u>Contractual Cashflow Test</u>**

Collect **<u>Contractual cashflow</u>** and Sell Financial Asset

Solely Payment Principal and Interest (SPPI)
(Basic lending arrangement)
Note: Interest = Time value of money (includes Cost, Inflation, adjustment for Liquidity risk, Credit risk, Variable or Fixed)

Cash flow other than Principal and Interest

**Amortized Cost**

- Business Model: Collect Contractual Cashflow
- Collect Contractual Cashflow = Payment of interest and principal only (SPPI)

**Initial Measurement:**

- Fair value (adjusted for transaction cost)

**Subsequent Measurement:**

- Carrying cost adjusted as follows
  Add: Interest using Effective Interest Rate
  Less: Principal Repayment
- Interest, Dividend recorded in P&L
- Gains /losses in Fair value also recorded in P&L

**FVTOCI**

- Business Model: Collect Contractual Cashflow and selling Financial Asset
- Collect Contractual Cashflow = Payment of interest and principal only (SPPI)

**Initial Measurement:**

- Fair value (adjusted for transaction cost)

**Subsequent Measurement:**

- Debt Instrument-
  - Interest/Dividend & FV gain/loss recorded in OCI
- Equity Instrument –
  - Interest/Dividend recorded in P&L
  - FV gain/loss recorded in OCI

**FVTPL**

- Business model: Make short term profits from trading (<u>Held for trading – Frequently buying & selling</u>)
- Collect Contractual Cashflow = Cash flow other than Principal and Interest
- Residual category (Investment in Shares & Derivative Investments)

**Initial Measurement:**

- Fair value
- Transaction cost charged to P&L

**Subsequent Measurement:**

- Interest/Dividend & FV gain/loss recorded in P&L

**Important points**

- Fair value is determined by discounting future contractual cash flows by reference to market rate of interest.
- The following table must be prepared while solving questions

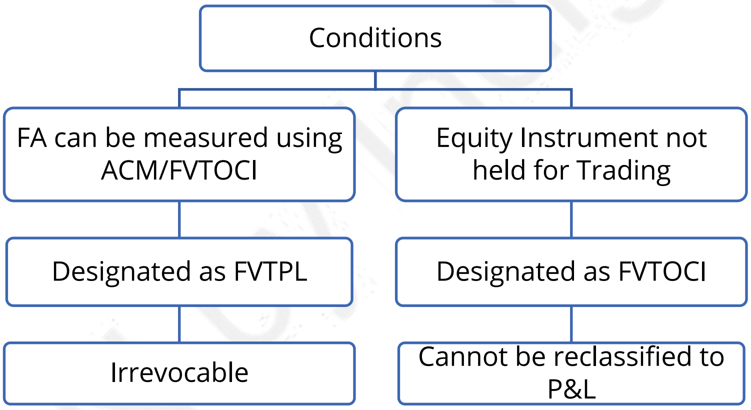
| Year | Op bal | Int @ Mkt rate | Receipt @ coupon rate | Closing balance |
|---|---|---|---|---|
| | | | | |

- Interest income = op bal x effective interes rate (EIR) or the market rate.

**Amortised Cost Method**

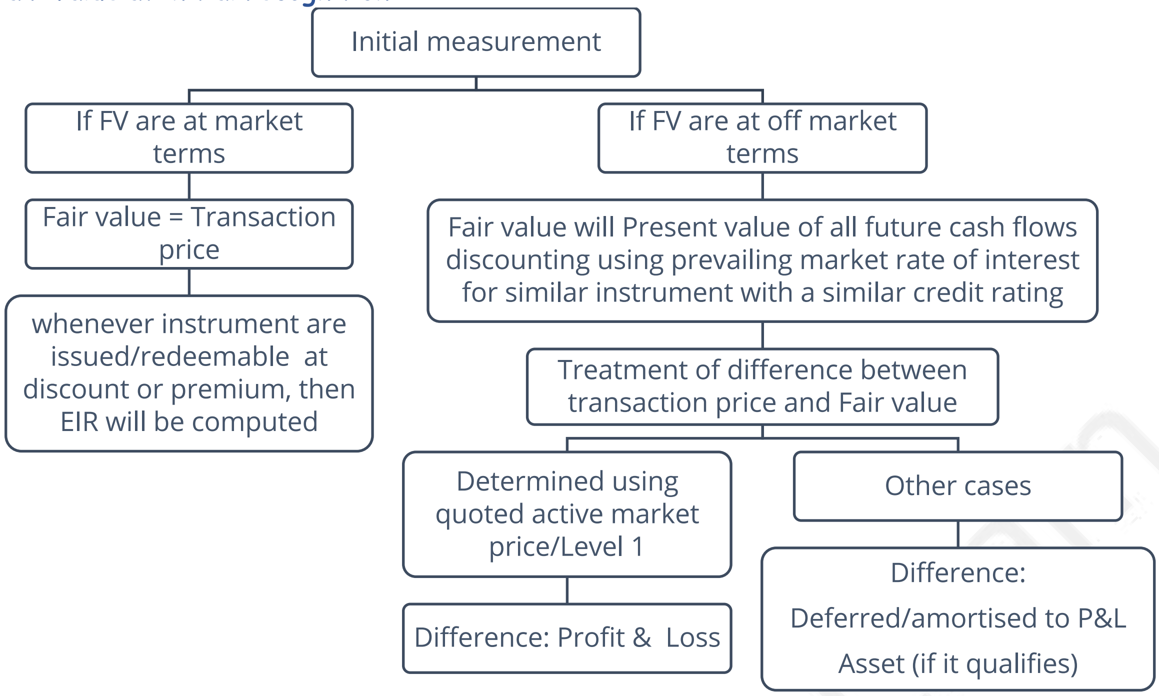
| Accounting entry on | Entry to be passed |
|---|---|
| Date of Acquistion | Dr. Financial Asset (FV + Transaction cost)<br>Cr. Bank |
| Year End | Dr. Financial Asset<br>Cr Interest income |
| Receipt of Interest | Dr. Bank<br>Cr. Financial Asset |
| Redemption | Dr. Bank<br>Cr. Financial Asset |

## 5.3 Exception to Classification of assets:




- If equity instruments are held for trading, they are classified as FVTPL.

## 5.4 Fair Value at initial recognition:




**Note:** Look at substance over form, while difference is accounted.
If the parties of contract
→ Related (Parent & Subsidiary Co., Employer & Employee), then treated as Asset in lender books/Equity in borrower books
→ Not related, then treated under Profit & loss
EIR – Effective interest rates

## 5.5 Loan between group companies

- Interest free and Repayable on demand: Fair value should not be less than the amount payable on demand in books of lender and No interest will be accrued,
- No Fixed maturity: the entities need to estimate repayment date and determine its measurement accordingly.
- PV of cashflows is considered to be the Financial Liability/Financial Asset and the balance amount given is treated as equity/investment.

## 5.6 Equity instrument where FV not determinable

- Consider all the facts and try to establish Fair value
- If FV cannot be determined, Cost may be a representative of Fair value (Invested in Start-up Co.)
- Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments). It cannot be assumed Cost = Fair value.
- Instrument are at market terms: FV will be transaction price.
- Instrument at off-market terms: Exchanged at off market terms.
- FV measured as present value of all future cash flows discounting using prevailing market rate of interest for similar instrument with a similar credit rating.
- Then Fair value ≠ Transaction price.

**Note:**

- Selling assets due to unanticipated funding needs, worst case or stress case scenarios would not affect the entity's assessment of the business mode & classification of Financial asset, there is no retrospective reclassification.
- Principle = Fair value of Financial Asset at initial recognition PV of Cash flow discounted at appropriate rate.
- Accounts Receivables: Recognise as per Ind as 115 -> Initial measurement at Transaction price. IF any interest/loss allowance (Financial component) -> Refer Financial Instrument.
- If Value of Asset turns Negative

Eg: Derivative Contract: Future of Xltd

- Current Position: Financial Asset (Favorable). In Future, share price falls: Financial Liability (Pay the money)

# 6 Classification and Measurement of Financial Liability

## 6.1 Initial and Subsequent measurement

- Initially recognised at Fair value
- Subsequent measurement depends on classification

Classification of Financial Liability

| Measured at Amortised Cost | Other basis where the gain/loss is recognise in Profit and loss |
|---|---|
| Condition: Solely the payment of Principal and interest on it (SPPI) | > Financial Guarantee Contracts<br>> Commitment to give loan at rates below the market. |
| **Measured at Fair Value through Profit and loss** | **Designated as Fair Value through Profit and loss (Irrevocable)** |
| Condition:<br>> Held for Trading.<br>>Contingent consideration recognised by an acquirer in a Business combination. | Condition:<br>> To avoid accounting mismatch<br>> Group of FA & FL is managed & evaluated on fair value basis (For Risk management purpose) |

## 6.2 Measurement of Financial Liability

| Amortised Cost method | FVTPL |
|---|---|
| • **Initial measurement:** Fair Value (adjusted for Transaction cost)<br>• **Subsequent measurement -** Interest (Using EIR)-> Recognised in P&L<br>• Changes in Rate of Interest in market will not have any Impact.<br>• Change in cashflow due to Floating rate of interest -> Revise the EIR | • **Initial measurement:** Fair Value (Transaction cost charged to P&L)<br>• **Subsequent measurement:** Changes in Interest will change Fair Value: >If due to own credit risk -> Recognised in OCI. >If due to other than own credit risk -> Recognised in P&L. |

**Note:**

- Equity Instrument initially recorded at 'Cost' and carried at 'Cost'
- The following table must be prepared while solving questions involving financial liability

| Year | Op bal | Int @ Mkt rate | Payment @ coupon rate | Closing balance |
|---|---|---|---|---|
| | | | | |

- Interest Expense = op bal x effective interes rate (EIR) or the market rate.

**Amortised Cost Method**

| Accounting entry on | Entry to be passed |
|---|---|
| Date of issue | Dr. Bank<br>Cr. Financial Liability (FV – Transaciton cost) |
| Year End | Dr. Interest cost<br>Cr. Financial liablity |
| Payment of interest | Dr. Financial liability<br>Cr. Bank |
| Redemption | Dr. Financial Liability<br>Cr. Bank |

# 7 Compound Financial Instrument

## 7.1 Definition

Those instruments which have features of both a financial liability and equity instrument are called "compound financial instruments"

## 7.2 Split Accounting for CFI

Compound Financial Instrument

- Financial Liability
  - Present value of all unavoidable cash flows using Market rate of interest, measured at Amortised cost method or FVTPL(if applicable).
- Equity component
  - Total Fair value CFI - Fair value of Financial liability

- Allocate the Transaction cost based on the ratio of gross carrying Value, after allocation of fair value.
- No gain/loss at time of initial recognition
- Fair value of FL is measured at Amortised cost method or FVTPL (if applicable).

**Accounting entry**
Dr. Bank
Cr. Financial Liability
Cr. Equity

## 7.3 Early Settlement/ Redemption:

Consideration paid is split between FL and Equity and recorded accordingly.

Early Redemption Price
(Consideration paid & transaction cost, if any)

- Liability Component
  - Present value of Future payments at market rate of Interest on the date of Early redemption
- Equity component
  - Early redemption price - Liability component

Note: Amount of gain or loss relating to the liability component is recognised in Profit and loss.

- Difference between original share and revised issue (as incentive to early conversion) is recognised in P&L account. (that incentive can be made in cash)
- Early Conversion: Transfer the liability part to Equity
- Early Repayment: consideration paid is split between FL and Equity and recorded accordingly.
- Any incentive paid in early conversion is recognised in P&L.
- If it is optionally convertible, principle value and Interest/dividend will be discounted. If it is compulsory convertible, only interest / dividend will be discounted.
- For calculating fair value of Liability component initially, market rate of interest will be considered instead of EIR considering transaction cost.

### 7.4 Settlement of Liability with equity

Loan → Converted to → Equity

Accounting treatment for settlement of Liability with equity

1. Derecognize the Financial Liability and credit equity
2. Valuation = Fair value of consideration given
3. Any difference in consideration is recognised in Profit and loss
4. Carrying amount of Financial liability is considered as fair value of equity, when fair value of equity cannot be determined.

Exception to the above accounting treatment:

- Creditors directly/ indirectly is a shareholder and acting to be shareholder.
- Entity and creditor are controlled by the same party
- It is convertible instrument from the beginning

## 8 Accounting treatment of Interest, Dividend, Gain or loss and Transaction cost

**Interest/ Dividend**

Financial liability

Dividend payment: recognised as interest expense (Using EIR)

If measured at FVTPL, Gain/loss: charged to P&L acc

Financial Asset

Interest income recognised in P&L

Equity

Any income: recorded as equity as dividend

**Transaction Cost**

Adjusted to cost of Financial Asset/Liability, unless it is carried at FVTPL

If recognised as FVTPL, they are charged to P&L a/c

Reduced from Equity (Only expense related to issuing/acquiring equity)
It will be charged to P&L if the issue of equity fails or if it is incurred after the issue

## 9 Treasury shares

- Company buys its own equity shares
- They are Equity instrument, but not Financial Asset.
- Accounting: Adjusted against equity and presented separately in line with Ind As 1
- No profit or loss is recognised on acquiring of treasury shares.

Note: In India under Companies act & SEBI regulations, a company cannot hold its own shares as investment. Hence It has to be extinguish within the stipulated time.

## 10 Offsetting

Entity has legally enforceable right to offset the asset and liability

+

Intends to settle on a net basis

→

Financial asset and Financial Liability can be set off and net amount will be presented in balance sheet

Note:

- Legally enforceable right should be current right, not contingent right
- Net presentation is not derecognition
- Example for legally enforceable right: If due dates for FA & FL is different, then no legally enforceable right.

## 11 Accounting for Financial guarantee Contract

Financial guarantee contracts and commitments to provide a loan at a below market interest rate are subsequently measured at higher of:

- The amount of the loss allowance, and
- The amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principle of Ind as 115

Apart from disclosure of guarantee given as Contingent liability, we have check whether there is any amount received for guarantee given or any liability need to pay should be accounted under Financial liability.

Guarantee Contract

- Without consideration

  (When the parties are related)

- With Consideration

  (Commission charged is consideration paid to avail the guarantee

Initial Recognition:

>Record transaction at fair value.
>calculate benefit under the guarantee, in absence of FV and record it at Present value

Subsequent recognition: Higher of:

> The amount of the loss allowance, and
> The amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principle of Ind as 115

Note:

- For Eg: Interest on Unguaranteed loan = 10% and Interest on Guarantee loan = 9%
  Benefit under guarantee: (10% - 9%) 1%.
  FV of Guarantee: PV of benefit discounted at market rate of interest.
- If Financial contract meet the definition of Insurance contract, Ind AS 104 will be applicable instead of Ind AS 109.

## 12 Derivative Financial Instrument

### 12.1 Derivative

A Financial instrument or other contract with all of the following three characteristics:

- Value changes due to underlying factor (Eg: specified interest rate, FI price, Commodity price, FE rate, index of prices or rates, credit rating or credit index, or other variable)
- No or Little initial net investment
- Future settlement

Contract with following two features are not Derivatives:

- Value of the contract changes with reference to one or more non-financial variable: and
- That non-financial variable (Temperature, earthquake or rainfall index) specific to one of the party to the contract
- All derivatives have to be accounted at FV through P&L. If it qualifies as hedging => Apply Hedge accounting principles.

### 12.2 Forward contract

@ Future Date, @Agreed price

Eg: Forward Contract – 1000 Dollars @ Rs.82 after 6 months

| Dollar ($) rate | For the Seller | For the Buyer |
|---|---|---|
| Increase – Rs.85 | Unfavourable | Favourable |
| Decrease – Rs.75 | Favourable | Unfavourable |

Favourable – Derivative Asset

Unfavourable – Derivative Liability

### 12.3 Future contract:

Contract to buy or sell an underlying asset/ instrument @ future date @ specified price for standard lot through an intermediary

**Forwards Contract** + **Additional Features**
> Entered into through intermediary
> Standard lot size
> Standard tenure/expiry
= **Future Contract**

| Forward Contract | Future Contract |
|---|---|
| Sell any Quantum (eg:732 dollars) | Sell Standard lot (eg:1000/2000 dollars) |
| No standard expiry | Expires on standard time |
| Contract directly between buyer & seller | There will be intermediate between buyer and seller |
| Flexible | Standard in terms of Tenure, expiry, quantity, Value |

### 12.4 Options

- Strike price is predetermined
- Time is predetermined
- For taking Risk, Option premium for writer


### 12.5 Swap

Payment on Exchange of Interest rate (Fixed & Floating rate) on notional principle

- Prepayment of Fixed interest rate, Variable Interest payment in Future → Derivative
- Prepayment of Variable Interest payment, Fixed interest rate in Future → Not derivative

Note: Share Warrant – Classified as Equity under Financial Instrument

### 12.6 Accounting for Derivatives

- All derivatives are measured at FV at initial recognition and at the end of each period.
- The FV gain or loss are recognised in P&L except in case of hedge accounting.

## 13 Embedded Derivatives

### 13.1 Embedded Derivative:

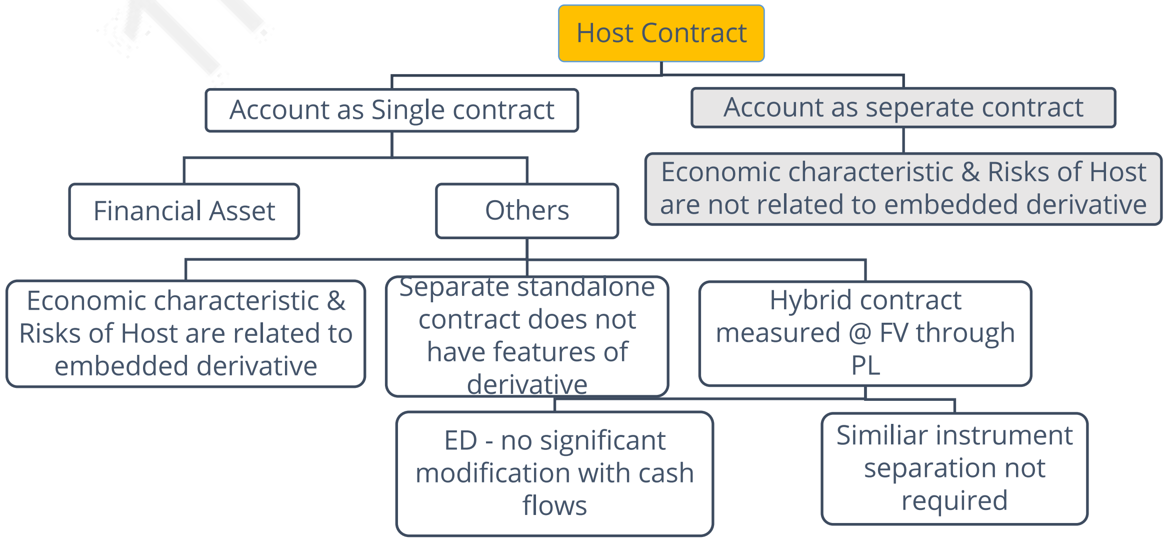
- A component of a hybrid contract
- That also includes a non-derivative host
- With the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

An embedded derivative causes some or all of the cashflows to be modified according to an underlying.

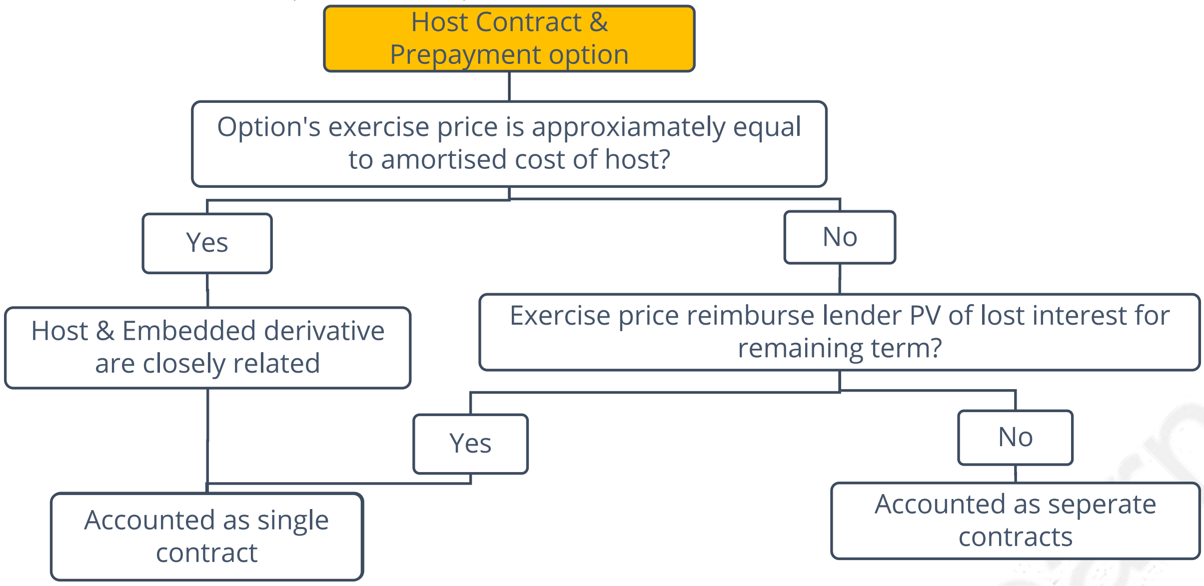

Example – Convertible Bond is a hybrid contract which has a host contract (non – derivative) in form of a bond and the conversion option in form of a derivative contract.

### 13.2 Accounting of Embedded Derivative:

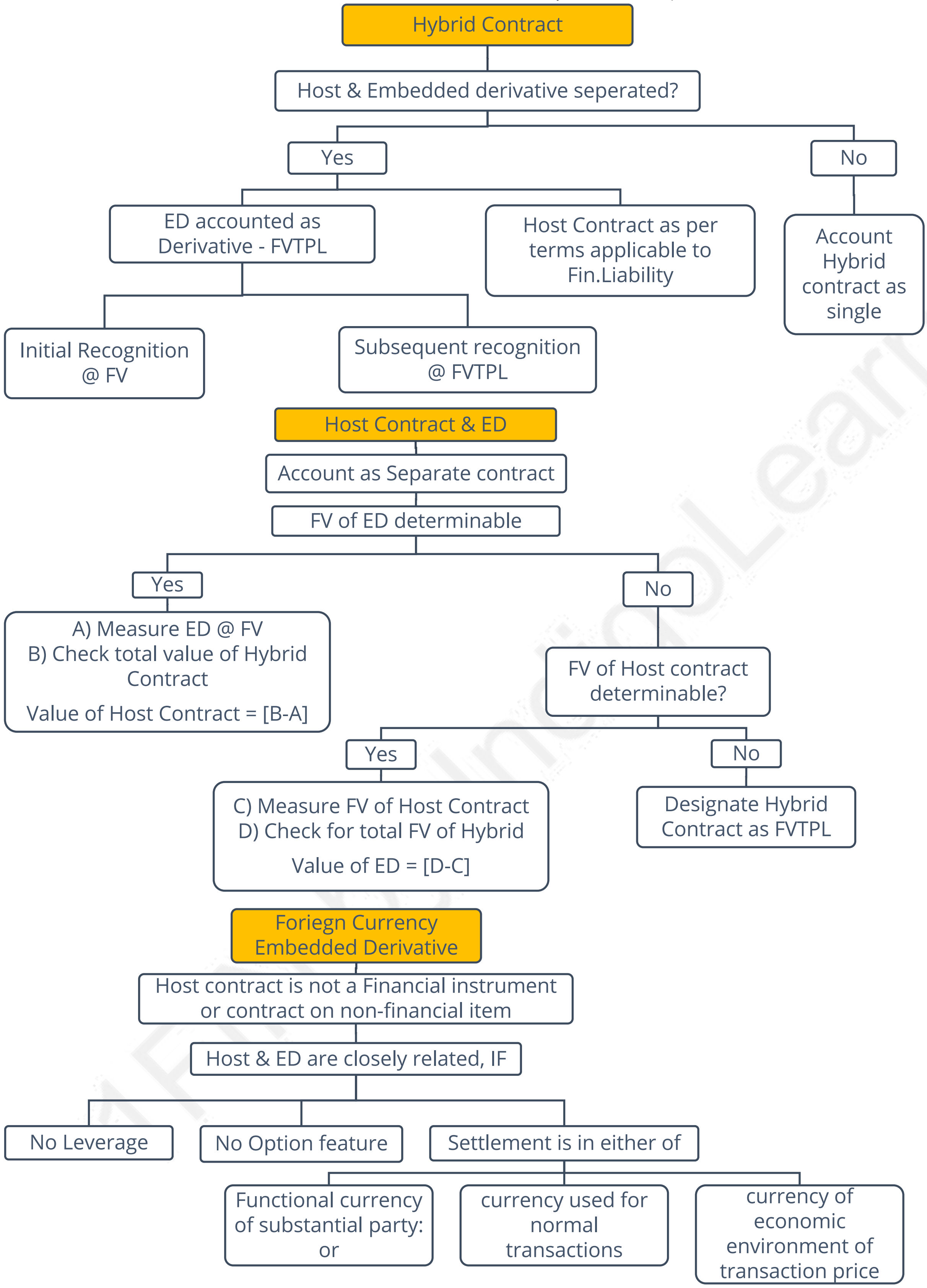
**Rules for Separation of Host & ED**



Evaluation of whether option is closely related to host contract?



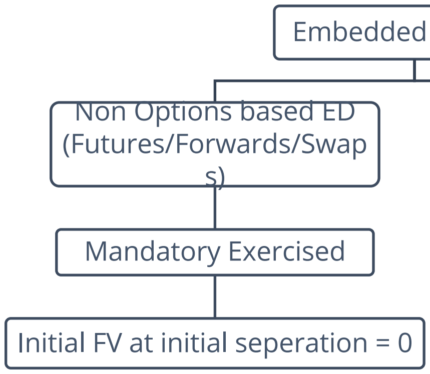
**Check Whether there is a need for Separation required of Host & ED?**



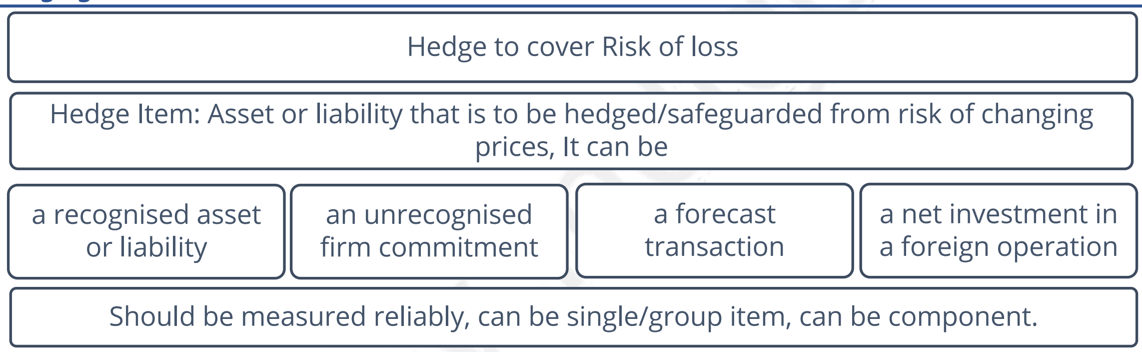

Steps for solving illustrations:

- Separate the host and ED if required
- At inception, if ED is a
  - Forward contract, then initial value = 0
  - Option contract, account derivative at the given value in the question
- At the end of each reporting period – recognise gain or loss on forward contract
  - If gain – increase the derivative asset

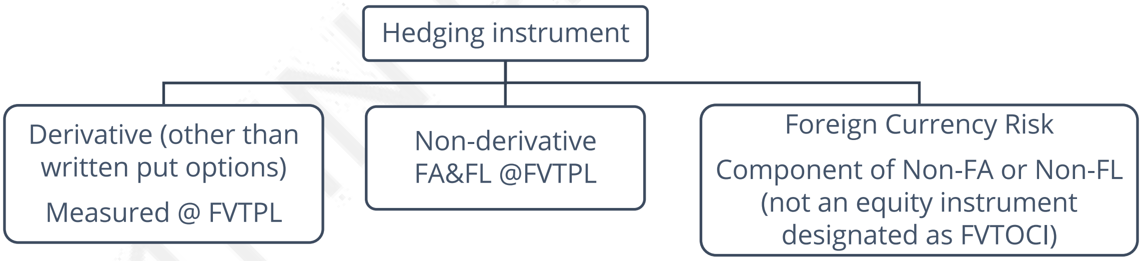
- IF loss – reduce the derivative asset/ create derivative liability
- At settlement date
  - Determine the FV
  - Arrive the gain or loss
  - Adjust the derivaive asset or liability
- On contract of purchase/sale of non-financial item
  - Account for amount received or paid through bank
  - Derivative asset or liability will be adjusted against the contract to sell/buy the non- financial item




## 14 Hedging




### 14.1 Hedging Instrument



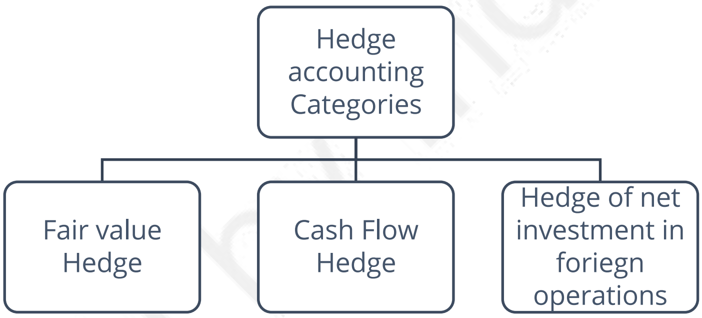

**Note:**

- If there is purchased option and also Written (sold) option and net impact is purchased option, then it can be considered as Hedging Instrument.
- Hedging instrument should be with the External party (Not with Group companies or related companies)
- Entire Instrument should designate as Hedge instrument, not in parts.
- Hedge accounting is not mandatory
- Once hedge accounting is started, till the time of qualification criteria is met, entity has to follow the hedge accounting.

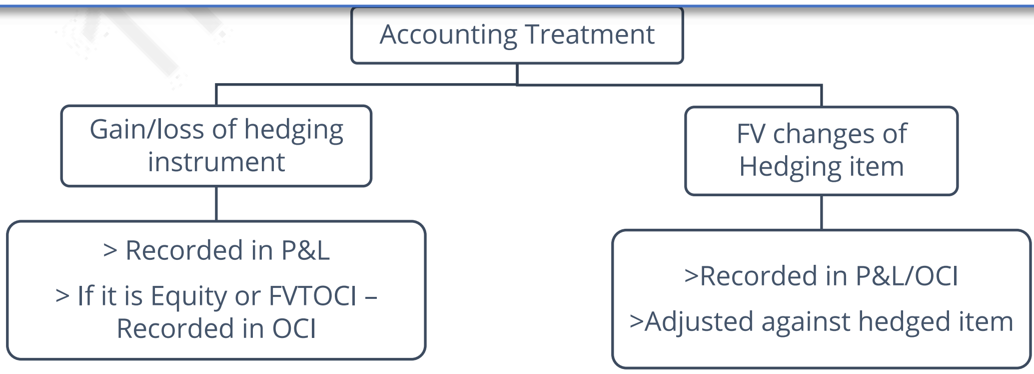
## 14.2 Conditions for Hedge Accounting

| | |
|---|---|
| Hedged items & instrument | Eligible Hedged item & Hedging instrument should exist |
| Proper formal documentation at inception | Risk Management policy with purpose and details |
| | Hedge item? |
| | Hedging Instrument? |
| | Hedge effectiveness? |
| | Measurement of effectiveness & ineffectiveness |
| | Hedge ratio? |
| | Risk management? |
| Meet Hedge effectiveness requirement | Economic relationship between item & instrument |
| | Credit risk should not dominate the changes in value of relationship |
| | Hedge Ratio = Hedging Instrument / hedged Item |

## 14.3 Hedging Accounting




A Fair value Hedge is a hedge of the exposure changes in fair value of a recognized asset/liability or a unrecognized firm commitment or component of any such item that is attributable to a particular risk and could affect profit or loss




A Cash Flow Hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with on or a component of recognized asset/liability or a highly probable forecast transaction and could affect the PL.

**Gain/loss of hedging instrument**

- Offsetting gain/loss Hedging item
  - Effective gain
    - Accumulate as Cash flow hedge reserve as OCI
- Balance
  - Ineffective Gain
    - Recognised in P&L

**Cash Flow Hedge Reserve (CFHR) under OCI**

- Pertains to Forecasted transaction
  - Result in non-financial asset/liability in future
    - CFHR adjusted with NFA/L
  - Result in firm commitment
    - Add CFHR to balance of firm commitment
- Ineffective Gain
  - Hedge items impact P&L
    - Transfer CFHR balance to P&L in same period

Note: Loss, which cannot be recovered should be reclassified to P&L

**Balance in Cash Flow Hedge Resereve (CFHR)**

- Is there a NFA/NFL created subsequently?
  - Yes
    - Adjust CFHR balance against NFA/NFL
  - No
    - Forecasting transactions of NFA/NFL becomes a Firm Commitment
      - Yes
        - Adjust CFHR balance against NFA/NFL
      - No
        - Take it to P&L when the hedge items impact the P&L

A Hedge of Net investment in foreign operations, 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

**Hedge of Net investment in foreign operations**

- Effective portion
  - OCI
- Ineffective portion
  - P&L

## 15 Recognition of Financial Instrument

Entity has to recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument.
Eg: Trade receivable recognised on sales happened (after delivery of goods), instead of sale agreement.
Examples for applying recognition principle

| Nature of contract | Recognition Principle |
|---|---|
| Receivables and payables | When entity becomes party to contract & has legal right to receive /legal obligation to pay cash |
| Firm commitment to purchase/ sell goods or service | When at least one of the parties has performed under the agreement i.e., ordered goods or services have been shipped/delivered/rendered |
| Firm commitment to purchase/ sell goods or services designated as measured at fair value through P&L | Net fair value recognised as asset or liability @ commitment date |
| Forward & Future contracts | On commitment date, No recognition |
| Option contract | Holder/ Writer becomes party to contract. As premium/ amount will be paid upfront |

**Ind AS 109 defines a regular way purchase or sale as,**

> A purchase or sale of a financial asset
> Under a contract
> Whose terms require deliver of the asset
> Within the time frame
> Established generally by regulation or convention in the marketplace concerned

- Trada date accounting
- Settlement date accounting

## 16 De-recognition of Financial Asset

Derecognition of Financial Asset

- Group of Financial asset
  - Entire group of FA
    Eg: Entire Trade receivables
  - Part of FA
    Eg: Part/group of trade receivables
- Single Financial Asset

### 16.1 Condition for partial De-recognition

The part comprises of specifically identified cash flows from a financial asset

1. Investment in Bonds

| Interest payment | Principal payment |
|---|---|

Both are specifically identified cash flows

2. Receivables of Rs.1 lakh from customer cannot specifically identify a part from the Financial asset

The part comprises of a fully proportionate (pro rata) share of the cash flows from a Financial asset

Trade receivables

Transfer 50% of cash flow

If Rs.10,000 Customer pays – Rs.5,000 to another

Another party

The part comprises pro rata share of specifically identified cash flows from a financial asset

Investment in Bonds

| Interest payment | Principal payment |
|---|---|

For eg: 50% of Interest or 50% of Principal transfer to another party

Any of the above 3 conditions are satisfied

- Yes → Apply the derecognition principles for a part of the financial asset or for a part of group of financial assets
- No → Need to apply the principles of derecognition to the Financial asset

Note:

- If any Financial asset (For eg: Trade receivable) agreed to transfer first some percentage (eg:60%) of the cashflows to another party, then it is not a pro rata share of cash flow. So, need to apply principles of derecognition to the Financial asset.
- Financial asset can be transferred to multiple parties, but pro rata share should be transferred & pro rata share should be received
  (For eg: Trade receivable - agreed to transfer 20% to one party, 30% to another party & 50% retained on every cashflow received)

### 16.2 Specific derecognition principles

2 Conditions

When cashflow from financial asset expire

> Debtors pays the money

> Debtors goes bankrupt and will not receive the money

> Investment in bond - Tenure is over the got back the money

Transfer the financial asset/part of the financial asset and transfer meets the derecognition criteria

> Sold the debtor

> Sold the investment in bond

> Sold the Equity shares

> And specific conditions have met

Transfer of Financial asset

- When the entity has transferred the cash flows of Financial asset
  - The risk & rewards has been transferred
- Entity retains the contractual right to collect the cashflows
  - But after collecting the cashflows the entity has to transfer the cashflows to a 3rd party
    - > Entity has obligation to pay only if the customer pays
    - > Entity does not have any further control/right to sell or pledge the financial asset
    - > Entity does not have right to delay the transfer of cashflows

**Additional conditions to be checked for transfer of financial asset**

Whether substantially risk & rewards(If there is unconditional sale of financial asset) has been transferred

- Eg: Entity sold the cashflows from customer to 3rd party factor,
- If the customer does not pay -> Entity has to pay. Financial asset has not been transferred.

| If risk & rewards are transferred | If risk & rewards are not transferred |
|---|---|
| ↓ | ↓ |
| Derecognise the asset (Trade receivable) | Amount received from factor is recognised as liability |

### 16.3 Sale transaction with repurchase agreement

Re-purchase Obligation [REPO]
(Sale transaction with repurchase agreement)

- Fixed Price or Selling Price + Interest
  - Risk & Rewards are retained
- Fair value
  - Risk & Rewards are transferred

### 16.4 Transfer with Options, SLB arrangements & Bills receivable

| Transfer of financial asset and agreement has a call option | Buyer has a put option |
|---|---|
| ↓ | ↓ |
| Deeply out of the money (Not likely to be exercised) | Deeply out of the money (Not likely to be exercised) |
| ↓ | ↓ |
| Risk & Rewards have been transferred | Risk & Rewards have been transferred |

| Call option | Put option |
| --- | --- |
| ↓ | ↓ |
| Deeply in the money (More likely to be exercised) | Deeply in the money (More likely to be exercised) |
| ↓ | ↓ |
| Retained risk & rewards | Retained risk & rewards |

Note:

- ➔ Securities lending and borrowing arrangement: Not transferred the risk & rewards
- ➔ Bills receivable discounted with the bank – cannot derecognize the bills receivable

Entity transferred the Financial asset
↓
Any loss arising out of financial asset born by entity
↓
Risk & Rewards are not substantially transferred
↓
Cannot derecognise the financial asset

**Bills receivable discounted with the bank**

| |
| --- |
| Amount received from the bank at the time of discoutng -> Create a Liability |
| Continue to recognise the bills receivable |
| On the due date if drawee pays to the bank -> Derecognise the Bills receivable |

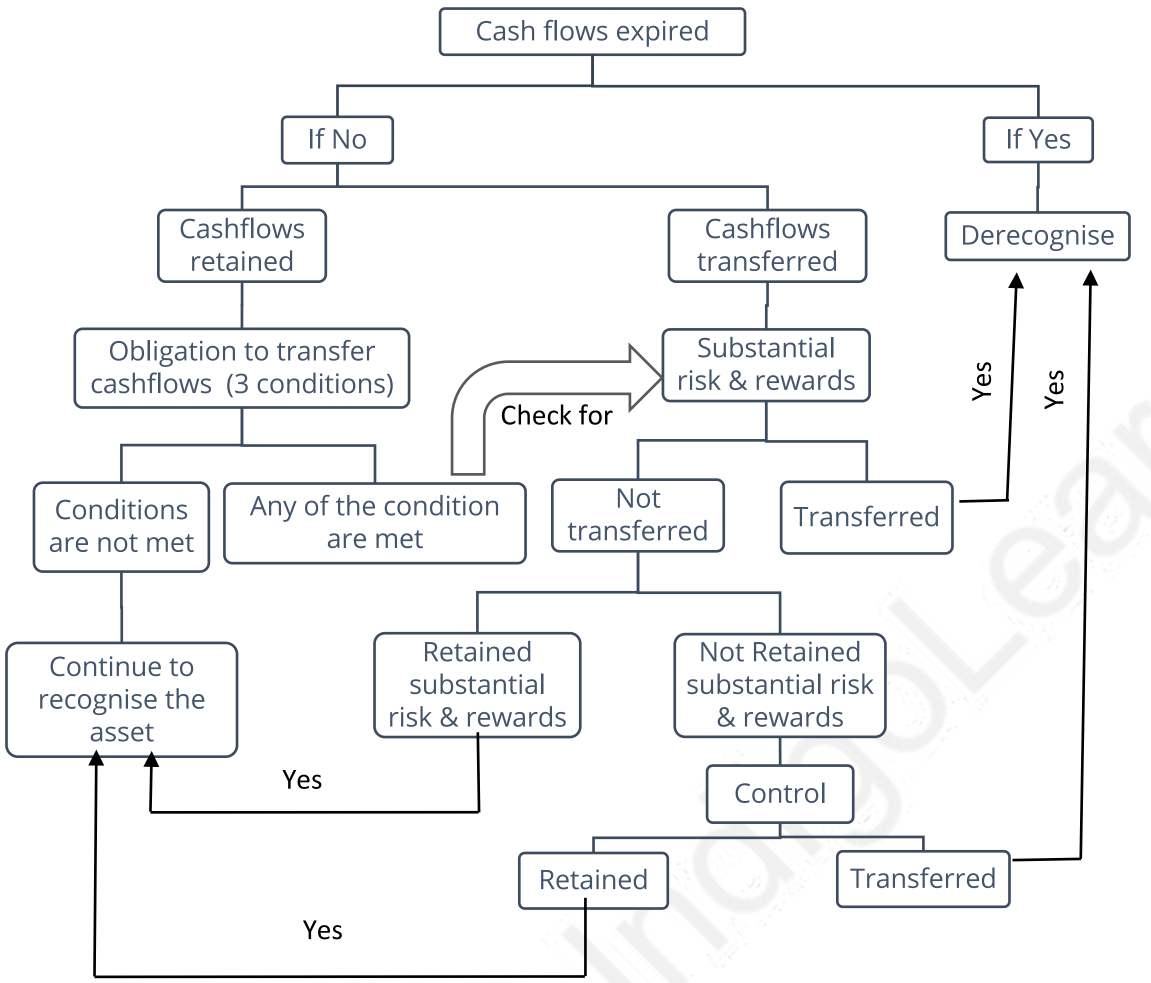
Entity has transferred the substantial risk & rewards of financial asset

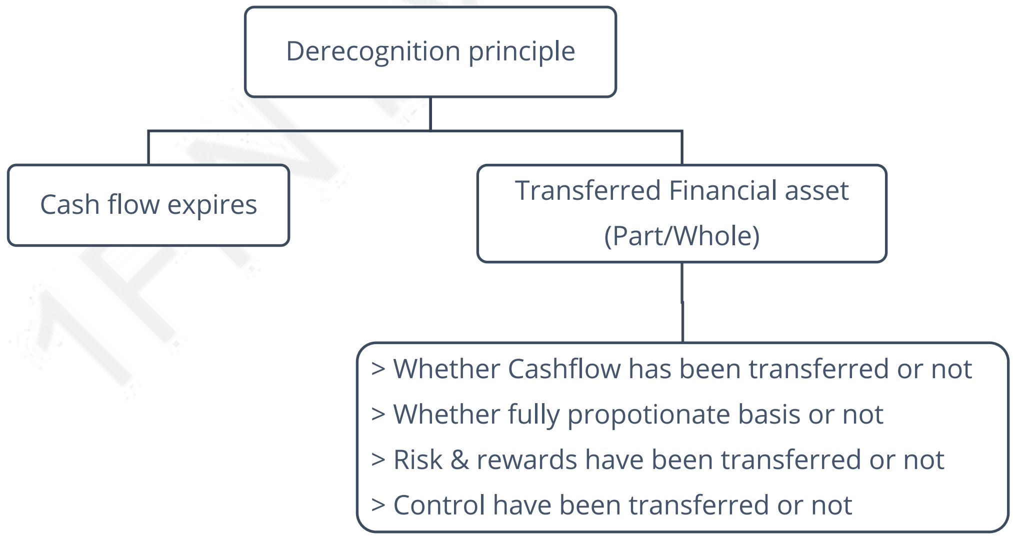
- If Yes → Derecognise the Financial asset
- If No → Should not Derecognise the Financial asset

Check the present value of net cash flows before the transfer and after the transfer

| | |
| --- | --- |
| Varibility is not significant | Varibility is significant |
| Risk & Rewards have not been retained | Risk & Rewards have been transferred |
| If the entity retains the control | If the entity transferred the control |
| ↓ | ↓ |
| Continue to recognise the financial asset | Derecognise the asset |

## 16.5 Summary


Cash flows expired
If No
If Yes
Cashflows retained
Cashflows transferred
Derecognise
Obligation to transfer cashflows (3 conditions)
Check for
Substantial risk & rewards
Yes
Yes
Conditions are not met
Any of the condition are met
Not transferred
Transferred
Continue to recognise the asset
Retained substantial risk & rewards
Not Retained substantial risk & rewards
Yes
Control
Retained
Transferred
Yes


Derecognition principle
Cash flow expires
Transferred Financial asset (Part/Whole)
> Whether Cashflow has been transferred or not
> Whether fully propotionate basis or not
> Risk & rewards have been transferred or not
> Control have been transferred or not

| Derecognition of financial asset | | |
|---|---|---|
| For entire Financial asset | For part of financial asset | |
| Gain/loss will be recognised in P&L | Split the carrying amount on the basis of relative fair value between | |
| | Part of financial asset that entity retained | Part of financial asset that entity transferred |
| | Continue to recognise | Derecognise |

Financial asset measured at Fair value through other comphrehensive income

↓

Meet the classification

1) SPPI test 2) Wants to sell the financial asset

↓

Recognise it as FVOCI

↓

> The cummulative gain/loss on fair value changes are accumulated as OCI
>
> When we derecognise the financial asset which is measured at FVOCI -> the accumulated balance in other comprehensive income will be reclassified to P&L

↓

Equity instrument which are designated as FVOCI

If it is by choice -> Gain/loss accumulated in OCI can be never be reclassified to P&L

-> Gain/Loss on derecognition will also be accumulated in OCI

Continuous involvement in the financial asset: Entity involved in the financial asset even after transfer of financial asset.

# 17 De-recognition of Financial Liability

## 17.1 Derecognition of FL

Derecognition of Financial liability or a part of financial liability -> only when financial liability or part of financial liability is extinguished.

Derecognition of Financial liability or a part of financial liability

↓

when financial liability or part of financial liability is extinguished.

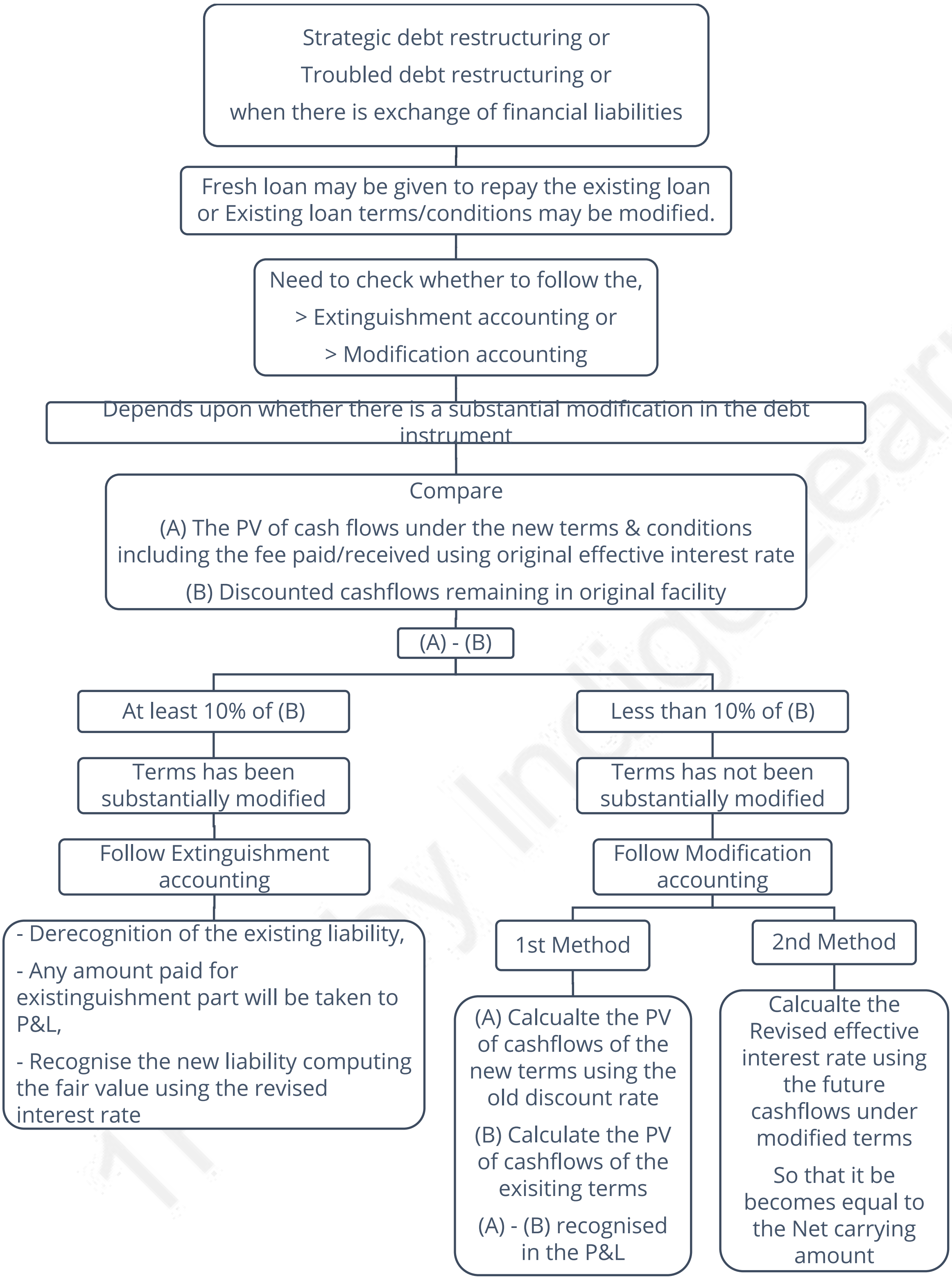
↓

| When the entity discharged the liability or a part of the liability by making cash payments or transferring assets/goods services OR | The person who has to pay is legally released from the primary responsibility of discharging the liability |
|---|---|

Eg:

- Advance received from customers (Financial liability) → Extinguished when customer is provided with goods or services
- Entity A has to receive Rs.1000 from Entity B & Entity B taken over by Entity C. Then Entity C is responsible for making payment to Entity A. Now Entity released from the primary responsibility of discharging the liability

### 17.2 Modification of cashflows (Debt restructuring)




Transaction cost

- is adjusted from the carrying amount of FL if there is no substantial modification.
- Is transferred to P&L if there is substantial modification

### 17.3 Conversion of debt to equity (Debt for Equity swap)

Financial liability will be derecognised only when derecognition principles are met

↓

Equity instrument which is issued is measured at the fair value. If FV of Equity cannot be measured reliably, then consider FV of liability which is being exchanged.

↓

Difference between carrying amount of liability and consideration received is recognised in P&L.

Equity issued for the part of the liability

Whether modification involed

Whether terms have been substantially modified

- Yes → Follow extinguishment accounting
- No → Follow Modification accounting

Accounting for debt for equity swap is not applicable in 3 situation

1) Where the creditor is acting in capacity of a shareholder

2) Where the borrower and lender are controlled by the same entity before and after modification. The substance of the transaction either to issue equity or take back the equity

3) Where equity is been issued as a part of the original agreement.

## 18 Impairment of Financial Asset

### 18.1 Applicability of Impairment

Financial Asset measured at

- Amortised cost → Impairment - Applicable
- FVOCI
  - Debt → Impairment - Applicable
  - Equity → Impairment - Not applicable (Because there is no contractual cashflows)
- FVTPL → Impairment - Not applicable (Because already it is measured at FV)

Note:

Impairment applicable to the following, if it is Financial asset

- Lease receivables
- Trade receivables
- Contract assets
- Financial guarantee / Loan commitment

## 18.2 Expected Credit loss

| **Contractual cashflows (A):** Payment of Principle & Payment of interest | **Expected Cashflows (B):** Expected payment/ Collection from selling of assets/ Collection from invoking the guarantee |
|---|---|

Difference between (A) and (B) discounted to its PV is called the **Expected credit loss**

Discounting rate --> Effective interest rate

Exception: If there are purchased or originated credit impaired assets --> Discounted at credit adjusted discount rate

Expected credit loss

| 12 months Expected credit loss | Life time Expected credit loss |
|---|---|
| Expected credit loss over the next 12 months period | Expected credit loss over the entire life time of financial asset |
| | Higher when compare to 12 months Expected Credit loss |

Note: Entity has to make provisions for Expected Credit loss either of the above based on the condition of the financial asset.

Criteria to decide the stage of the financial asset:

1) Credit risk of the financial asset
2) How are the financial assets priced in the market?
3) Pricing of credit default swaps

Depending on the stage that the financial asset falls → calculate the Expected Credit loss

| **Simplified Approach** | **Approach for purchase or originated credit impaired assets** | **3 Stage Model (General approach)** | | |
|---|---|---|---|---|
| | | Stage 1 | Stage 2 | Stage 3 |
| For trade receivables, lease receivables and contract assets | Compute the effective interest rate considering the FV on the date of transaction and expected cashflow. IF the Expected cashflows deteriorate provide for impairment | Financial asset where there has not been any significant increase in the credit risk | There is significant increase in the credit risk, but there is no credit impairment which is visible | There is significant increase in the credit risk and there is clear evidence of credit impairment |
| Compute the Expected life time Credit losses | | Provide for 12 months Expected credit loss & recognise income on the gross carrying amount of the financial asset | Provide for life time Expected credit loss & recognise income on the gross carrying amount of the financial asset | Provide for life time Expected credit loss & recognise income on the net carrying amount of the financial asset |

When can an entity consider that the credit risk has increased significantly?

If the payment is not received for the period for 30 days after due date

--> Presume that the credit risk has increased significantly

Above presumption can be rebutted if the entity can demonstrate that this credit risk has not increased significantly

Whether the asset is credit impairment

>> Significant financial difficulty

>> Breach of contract

>> Borrower has received concession from other lenders

>>Probability of the borrower that they will file for bankruptcy

>> Disappearance of an active market for the financial asset because of financial difficulty

>> Borrower has issued further bonds at deep discounted prices

Whenever measuring Expected credit loss

Calculate various loss case scenarios

Assign probability

Accordingly determine the expected credit loss

Note:

- Whenever entity is looking at different outcomes it should not spend undue amount of efforts, time and cost to determine the ultimate outcome.
- An entity may use practical experience in case of calculation of expected credit losses
- Simplified approach will not be applied when the trade receivables has a significant financing component
- Even if the trade receivable, lease receivables or contract assets have significant financial component but as a matter of accounting policy, entity decides to provide for life time expected loss

## 19 Reclassification of Financial Instrument

Financial liabilities cannot be reclassified

Financial assets can be reclassified

only if there is a change in the business model

| | From ACM | From FVTOCI | From FVTPL |
|---|---|---|---|
| **To ACM** | - | Transfer @ Fair Value (+/-) Adjust Accumulated balance in OCI | Transfer @ Fair Value New EIR has to calculate |
| **To FVTOCI** | Transfer @ Fair Value Difference recognized in OCI | - | Transfer @ Fair Value New EIR has to calculate |
| **To FVTPL** | Transfer @ Fair Value Difference recognized in P&L | Transfer @ Fair Value Transfer Accumulated balance in OCI to P&L | - |

## Disclosure in Financial statement

- Balance sheet
- Statement of profit or loss
- Notes to Accounts

## Balance sheet disclosures

- Financial Asset measured at
  - Amortised cost Method
  - FVOCI
    - >Designated as per standard
    - > Designated voluntarily
  - FVTPL
    - >Designated as per standard
    - > Designated voluntarily
- Financial Liability measured at
  - FVTPL
    - >Designated as per standard
    - > Designated voluntarily
  - Amortised cost method

Separate disclosure for each

**Financial asset could have been Amortised cost/ FVTPL**

Entity opted to designated as FVTPL

Additional disclosure:

- Credit Risk Exposure
- Derivatives entered into?

**Financial liability designated as FVTPL**

Separate Disclosure:

- Changes in FV
- Changes attributable to Credit risk
- Amount recognised at derecognition

**Investment in Equity instruments designated as FVTOCI**

Additional Disclosures:

- Instruments designated as FVTOCI
- Reason for designated so
- FV of such investment at end of reporting period
- Dividend recognised during the period
- Gain/loss reclassified within equity

## Reclassification Disclosure

For each reclassification of Financial asset, an entity shall disclose:

a) the date of reclassification

b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statement

c) the amount reclassified into and out of each category

Financial Asset reclassified from FVTPL to FVTOCI/Amortised cost:

a) the effective interest rate determined on the date of reclassification and

b) the interest revenue recognised

Financial Asset reclassified from FVTPL to FVTOCI/Amortised cost & from FVOCI to Amortised cost:

a) FV of FA at end of reporting period: &

b) FV gain or loss that would have been recognised in P&L or OCI if not for reclassification

## Offsetting Financial Asset & Financial Liability

Additional Disclosure

Provide effect or potential effect of netting arrangements on the entity's financial position:

a) gross amount of those recognised FA & FL:

b) amount set-off as per Ind AS 32

c) net amount presented in the balance sheet

## Financial Asset given as security - Collateral

Disclosure

a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with Ind AS 109; and

b) the terms and conditions relating to its pledge

Allowance for credit losses of FA which are FVTOCI → Not reduced from balance of FA → Seperate disclosure

## Defaults & Breaches

Disclosure for loan & payables at the end of the year:

a) details of any defaults during the period of principal, interest, sinking fund or redemption terms of those loan payable:

b) Carrying amount of the loans payable in default at the end of the reporting period;

c) Whether the defaults was remedied, or the terms of the loans payable were renegotiated, before the financial statements were approved for issue.

Defaults during the period - Disclosure required

Other disclosure

Hedge accounting:

> Entity's risk management strategy for each category - what & how its applied:

> Effect on future cashflows - amount, timing & uncertainity

> Effect that hedge accounting has had on the entity's balance sheet, statement of profit and loss and statement of change in equity

Accounting policies

Disclosure - Statement of Profit & loss

Income, Expense, gains or losses

An entity shall disclose the following items of income, expense, gains or losses either in the statement of profit and loss or the notes:

a) Net gain or net losses

b) total interest revenue and total interest expense (calculated using the Effective interest method) for

i. FA @ amortised cost

ii. FA @ FVTOCI

iii. FL @ FVTPL

c) Fee income and expense (other than amounts included in determining the EIR)

Separate Disclosure:

i) FA& FL@ FVTPL ( FA/FL designated as FVTPL need separate disclosure for which is mandatory designation as per Ind AS 109 and Voluntary designation)

ii) Financial liabilities measured a amortised cost

iii) Financial assets measured a amortised cost

iv) investment in equity instruments designated at FVOCI

v) FA measured at FVTOCI

Fair Value

> For each class of financial assets and financial liabilities

> an entity shall disclose the fair value of that class of assets and liabilities

> in a way that permits it to be compared with its carrying amount

Offset them only to the extent that their carrying amount are offset in the balance sheet

Disclosure of fair value are not required:

> When the carrying amount is a reasonable approxiamation of fair value,

> For a contract containing a discretionary participation feature (as described in Ind AS 104) if the fair value of that feature cannot be measured realibly; or

> for lease liabilities

## Disclosure

### Risk arising from Financial Instrument

An entity shall disclose:

> information that enables users of its financial statements

> to evaluate the nature and extent of risks arising from financial instruments

> to which th entity is exposed

> at end of the reporting period

Qualitative disclosure ( for each type of risk)

a) the exposure to risk and how they arise;

b) its objectives, policies and process for managing the risk and the methods used to measure the risks; and

c) any changes in (a) or (b) from the previous period

Quantitative disclosure (for each type of risk)

a) summary quantitative data generated about its exposure at the end of the reporting period.

b) Credit Risk, Liquidity Risk & Market Risk

Financial Liabilities

- Non-derivative
  - Ageing analysis
- Derivative
  - Ageing analysis

An entity disclose:

> A maturity analysis for non-derivative FL that shows the remaining contractual maturities

> A maturity analysis for derivatives FL that gives timing of the cash flows

> a description of how it manages the liquidity risk inherent

## Market Risk

a) sentivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;

b) the method and assumptions used in preparing the sensitivity anlysis; and

c) changes from the previous period in the methods nad assumptions used, and the reasons for such changes

## Financial Instruments – Scope & Definitions

## 1. Illustration

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.

Amount repayable at end of $6^{th}$ Year = 10,00,000 x 1.12 x 1.12 =12,54,400
FV = PV (at beginning of $5^{th}$ year) x (1+r)^n
= 10,00,000 x (1.12)^2
Amount demanded for one time settlement = 13,00,000
Additional amount = 45,600

# Financial Assets, Financial Liabilities & Equity

## 1. Illustration

Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.

Evaluate the Contractual cash flows characteristics test.

**Answer**

The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest to an unleveraged inflation index resets the time value of money to a current level.

In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.

However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates the holder for changes in the credit risk of the instrument, such that contractual cash flows are solely payments of principal and interest). That is because the contractual cash flows reflect a return that is inconsistent with a basic lending arrangement.

## 2. Illustration

Instrument F is a bond that is convertible into a fixed number of equity instruments of the issuer. Analyse the nature of cash flows.

## 3. Illustration

a. An entity purchased a debt instrument for 1,00,000. The instrument pays interest of 6,000 annually and has 10 years to maturity when purchased. The entity intends to hold the asset to collect the contractual cash flows.

   Evaluate the business model test.

**Solution**

Entity's objective is to hold the asset to collect the contractual cash flows and not to sell the assets before the maturity period.

Thus, the debt instrument would meet the 'hold-to-collect' business model test.

b. An entity purchased a debt instrument for 1,00,000. The instrument pays interest of 6,000 annually and has 10 years to maturity when purchased. The entity intends to hold the asset to collect the contractual cash flows. Six years have passed and the entity is suffering a liquidity crisis and needs to sell the asset to raise funds.
Evaluate the business model test.

**Solution**

Since the sale of financial assets was not expected on initial classification and therefore, does not affect the classification (i.e. there is no retrospective reclassification).
Thus, the debt instrument would still meet the 'hold-to-collect' business model test.

c. Parent H Ltd. provides a loan to its Subsidiary S Ltd. The loan is classified as a current liability in Subsidiary S's financial statements and has the following terms:
- Interest free loan.
- No fixed repayment terms
- Repayable on demand of Parent H Ltd.

Does the loan meet the 'SPPI' or contractual cash flows characteristic test?

**Solution**

Yes. The terms for the repayment of the principal amount of the loan on demand satisfies the criterion of SPPI.

d. Parent H Ltd. provides a loan of INR 100 million to Subsidiary B. The loan has the following terms:
- No interest
- Repayable in ten years.

Does the loan meet the 'SPPI' or contractual cash flows characteristic test?

**Solution**

Yes. The terms for the repayment of the principal amount of the loan on demand satisfies the criterion of SPPI.

e. Entity A Ltd. lends Entity B Ltd. INR 5 million for ten years, subject to the following terms:
- Interest is based on the prevailing variable market interest rate.
- Variable interest rate is capped at 10%.
- Repayable in ten years.

Does the loan meet the 'SPPI' or contractual cash flows characteristic test?

**Solution**

Contractual cash flows of both a fixed rate instrument and a floating rate instrument are payments of principal and interest as long as the interest reflects consideration for the time value of money and credit risk.
Therefore, a loan that contains a combination of a fixed and variable interest rate meets the contractual cash flow characteristics test.

f. H Ltd. makes sale of goods to customers on credit of 60 days. The customers are entitled to earn a cash discount @ 5% per annum if payment is made before 60 days and an interest @ 12% per annum is charged for any payments made after 60 days. Company does not have a policy of selling its debtors and holds them to collect contractual cash flows.

Evaluate the financial instrument.

**Solution**

In the above case, since H Ltd. has a contractual right to receive cash flows from its customers and therefore such trade receivable are financial assets for H Ltd.
Further, H Ltd. business model test to collect will satisfy as the objective is to hold its trade receivable to collect contractual cash flows till the end of maturity period and such trade receivable recorded in books represents contractual cash flows that are solely payments of principal and interest if paid beyond credit period.
Hence such trade receivables are classified at amortised cost.

## 4. Illustration

A Ltd. (the 'Company') has obtained the premises from B Ltd. on lease to carry on its business. The lease contract period is 5 years. As per the lease agreement, A Ltd. has paid security deposits to B Ltd. amounting to Rs. 10 Lac which is refundable after the expiry of lease agreement.

How would such deposits be treated in books of the A Ltd. ?

**Solution**

In the above case, since A Ltd. has a contractual right to receive cash flows from its Lessor, B Ltd. and therefore such security deposits receivable are financial assets for A Ltd.

Further, A Ltd. business model test to collect will be satisfied as the objective is to hold its security deposits receivable to collect contractual cash flows till the end of maturity period. And such trade receivable recorded in books represents contractual cash flows that are solely payments of principal and interest.

Hence such security deposits receivables are classified at amortised cost.

## 5. Illustration

Containers Ltd provides containers for use by customers for multiple purposes. The containers are returnable at the end of the service contract period (3 years) between Containers Ltd and its customers. In addition to the monthly charge, there is a security deposit that each customer makes with Containers Ltd for Rs. 10,000 per container and such deposit is refundable when the service contract terminates. Deposits do not carry any interest. Analyse the fair value upon initial recognition in books of customers leasing containers. Market rate of interest for 3 year loan is 7% per annum

## 6. Illustration

Loan amount – Rs. 10,00,000
Tenure of Loan – 5 years
Rate on loan – 5%
Market rate – 8 %
Upfront fee paid by the borrower – Rs. 1,20,000

Prepare interest amortisation schedule.

## 7. Illustration

A Ltd has made a security deposit for lease whose details are described below. Make necessary journal entries for accounting of the deposit in the first year and last year. Assume market interest rate for a deposit for similar period to be 12% per annum.

| | |
|---|---|
| Date of Security Deposit (Starting Date) | 1-Apr-20X1 |
| Date of Security Deposit (Finishing Date) | 31-Mar-20X6 |
| Total Lease Period | 5 years |
| Discount rate | 12.00% |
| Security deposit (A) | 10,00,000 |

Present value factor at the 5th year 0.567427

## 8. Illustration FVTOCI & ACM

Investment in Debentures – Rs. 1,00,000
Transaction cost – Rs. 2,000
ROI on debentures – 10%
Tenure – 3 years
Effective Interest rate – 9.207%

Pass journal entries.

## 9. Illustration

An entity acquires a financial asset for CU 100 plus a purchase commission of CU 2. Initially, the entity recognises the asset at CU 102. The reporting period ends one day later, when the quoted market price of the asset is CU 100. If the asset were sold, a commission of CU 3 would be paid. How would transaction costs be accounted in books of the entity?

**Initial recognition**

| | |
|---|---|
| Financial Asset Dr. 102 | |
| To Bank. | 102 |

**At year end**

| | |
|---|---|
| OCI Dr. | 2 |
| To Financial Asset | 2. |

## 10. Illustration

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

## 11. Illustration

The shareholders of Company C provide C with financing in the form of loan notes to enable it to acquire investments in subsidiaries. The loan notes will be redeemed solely out of dividends received from these subsidiaries and become redeemable only when C has sufficient funds to do so. In this context, 'sufficient funds' refers only to dividend receipts from subsidiaries. Analyse the initial measurement of loan notes.

Amount lent – Rs. 1,00,000
Market rate of Interest is 10%
Rate of interest under the loan – 5%

FV of Loan = Rs. 80,000
FV of Investment in Equity of C = Rs. 20,000

In the books of Company C
Financial Liability – Rs. 80,000
Equity – Rs. 20,000

## 12. Illustration

Silver Ltd. has made an investment in optionally convertible preference shares (OCPS) of a Company – Bronze Ltd. at Rs. 100 per share (face value Rs. 100 per share). Silver Ltd. has an option to convert these OCPS into equity shares in the ratio of 1:1 and if such option not exercised till end of 9 years, then the shares shall be redeemable at the end of 10 years at a premium of 20%.
Analyse the measurement of this investment in books of Silver Ltd.

## 13. Illustration

XYZ Ltd. is a company incorporated in India. It provides INR 10,00,000 interest free loan to its wholly owned Indian subsidiary (ABC). There are no transaction costs.

How should the loan be accounted for, in the Ind AS financial statements of XYZ, ABC and consolidated financial statements of the group?

Consider the following scenarios:

a) The loan is repayable on demand.
b) The loan is repayable after 3 years. The current market rate of interest for similar loan is 10% p.a. for both holding and subsidiary.
c) The loan is repayable when ABC has funds to repay the loan.

## 14. Illustration

A Ltd has made a borrowing from RBC Bank for Rs. 10,000 at a fixed interest of 10% per annum. Loan processing fees were additionally paid for Rs. 500 and loan is payable after 5 years in bullet repayment of principal.

Details are as follows:

| | |
|---|---|
| Loan amount | Rs. 10,000 |
| Date of loan (Starting Date) | 1-Apr-20X1 |
| Date of repayment | 31-March-20X6 |
| Interest rate | 10.00% |
| Interest to be charged and paid yearly | |
| Upfront fees | Rs. 500 |

How would loan be accounted in books of A Ltd?

## 15. Illustration

A Ltd has made a borrowing from RBC Bank for Rs. 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for Rs. 500 and loan is payable 4 half-yearly instalments of Rs. 2,500 each.

Details are as follows:

| | |
|---|---|
| Loan amount | Rs. 10,000 |
| Date of loan (Starting Date) | 1-Apr-20X1 |

| | |
|---|---|
| Date of loan (Finishing Date) | 31-March-20X3 |

Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)

| | |
|---|---|
| Instalment amount | Rs. 2,500 |
| Interest rate | 12.00% |
| Interest to be charged quarterly | |
| Upfront fees | Rs. 500 |

How would loan be accounted in books of A Ltd?

Consider IRR is 16.60% p.a.

## 16. Illustration

P Ltd. has issued puttable ordinary shares to Q Ltd. Q Ltd. has also entered into an asset management contract with P Ltd. whereby Q Ltd. is entitled to 50% of the profit of P Ltd. Normal commercial terms for similar contracts will entitle the service provider to only 4%- 6% of the net profits. Examine whether the financial instrument will be classified as equity.

## 17. Illustration

A Ltd. issued compulsorily convertible preference shares (CCPS) at Rs. 100 each (Rs. 10 face value + Rs. 90 premium per share) for Rs. 10,00,000. These are convertible into equity shares at the end of 10 years, where the number of equity shares to be issued shall be determined based on fair value per equity share to be determined at the time of conversion.

Evaluate if this is financial liability or equity? What if the conversion ratio was fixed at the time of issue of such preference shares?

## 18. Illustration

On 1 January 20X1, Entity X writes a put option for 1,00,000 of its own equity shares for which it receives a premium of Rs. 5,00,000.
Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of Rs. 22,000,000. The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted.

Dr. Equity 2 Crores (assumed PV)
Cr. FL 2 Crores

## 19. Illustration

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.

$1000/(1.12)^2 = 797.19$ = PV of Liability [Recognise liability]

Correspondingly – 797 will be recognised under equity.

## 20. Illustration

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. using a pre- determined formula.

The formula is:
100 crores X (1 +10%)^5 divided by Fair value on date of conversion

Examine the nature of the financial instrument.

## 21. Illustration

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.

## 22. Illustration

ST Ltd. purchases an option from AT Ltd. entitling the holder to subscribe to fixed number of equity shares of issuer at a fixed exercise price of Rs. 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs. 2 per option. Examine whether the financial instrument will be classified as equity.

## 23. Illustration

WC Ltd. writes an option in favour of GT Ltd. wherein the holder can purchase issuer's equity instruments at prices that fluctuate in response to the share price of issuer.
As per the terms, if the share price of issuer is less than Rs. 50 per share, option can be exercised at Rs. 40 per share. If the share price is equal to or more than Rs. 50 per share, option can be exercised at Rs. 60 per share. Explain the nature of the financial instrument.

## 24. Illustration

Acquirer Ltd. enters into an arrangement with shareholders of Target Ltd. wherein Acquirer Ltd. will purchase shares of Target Ltd. in a share swap arrangement against a variable amount of cash i.e. market value of Target Ltd.'s equity shares. The share swap ratio is agreed as 1:5 i.e. 1 equity share of Acquirer Ltd. for every 5 equity shares held in Target Ltd. Examine whether the financial instrument will be classified as equity.

## 25. Illustration

On 1 January 20X1, NKT Ltd. subscribes to convertible preference shares of VT Ltd. The conversion ratio varies as below:

Conversion upto 31 March 20X1: 1 equity share of VT Ltd. for each preference share held
Conversion upto 30 June 20X1: 1.5 equity share of VT Ltd. for each preference share held
Conversion upto 31 December 20X1: 2 equity share of VT Ltd. for each preference share held.

Examine whether the financial instrument will be classified as equity.

## 26. Illustration

On 1 January 20X1, HT Ltd. subscribes to convertible preference shares of RT Ltd. The preference shares are convertible in the ratio of 1:1.
The terms of the instrument entitle HT Ltd. to proportionately more equity shares of RT Ltd. in case of a stock split or bonus issue. Examine whether the financial instrument will be classified
as equity.

## 27. Illustration

On 1 January 20X1, PG Ltd. subscribes to convertible preference shares of BG Ltd. at Rs. 100 per preference share. The preference shares are convertible in the ratio of 10:1 i.e. 10 equity shares for each preference share held. On a fully diluted basis, PG Ltd. is entitled to 30% stake in BG Ltd. If subsequent to the issuance of these convertible preference shares, BG Ltd. issues any equity instruments at a price lower than Rs. 10 per share, conversion ratio will be changed to compensate PG Ltd. for dilution in its stake below the expected dilution at a price of Rs. 10 per share. Examine the nature of the financial instrument.

## 28. Illustration

On 1 January 20X1, NG Ltd. subscribes to convertible preference shares of AG Ltd. at Rs. 100 per preference share. On a fully diluted basis, NG Ltd. is entitled to 30% stake in AG Ltd.
The preference shares are convertible at fair value, subject to, NG Ltd.'s stake not going below 15% and not going above 40%. Examine the nature of the financial instrument.

## 29. Illustration

On 1 January 20X1, STAL Ltd. subscribes to convertible preference shares of ATAL Ltd. The preference shares are convertible as below:
Convertible 1:1 if another strategic investor invests in the issuer within one year
Convertible 1.5:1: if a prospectus filing is successfully completed within 2 years

Convertible 2:1: if a binding agreement for sale of majority stake by equity shareholders is entered into within 3 years

Convertible 3:1: if none of these events occur in 3 years' time.
Examine whether the financial instrument will be classified as equity.

## 30. Illustration

On 1 January 20X1, RHT Ltd. subscribes to convertible preference shares of RDT Ltd. The preference shares are convertible as below:

Convertible 1:1 if another strategic investor invests at an enterprise valuation (EV) of USD 100 million.
Convertible 1.5:1: if another strategic investor invests at EV of USD 150 million
Convertible 2:1: if another strategic investor invests at EV of USD 200 million
Convertible 3:1: if no strategic investment is made within a period of 3 years
Examine the nature of the financial instrument

## 31. Illustration

Optionally Convertible Debentures – Rs. 20,00,000
Coupon – 6%
Tenure – 3 Years
Rate without conversion option – 9%
Conversion option – 1,000 shares
Compute the amount of Financial Liability and Equity

## 32. Illustration

Optionally Convertible Debentures – Rs. 20,00,000
Coupon – 6%
Tenure – 3 Years
Rate without conversion option – 9%
Transaction cost incurred. -Rs. 1,00,000

Conversion option – 1,000 shares
Compute the amount of Financial Liability and Equity

## 33. Illustration

D Ltd. issues preference shares to G Ltd. for a consideration of Rs. 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a. and is payable at the end of every year.
The prevailing market rate for similar preference shares, without the conversion feature or issuer's redemption option, is RBI base rate plus 4% p.a. On the date of contract, RBI base rate is 9% p.a.
Calculate the value of the liability and equity components.

## 34. Illustration

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:

| | |
|---|---|
| Date of Allotment | 01-Apr-20X1 |
| Date of Conversion | 01-Apr-20X6 |
| Number of Preference Shares | 10,000 |
| Face Value of Preference Shares | 150 |
| Total Proceeds | 15,00,000 |
| Rate of dividend | 10% |
| Market Rate for Similar Instrument | 15% |
| Transaction Cost | 30,000 |
| Face value after conversion | 10 |
| Effective interest rate | 15.86% |

## 35. Illustration

K ltd. issued 500,000, 6% convertible debentures @ Rs. 10 each on 01 April 20X1. The debentures are due for redemption on 31 March 20X5 at a premium of 10%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%.
You are required to separate the debt and equity components at the time of issue and show the accounting entries in Company's books at initial recognition. The following present values of Re 1 at 6% and at 10% are provided:

| Interest rate | Year 1 | Year 2 | Year 3 | Year 4 |
|---|---|---|---|---|
| 6% | 0.94 | 0.89 | 0.84 | 0.79 |
| 10% | 0.91 | 0.83 | 0.75 | 0.68 |

## 36. Illustration

On 1 April 20X1, an 8% convertible loan with a nominal value of Rs. 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 48,000 has already been paid and included as a finance cost.
Present value rates are as follows:

Year @ 8% @ 10%

| | | |
|---|---|---|
| 1 | 0.93 | 0.91 |
| 2 | 0.86 | 0.83 |
| 3 | 0.79 | 0.75 |
| 4 | 0.73 | 0.68 |

Explain how will the Company account for the above loan notes in the financial statements for the year ended 31 March 20X2?

## 37. Illustration

X Ltd. issues Rs. 1.5 crore convertible bonds on 1st April, 2018. The bonds have a life of 8 years and a face value of Rs. 10 each and offer interest @ 5.5% p.a. payable at the end of each financial year.

Bonds are issued at their face value and each bond can be converted into one ordinary share of X Ltd. 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 7% p.a.

You are required to:
(i) Provide the journal entries from financial year 2018-2019 to financial year 2021-2022;
(ii) Calculate the interest expenses across all eight years of the life of the convertible bonds;
(iii) Give the accounting entries if the holders of the bonds elect to convert the bonds to ordinary shares at the end of the fourth year (after receiving interest for the fourth year).

(14 Marks)

# Financial Assets, Financial Liabilities & Equity

## 1. Illustration

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

## 2. Illustration

Company A, an Indian company whose functional currency is Rs. enters into a contract to purchase machinery from an unrelated local supplier, company B. The functional currency of company B is also Rs. . However, the contract is denominated in USD, since the machinery is sourced by company B from a US based supplier. Payment is due to company B on delivery of the machinery.

| | |
|---|---|
| Contract/order date | 9 September 20X1 |
| Delivery/payment date | 31 December 20X1 |
| Purchase price | USD 1,000,000 |
| USD/Rs. Forward rate on 9 September 20X1 for 31 December 20X1 maturity | 67.8 |
| USD/Rs. Spot rate on 9 September 20X1 | 66.4 |
| USD/Rs. Forward rates for 31 December, on: | |

| | |
|---|---|
| 30 September | 67.5 |
| 31 December (spot rate) | 67.0 |

Company A is required to analyse if the contract for purchase of machinery (a capital asset) from company B contains an embedded derivative and whether this should be separately accounted for on the basis of the guidance in Ind AS 109. Also give necessary journal entries for accounting the same.

## 3. Illustration

Company Z is engaged in the business of importing oil seeds for further processing as well as trading purposes. It enters into the following types of contracts as on 1 October 20X1:

| Particulars | Contract 1 | Contract 2 | Contract 3 |
|---|---|---|---|
| Nature of Contract | Import of oil seeds from a foreign supplier | Purchase of oil seeds froma domestic producer / supplier | Contract to sell oil seeds on the commodity exchange |
| Quantity and rate | 100 MT at USD 400 per MT to be delivered as on 31 March 20X2 | 50 MT at Rs. 30,000 per MTto be delivered as on 31 January 20X2 | 50 MT at USD 450 per MT, maturing as on 15 January 20X2 |
| Net settlement clause includedin the contract | Yes | Yes | Yes |
| Net settlement in practice for similar contracts | There have also been several instances of theoil seeds being sold prior to or shortly after taking delivery. These instances of net settlement constitute approximately 30 per cent of the value of total import contracts. | Yes – company Z has net settled some of the domestic purchase contracts. However, these instances constitute only 1 per cent of the total domestic purchase contracts invalue. The remaining contractsare settled by taking delivery of oil seeds which are used for further processing. | Yes - these contracts are required to be net settled with the exchange on the maturity date. Company Z enters into these types of derivative contracts to hedge the risks on its domestic oil seeds purchase contracts |

Company Z is required to determine if the contracts entered into for purchase and sale of oil seeds are derivatives within the scope of Ind AS 109 or are executory contracts outside the scope of Ind AS 109.

# Recognition & Derecognition of Financial Instruments

## 1. Illustration

Entity A makes a five-year interest-bearing loan (the 'original asset') of Rs. 100 crores to Entity B. Entity A settles a Trust and transfers the loan to that Trust. The Trust issues participatory notes to an investor, Entity C, that entitle the investor to the cash flows from the asset.

As per Trust's agreement with Entity C, in exchange for a cash payment of Rs. 90 crores, Trust will pass to Entity C 90% of all principal and interest payments collected from Entity B (as, when and if collected). Trust accepts no obligation to make any payments to Entity C other than 90% of exactly what has been received from Entity B. Trust provides no guarantee to Entity C about the performance of the loan and has no rights

to retain 90% of the cash collected from Entity B nor any obligation to pay cash to Entity C if cash has not been received from Entity B.
Compute the amount to be derecognised.

## 2. Illustration

A financial asset is sold under repurchase agreement. The repurchase price as per that agreement is (a) fixed price or (b) sale price plus a lender's return. Let's look at three alternate scenarios:

i. Repurchase agreement is for the same financial asset.
ii. Repurchase agreement is for substantially the same asset
iii. Repurchase agreement provides the transferee a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date.

State whether the derecognition principles will be applied or not.

## 3. Illustration

A financial asset is sold and the transferor has a call option. Let's look at some alternate scenarios:

i. Call option is deeply in the money
ii Call option is deeply out of the money.

What if the transferor holds a call option on an asset that is readily obtainable in the market?

iii Call option is neither deeply in the money nor deeply out of the money State whether the derecognition principles will be applied or not.

## 4. Illustration

An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount.

Scenarios:

i. Notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time.
ii. Amortisation of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset.

State whether the derecognition principles will be applied or not.

## 5. Illustration

Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company D agrees to pay Rs. 91.5 crores, less a servicing charge of Rs. 1.5 crores (net proceeds of Rs. 90 crores), in exchange for 100% of the cash flows from short-term receivables.
The receivables have a face value of Rs. 100 crores and carrying amount of Rs. 95 crores.

The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses up to Rs. 5 crores, over and above the expected credit losses of Rs. 5 crores. The guarantee is estimated to have a fair value of Rs. 0.5 crores. Calculate the amount of continuing involvement asset.

## 6. Illustration

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs. 10,00,000, bearing interest at 10% (payable annually on 31st December each year). The bonds are redeemable on 31 December 20X9 for Rs. 10,00,000. 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:

- the term is extended to 31 December 20Y1;
- interest payments are reduced to 5% p.a.;
- the bonds are redeemable on 31 December 20Y1 for Rs. 15,00,000; and
- legal and other fees of Rs. 1,00,000 are incurred.

XYZ Ltd. determines that the market interest rate on 1 January 20X5 for borrowings on similar terms is 11%.

## 7. Illustration

On 1 January 20X0, XYZ Ltd. issues 10 year bonds for Rs. 1,000,000, bearing interest at 10% (payable annually 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 and other fees of Rs. 50,000 are incurred.

On 1 January 20X5, the discounted present value of the remaining cash flows of the original financial liability is Rs. 10,00,000.

## 8. Illustration

Wheel Co. Limited borrowed Rs. 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: Rs. 5,870,096 Effective interest rate on loan: 11.50%

On 31 December 20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3
- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2

## 9. Illustration

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

## 10. Illustration

Entity A originates a single 10 year amortising loan for CU1 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. At reporting date, the entity determines no change in PoD. Calculate loss allowance.

| | |
|---|---|
| Amount o/s | 1,000,000 |
| Loss | 25% |
| PoD | 0.5% |
| ECL (12m) | 1,000,000 x 25% x 0.5% = 1,250 |

## 11. Illustration

Bank A originates 2,000 bullet loans with a total gross carrying amount of CU 500,000. Bank A segments its portfolio into borrower groups (Groups X and Y) on the basis of shared credit risk characteristics at initial recognition. Group X comprises 1,000 loans with a gross carrying amount per client of CU 200, for a total gross carrying amount of CU 200,000. Group Y comprises 1,000 loans with a gross carrying amount per client of CU 300, for a total gross carrying amount of CU 300,000. There are no transaction costs and the loan contracts include no options (for example, prepayment or call options), premiums or discounts, points paid, or other fees. Calculate loss rate when

| Group | Historic per annum average defaults | Present value of observed loss assumed |
|---|---|---|
| X | 4 | CU 600 |
| y | 2 | CU 450 |
| | Total value of loan | Loss rate |
| X | 2,00,000 | 600/200,000 = 0.3% |
| y | 3,00,000 | 450/300,000 = 0.15% |

## 12. Illustration

Company M, a manufacturer, has a portfolio of trade receivables of CU 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 Ind AS 115. 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 expected credit losses.

Please use the following information of debtors outstanding:

| | Gross carrying amount |
|---|---|
| Current | CU 15,000,000 |
| 1-30 days past due | CU 7,500,000 |
| 31-60 days past due | CU 4,000,000 |
| 61-90 days past due | CU 2,500,000 |
| More than 90 days past due | CU 1,000,000 |
| | CU 30,000,000 |

Company M uses following default rates for making provisions:

| | Current | 1-30 days past due | 31-60 days past due | 61-90 days past due | More than 90 days past due |
|---|---|---|---|---|---|
| Default rate | 0.3% | 1.6% | 3.6% | 6.6% | 10.6% |

## 13. Illustration

An entity purchases a debt instrument with a fair value of Rs 1,000 on 15th March, 20X1 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5% over the contractual term of 10 years, and has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset. On 31st March 20X1 (the reporting date), the fair value of the debt instrument has decreased to Rs 950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that ECL should be measured at an amount equal to 12 month ECL, which amounts to Rs 30. On 1st April 20X1, the entity decides to sell the debt instrument for Rs 950, which is its fair value at that date. Pass journal entries for recognition, impairment and sale of debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided

## Comprehensive Illustrations

### 14. Illustration

As part of staff welfare measures, Y Co Ltd. has contracted to lend to its employees sums of money at 5% per annum rate of interest. The amounts lent are to be repaid in five equal instalments for principal along with the interest. The market rate of interest is 10% per annum for comparable loans. Y lent Rs. 1,600,000 to its employees on 1st January 20X1.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31 December 20X1, for the transaction and also compute the value of loan initially to be recognised and amortised cost for all subsequent years.

For the purpose of calculation, following discount factors at interest rate of 10% per annum may be adopted –

At the end of year –

| Year | Present value factor |
|---|---|
| 1 | .909 |
| 2 | .827 |
| 3 | .751 |
| 4 | .683 |
| 5 | .620 |

### 15. Illustration

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.

| | |
|---|---|
| Nature | Non-cumulative redeemable preference shares |
| Repayment: | Redeemable after 5 years |
| Date of Allotment: | 1-Apr-20X1 |
| Date of repayment: | 31-Mar-20X6 |
| Total period: | 5.00 years |
| Value of preference shares issued: | 100,000,000 |
| Dividend rate | 0.0001% |
| Market rate of interest | 12% per annum |
| Present value factor | 0.56743 |

PV of 100,000,000 at 12% = 0.56743 x 100,000,000
=56,743,000

### 16. Illustration

On 1st January 20X1, SamCo. 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. SamCo. Ltd. did not pay 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 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:

31-Mar : (25,000)
30-Jun : (15,000)
30-Sep : 12,000
Spot rate on 31-Dec : 66 per USD (FV = 20,000 x (66-68) i.e (40,000)

## 17. Illustration

Entity A (an Rs. functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an Rs. functional currency entity) to sell equipment on 30 June 20X1.

| | |
|---|---|
| Spot rate on 1 January 20X1: Rs. /USD | 45 |
| Spot rate on 31 March 20X1: Rs. /USD | 57 |
| Three-month forward rate on 31 March 20X1: Rs. /USD | 45 |
| Six-month forward rate on 1 January 20X1: Rs. /USD | 55 |
| Spot rate on 30 June 20X1: Rs. /USD | 60 |

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.

## 18. Illustration

Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Principal amount: 1,000,000
- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 January 20X1
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Mr. S, pre-pays Rs. 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to Rs. 400,000. Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109.

## 19. Illustration – Nov-22 [12 Marks]

On 1st April, 2021 "Fortunate Bank" has provided a loan of ` 25,00,000 to Mohan Limited for 4 years at 10% p.a. and the loan has been guaranteed by Surya Limited, which is a holding company for Mohan Limited. Interest payments are made at the end of each year and the principal is repaid at the end of the loan term. If Surya

Limited had not issued a guarantee, 'Fortunate Bank' would have charged Mohan Limited an interest rate of 14% p.a. Surya Limited does not charge Mohan Limited for providing the guarantee.

On 31st March 2022, there is 2% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2023, there is 4% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

On 31st March 2024, there is 5% probability that Mohan Limited may default on the loan in the next 12 months. If Mohan Limited defaults on the loan, Surya Limited does not expect to recover any amount from Mohan Limited.

You are required to provide accounting treatment of financial guarantee as per Ind AS 109 in the books of Surya Limited on initial recognition and in subsequent periods till 31st March, 2024.

# BUSINESS COMBINATION AND CORPORATE RESTRUCTURING

**Contents**

- Terms used in "Business Combination"
- Differences between Ind AS 103 and AS 14
- Purchase Consideration
- Goodwill
- Contingent payments to employee shareholders and acquirer share-based payment awards exchanged for awards held by the acquiree's employees.
- Subsequent measurement and accounting principles for reacquired rights, contingent liabilities, indemnification assets and contingent consideration
- Disclosure requirements under Ind AS 103

## 1 Introduction

A **business combination** is a transaction in which the acquirer obtains control of another business (the acquiree). These are the most common form of business transactions through which companies grow in size rather than organic activities.

## 2 Scope of Ind AS 103

Ind AS 103 is applicable to a transaction or other event that meets the definition of a business combination. It is not applicable to

a. The formation of a **joint arrangement**.
b. The acquisition of an asset or a group of assets that does not constitute a business i.e. it is an **asset acquisition**.

## 3 Control of a business

An entity obtains control of a business by

a. Acquiring net assets or acquiring its significant equity interest
b. Contract in which case the acquirer would neither have acquired net assets nor equity interest. (Controlling interest = zero and non-controlling interest = 100%).

## 4 Definition and Elements of Business

### 4.1 Definition of Business

Ind AS 103 defines business as

- an integrated set of activities and assets
- that is capable of being conducted and managed
- for the purpose of providing goods or services to customers,
- generating investment income (such as dividends or interest) or
- generating other income from ordinary activities.

> Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as business

### 4.2 Elements of Business

The three elements of a business are defined as follows:

**(a) Input**: Any economic resource that creates outputs or has the ability to contribute to the creation of outputs, when one or more processes are applied to it.

**For Example:**

Non-current Assets, intellectual property, ability to obtain access to necessary materials or rights and employees.

(b) **Process**: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates output or has the ability to contribute to the creations of outputs.
**For Example:**
Strategic management processes, operational processes and resource management processes

(c) **Output**: The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

### 4.3 Acquisition of Shell Company

The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, acquirer should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary.

### 4.4 Further Assessment – Substantive Process

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and a substantive processes applied to those inputs.
To determine whether **acquired process is substantive**, following has to be considered:

| No Output | Output is present |
|---|---|
| (i) It is critical to the ability to develop or convert an acquired input or inputs into outputs. | (i) It is critical to the ability to continue producing outputs. |
| (ii) The inputs acquired include<br>a. Organised workforce that has the necessary skills, knowledge, or experience to perform that process<br>b. Other inputs that the organised workforce could develop or convert into outputs. | (ii) The inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process |
| | (iii) Activities when applied to an applied inputs, significantly contributes to the ability to continue producing outputs and<br>a. Is considered unique or scarce<br>b. Cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs |

### 4.5 Asset Concentration Test (Optional)

- **Test is met**
  - Not a business
  - No Further assessment is needed
- **Test is not met**
  - Further assessment to be made

This test has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business. This test is optional and the decision to apply is made on a transaction-to-transaction basis.

**Conditions:**

The concentration test is met **if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets**.

**Three Step process for concentration test:**

Measure the Fair Value of Gross Assets acquired.

Identify the single identifiable assets or group of similar identifiable asset

Determine if substantially all of the value determined in Step 1 is concentrated in the value determined in Step 2. If yes, then it is an asset acquisition

For the concentration test –

(a) Gross assets acquired shall

- **Exclude** cash and cash equivalents, deferred tax assets, and goodwill resulting from the effects of deferred tax liabilities
- In fair value of the gross assets acquired shall **include** any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired.

(b) a single identifiable asset shall include

- Any asset or group of assets that would be recognized and measured as a single identifiable asset in a business combination
- A tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (or from an underlying asset subject to a lease, as defined in Ind AS 116, Leases), without incurring significant cost, or significant diminution in utility or fair value to either asset

(c) When assessing whether assets are similar, an entity shall consider the nature of each single identifiable asset and the risks associated with managing and creating outputs from the assets

(d) The following shall not be considered similar assets:

(i) a tangible asset and an intangible asset

(ii) tangible assets in different classes unless they are considered a single identifiable asset

(iii) identifiable intangible assets in different classes

(iv) a financial asset and a non-financial asset

(v) financial assets in different classes; and

(vi) Identifiable assets that are within the same class of asset but have significantly different risk characteristics.

**Fair Value of gross asset:**

(a) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)
(b) Fair value of liabilities assumed.
(c) Cash and cash equivalent and deferred tax assets and goodwill resulting from DTL's.

## 5 Business Combination – Definition

**Business combination occurs when an entity obtains control of a business by acquiring net assets or acquiring its significant equity interest.** The entity acquiring the business is called the acquirer and the entity transferring/selling the business is called acquiree.

A business combination may be structured in a variety of ways for legal, taxation or other reasons :

a. one or more businesses become subsidiaries of an acquirer : Tata acquired 1mg
b. the net assets of one or more businesses are legally merged into the acquirer : Kotak acquiring net assets of ING Vysya bank
c. The owners transfer their equity interests to another combining entity or its owners : Flipkart founders (Bansals) transferring stake to Walmart.
d. all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity : Vodafone and Idea form a new entity VodafoneIdea (VI)
e. a group of former owners of one of the combining entities obtains control of the combined entity. : Bjyu's owners controlling Byju's +Akash

## 6 Differences between Business Combination and Acquisition of group of assets

A business combination is different from acquisition of group of assets. A group of assets may not meet the definition of business as explained above.

| Particulars | Business Combination | Acquisition of group of assets |
|---|---|---|
| Intangible Assets | Recognise at fair value, if they are separately identifiable | Recognised and measured based on an allocation of the overall cost of the transaction with reference to their relative fair values |
| Goodwill | Recognised as a separate asset | No goodwill would be recognised |
| Acquisition related costs | Expensed in the period in which such costs are incurred. | Capitalised as a component of the cost |
| Deferred Tax Accounting | Deferred taxes are recorded on temporary differences of assets acquired (other than goodwill) and liabilities assumed in a business combination. | No deferred taxes are recognised for temporary differences on asset acquisitions (on initial recognition). |
| Gain on bargain purchases | Gain is recognised by the acquirer in other comprehensive income and accumulates the same in equity as capital reserve. | No gain is recognised for a bargain purchase. |
| Contingent liabilities assumed | To be recognised if represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss. | Not recognised, subject to Ind AS 37. |

## 7 Acquisition Accounting for Business Combinations

The following key steps are involved in the acquisition accounting for business combinations

| Step 1 | Step 2 | Step 3 | Step 4 |
|---|---|---|---|
| • Identifying the acquirer | • Determining the acquisition date. | • Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree | • Recognising and measuring goodwill or a gain from a bargain purchase |

## 8 Identifying Acquiring Enterprise

### 8.1 The Acquiring enterprise / Acquirer

**The acquiring enterprise is the enterprise which obtains control** (control is defined in Ind AS 110)

As per Ind AS 110 'Consolidated Financial Statements', an investor controls an investee if and only if the investor has **all** the following:

(a) power over the investee
(b) exposure, or rights, to variable returns from its involvement with the investee.
(c) The ability to use its power over the investee to affect the amount of the investor's returns.

In order to ascertain control do not look at the voting rights only. Evaluate otherfactors also like board control, potential voting rights etc.

Control assessment does not depend only on voting rights. It also depends upon the following

(a) Potential voting rights
(b) Rights of non-controlling shareholders; and
(c) Other contractual right of the investor if those are substantive in nature.

### 8.2 Acquisitions through payment of cash or incurring of liability

In these cases, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

### 8.3 Acquisitions through issue of equity instrument

In these cases, the acquirer is usually the entity that issues its equity interests. However, in case of "reverse acquisitions" the issuing entity is acquiree.

**Other Relevant facts and circumstances in identifying the acquirer effected by exchanging equity interests**

| Facts and circumstances | Acquirer |
|---|---|
| Relevant voting rights in combined entity after the business combination | Combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity<br><br>An entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities. |

| | |
|---|---|
| Existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest: | Combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity |
| The composition of the governing body of the combined entity: | Combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity |
| The composition of the senior management of the combined entity: | Combining entity whose (former) management dominates the management of the combined entity. |
| The terms of the exchange of equity interests | Combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities. |

### 8.4 Acquisitions involving Shell Company and Reverse Acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. For e.g Entity A legally acquires Entity B by issuing shares to owners of Entity B. Post acquisition, the shareholders of B hold 70% of stake in combined entity. Though for legal purpose, Entity A is the acquirer, for accounting purpose Entity B is considered as the acquirer since in substance owners of B controls the combined entity.

Reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. The public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

| | |
|---|---|
| Public Entity | Acquiree for the accounting purpose.<br>It must meet the definition of a business for the transaction to be accounted for as a reverse acquisition. (Ind AS 103 will apply) |
| Private Entity | Acquirer for accounting purposes |

## 9 Determining the Acquisition Date

Acquisition date is

(a) The date on which the acquirer obtains control of the acquire.
(b) Acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquire
(c) Acquiree’s results are consolidated from this date

## 10 Determination of the Purchase Consideration

Purchase consideration is

(a) Fair Value of assets transferred (including cash) to the former owners + liabilities incurred by the

(b) FV of Contingent consideration

(c) Equity interests issued by the acquirer.

Acquirer's share-based payment awards exchanged for awards held by the acquiree's employees *shall be measured in accordance with the requirements of Ind AS 102*

| Situation | Action point |
|---|---|
| Consideration transferred includes assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date | The acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in the statement of profit and loss. |
| Transferred assets or liabilities remain within the combined entity after the business combination and the acquirer therefore retains control of them | • The acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date<br>• Shall not recognise a gain or loss in statement of profit and loss on assets or liabilities it controls both before and after the business combination.<br>• The asset transferred will affect the amount of NCI and goodwill that is recognised. |

### 10.1 Business Combination achieved in stages (Step Acquisition)

When an entity acquires another entity step by step through series of purchase, then the acquisition date will be the date on which the acquirer obtains control.

In step acquisition, the acquirer shall

(i) Remeasure its previously held equity interest in the acquiree at its acquisition-date fair value

(ii) Recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

The amount that was recognised in other comprehensive income in prior periods shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

When a party to a joint operation, obtains control of a joint operation business, the transaction will be considered as a business combination achieved in stages. The acquirer should re-measure its previously held interest in the joint operation at fair value at the acquisition date.

### 10.2 Business Combination achieved without the transfer of Consideration

These circumstances include

(a) The acquiree **repurchases a sufficient number of its own shares** for an existing investor (the acquirer) to obtain control

(b) **Minority veto rights lapse** that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses by **contract** alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously.

The equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.

### 10.3 Direct Cost of Acquisition

Any direct cost of acquisition should be recorded directly in profit and loss account and should not be included in purchase consideration

**For Example:** finder's fees, due diligence cost accounting, legal fees, investment banker fees, bonuses paid to employees for doing a successful acquisition

### 10.4 Contingent Consideration

The acquirer shall recognise the acquisition-date **fair value** of **contingent consideration** as part of the consideration transferred in exchange for the acquire.

The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability (or) shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

## 11 Purchase Price Allocation

The acquirer shall and measure all the assets and liabilities acquired on the acquisition date at FV.

### 11.1 Recognition

(a) Identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities at the acquisition date.

(b) Assets and liabilities which have been assumed as a part of the business combination deal should only be recorded. Any other assets which are not related to the acquisition should be accounted as per applicable Ind As.

(c) Assets / Liabilities not recognised by acquiree would also be recognised if it meets the recognition criteria.

**For example:**

The acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

### 11.2 Measurement

(a) The acquirer shall measure the **identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**

(b) For each business combination, the acquirer shall measure at the acquisition date components of **non-controlling interest in the acquiree** that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either

(i) fair value; or

(ii) proportionate share in the recognised amounts of the acquiree's identifiable net assets

### 11.3 Exception to the recognition and measurement principle

These exception principles are only limited to acquisition date accounting and may be different than the requirements of other accounting standards. This will result in

**Scenario 1**
- An asset or liability which otherwise would not have been recorded gets recorded

**Scenario 2**
- The assets and liabilities are measured at a value other than the acquisition date fair values.

<table>
<tr><td colspan="2">Recognition Exceptions</td></tr>
<tr><td>Contingent Liability</td><td>
<table>
<tr><th>Outcome</th><th>Ind AS 37</th><th>Business Combination</th></tr>
<tr><td>Possible Obligation</td><td>Not recognised</td><td>Not recognised</td></tr>
<tr><td>Present obligation - not probable that an outflow of economic benefits will occur</td><td>Not recognised</td><td>Recognised if reliably measured at Fair Value.</td></tr>
<tr><td>Present obligation - probable that an outflow of economic benefits will occur, but cannot be measured reliably</td><td>Not recognised</td><td>Not recognised</td></tr>
</table>
The FV of contingent liability is considered on date of acquisition.</td></tr>
<tr><td colspan="2">Both Recognition and Measurement Exceptions</td></tr>
<tr><td>Income Taxes</td><td>(a) No deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. (Ind AS 12)<br>(b) The acquirer shall account for the potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with Ind AS 12.</td></tr>
<tr><td>Post retirement obligation</td><td>The acquirer records the fair value of the obligations for any post retirement obligation as per the principles of Ind AS 19 which is an exception of the general fair value rule</td></tr>
<tr><td>Indemnification Assets</td><td>The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a</td></tr>
</table>

| | |
|---|---|
| | specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency.<br><br>The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item (liability) measured on the same basis as the indemnified item |
| Leases | **Acquiree is a lessee:**<br>(i) The acquirer shall recognise right-of-use assets and lease liabilities for leases and measure at same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.<br>(ii) The acquirer shall measure the lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date.<br>(iii) The acquirer is not required to recognise right-of-use assets and lease liabilities for - leases for which the remaining lease term ≤ 12 months of the acquisition date; or leases for which the underlying asset is of low value.<br><br>**Acquiree is a lessor:**<br>In measuring the acquisition-date fair value of an asset, the acquirer shall take into account the terms of the lease. The acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms. |
| Assembled workforce | The acquirer subsumes into Goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. |
| **Measurement Exceptions** | |
| Reacquired rights | These are the rights which the acquirer before acquisition may have granted to the acquiree to use certain assets which belongs to the acquirer.<br><br>The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract without considering the effect of potential renewals. |
| Intangible Assets | The acquirer shall record separately from Goodwill, the identifiable intangible acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion. |
| Share based transactions | Measured in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date. |
| Assets held for sale | Measured in accordance with Ind AS 105, at fair value less costs to sell in accordance with that Ind AS. |

## 11.4 Intangible Assets

| | |
|---|---|
| **Recognition of Intangible Asset in Business Combination** | Transaction meets the definition of Asset |
| | Asset is identifiable either by Contractual/Legal criteria or separability Criteria |

**Contractual Legal Criteria:**
An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.
**For Example:**
Technology patent, nuclear power plant

**Separability Criteria:**
Sometimes, an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability.

**Assembled Workforce and other items that are not identifiable:**
Assembled workforce is not an identifiable asset to be recognised separately from goodwill. Any value attributed to it is subsumed into goodwill.
An assembled workforce does not represent the intellectual capital of the skilled workforce—the knowledge and experience that employees of an acquiree bring to their jobs.

**Reacquired Rights**
A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill.If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss.

## 11.5 Goodwill recognition and measurement

| | |
|---|---|
| **Fair value of** | |
| - **Purchase consideration** (Including contingent consideration) | 1 |
| - **Existing Stake** | 2 |
| **Value of NCI** | |
| - **Fair value** | 3 |
| - **Proportion of net assets** | |
| **Total [A]** | 1+2+3 |
| | |
| **Fair value of identifiable Net Assets** (Including FV of contingent liabilities) | 4 |
| **Total [B]** | 4 |
| **Goodwill** (If A > B) | **A-B** |
| **Bargain Purchase** (If A < B) | **B-A** |

Recognise Goodwill as of the acquisition date measured as the excess of

Aggregate of:

(i) the purchase consideration transferred at acquisition-date fair value

(ii) The amount of any non-controlling interest in the acquiree

(iii) the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree. **(Stage wise combination)**

Fair value of of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

## 11.6 Goodwill Vs Bargain Purchase

Bargain purchase is a circumstance where the value of net assets acquired in a business combination exceeds the purchase consideration.

The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve.

The gain shall be attributed to the acquirer and there will no allocation to the non-controlling shareholders.

A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion.

If consideration paid > Net assets, the difference is called as Goodwill

If consideration paid < Net assets, the difference is called gain on bargain purchase

## 11.7 Measurement period

**Information not available on the acquisition date:**

- Do the purchase price allocation on a provisional basis.
- Adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date retrospectively
- Recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable.

The measurement period shall not exceed one year from the acquisition date. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Ind AS:

- the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquire
- the consideration transferred for the acquiree (or the other amount used in measuring goodwill); • in a business combination achieved in stages, the equity interest in the acquire previously held by the acquirer; and
- The resulting goodwill or gain on a bargain purchase.

Any change i.e. increase or decrease in the net assets acquired due to new information available during the measurement period which existed on the acquisition date will be adjusted against goodwill. However, after the measurement period ends, any change in the value of assets and liabilities due to an information which existed on the valuation date will be accounted as an error as per Ind AS 8, Accounting policies, Changes in Accounting Estimates and Errors.

### 11.8 Determining what is part of the business combination transaction

The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. The acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, i.e. amounts that are not part of the exchange for the acquiree.

The following are examples of separate transactions that are not to be included in applying the acquisition method:

(a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree –e.g. a law suit or a supply contract.

(b) a transaction that remunerates employees or former owners of the acquiree for future services; and

(c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

### 11.9 Contingent Payment to Employees or Selling Shareholders

Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

| **Post acquisition compensation** | **Contingent Consideration for acquisition** |
|---|---|
| *Selling shareholders become employees and payment will not be made if service terminated.* | *Selling shareholders become employees and payment will be made even if service terminated.* |
| *Duration of employment equal or greater than contingent payment period* | *Duration of employment is shorter than the contingent payment period.* |
| *Compensation is reasonable* | *Compensation is not reasonable (excess)* |
| | *Selling shareholders who do not become employees receive less payment. In such cases the excess* |

| | |
|---|---|
| | *compensation represents consideration for acquisition* |
| *Shareholders holding few shares continue as employees* | *Shareholders holding high number of shares continue as employees* |
| *Valuation is appropriate* | *Valuation for the purpose of combination is at the lower end* |
| *Contingent payment based on profit sharing arrangement* | *Contingent payment based on multiple of earnings to determine valuation* |

## 11.10 Acquirer SBP awards exchanged for Awards held by Acquiree's employees

Students are required to complete Ind AS 102 to understand this section better.

- An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. Reliance acquired 1mg. The employees of 1mg had ESOPs granted by 1mg. Reliance can replace ESOPs granted by 1mg by its own ESOPs.

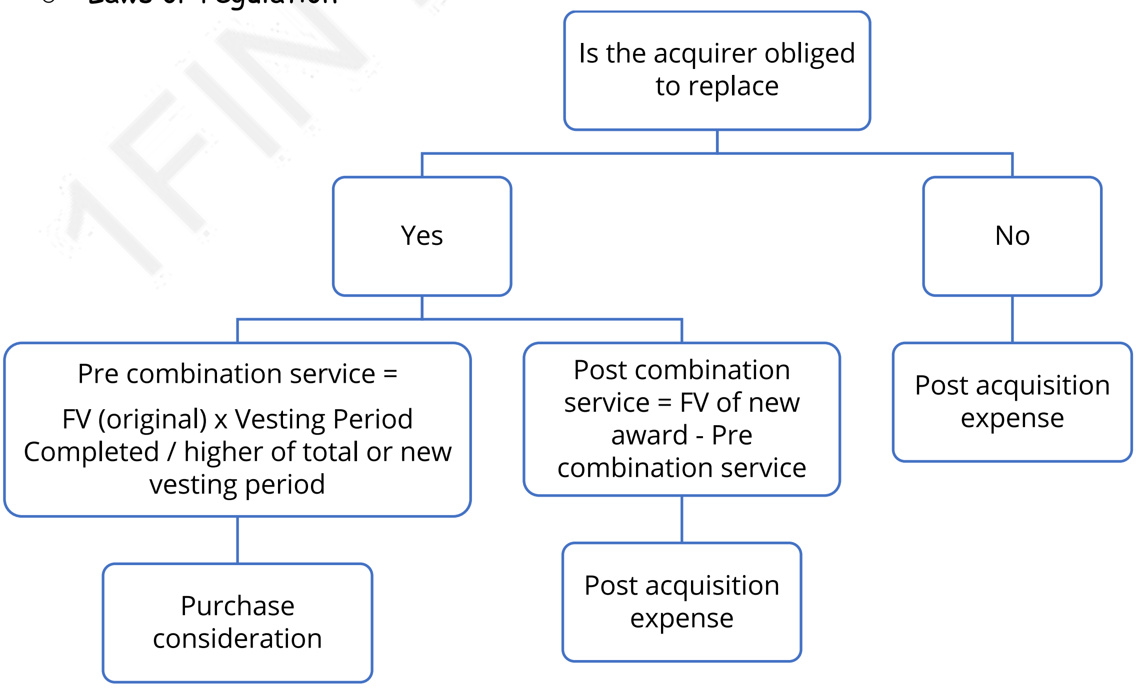
- The above share based payment awards will include vested and unvested shares.

- Exchanges of share options or other share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with Ind AS 102, Share based Payment.

- The replacement of awards will be considered to calculate consideration for acquisition.

- If acquiree SBP expire due to acquisition, then the replacement awards are considered to be post acquisition expenses.

- **Replacement awards which should be considered for determining purchase consideration are those which the acquirer is obliged** due to
  - Terms of acquisition agreement
  - Terms of existing SBP awards
  - Laws or regulation




Total vesting period = Vesting Completed + New Vesting period

### 11.11 Non Replacement Awards

In some cases, the acquiree's awards are not replaced.

- In case shares are vested – These represent NCI and are measured at their market based measure.
- In case shares are unvested – Treat as per 11.10

## 12 Subsequent Measurement and Accounting

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable Ind AS for those items, depending on their nature. However, Ind AS 103 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

| Asset acquired | Action point |
|---|---|
| Reacquired rights | Amortise over the remaining contractual period of the contract in which the right was granted.<br>An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale. |
| Contingent Liabilities | Recognise at higher of<br>(a) the amount that would be recognised in accordance with Ind AS 37<br>(b) the amount initially recognised less, if appropriate, the cumulative amount of income recognised. |
| Indemnification Asset | At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount<br>The acquirer shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it. |
| Contingent consideration | The acquirer shall account for changes in the fair value of contingent consideration as follows:<br>(a) Contingent consideration classified as equity shall not be re-measured and its subsequent settlement shall be accounted for within equity.<br>(b) Other contingent consideration that is measured at fair value with gain or loss recognised in P&L. |

## 13 Common Control Business Combinations

- Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
- Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group.
- The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities

under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.
- The fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements of the group in accordance with Ind AS 27 is not relevant to determining whether a combination involves entities under common control.
- An entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind ASs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control.
- A group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

## 14 Method of accounting for common control business combinations

Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interest method.**
The pooling of interest method is considered to involve the following:
(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.
(ii) No adjustments are made to reflect fair values or recognise any new assets or liabilities. The only adjustments that are made is to harmonise accounting policies.
(iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

**Consideration:**
The consideration may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

**Balance of the retained earnings:**
Balance appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.
The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.
Difference between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes.

## 15 Disclosures

The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

a) during the current reporting period; or

b) after the end of the reporting period but before the financial statements are approved for issue.

Ind AS 103 requires detailed disclosures on Business Combination. The acquirer shall disclose the following information for each business combination that occurs during the reporting period:

a. the name and a description of the acquiree.
b. the acquisition date.
c. the percentage of voting equity interests acquired.
d. the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
e. a qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors.
f. the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
   I. cash;
   II. other tangible or intangible assets, including a business or subsidiary of the acquirer;
   III. liabilities incurred, for example, a liability for contingent consideration; and
   IV. equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
g. for contingent consideration arrangements and indemnification assets:
   i. the amount recognised as of the acquisition date;
   ii. a description of the arrangement and the basis for determining the amount of the payment; and
   iii. an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.

h. for acquired receivables:
   i. the fair value of the receivables;
   ii. the gross contractual amounts receivable; and
   iii. the best estimate at the acquisition date of the contractual cash flows not expected to be collected. The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.

i. the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.

j. for each contingent liability recognised, the information required in paragraph 85 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:

   i. the information required by paragraph 86 of Ind AS 37; and
   ii. the reasons why the liability cannot be measured reliably.

k. the total amount of goodwill that is expected to be deductible for tax purposes.

n. in a bargain purchase
   i. the amount of any gain recognised in other comprehensive income in accordance with paragraph 34;
   ii. the amount of any gain directly recognised in equity in accordance with paragraph 36A; and
   iii. a description of the reasons why the transaction resulted in a gain in case of (i) above.

o. for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:
   i. the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
   ii. for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.

p. in a business combination achieved in stages:
   i. the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
   ii. the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination (see paragraph 42) and the line item in the statement of profit and loss in which that gain or loss is recognised.

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are approved for issue, the acquirer shall disclose the information required as above unless the initial accounting for the business combination is incomplete at the time the financial statements are approved for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

To meet the objective of the Ind AS 103 disclosure requirements, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

a) if the initial accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally
   i. the reasons why the initial accounting for the business combination is incomplete;
   ii. the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
   iii. the nature and amount of any measurement period adjustments recognised during the reporting period.

b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:

i. any changes in the recognised amounts, including any differences arising upon settlement;

ii. any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

iii. the valuation techniques and key model inputs used to measure contingent consideration.

c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of Ind AS 37 for each class of provision.

d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:

i. the gross amount and accumulated impairment losses at the beginning of the reporting period.

ii. additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

iii. adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period

iv. goodwill included in a disposal group classified as held for sale in accordance with Ind AS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale

v. impairment losses recognised during the reporting period in accordance with Ind AS 36. (Ind AS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

vi. net exchange rate differences arising during the reporting period in accordance with Ind AS 21, The Effects of Changes in Foreign Exchange Rates.

vii. any other changes in the carrying amount during the reporting period.

viii. the gross amount and accumulated impairment losses at the end of the reporting period.

e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:

i. relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and

ii. is of such a size, nature or incidence that disclosure is relevant to understand the combined entity's financial statements.

*Students are advised to read the disclosure couple of times to gain an understanding.*

## 16 Significant difference between Ind AS 103 and AS 14

| **Basis** | **Ind AS** | **AS 14** |
|---|---|---|
| Primary guidance | Ind AS 103 – Business Combination | AS 14 – Amalgamation<br>AS 21 – Consolidated Financial Statements |
| Amalgamation methods | • Acquisition method only.<br>• Pooling of interest method is applicable only when there is combination of entities which are under common control | • Purchase method<br>• Pooling of interest method |

| | | |
|---|---|---|
| Fair value | The consideration, identifiable assets, identifiable liabilities have to be fairly valued | No specific guidance under AS 14 |
| Non-controlling interest | Provides guidance. It is measured either at fair value or proportionate share in the fair value of net assets | No specific guidance in AS 14.<br>AS 21 provides guidance to be measured at share in the net assets method. |
| Acquisition related costs | Acquisition related costs such as finder's fee, due diligence costs, etc. are expensed as incurred. | There is no specific guidance, but they are generally capitalised. |
| Goodwill or capital reserve (gain on bargain purchase) | Gain on bargain purchase is recognised in OCI if there is sufficient evidence that shows the appropriateness of bargain purchase gain.<br>Goodwill is not amortised but tested for impairment annually | Difference between the purchase consideration and the net assets acquired is recorded as goodwill or capital reserve (presented as equity) as the case may be.<br>Goodwill arising on amalgamation is amortised over its useful life not exceeding five years unless a longer period is justified.<br>There is no specific guidance on goodwill arising on subsidiaries acquired which are not amalgamations.<br>In practice, such goodwill is not amortised but tested for impairment. |
| Asset acquisition | Similar to Indian GAAP | The transactions that do not meet the definition of amalgamation / acquisition of a subsidiary, are accounted as asset acquisitions without any goodwill or capital reserve recognised separately and the consideration is apportioned to the various assets on a fair value basis as determined by competent valuers. |
| Contingent consideration | Initially recognised at acquisition date fair value<br>**Subsequent measurement:**<br>• Contingent consideration classified as equity is not remeasured.<br>• Contingent consideration classified as liability generally remeasured at fair value with changes at every reporting period end until settlement, with changes in fair value recognised in profit or loss. | Contingent consideration is included in the purchase consideration as at the date of amalgamation, if payment is probable and a reasonable estimate of the amount can be made.<br>In other cases, the adjustment is recognised in the profit and loss account as and when it becomes determinable.<br>Others:<br> There is no specific guidance. In practice, contingent consideration is recognised when the contingency is resolved. |

| | | |
|---|---|---|
| In-process research and development | • Initially recognised at acquisition date fair value.<br>• Subsequently measured in accordance with Ind AS 38 | There is no specific guidance. |
| Measurement period | Ind AS 103 provides for a measurement period after the acquisition date for the acquirer to adjust the provisional amounts recognised to reflect the additional information that existed as at the date of acquisition.<br>The measurement period is limited to one year from the acquisition date. | There is no specific guidance |
| Step Acquisition | Any equity interest in the acquiree held by the acquirer immediately before obtaining the control over the acquiree is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss | If two or more investments are made over a period of time, the equity of the subsidiary at the date of investment is generally determined on a step-by-step basis. |
| Transactions between entities under common control | Appendix C to Ind AS 103 provides detailed guidance which is very similar to the pooling of interest method as specified by AS 14. | There is no specific guidance. |

## 17 Carve-in and Carve-out from IFRS

| | IFRS-3 | Ind AS 103 |
|---|---|---|
| Carve-out | Bargain purchase gain arising on business combination to be recognised in profit or loss as income | Bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve |
| Carve-in | Excludes from its scope business combinations of entities under common control. | Appendix C of Ind AS 103, Business Combinations gives guidance in this regard. |

## Illustrations

### 1. Illustration

Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of Rs. 10 each. The quoted market price of shares of Nafa Ltd. was Rs. 12 on the date acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was Rs. 80,00,000.

Bima Ltd. wired Rs. 50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was Rs. 25 per share. Bima Ltd. also agrees to pay additional consideration of Rs. 15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds Rs. 1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is Rs. 9,80,000. Nafa Ltd. incurred Rs. 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value. How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry.

### 2. Illustration

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for Rs. 8,000 crore. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28. At 31st March, 20X2, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

| | (Rs. in crore) |
|---|---|
| Share of profit or loss | 700 |
| Share of exchange difference in OCI | 100 |
| Share of revaluation reserve of PPE in OCI | 50 |

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore Rs. 8,850 crore (8,000 + 700 + 100 + 50).

On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash Rs. 25,000 crore.

The following additional information is relevant at that date:

| | (Rs. in crore) |
|---|---|
| Fair value of the 30% interest already owned | 9,000 |
| Fair value of XYZ's identifiable net assets | 30,000 |

How should such business combination be accounted for?

### 3. Illustration

Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On 1st November, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

Consideration: Company A transfers cash of Rs. 59,00,000 and issues 1,00,000 shares on 1st November. The market price of Company A's shares on the date of issue is Rs. 10 per share.

Contingent consideration: Company A agrees to pay additional consideration of
Rs. 7,00,000 if the cumulative profits of Company B exceed Rs. 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be
Rs. 3,00,000 at the acquisition date.

Transaction costs: Company A pays acquisition-related costs of Rs. 1,00,000.

Non-controlling interests (NCI): The fair value of the NCI is determined to be
Rs. 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.

Previously held non-controlling equity interest: Company A has owned 25% of the shares in Company B for several years. At 1st November, the investment is included in Company A's consolidated balance sheets at Rs. 6,00,000, accounted for using the equity method; the fair value is Rs. 20,00,000.

The fair value of Company B's net identifiable assets at 1st November is Rs. 60,00,000, determined in accordance with Ind AS 103.
Determine the accounting under acquisition method for the business combination by Company A.

## 4. Illustration

Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of Rs. 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at Rs. 15 crores and Rs. 100 crores respectively.
Find the value at which NCI has to be shown in the financial statements.

## 5. Illustration FVTOCI & ACM

On 1st April, 20X1, Company A acquired 5% of the equity share capital of Company B for 1,00,000. A accounts for its investment in B at Fair Value through OCI (FVOCI) under Ind AS 109, Financial Instruments: Recognition and Measurement. At 31st March, 20X2, A carried its investment in B at fair value and reported an unrealised gain of Rs. 5,000 in other comprehensive income, which was presented as a separate component of equity. On 1st April, 20X2, A obtains control of B by acquiring the remaining 95 percent of B.
Comment on the treatment to be done based on the facts given in the question.

## 6. Illustration

ABC Ltd. a pharmaceutical group acquires XYZ Ltd. another pharmaceutical business. XYZ Ltd. has incurred significant research costs in connection with two new drugs that have been undergoing clinical trials. Out of the two drugs, one drug has not been granted necessary regulatory approvals. However, ABC Ltd. expects that approval will be given within two years. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons why entity ABC Ltd. decided to acquire entity XYZ Ltd. Whether the research and development on either of the drugs be recognised as an intangible asset in the books of ABC Ltd.?

## 7. Illustration

ABC Ltd. acquires PQR Ltd. for a consideration of Rs. 1 crore. Four years ago, ABC Ltd. had granted a ten-year license allowing PQR Ltd. to operate in Europe. The cost of the license was Rs. 2,50,000. The contract allows either party to terminate the franchise at a cost of the unexpired initial fee plus 20%. At the date of acquisition, the settlement amount is Rs. 1,80,000 [(Rs. 2,50,000 x 6/10) + 20%].

ABC Ltd. has acquired PQR Ltd., because it sees high potential in the European market and wishes to exploit it. ABC Ltd. calculates that under current economic conditions and at current prices it could grant a six-year franchise for a price of Rs. 4,50,000.

How is the license accounted for as part of the business combination?

## 8. Illustration

Vadapav Ltd. is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd. is one of the franchisee of Vadapav Ltd. and is and operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1st April, 20X2. On the acquisition date, Vadapav Ltd. determines that the license agreement reflects current market terms.

## 9. Illustration

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of Rs. 15 crore. The former owners of B Ltd. were required to dispose off their investments in B Ltd. by a specified date, and accordingly they did not have sufficient time to find potential buyers. A qualified valuation professional hired by the management of A Ltd. measures the identifiable net assets acquired, in accordance with the requirements of Ind AS 103, at Rs. 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at Rs. 4.2 crore. How should A Ltd. recognise the above bargain purchase?

## 10. Illustration

Scenario 1: New information on the fair value of an acquired loan

Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B's financial statements for the year ended 30th September, 20X1, which indicate significant decrease in Borrower B's income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.

Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period.
Bank F acquires Bank E in a business combination in October, 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.
Comment on the treatment done by Bank F.

## 11. Illustration

Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of Rs. 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at Rs. 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.
State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process

Fair value of Net Assets - 10 Mio

Fair value of Consideration – 5 Mio
Value of NCI – 30 % x 10 Mio = 3 Mio

Total = 8 Mio

Gain on bargain purchase = 2 Mio.

## 12. Illustration

On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of Rs. 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at Rs. 500 and the liabilities assumed are measured at Rs. 100. Alpha Ltd. engages on independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is Rs. 84.
Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.
Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied?

## 13. Illustration

ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 20X1, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 20X1, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 20X1, the market value of an equity share in ABC Ltd. was Rs. 6.50 and the market value of an equity share in JKL Ltd. was Rs. 6.

- On 30th June, 20X2, ABC Ltd. will make a cash payment of Rs. 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. On 1st July, 20X1, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.

- On 30th June, 20X3, ABC Ltd. may make a cash payment of Rs. 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 20X1. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 20X1 to 30th June, 20X3. On 1st July, 20X1, the fair value of this contingent consideration was Rs. 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was Rs. 2,20,00,000.

On 1st July, 20X1, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was Rs. 6,00,00,000. On 1st July, 20X1, the fair values of these net assets was Rs. 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.
During the nine months ended on 31st March, 20X2, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 20X2 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non- controlling interest in JKL Ltd. at the acquisition date.

## 14. Illustration

How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:
On 1 April 20X1, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of Rs. 10 per share;
b. a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds Rs. 1 crore.
    i. The fair value of the shares of A Ltd. on the date of acquisition is Rs. 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs. 25 lakhs.
    ii. During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded Rs. 1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is Rs. 25 per share.
    iii. Continuing with the fact pattern in (a) above except for:
c. The number of shares to be issued after one year is not fixed.

d. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after a year.

## 15. Illustration

As part of its business expansion strategy, KK Ltd. is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, KK Ltd. has acquired on 1st April, 20X1, 100% shares of ABR Ltd. that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at Rs. 35 crores. The fair value of ABR Ltd.' s net assets was Rs. 15 crores, but does not include:

(i) A patent owned by ABR Ltd. for an established successful intermediate drug that has a remaining life of 8 years. A consultant has estimated the value of this patent to be Rs. 10 crores. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated Rs. 15 crores.

(ii) ABR Ltd. has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was Rs. 12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at Rs. 20 crores.

(iii) ABR Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the Company has been granted an exclusive five-year license to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is a valuable asset which assures guaranteed sales and the value for the same is estimated at Rs. 10 crores.

KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS.

## 16. Illustration

Entity A acquires entity B. Entity A agrees with the former shareholders of entity B to pay Rs. 900, with an additional payment of Rs. 500 if the subsequent earnings of entity B reach a specified target in three years. The former shareholders also become employees. On the acquisition date, the fair value of the net assets of entity B amount to Rs. 850, and the fair value of additional payment is estimated at Rs. 200. At the acquisition date, the outflow of additional payment is not probable.
Over the next three years, the cumulative earnings of entity B (before considering the effects of the additional payments) amount to Rs. 1,050. At the end of year three, entity A pays Rs. 500 as the conditions were met.
State the impact on the financial position and results of classifying the payments as remuneration and contingent consideration.

## 17. Illustration

X Ltd. agreed to takeover Y Ltd. as on 1 October, 2018. No Balance Sheet of Y Ltd. was prepared on that date: Summarised Balance Sheets of X Ltd. and Y Ltd. as at 31st March 2018 is as below.

| Liabilities | X Ltd (Rs.) | Y Ltd (Rs.) | Assets | X Ltd (Rs.) | Y Ltd (Rs.) |
|---|---|---|---|---|---|
| Equity of Rs.10 each fully paid | 20,00,000 | 15,00,000 | Fixed assets | 15,50,000 | 12,60,000 |
| Reserves and Surplus: | | | Current Assets: | | |
| Reserve | 3,90,000 | 3,40,000 | Stock | 5,35,500 | 3,81,500 |
| Profit & Loss A/c | 3,30,000 | 1,60,000 | Debtors | 3,49,500 | 2,31,000 |

| | | | | | |
|---|---|---|---|---|---|
| Creditors | 85,000 | 75,000 | Bank | 3,40,000 | 1,80,000 |
| | | | Miscellaneous Expenditure: | | |
| | | | Preliminary Expenses | 30,000 | 22,500 |
| Total | 28,05,000 | 20,75,000 | Total | 28,05,000 | 20,75,000 |

Additional information available:

(i) For the six months period from 1st April 2018, X Ltd. and Y Ltd. made profits of Rs. 5,40,000 and Rs. 3,60,000 respectively, after writing off depreciation @ 10% per annum on their fixed assets.

(ii) Both the companies paid on 1 August 2018, equity dividends of 10%. Dividend tax at 15% was paid, by each of them on such payments.

(iii) Goodwill of Y Ltd. was valued at Rs.1,68,900 on the date of takeover. Stock of Y Ltd., subject to an abnormal item of Rs. 8,500 to be fully written off, would be appreciated by 20% for purpose of takeover.

(iv) X Ltd. would issue to Y Ltd.'s shareholders fully paid equity shares of Rs.10 each, on the basis of the comparative intrinsic values of the shares on the date of takeover.

You are required to:

(1) Calculate consideration to be transferred by X Ltd.

(2) Calculate Number of shares to be issued by X Ltd. to Y Ltd.

(3) Ascertain closing bank balance which will appear in the Balance Sheet of X Ltd. (After absorption of Y Ltd.).

## 18. Illustration

AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X1

| ASSETS | AX(000) | BX(000) |
|---|---|---|
| Non Current Assets | | |
| Property, Plant and Equipment | 8,500 | 7,500 |
| Financial assets | | |
| Investment | 1,050 | 550 |
| Current assets | | |
| Inventory | 1,250 | 2,750 |
| Financial assets | | |
| Trade receivables | 1,800 | 4,000 |
| Cash and Cash equivalent | 450 | 400 |
| **Total** | **13,050** | **15,200** |
| EQUITY AND LIABILITIES | | |
| Equity | | |
| Equity share capital (of face value of Rs. 10 each) | 6,000 | 7,000 |
| Other equity | 3,050 | 2,700 |

| | | |
|---|---|---|
| Liabilities | | |
| Non-current liabilities | | |
| Financial liabilities | | |
| Borrowings (12% Debentures) | 3,000 | 4,000 |
| Current liabilities | | |
| Financial liabilities | | |
| Trade payables | 1,000 | 1,500 |
| **Total** | 13,050 | 15,200 |

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.
Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd.

The fair value of net assets of AX and BX limited are as follows:

| Assets | AX Ltd. ('000) | BX Ltd. ('000) |
|---|---|---|
| Property, Plant and Equipment | 9,500 | 1,000 |
| Inventory | 1,300 | 2,900 |
| Fair value of the business | 11,000 | 14,000 |

## 19. Illustration

The balance sheet of Professional Ltd & Dynamic Ltd is given below

| **Assets** | **Professional Ltd** | **Dynamic Ltd** |
|---|---|---|
| **Non-Current Assets:** | | |
| Property, plant and equipment | 300 | 500 |
| Investment | 400 | 100 |
| **Current assets:** | | |
| Inventories | 250 | 150 |
| Financial assets | | |
| Trade receivables | 450 | 300 |
| Cash and cash equivalents | 200 | 100 |
| Others | 400 | 230 |
| **Total** | 2,000 | 1,380 |
| **Equity and Liabilities** | | |
| **Equity** | | |
| Share capital- Equity shares of Rs. 100 each of Dynamic Ltd. and Rs. 10 each of Professional Ltd. | 500 | 400 |
| Other Equity | 810 | 225 |
| **Non-Current liabilities:** | | |
| **Financial liabilities** | | |
| Long term borrowings | 250 | 200 |
| Long term provisions | 50 | 70 |
| Deferred tax | 40 | 35 |
| **Current Liabilities:** | | |

| | | |
|---|---|---|
| **Financial liabilities** | | |
| Short term borrowings | 100 | 150 |
| Trade payables | 250 | 300 |
| **Total** | **2,000** | **1,380** |

Other information

- Professional Ltd. acquired 70% shares of Dynamic Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of Professional Ltd. for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was Rs. 40 per share.

- The fair value exercise resulted in the following: (all nos in Lakh)
  - Fair value of PPE on 1st April, 20X2 was Rs. 350 lakhs.
  - Professional Ltd also agreed to pay an additional payment as consideration that is higher of 35 lakh and 25% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by Dynamic Ltd. This additional amount will be due after 2 years. Dynamic Ltd has earned Rs. 10 lakh profit in the preceding year and expects to earn another Rs. 20 Lakh.
- In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of Rs. 20 lakh provided he stays with the Company for two year after the acquisition.
- Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:
  - Original award- Rs. 5 lakh
  - Replacement award-Rs. 8 lakh.
- Dynamic Ltd had a lawsuit pending with a customer who had made a claim of Rs. 50 lakh. Management reliably estimated the fair value of the liability to be Rs. 5 lakh.
- The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1st April, 20X2. Assume 10% discount rate.

## 20. Illustration

H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

| Date | Equity stake purchased | Remarks |
|---|---|---|
| 1st November, 20X6 | 15% | The shares were purchased based on the quoted price on the stock exchange on the relevant dates. |
| 1st January, 20X7 | 45% | |

Both the above-mentioned companies have Rupees as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 20X7. Following is the Balance Sheet of S Ltd. as on that date

| Particulars | Carrying value(Rs. in crore) | Fair value(Rs. in crore) |
|---|---|---|
| ASSETS: | | |
| Non-current assets<br>Property, plant and equipment | 40.0 | 90.0 |
| Intangible assets | 20.0 | 30.0 |
| Financial assets | | |
| - Investments | 100.0 | 350.0 |
| Current assets<br>Inventories | 20.0 | 20.0 |
| Financial assets | | |
| Trade receivables | 20.0 | 20.0 |
| Cash held in functional currency | 4.0 | 4.0 |
| Other current assets<br>Non-current asset held for sale | 4.0 | 4.5 |
| **TOTAL ASSETS** | **208** | |
| **EQUITY AND LIABILITIES:** | | |
| Equity | | |
| (a) Share capital (face value Rs. 100) | 12.0 | 50.4 |
| (b) Other equity | 141.0 | Not applicable |
| Non-current liabilities | | |
| (a) Financial liabilities | | |
| - Borrowings | 20.0 | 20.0 |
| Current liabilities | | |
| (a) Financial liabilities | | |
| - Trade payables | 28.0 | 28.0 |
| (b) Provision for warranties | 3.0 | 3.0 |
| (c) Current tax liabilities | 4.0 | 4.0 |
| **TOTAL EQUITY AND LIABILITIES** | **208.0** | |

Other information:

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 20X7:

| **Particulars** | **Fair value (Rs. in crore)** | **Remarks** |
|---|---|---|
| Law suit filed by a customer for a claim of Rs. 2 crore | 0.5 | It is not probable that an outflow of resources embodyingeconomic benefits will berequired to settle the claim.<br>Any amount which would be paid in respect of law suit will be tax deductible. |
| Income tax demand of Rs. 7 crore raised by tax authorities; S Ltd. has challenged the | 2.0 | It is not probable that an outflow of resources embodyingeconomic benefits will berequired to settle the claim. |

| demand in the court. | | |
|---|---|---|

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of Rs. 1 crore. Rs.1 crore represents the acquisition date fair value of the indemnification undertaking. Any amount which would be received in respect of the above undertaking shall not be taxable.

The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.
Carrying value of non-current asset held for sale of Rs. 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.

In consideration of the additional stake purchased by H Ltd. on 1st January, 20X7, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 20X7 is Rs. 10,000 per share.

On 1st January, 20X7, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 20X9, H Ltd. will pay Rs. 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 20X9 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 20X7 and 31st March, 20X7 as Rs. 22 crore and Rs. 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:

| | |
|---|---|
| As on November, 20X6 | Rs. 350 per share |
| As on 1st January, 20X7 | Rs. 395 per share |
| As on 31st March, 20X7 | Rs. 420 per share |

On 31st May, 20X7, H Ltd. learned that certain customer relationships existing as on 1st January, 20X7, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 20X7. The fair value of such customer relationships as on 1st January, 20X7 was Rs. 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).
On 31st May, 20X7 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 20X7 to 31st March, 20X7, the fair value of such customer relationships has increased to Rs. 4 crore as on 31st March, 20X7.

On 31st December, 20X7, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.

***You are required to provide your detailed responses to the following, along with reasoning and computation notes:***

(a) What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 20X7. For this purpose, measure non-controlling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

(b) Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 20X7? If yes, provide relevant journal entries.

(c) What should be the accounting treatment of the contingent consideration as on 31st March, 20X7?

## 21. Illustration

AX Ltd. and BX Ltd. amalgamated from 1st January, 20X2. A new Company ABX Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X1

| ASSETS | AX(000) | BX(000) |
|---|---|---|
| Non Current Assets | | |
| Property, Plant and Equipment | 8,500 | 7,500 |
| Financial assets | | |
| Investment | 1,050 | 550 |
| Current assets | | |
| Inventory | 1,250 | 2,750 |
| Financial assets | | |
| Trade receivables | 1,800 | 4,000 |
| Cash and Cash equivalent | 450 | 400 |
| **Total** | **13,050** | **15,200** |
| **EQUITY AND LIABILITIES** | | |
| Equity | | |
| Equity share capital (of face value of Rs. 10 each) | 6,000 | 7,000 |
| Other equity | 3,050 | 2,700 |
| Liabilities | | |
| Non-current liabilities | | |
| Financial liabilities | | |
| Borrowings (12% Debentures) | 3,000 | 4,000 |
| Current liabilities | | |
| Financial liabilities | | |
| Trade payables | 1,000 | 1,500 |
| **Total** | **13,050** | **15,200** |

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

***Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd assuming that it is a common control transaction.***

The fair value of net assets of AX and BX limited are as follows:

| Assets | AX Ltd. ('000) | BX Ltd. ('000) |
|---|---|---|
| Property, Plant and Equipment | 9,500 | 1,000 |
| Inventory | 1,300 | 2,900 |

| | | |
|---|---|---|
| Fair value of the business | 11,000 | 14,000 |

## 22. Illustration

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.
On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was: (Rs. in crores)

| | | Laptops | Mobiles | Total |
|---|---|---|---|---|
| Property, Plant and Equipment cost | | 250 | 500 | 750 |
| Depreciation | | (225) | (400) | (625) |
| Net Property, Plant and Equipment | (A) | 25 | 100 | 125 |
| Current assets: | | 200 | 500 | 700 |
| Less: Current liabilities | | (25) | (400) | (425) |
| (B) | | 175 | 100 | 275 |
| Total | (A+B) | 200 | 200 | 400 |
| Financed by: | | | | |
| Loan funds | | - | 300 | 300 |
| Capital : Equity Rs. 10 each | | 25 | - | 25 |
| Surplus | | 175 | (100) | 75 |
| | | 200 | 200 | 400 |

Division Mobiles along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise Ltd. was holding 52% shareholding of the Company.
Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

## 23. Illustration

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as on 31st October X1 is given below.

| | Maxi division | Mini division | Total(in crores) |
|---|---|---|---|
| Property, Plant and Equipment | | | |
| Cost | 600 | 300 | 900 |
| Depreciation | (500) | (100) | (600) |
| W.D.V. (A) | 100 | 200 | 300 |
| Current assets | 400 | 300 | 700 |
| Less: Current liabilities | (100) | (100) | (200) |
| (B) | 300 | 200 | 500 |
| Total (A+B) | 400 | 400 | 800 |
| Financed by : | | | |

| | | | |
|---|---|---|---|
| Loan funds (A) | - | 100 | 100 |
| (secured by a charge on property, plant and equipment) | | | |
| | | | |
| Own funds: | | | |
| Equity capital (fully paid up Rs. 10 per share_ | | | 50 |
| | | | |
| Other Equity | | | 650 |
| (B) | | | 700 |
| Total (A+B) | | | 800 |

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division. Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of Rs. 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "share holders wealth".

## 24. Illustration

| | Amount (Rs. in thousands) | |
|---|---|---|
| **Particulars** | **Entity A** | **Entity B** |
| Current Assets | 600 | 800 |
| Non Current Assets | 1,200 | 2,900 |
| Total Assets | 1,800 | 3,700 |
| Current Liabilities | 400 | 200 |
| Non - Current Liabilities | 300 | 1200 |
| Total Liabilities | 700 | 1400 |
| Equity | | |
| 30,000 Shares of Rs. 10 Each<br>1,50,000 shares to SH of B Ltd | 300 | |
| 60,000 Shares of Rs. 10 Each | | 600 |
| Retained Earnings | 800 | 1700 |
| Total Equity | 1100 | 2300 |
| Total Equity and Liability | 1800 | 3700 |

On 31 March 20X1, Entity A issues 2.5 shares in exchange for each share of Entity B. All of entity B's shareholders exchange their shares. The quoted market price of Entity B's share as at 31st March, .20X1 is Rs. 105 per share and Entity A's share price as at 31st March, 20X1 is Rs. 20 per share. Assume the fair value of Entity A's identifiable net assets as at 31st March, 20X1 are the same as carrying values and ignore tax effect.

You are required to compute Goodwill.

## 25. Illustration

On 31st December, 20X1, Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.
The fair value of each ordinary share of Entity B at 31st December, 20X1 is Rs. 40. The quoted market price of Entity A's ordinary shares at that date is Rs. 16.
The fair values of Entity A's identifiable assets and liabilities at 31st December, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at 31st December, 20X1 is Rs. 1,500.

The balance sheets of Entity A and Entity B immediately before the business combination are:

| | Entity A(legal parent, accounting acquiree) | Entity B (legal subsidiary, accounting acquirer) |
|---|---|---|
| Current assets | 500 | 700 |
| Non-current assets | 1,300 | 3,000 |
| Total assets | 1,800 | 3,700 |
| Current liabilities | 300 | 600 |
| Non-current liabilities | 400 | 1,100 |
| Total liabilities | 700 | 1,700 |
| Shareholders' equity | | |
| Retained earnings | 800 | 1,400 |
| Issued equity | | |
| 100 ordinary shares | 300 | |
| 60 ordinary shares | | 600 |
| Total shareholders' equity | 1,100 | 2,000 |
| Total liabilities and shareholders' equity | 1,800 | 3,700 |

Assume that Entity B's earnings for the annual period ended 31st March, 20X1 were Rs. 600 and that the consolidated earnings for the annual period ended 31st March, 20X2 were Rs. 800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31st March, 20X1 and during the period from 1st January, 20X1 to the date of the reverse acquisition on 31st December, 20X1.
Calculate the fair value of the consideration transferred measure goodwill and prepare consolidated balance sheet as on 31st December, 20X1.

## 26. Illustration

On 9th April, 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10th May, 20X2, the board of directors of Shyam Ltd. authorized their management to pursue the merger with Ram Ltd. On 15th May, 20X2, management of Shyam Ltd. offered management of Ram Ltd. 12,000 shares of Shyam Ltd. against their total share outstanding. On 31st May, 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder's vote. On 2nd June, 20X2 both the companies jointly made a press release about the proposed merger.

On 10th June, 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15th June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

| Date | Price per share |
|---|---|
| 9th April | 70 |
| 10th May | 75 |
| 15th May | 60 |
| 31st May | 70 |
| 2nd June | 80 |
| 10th June | 85 |
| 15th June | 90 |

What is the acquisition date and what is purchase consideration in the above scenario? Examine whether the financial instrument will be classified as equity.

## 27. Illustration

Entity A and entity B provide construction services in India. Entity A is owned by a group of individuals, none of whom has control and does not have a collective control agreement. Entity B is owned by a single individual, Mr. Ram. The owners of entities A and B have decided to combine their businesses. The consideration will be settled in shares of entity B. Entity B issues new shares, amounting to 40% of its issued share capital, to its controlling shareholder, Mr. Ram. Mr. Ram then transfers the shares to the owners of entity A in exchange for their interest in entity A. At this point Mr. Ram controls both entities A and B, owning 100% of entity A and 71.42% of entity B. Mr. Ram had a controlling interest in both entity A and entity B before and after the contribution. Is the combination of entities A and B a combination of entities under common control?

## 28. Illustration

Company X is engaged in the business of exploration & development of Oil & Gas Blocks.
Company X currently holds participating interest (PI) in below mentioned producing Block as follows:

| Block Name | X | Y | Z | Total | |
|---|---|---|---|---|---|
| AWM/01 | | 30% | 60% | 10% | 100% |

For the above Block, Company X, Y & Z has entered into unincorporated Joint Venture.

Company Y is the Operator of the Block AWM/01. Company X & Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X & Company Z at each month end in respect of their share of expenditure incurred in Joint Venture. All the manpower and requisite facilities / machineries owned by the Joint venture and thereby owned by all the Joint Operators.'

For past few months, due to liquidity issues, Company Z defaulted in payment of cash calls to operators. Therefore, company Y (Operator) has issued notice to company Z for withdrawal of their participating right from on 01.04.20X1. However, company Z has filed the appeal with arbitrator on 30.04.20X1.

Financial performance of company Z has not been improved in subsequent months and therefore company Z has decided to withdraw participating interest rights from Block AWM/01 and entered into sale agreement with Company X & Company Y. As per the terms of the agreement, dated 31.5.20X1, Company X will receive 33.33% share & Company Y will receive 66.67% share of PI rights owned by Company Z.

Company X is required to pay Rs. 1 Lacs against 33.33% share of PI rights owned by Company Z. After signing of sale agreement, Operator (company Y) approach government of India for modification in PSC (Production Sharing Contract) i.e. removal of Company Z from PSC of AWM/01 and government has approved this transaction on 30.6.20X1. Government approval for the modification in PSC is essential given the industry in which the joint operators operate.

| Particulars | Company X | | Company Z | |
|---|---|---|---|---|
| | 31.5.20X1 | 30.6.20X1 | 31.5.20X1 | 30.6.20X1 |
| Assets | | | | |
| Non-Current Assets | | | | |
| Property, Plant & Equipment | 5,00,000 | 10,00,000 | 1,50,000 | 3,00,000 |
| Right of Use Asset | 1,00,000 | 2,00,000 | 10,000 | 20,000 |
| Development CWIP | 50,000 | 1,00,000 | 50,000 | 1,00,000 |
| Financial Assets | | | | |
| Loan receivable | 25,000 | 50,000 | 25,000 | 50,000 |
| Total Non-Current Assets | 6,75,000 | 13,50,000 | 2,35,000 | 4,70,000 |
| Current assets | | | | |
| Inventories | 1,00,000 | 2,00,000 | 15,000 | 30,000 |
| Financial Assets | | | | |
| Trade receivables | 1,50,000 | 3,00,000 | 50,000 | 1,00,000 |
| Cash and cash equivalents | 2,00,000 | 4,00,000 | 1,00,000 | 2,00,000 |
| Other Current Assets | 2,25,000 | 50,000 | 25,000 | 50,000 |
| Total Current Assets | 6,75,000 | 9,50,000 | 1,90,000 | 3,80,000 |
| Total Assets | 13,50,000 | 23,00,000 | 4,25,000 | 8,50,000 |
| Equity and Liabilities | | | | |
| Equity | | | | |
| Equity share capital | 3,00,000 | 3,00,000 | 1,00,000 | 1,00,000 |
| Other equity | 2,00,000 | 3,00,000 | 75,000 | 2,50,000 |
| Total Equity | 5,00,000 | 6,00,000 | 1,75,000 | 3,50,000 |
| Liabilities | | | | |
| Non-Current Liabilities | | | | |
| Provisions | 4,00,000 | 8,00,000 | 1,00,000 | 2,00,000 |

| | | | | |
|---|---|---|---|---|
| Other Liabilities | 1,50,000 | 3,00,000 | 50,000 | 1,00,000 |
| Total Non-Current Liabilities | 5,50,000 | 11,00,000 | 1,50,000 | 3,00,000 |
| Current Liabilities | | | | |
| Financial Liabilities | | | | |
| Trade Payables | 3,00,000 | 6,00,000 | 1,00,000 | 2,00,000 |
| Total Current Liabilities | 3,00,000 | 6,00,000 | 1,00,000 | 2,00,000 |
| Total Liabilities | 13,50,000 | 23,00,000 | 4,25,000 | 8,50,000 |

Additional Information:

1. Fair Value of PPE & Development CWIP owned by Company Z as per Market participant approach is Rs. 5,00,000 & Rs. 2,00,000 respectively.
2. Fair Value of all the other assets and liabilities acquired are assumed to be at their carrying values (except cash & cash equivalent). Cash and cash equivalents of Company Z are not to be acquired by Company X as per the terms of agreement.
3. Tax rate is assumed to be 30%.
4. As per Ind AS 28, all the joint operators are joint ventures whereby each parties that have joint control of the arrangement have rights to the net assets of the arrangement and therefore every operator records their share of assets and liabilities in their books.

You need to determine the following:

1. Whether the above acquisition falls under business or asset acquisition as defined under business combination standard Ind AS 103?
2. Determine the acquisition date in the above transaction?
3. Prepare Journal entries for the above-mentioned transaction?
4. Draft the Balance Sheet for Company X based on your analysis in Part 1 above as at acquisition date.

## 1 Introduction

Consolidated financial statements provide a complete overview of the operations and profitability of the entire group which is controlled by the parent. Separate financial statements present the financial position of a single entity for which the financial statements are prepared.

## 2 Requirement to prepare Consolidated Financial Statements

**Section 129(3) of Companies Act, 2013** requires a company having subsidiary(s) to prepare consolidated financial statement of all the subsidiary(s) in the same form and manner as that of its own and to lay such consolidated financial statement before the Annual General Meeting of the company for adoption.

**Ind AS 110 'Consolidated Financial Statements'** provides the criteria for evaluation of whether an entity controls one or more other entities to treat them as subsidiaries of the entity. It also explains the procedures for preparation of consolidated financial statements including the requirements for elimination of inter-company transactions, accounting of non-controlling interests, accounting of loss of control over subsidiaries etc.

## 3 Consolidation Process

- Determine date of obtaining control. (Goodwill/ Capital reserve under Ind AS 103)
- Identify parent's stake and non-controlling interest
- Analysis of reserves (both pre-acquisition and post acquisition)
- Calculate goodwill/ bargain on purchase
- Determine carrying amount of non-controlling interest
- Determine parent's consolidated reserve balance
- Eliminate Inter-company balances & Unrealised profits
- Prepare consolidated balance sheet

## 4 Calculation of Goodwill/Capital reserve

| |
|---|
| Determine the fair value of consideration transferred |
| Determine the amount of non-controlling interest |
| Determine the fair value of subsidiary's identifiable net assets as per Ind AS 103 |
| Determine goodwill / gain on bargain purchase (i.e. capital reserve) |

## 5 Calculation of Goodwill/ Capital reserve in case of step acquisition

In a business combination achieved in stages, the acquirer shall

(a) remeasure its previously held equity interest (investment) in the acquiree at its acquisition-date fair value and

(b) recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income (depending classification as per Ind AS 109).

(c) the acquirer derecognises its investment asset in an entity in its consolidated financial statements when it achieves control.

## 6 Control obtained without transfer of consideration

These include –

(a) The acquiree **repurchases** a sufficient number of its own shares for an existing investor (the acquirer) to obtain control. For e.g. if the acquiree buy backs shares from other investors, the acquirer's % holding would increase and control is obtained.

(b) **Minority veto rights lapse** that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses **by contract** alone.

The acquirer shall remeasure its existing equity interest in the acquiree at its acquisition date fair value (and recognise the gain or loss on such remeasurement in profit or loss or other comprehensive income, as the case may be) and use that to compute goodwill or gain on bargain purchase.

In a business combination achieved by contract alone, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests (100%) in the acquiree are attributed to the non-controlling interest.

## 7 Measurement of Non Controlling Interest

The acquirer shall **measure at the acquisition date** components of non-controlling interest that give the holder ownership interest in the acquiree at either:

a) Fair value or
b) The present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

## 8 Consolidation Adjustments

### 8.1 Elimination of intra group transactions

Intra – group balances and intra – group transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intra – group transactions should also be eliminated unless cost cannot be recovered.

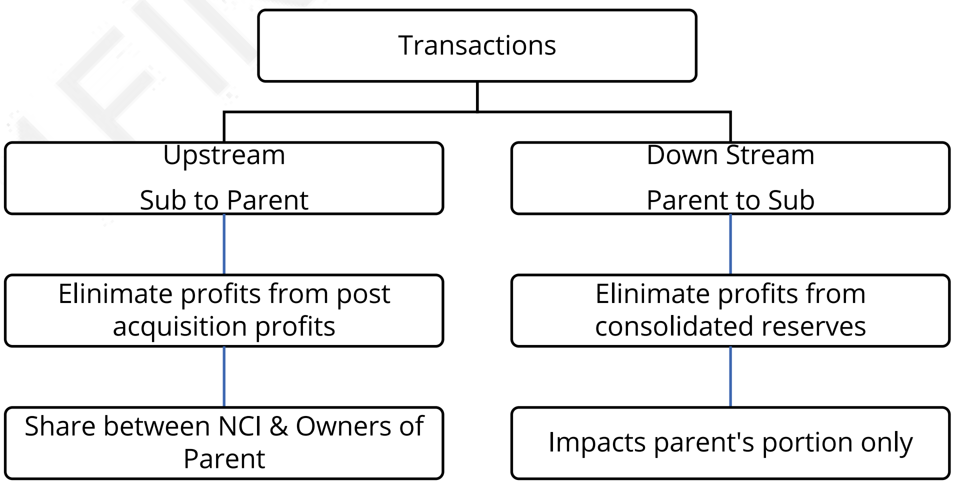
**For Example:**

(a) Liabilities due to one group entity by another will be set off against the corresponding asset in the other group entity.
(b) Sales made by one group entity to another should be excluded from turnover and from purchase

### 8.2 Unrealised profit on transfer of assets

Unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and Property, Plant and Equipment, Intangible Assets and Investment Property, are eliminated in full.

The requirement to eliminate such profits in full applies to the transactions of all subsidiaries that are consolidated – even those in which the group's interest is less than 100%.




In case non current assets like PPE are sold by one group company to another group company, the depreciation in stand alone financial statements is charged based on the acquisition price by the buyer. In consolidated financial statements, the difference in depreciation (calculated based on selling price and cost) should be adjusted

### 8.3 Dividends declared by subsidiary

Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting. Dividend is recognised in statement of profit and loss by holding when it obtains right to receive

### 8.4 Negative balance – Non Controlling Interest

(i) Do not adjust the loss of minority interest from parent company share
(ii) Show it as negative balance under equity

## 9 Uniform accounting policies

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

## 10 Chain holding under consolidation

### 10.1 Meaning:

Chain-holding refers to situations wherein a parent is controlling a subsidiary indirectly, i.e., having a controlling interest over a company indirectly.

**For Example:**

Parent company (P Ltd.) holding controlling interest in a subsidiary (S1 Ltd.).
S1 Ltd is holding a controlling interest in another company (S2 Ltd.).
In this case, P Ltd. is having an indirect control over S2 Ltd. through its direct subsidiary S1 Ltd.

### 10.2 Consolidation procedure in case of chain-holding

**Situation 1 – Sub subsidiaries**

Parent P □□80% □□Subsidiary 1 □□60% □□Sub-subsidiary (S2)

In the above case,

- P owns 80% of 60% = 48% of S2
- The non-controlling interest (NCI) in S1 owns 20% of 60% = 12% of S2
- The non-controlling interest (NCI) in S2 itself owns the remaining 40% of the S2 equity.

The date the sub-subsidiary (S2) comes under the control of the holding company is either

- The date P acquired S1 if S1 already holds shares in S2, or
- If S1 acquires shares in S2 later, i.e. after the acquisition by P in S1, then such date of acquisition by S1.

**Situation 2 - Direct holding in sub-subsidiaries:**

Parent P holds 80% of shares in Subsidiary 1 and 10 percent of shares in subsidiary 2.
Subsidiary 1 holds 75% of shares in Subsidiary 2.

| Particulars | Percentage |
|---|---|
| Direct non-controlling share (NCI) in S1 | 80% |
| Direct non-controlling share (NCI) in S2 (25-10) | 15% |
| Indirect non-controlling share (NCI) in S2 of 20% x 75% | 15% |

The effective interest in sub-subsidiary is

| | |
|---|---|
| Group (80% x 75%) | 60% |
| Direct holding | 10% |
| **Control** | 70% |

## 11 Loss of control in subsidiary

A parent can lose control over a subsidiary in a number of ways. These include:

(a) Loss of control due to outright sale **(entire stake is sold off)**

(b) Loss of control due to partial sale **(parent retains interest as an associate, jointly controlled entity or a financial asset)**

(c) Deemed loss of control where no consideration is received but the parent's interest is diluted in some other manner such as

- voting rights issued to a new investor
- control on relevant activities
- consolidation of voting rights of other shareholders
- an investor acquiring substantial stake from the stock exchange.

### 11.1 Accounting treatment on loss of control of a subsidiary

| Derecognise | Recognise | Reclassify | Recognise gain/loss |
|---|---|---|---|
| • The assets including any goodwill) and liabilities of the subsidiary<br>• The carrying amount of any non-controlling interests in the former subsidiary | • The fair value of the consideration received<br>• If loss of control involves a distribution of shares of the subsidiary to owners, then that distribution; and<br>• any investment retained in the former subsidiary at its fair value at the date when control is lost | To profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in other comprehensive income in relation to the subsidiary. | Recognise any resulting difference as a gain or loss in profit or loss attributable to the parent |
| | The fair value at which the retained interest is recognized shall be regarded as<br>• The fair value on initial recognition of a financial asset in accordance with Ind AS 109 or,<br>• When appropriate, the cost on initial recognition of an investment in an associate or joint venture. | The parent shall account for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities | |

### 11.2 Loss of control of a subsidiary in two or more arrangements

The above requirement is relevant because Ind AS 110 requires an entity to record gain / loss on disposal of investment in subsidiary in profit or loss only when the control is lost.

A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction.

One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

(i) They are entered into at the same time or in contemplation of each other.

(ii) They form a single transaction designed to achieve an overall commercial effect.

(iii) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

(iv) One arrangement considered on its own is not economically justified, unless it is considered together with other arrangements.

**For Example:**
When a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

## 12 Preparation of consolidated financial statements after applying consolidation principles

### 12.1 Preparation of consolidated balance sheet

- Assets and outside liabilities of the subsidiary company are combined with those of the parent company.
- Appropriate intra group elimination adjustments are recognised.
- The equity share capital of the subsidiary and investment of parent company are eliminated and goodwill / capital reserve and non-controlling interest are recognised.
- The parent's share in post-acquisition profits of the subsidiary company (added to appropriate concerned account of the parent company) are accounted in consolidated balance sheet.

### 12.2 Preparation of consolidated profit & loss

- The items of income and expenses are added on line by line basis.
- Intra-group transactions are eliminated in full

### 12.3 Preparation of consolidated profit & loss

- Items of cash flow from various activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be eliminated.

## 13 Ind AS 110 – Theory concepts

### 13.1 Introduction

A parent that controls one or more subsidiaries should prepare consolidated financial statements.
However, the parent entity that meets all of the following conditions **need not present consolidated financial statements:**

(i) The entity is a **wholly owned or partly owned subsidiary** of another entity and all the **owners** of the entity are **informed, and they do not object** to the entity not preparing consolidated financial statements

(ii) The **debt or equity instruments of the entity are not traded** in a public market (whether domestic or foreign stock exchange or an over-the-counter market, including local and regional markets)

**(iii)** The entity **has not filed nor is it in the process of filing** its financial statements with a securities commission or other regulatory organisation for the **purpose of issuing any class of instruments in a public market**

(iv) The entity's **ultimate or any intermediate parent** produces financial statements that are **available for public use** and comply **with Ind AS**, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110

### 13.2 Exceptions to consolidation

(i) Post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19 'Employee Benefits' applies.

(ii) An investment entity that is required to measure all of its subsidiaries at fair value through profit or loss need not present consolidated financial statements

### 13.3 Investment Entity

An entity is an investment entity if it fulfils all the following conditions:

(i) **Obtains funds** from one or more investors for providing those investor(s) with investment management services.

(ii) Commits to its investor(s) that its business purpose is **to invest funds solely for returns** from capital appreciation, investment income, or both
**(iii)** Measures and evaluates the performance of substantially all of its investments on a **fair value basis.**

An entity is **not an investment entity**, if the entity or another member of the group containing the entity obtains, or has the objective of obtaining, other benefits from the entity's investments that are **not available to other parties that are not related to the investee.** Such other benefits includes

a. Acquisition, use, exchange or exploitation of the processes, assets or technology of an investee.
b. Joint arrangements or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services.
c. Financial guarantees or assets provided by an investee for borrowing arrangements of the entity or another group member.
d. An option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity
e. Transactions between the entity or another group member and an investee that are
   - On terms that are unavailable to unrelated parties; or
   - Not at fair value; or
   - Represent a substantial portion of the investee's or the entity's or other group entities' business

**Characteristics of an Investment Entity**

(i) More than one investment
(ii) More than one investor
(iii) Investors are not related parties of the entity
(iv) Entity has ownership interests in the form of equity or similar interests

## 13.4 Control Evaluation

An entity controls another entity when all the 3 conditions are satisfied

(i) Power over the investee
(ii) Exposure, or rights, to variable returns from the investee
(iii) Ability to use power over the investee to affect the investor's returns

## 13.5 Power over the investee

An investor gets power over an investee if

(i) Existing rights that give it
(ii) the current ability
(iii) to direct the relevant activities of the investee

## 13.6 Identification of relevant activities

Relevant activities are activities of the investee that significantly affect the investee's returns. Relevant activities includes but not limited to

(i) Selling and purchasing of goods and services
(ii) Managing financial assets during their life (including upon default)
(iii) Selecting, acquiring or disposing of assets
(iv) Researching and developing new products or processes
(v) Determining a funding structure or obtaining funding
(vi) Establishing operating and capital decisions of the investee, including budgets
(vii) Appointing, terminating and remunerating an investee's key management personnel or service providers

## 13.7 Rights that give power to an investor

(i) Rights in the form of voting rights (or potential voting rights)
(ii) Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities
(iii) Rights to appoint or remove another entity that directs the relevant activities
(iv) Rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor
(v) Other rights (such as decision-making rights specified in a management contract)

## 13.8 Substantive Vs Protective Rights

**Protective rights:**

Protective rights are the rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate

(i) These rights do not give investor power over the investee.

(ii) Relate to protect the interest of the party holding those rights without giving the holder the right over the relevant activities of the investee.

**For Example:**

(a) A right exercisable by an investor only in the event of a fraud or default by other investors having power to take decisions about relevant activities.

(b) A lender's right to appoint its nominee director in the Board of a borrower to ensure the borrower do not engage in any activities that significantly increase the credit risk of borrower

(c) Rights held by minority shareholders to approve decisions related to capital expenditure greater than required in normal course of business or to approve issue of equity or debt instruments

(d) Rights of investors to approve or block decisions related to change in the name of the investee, amendment to constitutional documents of the investee to enter into a new business, change in the registered office of the investee, etc.

**Substantive rights:**

The general rule is that Substantive rights come from voting rights.

Substantive rights give the investor power over the investee and relate to the relevant activities of the investee. Holder must have the practical ability to exercise that right.

**Factors to be considered while assessing whether the rights are substantive:**

(i) Whether there are any barriers that prevent the holder from exercising the rights. Such barriers include

(a) Financial penalties and incentives

(b) High exercise or conversion price

(c) Terms and conditions that make it unlikely that the rights would be exercised

(d) The absence of an explicit, reasonable mechanism in the founding documents of an investee or in applicable laws or regulations that would allow the holder to exercise its rights.

(e) The inability of the holder of the rights to obtain the information necessary to exercise its rights.

(f) Operational barriers or incentives. For example, in case of a venture capital fund managed by an asset manager, there is absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the existing manager.

(g) Legal or regulatory requirements.

(ii) When the exercise of rights requires agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive.

(iii) Whether the party or parties that hold the rights would benefit from the exercise of those rights. **For example,** the holder of potential voting rights in an investee shall consider the exercise or conversion price of the instrument. The potential voting rights are more likely to be substantive when the exercise price is lower than the market price or when there are other synergies anticipated between the investor and the investee.

## 13.9 Evaluation of right

| Rights held by the Investor | Rights held by other party | Conclusion on Power |
|---|---|---|
| Substantive | Protective | Investor has power |
| Protective | Substantive | Other parties have Power |
| Substantive | Substantive | Further evaluation |

### 13.10 Franchises

In a franchise agreement, the investee i.e., the franchisee usually give the franchisor the rights that are related to protect the franchise brand.

**Salient features of a franchise agreement that indicate that rights of franchisor are protective rights:**

(a) Franchisor's right do not give it ability to direct the relevant activities of franchisee
(b) Other parties have current ability to direct the relevant activities of the franchisee
(c) Franchisor's rights do not affect the rights of others to take decisions about relevant activities
**(d)** Franchisee operates the business for its own account

The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

### 13.11 Power without a majority of voting rights

The general rule is that substantive rights come from voting rights. There can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee.

**For Example:**

(a) Purpose and design of investee.
(b) Rights from other contractual arrangements
(c) The investor's voting rights. **(De-facto control)**
(d) Special relation between investor and investee.

**De-facto control:**

There may be certain situations where even though an investor is not holding majority of the voting rights, but the voting rights held by it are sufficient to give it practical ability to have power over the investee unilaterally. In assessing the sufficiency of the voting rights of an investor, one should consider the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders

| **Particulars** | **Higher number or size** | **Lower number or size** |
|---|---|---|
| Number of voting rights held by investor | More likely to have power | Less likely to have power |
| Size of investor's voting rights relative to voting rights held by other holders | More likely to have power | Less likely to have power |
| Number of parties required to outvote the investor | More likely to have power | Less likely to have power |

**Special relation between investor and investee:**

Ind AS 110 provides guidance to enable the assessment of power whereby the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. Following are some of the examples of such evidences

- The investor can appoint or approve the investee's key management personnel who can direct the relevant activities
- The investor can direct the investee to enter into, or can veto any changes to, significant transactions for the benefit of the investor
- The investor can dominate either the nominations process for electing members of the investee's governing body or the obtaining of proxies from other holders of voting rights.
- The investee's key management personnel are related parties of the investor
- The majority of the members of the investee's governing body are related parties of the investor

**Exposure or rights to Variable returns from Investee:**

Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative.

An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns.

Variable returns include

- Dividends, other distributions of economic benefits from an investee
- Changes in the value of the investor's investment in that investee
- Remuneration for servicing an investee's assets or liabilities
- Fees and exposure to loss from providing credit or liquidity support
- Residual interests in the investee's assets and liabilities on liquidation
- Tax benefits
- Access to future liquidity
- Returns that are not available to other interest holders

**Link between power and returns:**
An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.
Thus, an investor with decision-making rights shall determine whether it is a **principal or an agent.** An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties.
An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly.
A decision maker shall consider the all the factors below, in determining whether it is an agent

- The scope of the decision-making authority
- Rights held by other parties **(Removal rights/Other substantive rights)**
- **Remuneration from the investee** – If the magnitude of, and variability associated with, the decision maker's remuneration relative to the returns expected from the activities of the investee is higher, then decision maker is principal. If the magnitude is lower, then decision maker is an agent.
- **Exposure to variable returns from other interests in the investee** - The magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate is higher, then decision maker is principal. If the magnitude is lower, then decision maker is an agent.

## 14 Ind AS 111 – Joint Arrangements

### 14.1 Assessment of Joint Arrangement

A joint arrangement is an arrangement of which two or more parties have joint control. The characteristics of joint arrangement are

- The parties are bound by a contractual arrangement
- The contractual arrangement gives two or more of those parties joint control of the arrangement

### 14.2 Contractual Arrangement

One of the essential elements of a joint arrangement is that there has to be a contractual arrangement between the parties to the arrangement. The contractual arrangement generally deals with such matters as

- Purpose, activity and duration of the joint arrangement
- How the members of the board of directors, or equivalent governing body, of the joint arrangement, are appointed.
- Decision making process such as matters requiring decisions from the parties, voting rights of parties and the required level of support for those matters.
- Capital or other contributions required of the parties
- How the parties share assets, liabilities, revenues, expenses or profit or loss relating to the joint arrangement.

### 14.3 Joint Control

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

In order to assess the joint control, an entity that is a party to an arrangement should first assess that whether the contractual arrangement gives all the parties or a group of the parties control over the arrangement. All the principles of control assessment, would be relevant while doing the assessment of joint control by the parties

- Power over the relevant activities of the investee
- Exposure to returns
- Ability to use the power to affect the returns of the investee

### 14.4 Types of Joint Venture

The entity needs to determine whether the joint arrangement is a joint operation or a joint venture depending upon the rights and obligations of the parties to the arrangement to determine the way the joint arrangement is accounted for i.e. whether it is a consolidation of assets, liabilities, income and expenses or use of equity method specified under Ind AS 28.

**Joint Operation:**

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators

**Joint Venture:**

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

If the joint arrangement is structured through a separate vehicle, then the entity shall consider

- The legal form of the separate vehicle
- The terms of the contractual arrangement
- When relevant, other facts and circumstances

## 15 Ind AS 28 – Investments in Associates and Joint Ventures

### 15.1 Scope

Ind AS 28 shall be applied by all entities that are

- investors with joint control of an investee (i.e. the investee is a joint venture of the investor) or
- significant influence over an investee (i.e. the investee is an associate of the investor)

### 15.2 Significant Influence

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. Substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

### 15.3 Presumption of significant influence

- If an entity holds (directly or indirectly through a subsidiary) 20% or more of the voting rights of an investee then it is presumed that the entity has significant influence, unless it can be clearly demonstrated that it is not the case.
- If the entity holds, (directly or indirectly through a subsidiary), less than 20% of¬ the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.

### 15.4 Judgement required in assessment of significant influence

The investor shall consider following factors which generally demonstrate the existence of significant influence:

- Representation on the board of directors or equivalent governing body of the investee
- Participation in policy-making processes, including participation in decisions about dividends or other distributions
- Material transactions between the entity and its investee
- Interchange of managerial personnel
- Provision of essential technical information

### 15.5 Consideration of potential voting rights

- Potential voting rights that are currently exercisable are considered when assessing whether an entity has significant influence.

- Potential voting rights that are currently not exercisable are not considered for the assessment.
- In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances except
    - the intentions of management and
    - the financial ability to exercise those potential rights.

### 15.6 Loss of Significant Influence

An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee.
The loss of significant influence can occur with or without a change in ownership levels.

## 16 Equity method of Accounting in CFS

Investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income

### 16.1 Application of equity method

Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

- Initial entry to record investment done in associate or joint venture at cost
- Recording of investor's share in the profit / loss of the associate or joint venture after the date of acquisition
- Recording of investor's share in the other comprehensive income of the associate or joint venture after the date of acquisition
- Distributions received from an investee (dividends/share of profit)

### 16.2 Potential voting rights

The possible effect of exercise or conversion of any potential voting rights are not considered for applying equity method. Instruments with such potential voting rights are accounted for as per Ind AS 109.
But, if potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture. In such cases, the investor shall account for instruments with such potential voting rights as per equity method

### 16.3 Exemptions from Equity Method

**Exemption 1**

- Entity is wholly owned or partly owned subsidiary of another entity and all the owners of entity are informed and they do not object to entity not applying equity method.
- The entity's ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.

**Public trading of instruments of the entity**

- The debt or equity instruments of the entity are not traded in a public market (whether domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
- The entity has not filed nor is it in the process of filing its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

**Exemption 2**

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. Such election shall be made separately for each associate or joint venture at time of its initial recognition.

**Exemption 3**

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109
If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation.

### 16.4 Outstanding Preference shares classified as equity

If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity should compute its share of profit or loss after adjusting for dividend on such shares, whether or not the dividends have been declared. No treatment is required if the shares are non cumulative.

### 16.5 Group's share in an associate or a joint venture

For applying the equity method, an entity shall consider the share held by it directly or indirectly (through a subsidiary) in an associate or a joint venture. The holding by the entity's associate or joint venture in another associate or joint venture of the entity is ignored for this purpose.

When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements which include the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures.

### 16.6 Upstream and Downstream transactions

The entity shall record such gain / loss in its financial statements only to the extent of the unrelated investors' interests in the associate or joint venture. In other words, the portion of gain / loss attributable to the entity will be eliminated.

### 16.7 Long term interests in associate or joint venture

An entity might hold financial instruments in an associate or joint venture other than the investments accounted for using the equity method.

These include preference shares and long term receivables or loans but do not include trade receivables, trade payables any long-term receivables for which adequate collateral exists, such as secured loans.

An entity shall account such long-term interest in accordance with Ind AS 109.

### 16.8 Interest in share of losses

- In case of a loss making associate or joint venture, an entity's share of losses of such associate or joint venture may equal or exceed its interest in the associate or joint venture.
- In such case, the entity discontinues recognized its share of further losses.
- The interest in the associate or joint venture not only includes the carrying amount of the investment in the associate or joint venture determined using the equity method but also includes any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture.
- An entity should first apply Ind AS 109 to long-term interests and then apply the above requirement of allocating to such long-term interest any share in loss of associate or joint venture.
- An entity shall not take account of any adjustments to the carrying value of long-term interests that arise from applying Ind AS 28.
- Losses recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).
- After the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

- If the associate or joint venture subsequently reports profits, the entity resumes recognized its share of those profits only after its share of the profits equals the share of losses not recognized.

## 17 Impairment of Joint Venture/ Associate

An entity shall determine whether there is an objective evidence that the entity's net investment in an associate or a joint venture is impaired.
The evidence of impairment arise as a result of

- One or more events that occurred after the initial recognition of the net investment (a 'loss event') and
- Loss event (or events) has an impact on the estimated future cash flows from the net¬ investment that can be reliably estimated.

### 17.1 Objective evidences of impairment

- Significant financial difficulty of the associate or joint venture
- Breach of contract, such as a default in payments by the associate or joint venture
- The entity granting a concession to associate or joint venture (because of its financial difficulties)
- It becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation
- Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture
- Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates
- Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

### 17.2 Impairment of goodwill included in carrying value of associate/JV

Goodwill is not tested separately for impairment, rather the entire carrying amount of the investment is tested for impairment as a single asset when there is objective evidence of impairment as mentioned above. Any impairment loss recognized is not allocated to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture.

## 18 Discontinuance of Equity method of Accounting

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture.

**Investment becomes subsidiary**

Ind AS 103 requires revaluation of the previously held interest in the equity accounted investment at its acquisition date fair value, with recognition of any gain or loss in profit or loss.

**Retained interest in the former associate or joint venture is a financial asset**

It shall be measured at fair value. The entity shall recognise in profit or loss any difference between:

- the fair value of any retained interest and any proceeds from disposing of a part interest in¬ the associate or joint venture; and
- the carrying amount of the investment at the date the equity method was discontinued.

## 19 Accounting of Joint Operations

### 19.1 Accounting of Interest in Joint operations in separate and consolidated financial statement of joint operator

A joint operator shall recognise in its separate and consolidated financial statements in relation to its interest in a joint operation:

- its assets, including its share of any assets held jointly
- its liabilities, including its share of any liabilities incurred jointly
- its revenue from the sale of its share of the output arising from the joint operation
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

  In case of joint operation, equity method is not applied and share of income, expenses, assets & liabilities are recognised.

### 19.2 Accounting for sales or contributions of assets to a joint operation in separate and consolidated financial statement of joint operator

When a joint operator sells or contributes any asset to the joint operation, it is in effect transacting with the other parties to the joint operation and hence the joint operator shall recognise gains and losses resulting from such transactions only to the extent of the other parties' interest in the joint operation.

### 19.3 Accounting for purchases of assets from a joint operation in separate and consolidated financial statement of joint operator

When a joint operator purchases any asset from the joint operation, it shall not recognise its share of the gains and losses until it resells those assets to a third party.

### 19.4 Accounting by an entity that is a party to the joint operation but does not have joint control

A party that participates in, but does not have joint control of, a joint operation,

- Account as per requirements mentioned in the standard for a joint operator if the party has rights to the assets, and obligations for the liabilities relating to the joint operations.
- Account as per the Ind AS applicable to that interest if the party does not has rights to the assets, and obligations for the liabilities relating to the joint operations.

## 20 Accounting of Joint Ventures

### 20.1 Accounting in the consolidated financial statements

A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28, unless the entity is exempted from applying the equity method as specified in that standard.

### 20.2 Accounting in the separate financial statements

In its separate financial statements, a joint venturer shall account for its interest in a joint venture in accordance Ind AS 27.

### 20.3 Accounting by an entity that is a party to the joint venture but does not have joint control

A party that participates in, but does not have joint control of, a joint venture shall also account for its interest in the arrangement in its separate and consolidated financial statements as follows:

- If the party do not have significant influence over the joint venture, account as per Ind AS 109.
- If the party has significant influence over the joint venture, account in separate and consolidated financial statements.

## 21 Ind AS 27 – Separate Financial Statements

The objective of Ind AS 27 is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

### 21.1 Scope

Ind AS 27 shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity

- elects, or
- is required by law,

to present separate financial statements.

It is to be noted that Ind AS 27 does not mandate which entities produce separate financial statements. It applies when an entity prepares separate financial statements that comply with Ind AS.

### 21.2 Separate Financial Statements

Separate financial statements are those presented by:

- a parent (i.e. an investor with control of a subsidiary) or
- an investor with investment in an associate or a joint venture,

in which the investments are accounted for at cost or in accordance with Ind AS 109 'Financial Instruments'.

**How are separate financial statements are presented?**

Separate financial statements are presented:

- in addition to consolidated financial statements or
- in addition to financial statements of an investor that does not have investments in subsidiaries but has investments in associates or joint ventures in which investments in associates or joint ventures are accounted for using the equity method.

There are two more scenarios in which separate financial statements are prepared:

**Scenario 1**

An entity that is exempted from:

- preparation of consolidated financial statements in accordance with Ind AS 110 (
- applying equity method as per Ind AS 28

may present separate financial statements as its only financial statements.

**Scenario 2**

As Ind AS 110, an investment entity that has one or more subsidiaries and the purpose and activities of all those subsidiaries is not to provide services that relate to the investment entity's investment activities then such investment entity shall not prepare consolidated financial statements. Instead, such investments in subsidiaries are to be accounted at fair value through profit or loss as per Ind AS 109.

In such case, investment entity presents separate financial statements as its only financial statements.

## 21.3 Preparation of Separate Financial Statements

An entity shall prepare its separate financial statements in accordance with all the applicable Ind ASs except that it shall account for investments in subsidiaries, associates and joint ventures in one of the following ways:

- At cost, or
- In accordance with Ind AS 109 (i.e. either at fair value through profit or loss or at fair value through other comprehensive income)

The entity shall apply the same accounting for each category of investments.

**Investments held by investment entities and similar entities**

Ind AS 110 requires an investment entity to measure its investment in subsidiaries at fair value through profit or loss as per Ind AS 109. Then the investment entity shall account for those investments in the same i.e. at fair value through profit or loss in the separate financial statements.

## 21.4 Accounting

When a parent ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:

**When an entity ceases to be an investment entity**

In such case, the entity shall account for an investment in a subsidiary in either of the following ways:

- Account at cost - The fair value of the subsidiary at the date of the change of status shall be used as the deemed cost at that date
- Continue to account in accordance with Ind AS 109

**When an entity becomes an investment entity**

In such case, the entity shall account for an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

In that case, the difference between the previous carrying amount of the subsidiary and its fair value at the date of the change of status of the investor shall be recognized as a gain or loss in profit or loss. The cumulative amount of any fair value adjustment previously recognized in other comprehensive income in respect of those subsidiaries shall be reclassified to profit or loss as if the investment entity had disposed of those subsidiaries at the date of change in status.

## 21.5 Reorganisation of Group Structure

A parent may reorganise the structure of its group by establishing a new entity as its parent.

Ind AS 27 provides guidance on how to calculate the cost of investment when a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

- the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
- the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and

- the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation,

If above conditions are fulfilled and the new parent elects to account for its investment in the original parent at cost then the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

## Illustrations

### 1. Illustration

From the following data, determine in each case:

1) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation

2) Goodwill or Gain on bargain purchase.

3) Amount of holding company's share of profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be Rs. 2,00,000 in each case

| Case | Subsidiary | % of shares owned | Cost | Date of Acquisition 1.04.20X1 | | Consolidation date 31.03.20X2 | |
|---|---|---|---|---|---|---|---|
| | | | | Share Capital [A] | Retained earnings [B] | Share Capital [C] | Retained earnings [D] |
| Case 1 | A | 90% | 1,40,000 | 1,00,000 | 50,000 | 1,00,000 | 70,000 |
| Case 2 | B | 85% | 1,04,000 | 1,00,000 | 30,000 | 1,00,000 | 20,000 |
| Case 3 | C | 80% | 56,000 | 50,000 | 20,000 | 50,000 | 20,000 |
| Case 4 | D | 100% | 1,00,000 | 50,000 | 40,000 | 50,000 | 56,000 |

The company has adopted an accounting policy to measure Non-controlling interest at NCI's proportionate share of the acquiree's identifiable net assets. It may be assumed that the fair value of acquiree's net identifiable assets is equal to their book values.

### 2. Illustration

On 31 March 20X2, Blue Heavens Ltd. acquired 100% ordinary shares carrying voting rights of Orange County Ltd. for ₹ 6,000 lakh in cash and it controlled Orange County Ltd. from that date. The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. statement of financial position were:

| | Blue Heavens Ltd. | Orange County Ltd. | |
|---|---|---|---|
| | Carrying Amount (₹ in lakh) | Carrying Amount (₹ in lakh) | Fair Value (₹ in lakh) |
| **Assets** | | | |
| **Non-current assets** | | | |
| Building and other PPE | 7,000 | 3,000 | 3,300 |
| Investment in Orange County Ltd. | 6,000 | | |
| **Current assets** | | | |
| Inventories | 700 | 500 | 600 |
| Trade receivables | 300 | 250 | 250 |
| Cash | 1,500 | 700 | 700 |
| **Total assets** | 15,500 | 4,450 | |

| | | | |
|---|---|---|---|
| **Equity and liabilities** | | | |
| **Equity** | | | |
| Share capital | 5,000 | 2,000 | |
| Retained earnings | 10,200 | 2,300 | |
| **Current liabilities** | | | |
| Trade payables | 300 | 150 | 150 |
| **Total liabilities and equity** | **15,500** | **4,450** | |

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

## 3. Illustration

Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. At 31 March 20X3, i.e. one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

| **Assets** | Blue | Orange |
|---|---|---|
| **Non-current assets** | | |
| PPE (Building and others) | 6,500 | 2,750 |
| Investment in Orange County Ltd. | 4,500 | |
| | 11,000 | 2,750 |
| **Current assets** | | |
| Inventories | 800 | 550 |
| Financial Asset -Trade receivables | 380 | 300 |
| Cash | 4,170 | 1,420 |
| | 5,350 | 2,270 |
| **Total assets** | **16,350** | **5,020** |
| **Equity and liabilities** | | |
| **Equity** | | |
| Share capital | 5,000 | 2,000 |
| Retained earnings | 11,000 | 2,850 |
| | 16,000 | 4,850 |
| **Current liabilities** | | |
| Financial Liabilities-Trade payables | 350 | 170 |
| | 350 | 170 |
| **Total liabilities and equity** | **16,350** | **5,020** |

Statements of Profit and Loss for the year ended 31 March 20X3:

| | **Blue Heavens Ltd.** Carrying Amount (₹ in lakh) | **Orange County Ltd.** Carrying Amount (₹ in lakh) |
|---|---|---|
| Revenue | 3,000 | 1,900 |
| Cost of sales | (1,800) | (1,000) |
| Administrative expenses | (400) | (350) |
| **Profit for the year** | **800** | **550** |

Note: Blue Heavens Ltd. estimates that goodwill has impaired by 98. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 March 20X2 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31 March 20X2 was sold during 20X3.

Prepare the Consolidated Balance Sheet as on March 31, 20X3 of group of entities Blue Heavens Ltd. and Orange County Ltd

## 4. Illustration

XYZ Ltd. Purchased 80% shares of ABC Ltd. On 1st April, 20X1 for Rs. 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was Rs. 1,00,000 and the balance in the Statement of Profit and Loss was Rs. 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. Has earned a profit of Rs. 20,000 and later on it declared and paid a dividend of Rs. 30,000.

Assume, the fair value of non-controlling interest is same as the fair value on a per-share basis of the purchased interest. All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is Rs. 1,50,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. Whenever it is received after approval in the ensuing annual general meeting.
What is the amount of non-controlling interest as on 1st April, 20X1 (using Fair value Method) and 31st March, 20X2? Also pass a journal entry on the acquisition date.

## 5. Illustration

A Ltd. Acquired 70% equity shares of B Ltd. On 1.4.20X1 at cost of Rs. 10,00,000 when B Ltd. Had an equity share capital of Rs. 10,00,000 and other equity of Rs. 80,000. In the four consecutive years B Ltd. Fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. Experienced turnaround and registered an annual profit of Rs. 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. Recorded annual profits of Rs. 1,00,000, and Rs. 1,50,000 respectively. Show the non- controlling interests and goodwill at the end of each year for the purpose of consolidation. Assume that the assets are at fair value.

## 6. Illustration

Entity P sells a 20% interest in a wholly owned subsidiary to outside investors for Rs. 100 lakh in cash. The carrying value of the subsidiary's net assets is Rs. 300 lakh, including goodwill of 65 lakh from the subsidiary's initial acquisition.

Pass journal entries to record the transaction.

Cash A/c Dr. 100 lakhs
To NCI 60 Lakhs (300 x 20%)
To Other Equity 40 Lakhs

## 7. Illustration

Entity A acquired 60% of entity B two years ago for Rs. 6,000. At that time, entity B's fair value was Rs. 10,000. B had net assets with a fair value of Rs. 6,000 (which is assumed same as book value). Goodwill of Rs. 2,400 was recorded (being Rs. 6,000 – (60% x Rs. 6,000). On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is Rs. 20,000 and entity A pays Rs. 4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is Rs. 12,000 and the carrying amount of the non- controlling interest is Rs. 4,000.

Pass journal entries to record the transaction.

Dr. NCI 2,000. [4,000/40% X 20%]
Dr. Other equity 2,000 [Balancing figure]
Cr. Cash 4,000

## 8. Illustration

A Ltd. Acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance Sheet finalized as on 1.4.20X0:

| | Rs. in thousand |
|---|---|
| Separate financial statements | As on 31.3.20X0 |
| Investment in subsidiary (70% interest) – at cost | 14,000 |
| Purchase price for additional 10% interest | 2,600 |
| **Consolidated financial statements** | |
| Non-controlling interests (30%) | 6,600 |
| Consolidated profit & loss account balance | 2,000 |
| Goodwill | 600 |

The reporting date of the subsidiary and the parent is 31 March 20X0. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

## 9. Illustration

A Ltd. Acquired 70% shares of B Ltd. On 1.4.20X0 when the fair value of net assets of B Ltd. was Rs. 200 lakh. During 20X0-20X1, B Ltd. Made profit of Rs. 100 lakh. Individual and consolidated balance sheets as on 31.3.20X1 are as follows:

Rs. lakh

| | A | B | Group |
|---|---|---|---|
| **Assets** | | | |
| Goodwill | | | 10 |
| PPE | 627 | 200 | 827 |
| Financial assets: | | | |
| Investments | 150 | | |
| Cash | 200 | 30 | 230 |
| Other current assets | 23 | 70 | 93 |
| | **1,000** | **300** | **1160** |
| **Equity and liability** | | | |
| Share capital | 200 | 100 | 200 |
| Other equity | 800 | 200 | 870 |
| Non-controlling interest | | | 90 |
| | **1,000** | **300** | **1160** |

A Ltd. Acquired another 10% stake in B Ltd. On 1.4.20X1 at Rs. 32 lakh. The proportionate carrying amount of the non-controlling interest is Rs. 30 lakh. Show the individual and consolidated balance sheet of the group immediately after the change in non-controlling interest.

In CFS
Dr. NCI 30
Dr. Other equity 2
Cr. Cash 32

In standalone
Investments in Sub 32
To Cash 32

## 10. Illustration

Amla Ltd. Purchased a 100% subsidiary for Rs. 10,00,000 at the end of 20X1 when the fair value of the subsidiary Lal Ltd.'s net asset was Rs. 8,00, 000.
The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for Rs. 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is Rs. 18,00,000 (including net assets of Rs. 16,00,000 & goodwill of Rs. 2,00,000).

Calculate gain / loss on sale of interest in subsidiary as on 31st March 20X4.

Gain/Loss in standalone financial statements

| | | | |
|---|---|---|---|
| Fair value of consideration received | | 9,00,000 | |
| Less: Cost of Investment | 40% of 10,00,000 | 4,00,000 | |
| Gain on sale | | | 5,00,000 |

In the consolidated financial statements, gain or loss on sale of stake is not recognised. The difference between amount recognised in NCI and consideration is adjusted directly under other equity.

| | | |
|---|---|---|
| Sale Proceeds | | 9,00,000 |
| Less: NCI recognised (40% x 18,00,000) | 7,20,000 | |
| Other equity | | 1,80,000 |

## 11. Illustration

Prepare the consolidated Balance Sheet as on 31st March, 20X2 of a group of companies comprising P Limited, S Limited and SS Limited. Their balance sheets on that date are given below:

| | P Ltd. | S Ltd. | SS Ltd. |
|---|---|---|---|
| Assets | | | |
| Non-Current Assets | | | |
| Property, Plant and Equipment | 320 | 360 | 300 |
| Investment: | | | |
| 32 lakh shares in S Ltd. | 340 | | |
| 24 lakh shares in SS Ltd. | | 280 | |
| Current Assets | | | |
| Inventories | 220 | 70 | 50 |
| Financial Assets | | | |
| Trade Receivables | 260 | 100 | 220 |
| Bills Receivables | 72 | - | 30 |
| Cash in hand and at Bank | 228 | 40 | 40 |
| | 1440 | 850 | 640 |
| Equity and Liabilities | | | |
| Shareholder's Equity | | | |
| Share Capital (Rs. 10 per share) | 600 | 400 | 320 |
| Other Equity | | | |
| Reserves | 180 | 100 | 80 |
| Retained earnings | 160 | 50 | 60 |
| Current Liabilities | | | |
| Financial Liabilities | | | |
| Trade Payables | 470 | 230 | 180 |
| Bills Payable | | | |
| P Ltd. | | 70 | |
| SS Ltd. | 30 | - | - |
| | 1440 | 850 | 640 |

The following additional information is available:

(i) P Ltd. Holds 80% shares in S Ltd. and S Ltd. holds 75% shares in SS Ltd. Their holdings were acquired on 30th September, 20X1.

(ii) The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

(iii) On 1st April, 20X1 the following balances stood in the books of S Ltd. And SS Ltd.

Rs. in Lakhs

| | S Ltd | SS Ltd |
|---|---|---|
| Reserves | 80 | 60 |
| Retained Earnings | 20 | 30 |

(iv) Rs. 10 lakhs included in the inventory figure of S Ltd, is inventory which has been purchased from SS Ltd at cost plus 25%.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume market prices of S Ltd and SS Ltd are the same as respective face values.

## 12. Illustration

In March 20X1 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is Rs. 20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at Rs. 12 per share, raising
Rs. 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were Rs. 4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder.

## 13. Illustration

A parent purchased 80% interest in a subsidiary for Rs. 1,60,000 on 1 April 20X1 when the fair value of the subsidiary's net assets was Rs. 1,75,000. Goodwill of Rs. 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs. 8,000 was charged in the consolidated financial statements for year ended 31 March 20X3. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 20X4 for Rs. 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was Rs. 2,25,000 (not including goodwill of Rs. 12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write off was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary in its separate financial statements at cost, as permitted by Ind AS 27.
Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 20X4.

## 14. Illustration

AT Ltd. Purchased a 100% subsidiary for Rs. 50,00,000 on 31st March 20X1 when the fair value of the net assets of BT Ltd. Was Rs. 40,00,000. Therefore, goodwill is Rs. 10,00,000. AT Ltd. Sold 60% of its investment in BT Ltd. On 31st March 20X3 for Rs. 67,50,000, leaving the AT Ltd. With 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd. Excluding goodwill is Rs. 80,00,000. Assume the fair value of the investment in associate BT Ltd. Retained is proportionate to the fair value of the 60% sold, that is Rs. 45,00,000.
Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

Scenario II

AT Ltd. Disposes of a 90% interest for Rs. 85,50,000 leaving the AT Ltd. With a 10% investment. The fair value of the remaining interest is Rs. 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold)

Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

## 15. Illustration

MN Ltd. was holding 80% stake in UV Ltd. Now, MN Ltd. has disposed of the entire stake in UV Ltd. in two different transactions as follows:

Transaction 1: Sale of 25% stake for a cash consideration of Rs. 2,50,000
Transaction 2: Sale of 55% stake for a cash consideration of Rs. 5,50,000

Both the transactions have happened within a period of one month. In accordance with the guidance given in Ind AS 110, both the transactions have to be accounted as a single transaction.

The net assets of UV Ltd. and non-controlling interest on the date of both the transactions was Rs. 9,00,000 and Rs. 1,80,000 respectively (assuming there were no earnings between the period of two transactions).

How MN Ltd. should account the transaction?

## 16. Illustration

P Pvt. Ltd. has a number of wholly-owned subsidiaries including S Pvt. Ltd. at 31st March 20X2. P Pvt. Ltd.'s consolidated balance sheet and the group carrying amount of S Pvt. Ltd.'s assets and liabilities (i.e the amount included in the consolidated balance sheet in respect of S Pvt. Ltd.'s assets and liabilities) at 31st March 20X2 are as follows:

| Particulars | Consolidated Rs. in millions) | Group carrying amountof S Pvt. Ltd. (Rs. in millions) |
|---|---|---|
| **Assets** | | |
| Non-Current Assets | | |
| Goodwill | 380 | 180 |
| Buildings | 3,240 | 1,340 |
| Current Assets | | |
| Inventories | 140 | 40 |
| Trade Receivables | 1,700 | 900 |
| Cash | 3,100 | 1000 |
| **Total Assets** | **8,560** | **3,460** |
| **Equities & Liabilities** | | |
| Equity | | |
| Share Capital | 1600 | |
| Other Equity | | |
| Retained Earnings | 4,260 | |
| Current liabilities | | |
| Trade Payables | 2,700 | 900 |
| **Total Equity & Liabilities** | **8,560** | **900** |

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when P Pvt. Ltd. group sold 100% shares of S Pvt. Ltd. to independent party for Rs. 3,000 millions.

## 17. Illustration

Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 20X2.

Reliance Ltd.'s consolidated balance sheet and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (ie the amount included in that consolidated balance sheet in respect of Reliance Jio Infocomm Ltd. assets and liabilities) at 31st March 20X2 are as follows:

| **Particulars** | **Consolidated (Rs. In '000)** | **Group carrying amt Reliance JioInfocomm Ltd. (Rs. In '000)** |
|---|---|---|
| **Assets** | | |
| Non-current Assets | | |
| Goodwill | 190 | 90 |
| Buildings | 1,620 | 670 |
| Current Assets | | |
| Inventories | 70 | 20 |
| Financial Assets | | |
| Trade Receivables | 850 | 450 |
| Cash | 1,550 | 500 |
| **Total Assets** | **4,280** | **1,730** |
| **Equity & Liabilities** | | |
| Equity | | |
| Share Capital | 800 | |
| Other Equity | | |
| Retained Earnings | 2,130 | |
| | 2,930 | |
| **Current liabilities** | | |
| Financial liabilities | | |
| Trade Payables | 1,350 | 450 |
| **Total Equity & Liabilities** | **4,280** | **450** |

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for Rs. 1000 thousand.

## 18. Illustration

As at the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited. During the financial year, AB Limited sells 70% of its equity interest in BC Limited to PQR Limited for a total consideration of Rs. 56 crore and consequently loses control of BC Limited. At the date of disposal, fair value of the 20% interest retained by AB Limited is Rs. 16 crore and the net assets of BC Limited are carry valued at Rs. 60 crore.

These net assets include the following:

(a) Debt investments classified as fair value through other comprehensive income (FVOCI) of Rs. 12 crore and related FVOCI reserve of Rs. 6 crore.

(b) Net defined benefit liability of Rs. 6 crore that has resulted in a reserve relating to net measurement losses of Rs. 3 crore.

(c) Equity investments (considered not held for trading) of Rs. 10 crore for which irrevocable option of recognising the changes in fair value in OCI has been availed and related FVOCI reserve of Rs. 4 crore.

(d) Net assets of a foreign operation of Rs. 20 crore and related foreign currency translation reserve of Rs. 8 crore.

In consolidated financial statements of AB Limited, 90% of the above reserves were included in equivalent equity reserve balances, with the 10% attributable to the non-controlling interest included as part of the carrying amount of the non-controlling interest.

What would be the accounting treatment on loss of control in the consolidated financial statements of AB Limited?

Ind AS 110 states that if a parent loses control of a subsidiary, the parent:
(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.
(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs.
(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

*Ind AS 110 also states that on loss of control over a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind AS, the amounts recognized in other comprehensive income in relation to the subsidiary .*

*If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognized in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.*

*In view of the basis in its consolidated financial statements, AB Limited shall:*

*(a) re-classify the FVOCI reserve in respect of the debt investments of Rs. 5.4 crore (90% of Rs. 6 crore) attributable to the owners of the parent to the statement of profit or loss*

| | | |
|---|---|---|
| *OCI Dr.* | *5.4* | |
| *To P&L* | | *5.4* |

*(b) transfer the reserve relating to the net measurement losses on the defined benefit liability of Rs. 2.7 crore (90% of Rs. 3 crore) attributable to the owners of the parent within equity to retained earnings.*

| | | |
|---|---|---|
| *Retained Earnings Dr.* | *2.7* | |
| *To OCI* | | *2.7* |

*(c) reclassify the cumulative gain on fair valuation of equity investment of Rs. 3.6 crore (90% of Rs. 4 crore) attributable to the owners of the parent from OCI to retained earnings under equity as per Ind AS 109, Financial Instruments*

| | | |
|---|---|---|
| *OCI Dr.* | | *3.6* |
| *To Retained Earnings* | *3.6* | |

*(d) reclassify the foreign currency translation reserve of Rs. 7.2 crore (90% × Rs. 8 crore) attributable to the owners of the parent to statement of profit or loss as per Ind AS 21which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI, shall be reclassified from equity to profit or loss on the disposal of foreign operation.*

| | | |
|---|---|---|
| *Dr. OCI* | *7.2* | |
| *To P&L* | | *7.2* |

*The balance 10% attributable to NCI will be derecognised along with NCI balance.*

| | |
|---|---|
| *Bank A/c Dr* | *56* |
| *Investment A/c Dr.* | *16* |

*NCI Dr.* 6

*To Net Assets* 60

*To Cons. P&L* 18

*(Being disposal of subsidiary.)*

## 19. Illustration

Summarise d Balance Sheets of PN Ltd. and SR Ltd. as on 31st March, 2018 were given as below:
(Amount in Rs.)

| Particulars | PN Ltd. | SR Ltd. |
|---|---|---|
| **Assets** | | |
| Land & building | 4,68,000 | 5,61,600 |
| Plant & Machinery | 7,48,800 | 4,21,200 |
| Investment in SR Ltd. | 12,48,000 | - |
| Inventories | 3,74,400 | 1,13,600 |
| Trade Receivables | 1,86,500 | 1,24,800 |
| Cash & Cash equivalents | 45,200 | 24,900 |
| **Total Assets** | **30,70,900** | **12,46,100** |
| **Equity & Liabilities** | | |
| Equity Share Capital (Shares of Rs. 100 each fully paid) | 15,60,000 | 6,24,000 |
| Other Reserves | 9,36,000 | 3,12,000 |
| Retained Earnings | 1,78,400 | 2,55,800 |
| Trade Payables | 1,46,900 | 34,300 |
| Short-term borrowings | 2,49,600 | 20,000 |
| **Total Equity & Liabilities** | **30,70,900** | **12,46,100** |

(i) PN Ltd. acquired 70% equity shares of Rs. 100 each of SR Ltd. on 1st October, 2017.

(ii) The Retained Earnings of SR Ltd. showed a credit balance of Rs. 93,600 on 1st April, 2017 out of which a dividend of 12% was paid on 15th December, 2017.

(iii) PN Ltd. has credited the dividend received to its Retained Earnings.

(iv) Fair value of Plant & Machinery of SR Ltd. as on 1st October, 2017 was Rs. 6,24,000. The rate of depreciation on Plant & Machinery was 10% p.a.

(v) Following are the increases on comparison of Fair Value as per respective Ind AS with book value as on 1st October, 2017 of SR Ltd. which are to be considered while consolidating the Balance Sheets:
(a) Land & Buildings Rs. 3,12,000
(b) Inventories Rs. 46,800
(c) Trade Payables Rs. 31,200.
(vi) The inventory is still unsold on Balance Sheet date and the Trade Payables are not yet settled.
(vii) Other Reserves as on 31st March, 2018 are the same as was on 1st April, 2017.
(viii) The business activities of both the company are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

Prepare the Consolidated Balance Sheet as on 31st March, 2018 of the group of entities PN Ltd. and SR Ltd. as per Ind AS.
May 2019 - (15 Marks)

## 20. Illustration

| Statement of Profit and Loss<br>For the year ended on 31st March, 20X2 | | | |
|---|---|---|---|
| | Notes | P Ltd. | Q Ltd. |
| i. Statement of Profit and Loss for the year ended on 31st March 20X2 | | | |
| Sales | 1 | 2,00,000 | 80,000 |
| Other Income | 2 | 3,000 | |
| Total Revenue | | 2,03,000 | 80,000 |
| Expenses | | | |
| Raw Material Consumed | 3 | 1,10,000 | 48,000 |
| Change in inventories finished stock | 4 | (5,000) | (3,000) |
| Employee benefit expenses | | 30,000 | 10,000 |
| Finance Costs | 5 | 2,700 | 1,000 |
| Depreciation | | 7,000 | 4,000 |
| Other Expenses | 6 | 10,350 | 6,040 |
| Total Expenses | | 1,55,050 | 66,040 |
| Profit Before Tax | | 47,950 | 13,960 |
| Tax Expense: | | | |
| Current Tax | 11 | 15,000 | 4,000 |
| Deferred Tax | | 2,000 | 1,000 |
| | | 17,000 | 5,000 |
| Profit after Tax | | 30,950 | 8,960 |
| ii. Statement of Other Comprehensive Income | | | |
| Fair Value gain on investment in subsidiary | 8 | 1,000 | 0 |
| Fair Value gain on other non-current investments* | 8 | 500 | 250 |
| | | 1,500 | 250 |

| Notes | P Ltd. | Q Ltd. |
|---|---|---|
| Note 1 - Sales | | |
| Sales to Q Ltd. | 20,000 | |
| Other Sales | 1,80,000 | 80,000 |
| | 2,00,000 | 80,000 |
| Note 2 - Other Income | | |
| Interest from Q Ltd. | 1,000 | |
| Royalty from Q Ltd. | 2,000 | |
| | 3,000 | |
| Note 3 - Raw Material Consumed | | |
| Opening Stock | 10,000 | 5,000 |
| Purchases from P Ltd. | | 20,000 |
| Other Purchases | 1,20,000 | 30,000 |
| Closing Stock | 20,000 | 7,000 |
| | 1,10,000 | 48,000 |
| Note 4 - Change in inventories of finished stock | | |
| Opening Stock | 10,000 | 5,000 |
| Closing Stock | 15,000 | 8,000 |
| | (5,000) | (3,000) |
| Note 5 - Finance Costs | | |
| Interest | 2,700 | |
| Interest to P Ltd. | | 1,000 |
| | 2,700 | 1,000 |
| Note 6 - Other Expenses | | |
| Long term provisions | 100 | 30 |
| Short Term provisions | 50 | 10 |
| Royalty to P Ltd. | | 2,000 |
| Others | 10,000 | 4,000 |
| Acquisition Expenses | 200 | |
| | 10,350 | 6,040 |

You are required to prepare consolidated profit and loss statement.

## 21. Illustration

Gamma Limited, a parent company, is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

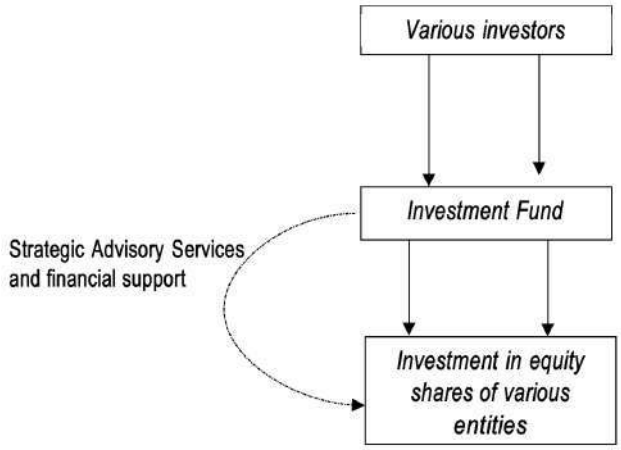
- Gamma Limited holds 100% Investment in G Limited and D Limited;
- G Limited and D Limited hold 60% and 40% in GD Limited respectively;
- Delta Limited is a 100% subsidiary of GD Limited

Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?

Secondly, if all other facts remain the same as above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

## 22. Illustration

An asset manager has set up and investment fund for the purpose of acquiring capital contributions from various investors (by issuing them units in the fund) and investing those contributions in the equity share capital of various entities for the purpose of earning capital appreciation on those investments. Following is the existing structure of the fund.




Apart from the investments in various entities, the investment fund also provides its investee the strategic advisory services so that it can result in increase in the capital appreciation from investments in those investees. It also provides its investees financial support in the form of loan to provide them with funds for acquiring capital assets. The investment fund does not hold such investments for a period longer than 5 years. The investment fund measures and evaluate the performance of the investments on fair value basis.
Whether the investment fund can be treated as an investment entity?

## 23. Illustration

PQR Ltd. is established with primary objective of investing in the equity shares of various pharmaceutical companies which are involved in the research and development of medicine for a critical illness. DEF Ltd. is a fellow subsidiary of PQR Ltd. and DEF Ltd. has entered into contractual arrangements with all the investees of PQR Ltd. that in case they are successful in developing the medicine then they will transfer the patent and distribution rights for that medicine to DEF Ltd. at less than market price.
Determine whether PQR Ltd. can be classified as investment entity.

## 24. Illustration

HTF Ltd. was formed by T Ltd. To invest in technology start-up companies for capital appreciation. T Ltd. holds a 70 percent interest in HTF Ltd. and controls HTF Ltd. The other 30 percent ownership interest in HTF Ltd. is owned by 10 unrelated investors. T Ltd. holds options to acquire investments held by HTF Ltd., at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of T Ltd. No plans for exiting the investments have been identified by HTF Ltd. HTF Ltd. is managed by an investment adviser that acts as agent for the investors in HTF Ltd.
Determine whether HTF Ltd. is an investment entity or not.

## 25. Illustration

A Ltd. is an asset manager of a venture capital fund i.e. Fund X. Out of the total outstanding units of the fund, 10% units are held by A Ltd. and balance 90% units are held by other investors. Majority of the unitholders of the fund have right to appoint a committee which will manage the day to day administrative activities of the fund. However, the decisions related to the investments / divestments to be done by Fund X is taken by asset manager i.e. A Ltd. Based on above, who has power over Fund X?

## 26. Illustration

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities.

Following is the relevant fact pattern related to fund manager:

- Within the defined parameters, the fund manager has discretion about the assets in which to invest.
- The fund manager has made a 10% pro rata investment in the fund and receives a market- based fee for its services equal to 1% of the net asset value of the fund.
- The fees are commensurate with the services provided.
- The fund manager does not have any obligation to fund losses beyond its 10% investment.

The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager but can redeem their interests within particular limits set by the fund.

Whether the fund manager controls the fund?

## 27. Illustration

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market- based fee for its services equal to 1% of assets under management and 20% of all the fund's profits if a specified profit level is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.
The above fact pattern and analysis applies to various scenarios described below. Each scenario is considered in isolation. Determine whether the fund manager control the fund?
Scenario A
The fund manager also has a 2% investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2% investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.
Scenario B
The fund manager has a more substantial pro rata investment in the fund but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.
Scenario C
The fund manager has a 20% pro rata investment in the fund but does not have any obligation to fund losses beyond its 20% investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

## 28. Illustration

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee.

The transaction was marketed to potential debt investors as an investment in a portfolio of asset- backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio.

On formation, the equity instruments represent 10% of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e. 1% of assets under management) and performance-related fees (i.e. 10% of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35% of the equity in the investee. The remaining 65% of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third-party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

Does the asset manager control the investee?

## 29. Illustration

A decision maker (the sponsor) sponsors a fund, which issues short-term debt instruments to unrelated third-party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the fund. Each transferor services the portfolio of assets that it sells to the fund and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the fund. The sponsor establishes the terms of the fund and manages the operations of the fund for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the fund, approves the assets to be purchased by the fund and makes decisions about the funding of the fund. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the fund and also provides credit enhancement and liquidity facilities to the fund. The credit enhancement provided by the sponsor absorbs losses of up to 5% of all of the fund's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor. Whether the sponsor has control over the fund?

## 30. Illustration

X Limited was holding 100% of the equity share capital of Y Limited and Y Limited was treated as a subsidiary by X Limited. Now, Y Limited issues convertible preference shares to Z Limited. As per the issue document of convertible preference shares, Z Limited also gets the rights to participate in the relevant activities of Y Limited whereby Z Limited's consent is also necessary to pass any decision by the equity shareholder of Y Limited (i.e. X Limited). Determine how should X Limited account for its investment in Y Limited in its consolidated financial statements after the issue of convertible preference shares by Y Limited to Z Limited?

## 31. Illustration

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the capital of PQ. However, the contractual terms of the joint arrangement states that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ and obligations for all other liabilities in PQ in proportion to their share of capital (i.e. 50% each).

PQ's balance sheet is as follows:

| **Liabilities** | **Rs.** | **Assets** | **Rs.** |
|---|---|---|---|
| Capital | 1,50,000 | Machinery | 2,50,000 |
| Bank Loan | 75,000 | Cash | 50,000 |
| Other Loan | 75,000 | | |
| | 3,00,000 | | 3,00,000 |

How should P record in its financial statements its rights and obligations in PQ?

## 32. Illustration

AB Ltd. and BC Ltd. have established a joint arrangement through a separate vehicle PQR. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Ltd. has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owned by PQR to a lender XYZ. AB Ltd. and BC Ltd. have rights to all other assets of PQR and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each)
PQR's balance sheet is as follows:

| Liabilities | Rs. | Assets | Rs. |
|---|---|---|---|
| Debt owed to XYZ | 240 | Cash | 40 |
| Employee benefit plan obligation | 100 | Building 1 | 240 |
| Equity | 140 | Building 2 | 200 |
| | 480 | | 480 |
| How should AB Ltd. record in its financial statements its rights and obligations in PQR? | | | |

## 33. Illustration

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for Rs. 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. Was Rs. 3,00,000 and the fair value was Rs. 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of Rs. 40,000 and other comprehensive income of Rs. 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

## 34. Illustration

Entity A holds a 20% equity interest in Entity B (as associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of Rs. 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for Rs. 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of Rs. 100.
The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

A's consolidated financial statements

| Assets | Rs. | Liabilities | Rs. |
|---|---|---|---|
| Investment in B | 200 | Equity | 200 |
| Total | 200 | Total | 200 |

21.5.1.1

21.5.1.2 B's consolidated financial statements

| Assets | Rs. | Liabilities | Rs. |
|---|---|---|---|
| Assets (from C) | 1,000 | Equity | 1,000 |
| Total | 1,000 | Total | 1,000 |

After – B's Consolidated Financial statements

| Assets | Rs. | Liabilities | | Rs. |
|---|---|---|---|---|
| Assets (from C) | 1,000 | Equity | 1,000 | |
| Cash | 300 | Equity transaction with non-controlling interest | 100 | |
| | | Equity attributable to owners | | 1,100 |
| | | Non-controlling interest | | 200 |
| Total | 1,300 | Total | | 1,300 |

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

## 35. Illustration

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of Rs. 10,00,000. This included profit of 10% on the transaction price i.e. profit of Rs. 1,00,000. Out the above inventory, M Ltd. sold inventory of Rs. 6,00,000 to outside customers. Hence, the inventory of Rs. 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

## 36. Illustration

X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of Rs 8,00,000. The asset's carrying value in X Ltd.'s books was Rs. 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Assume the same facts as above scenario except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

## 37. Illustration

An entity has following three type interests in an associate:

- Equity shares: 25% of the equity shares to which equity method of accounting is applied
- Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.
- Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.

At the start of year 1, the carrying value of each of the above interests is as follows:

- Equity shares – Rs. 10,00,000
- Preference shares – Rs. 5,00,000
- Long-term loan – Rs. 3,00,000

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5

| End of Year | Increase / (Decrease) in fair value of preference sharesas per Ind AS 109 | Impairment loss / (reversal) on long-term loan as per Ind AS 109 | Entity's share in profit / (loss) of associate |
|---|---|---|---|
| 1 | (50,000) | (50,000) | (16,00,000) |
| 2 | (50,000) | - | (2,00,000) |
| 3 | 1,00,000 | 50,000 | - |

| | | | |
|---|---|---|---|
| 4 | 50,000 | - | 10,00,000 |
| 5 | 30,000 | - | 10,00,000 |

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.
Based on above, determine the closing balance of each of the above interests at the end of each year.

## 38. Illustration

AB Limited holds 30% interest in an associate which it has acquired for a cost of Rs. 300 lakhs. On the date of acquisition of that stake, the fair value of net assets of the associate was Rs. 900 lakh. The value of goodwill on acquisition was Rs. 30 lakhs.

After the acquisition, AB Limited accounted for the investment in the associate as per equity method of accounting and now the carrying value of such investment in the consolidated financial statements of AB Limited is Rs. 360 lakhs. The associate has now issued equity shares to some investors other than AB Limited for a consideration of Rs. 800 lakhs. This has effectively reduced the holding of AB Limited to 20%. Determine how AB Limited should account for such reduction in interest in the associate?

## 39. Illustration

M Limited holds 90% interest in subsidiary N Limited. N Limited holds 25% interest in an associate O Limited. As at 31 March 20X1, the net assets of O Limited was Rs. 300 lakhs including profit of Rs. 40 lakhs for the year ended 31 March 20X1. Calculate how the investment in O Limited will be accounted in the consolidated financial statements of M Limited?

M Ltd – Parent
N Ltd – Subsidiary
O ltd – Associate

In N Ltd's Consolidated financial statements
N Ltd will recognise Investment in Associate as per equity method.
Carrying amount of investment = 25% of 300 = 75
Share of profit = 25% of 40 = 10 Lacs

In M Ltd's consolidated financial statement M ltd will recognise the investment in associate i.e at 75 Lakhs.

In M Ltd's consolidated P&L, M ltd will recognise share of profit

Attributable to M Ltd (owners of parent) – 90% of 10 lakhs – 9
Attributable to NCI. = 1 lakhs

## 40. Illustration

On 1st April 2019, Investor Ltd. acquires 35% interest in another entity, XYZ Ltd. Investor Ltd. determines that it is able to exercise significant influence over XYZ Ltd. Investor Ltd. has paid total consideration of Rs. 47,50,000 for acquisition of its interest in XYZ Ltd.

At the date of acquisition, the book value of XYZ Ltd.'s net assets was Rs. 90,00,000 and their fair value was Rs. 1,10,00,000. Investor Ltd. has determined that the difference of Rs. 20,00,000 pertains to an item of property, plant and equipment (PPE) which has remaining useful life of 10 years.

During the year, XYZ Ltd. made a profit of Rs. 8,00,000. XYZ Ltd. paid a dividend of Rs. 12,00,000 on 31st March, 2020. XYZ Ltd. also holds a long-term investment in equity securities. Under Ind AS, investment is

classified as at FVTOCI in accordance with Ind AS 109 and XYZ Ltd. recognized an increase in value of investment by Rs. 2,00,000 in OCI during the year. Ignore deferred tax implications, if any.
Calculate the closing balance of Investor Ltd.'s investment in XYZ Ltd. as at 31st March, 2020 as per the relevant Ind AS.

## 41. Illustration

On 1st April 20X1 Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 20X1 and utilisation of the property started on 1st January 20X2 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was Rs. 40 crores. Besides internal accruals, the cost was partly funded by way of loan of Rs. 10 crores taken on 1st January 20X1. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent Rs. 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as per applicable Ind AS.

## 1 Key Features

- **True and fair view of the affairs of the enterprise**
- **Relevance:** The financial statements should provide the relevant information for the period it is presented.
- **Understandability:** The financial statements should be readable and content lucid to digest.
- **Consistency**: The users of the financial statements will be benefitted only if the statements are released in periodic intervals and in standard formats.
- **Regulatory Compliance**:
- **Universality:** The financial statements should be comparable both within the industry and outside.

## 2 Best Practices

- **Compliance**
  Financial reporting is a regulated activity and compliance with the requirements is a must. Comply with the standards and regulations but also ensure your financial statements are an effective part of your wider communication with your stakeholders.

- **Complete**
  The information disclosed in the financial statements should be complete and should not lead to any further cross questioning in the mind of the users.

- **Simple and specific**
  Draft your notes, accounting policies, commentary on more complex areas in simple and plain English. Reduce generic disclosures and focus on company specific disclosures that explain how the company applies the policies.

- **Transparency**
  In preparation of financial statements many a times certain assumptions, or other bases are taken. Disclose those assumptions and bases transparently, so that they users are not misled.

- **Materiality**

  Information should only be disclosed if it is material. It is material if it could influence users' decisions which are based on the financial statements.

- **Integration of Notes**
  Notes cover the largest portion of the financial statements. They are an effective tool of communication and have the greatest impact on the effectiveness of your financial statements. Group notes into categories, place the most critical information more prominently or a combination of both. Integrate your main note of a line item with its accounting policy and any relevant key estimates and judgements.

  Ensuring that the accounting policies are disclosed in one place and not scattered across various notes.

- **Disclosure of Significant Accounting Policies**

  The financial statements should disclose your significant accounting policies. Disclose only your significant accounting policies – remove your non-significant disclosures that do not add any value. The disclosures should be relevant, specific to your company and explain how you apply your policies.

- **Disclosures of Key Estimates and Judgements**

  Effective disclosures about the most important estimates and judgements enable investors to understand your financial statements.

- **Integrated Approach**
  Financial statements are just one part of your communication with the stakeholders. An annual report typically includes financial statements, a management commentary and information about governance, strategy and business developments, CSR Reporting, Business Responsibility Reporting etc. There is also a growing trend towards integrated reporting.

## Illustrations

### 1. Illustration

On 1 April 20X1, Star Limited has advanced a housing loan of Rs. 15 lakhs to one of its employees at an interest rate of 6% per annum which is repayable in 5 equal annual instalments along with interest at each year end. Employee is not required to give any specific performance against this benefit. The market rate of similar loan for housing finance by banks is 10% per annum.

The accountant of the company has recognized the staff loan in the balance sheet equivalent to the amount of housing loan disbursed i.e. Rs. 15 lakhs. The interest income for the year is recognized at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 90,000 (6% of Rs. 15 lakhs).

Analyze whether the above accounting treatment made by the accountant is in compliance with the relevant Ind AS. If not, advise the correct treatment of housing loan, interest and other expenses in the financial statements of Star Limited for the year 20X1-20X2 along with workings and applicable Ind AS.

You are required to explain how the housing loan should be reflected in the Ind AS compliant Balance Sheet of Star Limited on 31 March 20X2..

### 2. Illustration

Pluto Ltd. has purchased a manufacturing plant for Rs. 6 lakhs on 1st April, 20X1. The useful life of the plant is 10 years. On 30th September, 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.
Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September, 20X3 and 31st March, 20X4 was Rs. 4 lakhs and Rs. 3.5 lakhs respectively.

The accountant has performed the following working:

**Carrying amount on initial classification as held for sale**

| | | |
|---|---|---|
| Purchase Price of Plant | 6,00,000 | |
| Less: Accumulated dep (6,00,000/ 10 Years) x 2.5 years | (1,50,000) | 4,50,000 |
| Fair Value less cost to sell as on 30th September, 20X3 | | 4,00,000 |
| The value will be lower of the above two | | 4,00,000 |

**Balance Sheet extracts as on 31st March, 20X4**

**Assets**

**Current Assets**

| | |
|---|---|
| Other Current Assets : | |
| Assets classified as held for sale | 3,50,000 |

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment along with the necessary workings.

## 3. Illustration

Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31 March 20X2.

(a) Owing to the proposed schedules of Indian Hockey League as well as Cricket Premier Tournament, Mumbai Challengers Ltd. needs a new stadium to host the sporting events. This stadium will form a part of the Property, Plant and Equipment of the company. Mumbai Challengers Ltd. began the construction of the stadium on 1 December, 20X1. The construction of the stadium was completed in 20X2-20X3. Costs directly related to the construction amounted to ₹ 140 crores in December 20X1. Thereafter, ₹ 350 crores have been incurred per month until the end of the financial year. The company has not taken any specific borrowings to finance the construction of the stadium, although it has incurred finance costs on its regular overdraft during the period, which were avoidable had the stadium not been constructed. Mumbai Challengers Ltd. has calculated that the weighted average cost of the borrowings for the period 1 December 20X1 to 31 March 20X2 amounted to 15% per annum on an annualized basis.
The company seeks advice on the treatment of borrowing costs in its financial statements for the year ending 31 March 20X2.

(b) Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.
At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of Rs. 49 crores.
Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above.

(c) Mumbai Challengers Ltd. measures its stadiums in accordance with the revaluation model. An airline company has approached the directors offering ₹ 700 crores for the property naming rights of all the stadiums for five years. Three directors are on the management boards of both Mumbai Challengers Ltd. and the airline. Additionally, statutory legislations regulate the financing of both the cricket and hockey clubs. These regulations prevent contributions to the capital from a related party which 'increases equity without repayment in return'. Failure to adhere to these legislations could lead to imposition of fines and withholding of prize money.

Mumbai Challengers Ltd. wants to know how to take account of the naming rights in the valuations of the stadium and the potential implications of the financial regulations imposed by the legislations.

## 4. Illustration

Neelanchal Gas Refinery Ltd. (hereinafter referred to as Neelanchal), a listed company, is involved in the production and trading of natural gas and oil. Neelanchal jointly owns an underground storage facility with another entity, Seemanchal Refineries Ltd. (hereinafter referred to as Seemanchal). Both the companies are engaged in extraction of gas from offshore gas fields, which they own and operate independently of each other. Neelanchal owns 60% of the underground facility and Seemanchal owns 40%. Both the companies have agreed to share services and costs accordingly, with decisions relating to the storage facility requiring unanimous agreement of the parties. The underground facility is pressurised so that the gas is pushed out when extracted. When the gas pressure is reduced to a certain level, the remaining gas is irrecoverable and remains in the underground storage facility until it is decommissioned. As per the laws in force, the storage facility should be decommissioned at the end of its useful life.

Neelanchal seeks your advice on the treatment of the agreement with Seemanchal as well as the accounting for the irrecoverable gas.

(b) Neelanchal has entered into a ten-year contract with Uttaranchal Refineries Pvt. Ltd. (hereinafter referred to as Uttaranchal) for purchase of natural gas. Neelanchal has paid an advance to Uttaranchal equivalent to the total quantity of gas contracted for ten years based on the forecasted price of gas. This advanced amount carries interest at the rate of 12.5% per annum, which is settled by Uttaranchal way of supply of extra gas. The contract requires fixed quantities of gas to be supplied each month. Additionally, there is a price adjustment mechanism in the contract whereby the difference between the forecasted price of gas and the prevailing market price is settled in cash on a quarterly basis. If Uttaranchal does not deliver the gas as agreed, Neelanchal has the right to claim compensation computed at the current market price of the gas.
Neelanchal wants to account for the contract with Uttaranchal in accordance with Ind AS 109 Financial Instruments and seeks your inputs in this regard.

## 5. Illustration

Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on 1st April, 20X1. The details of purchase price and market values of the properties are given as follows:

| **Particulars** | **Property 1 Factory** | **Property 2 Factory** | **Property 3 Let-Out** |
|---|---|---|---|
| Purchase price | 15,000 | 10,000 | 12,000 |
| Market value | 16,000 | 11,000 | 13,500 |
| Life | 10 Years | 10 Years | 10 Years |
| Subsequent Measurement | Cost Model | Revaluation | Revaluation Model |

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:
Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance with Ind AS. If not, advise the correct treatment along with working for the same.

## 6. Illustration

On 1st January, 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September, 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March, 20X2, that there was a 75% probability they would have to pay damages of Rs. 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of Rs. 12 lakhs to the customer on 15th May, 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May, 20X2.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

## 7. Illustration

Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April, 20X1, the company has received a government grant for Rs. 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. Eucalyptus trees are not considered as bearer plant in this case.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for Rs. 2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

## 8. Illustration

Mercury Ltd. has sold goods to Mars Ltd. at a consideration of Rs. 10 lakhs, the receipt of which receivable in three equal installments of Rs. 3,33,333 over a two year period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5 % (i.e. Rs. 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at Rs. 10 Lakhs and hence, the management has recognised the revenue from sale of goods for Rs. 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.
Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

## 9. Illustration

HIM Limited having net worth of Rs. 250 crores is required to adopt Ind AS from 1st April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

**Issue 1:** As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was Rs. 5,00,000. The land was acquired for a consideration of Rs. 5,00,000. However, the fair value of land as on the date of transition was Rs. 8,00,000.

Property, Plant & Equipment Dr. 3,00,000
To OCI – Revaluation surplus 3,00,000

**Issue 2:** Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was Rs. 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was Rs. 5,00,000.

Investments in Mutual Fund Dr. 1,00,000
To Retained Earnings 1,00,000

**Issue 3:** Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is Rs. 1,80,000 as against the carrying amount of loan which at present equals Rs. 2,00,000.

Financial liability Dr. 20,000
To Retained Earnings. 20,000

**Issue 4:** The company has declared dividend of Rs. 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Dividend Payable Dr. 30,000
To Retained Earnings 30,000

**Issue 5:** The company had acquired intangible assets as trademarks amounting to Rs. 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was Rs. 3,00,000. However, the company wants to carry the intangible assets at Rs. 2,50,000 only.

**Issue 6:** After consideration of possible effects as per Ind AS, the deferred tax impact is computed as Rs. 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue.

## Introduction

### 1.1 Ethics

Set of moral principles/ values or discipline dealing with what is good and bad

### 1.2 Code of Ethics

**ICAI's Code of Ethics (2019)**

- Applicable from 1st July 2020
- Derived from International Ethics Standard Board for Accountants (IESBA) issued by International Federation of Accountants (IFAC).

**Code of Ethics**

- **Fundamental principles** of ethics for CA
  - Establish standard of behaviour expected of CA
- **Conceptual Framework** that CA need to apply
  - In order to identify, evaluate and address threats to compliance with the fundatmental principles

## The Chartered Accountant Act, 1949

A person Qualifying CA becomes → Member of ICAI

- Member of ICAI → Their professional and other conduct as per CA Act
- Member of ICAI → Guilty of any Professional or Other misconduct → Liable to disciplinary action under Sec 21 of CA Act

**Note:**

- Chartered Accountants (CA) → hereinafter also called as "accountants"
- Those charged with Governance → hereinafter also called as "TCWG"

## Professional or Other Misconduct for a CA

Professional or Other misconduct → Any act or omission provided in any of the Schedules

| Particulars | | Professional misconduct | Other misconduct |
|---|---|---|---|
| Defined in | First Schedule | Part I, II and III | Part IV |
| | Second Schedule | Part I and II | Part III |
| Found guilty of any act or omission in any respective parts of Schedule | | In Professional Capacity - Professional capacity | In his personal affairs (non-professional work) - Other misconduct |

| Types of Schedules | | Part | No. of Clauses |
|---|---|---|---|
| | First Schedule | Part I: Professional misconduct in relation to Chartered Accountants in practice | No. of Clauses: 12 |
| | | Part II: Professional misconduct in relation to Members of the Institute in service | No. of Clauses: 2 |
| | | Part III: Professional misconduct in relation to Members of the Institute generally | No. of Clauses: 3 |
| | | Part IV: Other misconduct in relation to Members of the Institute generally | No. of Clauses: 2 |
| | Second Schedule | Part I: Professional misconduct in relation to Chartered Accountants in practice | No. of Clauses: 10 |
| | | Part II: Professional misconduct in relation to Members of the Institute generally | No. of Clauses: 4 |
| | | Part III: Other misconduct in relation to Members of the Institute generally | No. of Clauses: 1 |

**Note:**

- CA is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action
- <u>Council Guidelines in its Appendix 34 of the CA Act, 1949</u>, states that
  A member of the Institute who is an employee → shall exercise due diligence and shall not be grossly negligent in the conduct of his duties.
- The following part of the Code of Ethics shall be dealt with in Financial Reporting:
  Complying with the Code, Fundamental Principles and Conceptual Framework (applicable to all Chartered Accountants)

## Complying with the code, fundamental principles and Conceptual Framework

### 1.3 Complying with the Code

- The principle of professional behaviour requires a CA to comply with Code & relevant laws and regulations.
- Accountant shall comply with all other parts of the Code, where laws or regulations preclude an accountant from complying with certain parts of the Code.
- Accountants need to be aware of differences in local regulations from the provisions as set out in the Code and comply with the more stringent provisions unless prohibited by law or regulation.

**<u>Accountant's (CA) responsibility:</u>**

- <u>to act in public interest</u>, not exclusively to satisfy individual client or employing organisation's need.
- Prioritize the <u>Public Interest above their own interest</u>.

### 1.4 Fundamental Principles

<u>A CA shall comply each of the following **Fundamental Principles**</u>:

a) Integrity
b) Objectivity
c) Professional Competence and due care
d) Confidentiality
e) Professional behaviour

<u>A CA might consider **consulting with the following people**, when he found conflict while applying one with one or more fundamental principles</u>:

- Others within the firm or employing organization
- Those charged with governance

- Institute
- Legal counsel

Unless prohibited by law or regulation → Disassociate from the matter creating the conflict, if necessary or such consultation does not relieve accountant from resolving the conflict.

**Integrity:**

CA requires to be straightforward and honest in all professional and business relationships

A CA shall not knowingly be associated with reports, returns, communications or other information where he believes that the information contains:

- **materially false or misleading** statement;
- statements or information provided **negligently**; or
- Omits or obscures required information where such **omission or obscurity** would be misleading.

**Objectivity:**

A CA requires not to compromise professional or business judgement because of bias, conflict of interest or undue influence of others.

**Professional competence and due care:**

A CA required to

- attain and maintain professional knowledge and skill at the level

  → to ensure that client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and

- act diligently and in accordance with applicable technical and professional standards.

Maintain professional competence → requires a continuing awareness and an understanding of relevant technical, professional and business developments.

Diligence → Responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

**Confidentiality:**

CA requires to respect the confidentiality of information acquired as a result of professional and employment relationships

An accountant shall:

a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and to a close business associate or an immediate or a close family member;

b) Maintain confidentiality of information
   - within the firm or employing organization
   - disclosed by a prospective client or employing organization;

c) Not disclose or use of confidential information acquired as a result of professional and employment relationships
   - outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;
   - for the personal advantage of the accountant or for the advantage of a third party;
   - after that relationship has ended; and

d) Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance are obtained, respect the accountant's duty of confidentiality.

CA required to disclose confidential information in following circumstances:

a) Disclosure is required by law,
   for example: legal proceedings; or Infringement (violation) of law
b) Disclosure is permitted by law and is authorized by the client or the employing organization; and
c) There is a professional duty or right to disclose, when not prohibited by law:
   (i) To comply with the requirements of peer review or quality review of the Institute
   (ii) To respond to an inquiry or investigation by a professional or regulatory body;
   (iii) To protect the professional interests of a CA in legal proceedings; or
   (iv) To comply with technical and professional standards, including ethics requirements.

**Note:**

- Maintain confidential ethical principle, when providing payroll services to clients, unless required by law or authorized by the client
- CA must avoid using or sharing material information of the entity for personal gain (Eg: Insider trading)
- CA have an ethical duty to report fraudulent or manipulative activities that could impact the end users. Such disclosure does not breach the confidentiality.

**Professional Behaviour:**

To comply with relevant laws and regulations and avoid any conduct that discredit the profession

A CA shall be honest and truthful and shall not make:

a) Exaggerated/ High claims for the services offered by, or the qualifications or experience of, the accountant; or
b) Disparaging/ down grade references or unsubstantiated comparisons to the work of others.
c) Any direct or indirect measures to advertise any professional/other facts which are in violation of Advertisement Guidelines issued by the Council of the Institute from time to time.

## 1.5 Conceptual framework:

**CA shall apply the conceptual framework to**

a) Identify threats to compliance with the fundamental principles
b) Evaluate identified threats and
c) Address the threats by eliminating or reducing them to an acceptable level

**When applying the conceptual framework, the CA shall:**

i. Exercise professional judgment;
ii. Remain alert for new information and to changes in facts and circumstances; and
iii. Use the reasonable and informed third party test

**Professional Judgement:**

Involves application of relevant training, professional knowledge, skill, and experience commensurate with the facts and circumstances

The exercise of professional judgement is required when -

- CA applies the conceptual framework to make informed decisions about the courses of actions available, and

- ➢ to determine whether such decisions are appropriate in the circumstances.
- ➢ To understand of known facts and circumstances, which is prerequisite to proper application of conceptual framework.
- ➢ whether the fundamental principles have been complied

In exercising professional judgment to obtain this understanding, the CA might consider, among other matters, whether:

- There is reason to be concerned that potentially relevant information might be missing from the facts and circumstances known to the accountant.
- There is an inconsistency between the known facts and circumstances and the accountant's expectations.
- The accountant's expertise and experience are sufficient to reach a conclusion.
- There is a need to consult with others with relevant expertise or experience.
- The information provides a reasonable basis on which to reach a conclusion.
- The accountant's own preconception or bias might be affecting the accountant's exercise of professional judgment.
- There might be other reasonable conclusions that could be reached from the available information.

**Reasonable and informed third party Test:**

- ➢ Consideration by the CA about whether the same conclusions would likely be reached by another party

**Reasonable and informed third party**

- ➢ who can weigh all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made
- ➢ Who possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.

## CA In Service

### Conflict with Interest

A CA shall not allow a conflict of interest to compromise professional or business judgment.

**Examples** of circumstances that might create a **conflict of interest** include:

a) Serving in a management for two organizations and use of confidential information from one organization by the CA to the advantage or disadvantage of the other organization.

b) Undertaking a professional activity for each of two parties in a partnership → to assist them to dissolve their partnership.

c) Preparing financial information for certain members of management of the accountant's employing organization who are seeking to undertake a management buy-out.

d) Misuse of selecting responsibility - By selecting an immediate family member of the accountant as vendor to benefit them financially from the transaction

e) Misuse of governing capacity of approving certain investments for the company to their own & their family member's portfolio

### 1.6 Conflict Identification

A CA shall take reasonable steps

- to identify circumstances that might create a conflict of interest, and
- therefore, a **threat to compliance** with one or more of the fundamental principles.

Such steps shall include identifying:

- The nature of the relevant **interests and relationships** between the parties involved; and
- The **activity and its implication** for relevant parties.

## 1.7 Threats created by Conflict of Interest

In general, the **more** direct the **connection** between the professional activity and the matter on which the parties' interests conflict → the **more** likely the level of the **threat** is not at an acceptable level.

Example of an action

| To eliminate threats created by conflicts of interest | safeguards to address threats created by conflicts of interest | |
|---|---|---|
| withdrawing from the decision-making process related to conflict of interest matters | Restructuring or segregating certain responsibilities and duties | Obtaining appropriate oversight (Eg: acting under the supervision of an executive or non-executive director) |

## 1.8 Disclose and Consent

It is generally necessary to:

(a) Disclose the nature of the conflict of interest and how any threats created were addressed to the relevant parties and

(b) Obtain consent from the relevant parties for the CA to undertake the professional activity when safeguards are applied to address the threat.

- When addressing a conflict of interest, the CA is encouraged to seek guidance
  - from within the employing organization or
  - from the Institute,
  - legal counsel or
  - another accountant.
- When making such disclosures or sharing information within the employing organization and seeking guidance of third parties, the principle of confidentiality applies.

## Preparation and presentation of Information

A CA shall prepare and present the information

a) In accordance with a relevant reporting framework, where applicable

b) in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately

c) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately

Exercise professional judgment to:

i. Represent the facts accurately and completely in all material respects;

ii. Describe clearly the true nature of business transactions or activities; and

iii. Classify and record information in a timely and proper manner

## 1.9 Use of Discretion in Preparing or Presenting Information

CA shall not exercise such discretion with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately

<u>Example:</u>

- Determining **Estimates** - Determining fair value estimates in order to misrepresent profit or loss.
- Selecting or changing an **accounting policy or method** - selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss
- Determining the **timing of transactions** - timing the sale of an asset near the end of the fiscal year in order to mislead
- Determining the **structuring of transactions** - structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.
- Selecting **disclosures** - omitting or obscuring information relating to financial or operating risk in order to mislead.

When performing professional activities → CA shall exercise professional judgement to identify and consider:
- the purpose for which information is to be used
- The context within which the information is given
- The audience to whom it is addressed

when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions → that would enable those who might rely on such information to form their own judgments

### 1.10 Relying on the Work of Others

<u>Exercise professional judgment to determine what steps to take whether rely on the work of other will fulfill the responsibilities. Factors to consider:</u>

- The **reputation and expertise** of the other individual or organization and **resources available** to them
- Whether the other individual is subject to applicable **professional and ethics standards**.

Such information might be gained from prior association with, or from consulting others about, the other individual or organization.

### 1.11 Addressing Information that is or Might be Misleading

<u>If CA believes that the **information** with which the accountant is associated is **misleading**, then he shall take **appropriate actions** to seek to resolve the matter. Such action includes:</u>

- **Discussing** concerns that the information is misleading with the
  - CA's superior and/or
  - the appropriate level(s) of management within the accountant's employing organization or
  - TCWG
- and **requesting** such individuals to take appropriate action like
  - Having the information corrected
  - If the information has already been disclosed to the intended users, informing them of the correct information

<u>Note:</u> Consulting the policies and procedures of the employing organization (for example, an ethics or whistle-blowing policy) regarding how to address such matters internally

If the employing organization **has not taken appropriate action** → then **further actions** might be appropriate provided that the accountant remains alert to the principle of confidentiality:

- ➢ Consulting with:
  - o The Institute
  - o The internal or external auditor of the employing organization
  - o Legal counsel.
- ➢ Determining whether any requirements exist to communicate to:
  - o Third parties, including users of the information.
  - o Regulatory and oversight authorities.

If after exhausting all feasible options, information is still misleading → then the accountant shall refuse to be or to remain associated with the information or to resign from the employing organization, if necessary.

## Acting with sufficient expertise

A CA shall not intentionally mislead an employing organization as to the level of expertise or experience possessed.

A **self-interest threat** to compliance with the principle of professional competence and due care might be created if a CA has:

- Insufficient **time** for performing or completing the relevant duties.
- Incomplete, restricted or otherwise inadequate **information** & Inadequate **Resources** for performing the duties.
- Insufficient **experience**, **training** and/or **education**.

**Safeguards** to address such a self-interest threat include:

- Obtaining assistance or training from someone with the necessary expertise.
- Ensuring that there is adequate time available for performing the relevant duties.

Threat to compliance **cannot be addressed** → If the accountant determines that declining is appropriate, the accountant shall communicate the reasons.

## Financial interests, compensation and incentives linked to financial reporting and decision making

**Financial interests** include those arising from compensation or incentive arrangements linked to financial reporting and decision making.

A CA shall not manipulate information or use confidential information for personal gain or for the financial gain of others.

Financial interests by CA or immediate or close family members → might create threats to compliance with the fundamental principles.

Examples of self-interest threat situations in which the CA or an immediate or close family member:

- Has a motive and opportunity to manipulate **price- sensitive information** in order to gain financially.
- the value of which might be affected by decisions made by the accountant, Where they
  - o Holds a **direct or indirect financial interest** in the employing organization
  - o Is eligible for a **profit-related bonus**
  - o Holds, directly or indirectly, deferred bonus share rights or share options in the employing organization
- Participates in compensation arrangements which provide incentives to achieve targets or to support efforts to maximize the value of the employing organization's shares. An example of such an arrangement might be through participation in incentive plans which are linked to certain performance conditions being

met.

## Inducements, including gifts and hospitality

**An inducement** is an object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour.

Inducements can range: from minor acts of hospitality between business colleagues → result in non-compliance with laws and regulations.

An inducement can take many different forms, for example:

- Gifts.
- Hospitality.
- Entertainment.
- Political or charitable donations.
- Appeals to friendship and loyalty.
- Employment or other commercial opportunities.
- Preferential treatment, rights or privileges

### Immediate or Close Family Members

A CA shall remain alert to potential threats to the accountant's compliance with the fundamental principles created by

offering of an inducement

By | OR | To

an immediate or close family member of the accountant to a counterparty with whom the accountant has a professional relationship

CA shall advise the immediate or close family member not to offer or accept the inducement, if he aware that there is actual or perceived intent to improperly influence the behaviour of the CA or of the counterparty.

One of the Factor to determine the same is the nature or closeness of the relationship, between:

a. The accountant & the immediate or close family member;

b. The immediate or close family member & the counterparty; and

c. The accountant & the counterparty.

Non-compliance or suspected non-compliance with Laws and regulations

Whether Direct effect on the determination of material amounts and disclosures in the employing organization's financial statements

Direct effect

Indirect effect

but compliance with which might be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties

When responding to non-compliance or suspected noncompliance, the objectives of the CA are:

a) To comply with the principles of integrity and professional behaviour;

b) By alerting management or, where appropriate, TCWG of the employing organization, to seek to:

- Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
- Deter the non-compliance where it has not yet occurred; and
- To take such further action as appropriate in the public interest.

**Non-compliance with laws and regulations** comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

(a) The CA's employing organization;

(b) Those charged with governance of the employing organization;

(c) Management of the employing organization; or

(d) Other individuals working for or under the direction of the employing

Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

## 1.12 Responsibilities of All Chartered Accountants

If protocols and procedures exist within the CA's employing organization to address non-compliance or suspected non-compliance, the accountant shall consider them in determining how to respond to such non-compliance.

## 1.13 Responsibilities of Senior Chartered Accountants in Service

**Senior Chartered Accountants in service ("senior Chartered Accountants")** are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources

- There is a greater expectation for such individuals to take whatever **action is appropriate in the public interest** to respond to non- compliance or suspected noncompliance than other CAs within the employing organization.
- This is because of senior Chartered Accountants' roles, positions and spheres of influence within the employing organization.

## 1.14 Addressing the Matter

If Senior CA dentifies or suspects that non-compliance has occurred or might occur

discuss the matter with

- accountant's immediate superior
- The next higher level of authority within the employing organization, If the accountant's immediate superior appears to be involved in the matter

**The senior CA shall also take appropriate steps to**

- Have the matter communicated to TCWG
- Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority
- Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated
- Reduce the risk of re-occurrence
- Seek to deter the commission of the non-compliance if it has not yet occurred
- Disclosure: to provide all information necessary to enable the External auditor to perform the audit, if any is needed

## 1.15 Determining Whether Further Action Is Needed

The senior CA shall assess the appropriateness of the response of the accountant's superiors, if any, and TCWG.

<u>Examples of circumstances that might cause the senior CA no longer to have confidence in the integrity of the accountant's superiors and TCWG include situations where</u>:

- The accountant suspects or has evidence of **their involvement** or intended involvement in any non-compliance.
- **Contrary to legal or regulatory requirements**, they have **not reported**, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

<u>**Further action** that the senior CA might take includes:</u>

- **Informing** the management of the **parent entity** of the matter if the employing organization is a member of a group.
- **Disclosing** the matter to an **appropriate authority** as specified under respective law.
- **Resigning** from the employing organization, If limitations as to the further actions available to the accountant

### 1.16 Seeking Advice

<u>If it is **complex analysis and judgments matter**, the senior Chartered Accountant might **consider**:</u>

- Consulting internally.
- Obtaining legal advice to understand the accountant's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with the Institute.

### 1.17 Determining Whether to Disclose the Matter to an Appropriate Authority

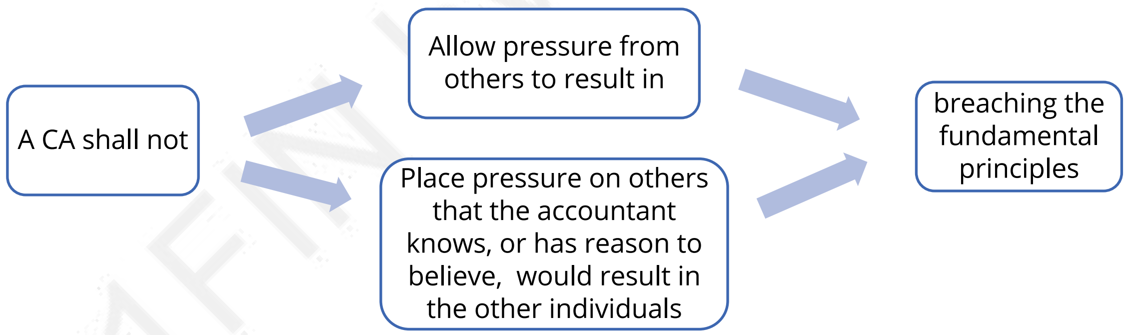
Disclosure of the matter to an appropriate authority would be done, if the matter to be investigated and action to be taken in the public interest. Otherwise disclosure is precluded.

### 1.18 Responsibilities of CAs Other than Senior Chartered Accountants

The accountant shall seek to obtain an understanding of the matter & Its nature.
CA identifies or suspects that noncompliance has occurred or might occur

- ➢ inform an immediate superior to enable the superior to take appropriate action
- ➢ If the accountant's immediate superior appears to be involved in the matter, the accountant shall inform the next higher level of authority within the employing organization.
- ➢ disclosure of the matter to an appropriate authority is an appropriate course of action and the accountant shall act in good faith and exercise caution when making statements and assertions.

## Pressure to Breach the Fundamental Principles




**Pressure might be explicit or implicit** and might come from:

- ➢ Within the employing organization, for example, from a colleague or superior.
- ➢ An external individual or organization such as a vendor, customer or lender.
- ➢ Internal or external targets and expectations.

Example:

- ➢ Pressure related to conflicts of interest
- ➢ Pressure from a family member to select them in CA's employing organization's bidding

### 1.19 Discussion

<u>Discussion of the matter with:</u>

- ➢ Individual who is exerting the pressure to seek to resolve it.

- Accountant's superior, if the superior is not the individual exerting the pressure.
- Escalating the matter within the employing organization, including when appropriate, explaining any consequential risks to the organization, for example with:
    - Higher levels of management.
    - Internal or external auditors.
    - TCWG

### 1.20 Consulting

Consulting with:

- A colleague, superior, human resources personnel, or another Chartered Accountant;
- Institute or industry associations; or
- Legal counsel.

### 1.21 Disclosing

Disclosing the matter in line with the employing organization's policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.

**Note:**

- Discussion and consultation, which requires being alert to the principle of confidentiality
- An example to eliminate threats created by pressure → CA's request for a restructure of, or segregation of, certain responsibilities and duties so that the accountant is no longer involved with the individual or entity exerting the pressure.

**Illustrations**

## 1. Illustration

Infostar Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

| Range of Profit after tax | Bonus (% of Net Profits) |
|---|---|
| Less than ₹ 1 crore | 0% |
| ₹ 1 crore to < ₹ 5 crores | 2% |
| ₹ 5 crores to < ₹ 10 crores | 4% |
| ₹ 10 crores to < ₹ 20 crores | 6% |
| ₹ 20 crores to < ₹ 30 crores | 8% |
| ₹ 30 crores and above | 10% |

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of ₹ 2 crores.

Issue:

On 25 March 20X2, Infostar Ltd. sold land located adjacent to its head office to a third party Zest Ltd. for a consideration of ₹ 40 crores, with an option to purchase the land back on 25 May 20X2 for ₹ 40 crores plus a premium of 6%. The amount received from the transaction eliminated the bank overdraft of Infostar Ltd. as on 31 March 20X2. On instructions of the Chief Financial Officer of the company, who is a chartered accountant, the transaction was treated as a sale, including the profit arising on disposal in the Statement of Profit and Loss for the year ending 31 March 20X2.

Required:

Discuss the ethical and accounting implications of the above issues with respect to a chartered accountant in service, referring to the relevant Ind AS wherever appropriate.

## 2. Illustration

Rustom Ltd., a company engaged in oil extraction, has a present obligation to dismantle the oil rig installed by it at the end of the useful life of 10 years. Rustom Ltd. cannot cancel this obligation or transfer it. Rustom Ltd. intends to carry out the dismantling work itself and estimates the cost of the work to be ` 100 crores at the end of 10 years.

The directors of Rustom Ltd. are aware of the requirements of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', read with Ind AS 16 'Property, Plant and Equipment'. However, they propose to expense the costs of dismantling the oil rig as and when incurred, with no entries or disclosures in the latest financial statements. They argue that application of Ind AS involves judgment, and although prudence is mentioned in the Conceptual Framework, it is only one among the many ways of achieving faithful representation.

Required:

Discuss whether the directors are acting unethically in the above instance what should be the practicing Chartered Accountant's course of action in this regard.

## 3. Illustration

Alaap Ltd.'s directors feel that the company needs a significant injection of capital in order to modernize plant and equipment as the company has been promised firm orders if it can produce goods of international standards. The current lending policies of the banks require prospective borrowers to demonstrate strong projected cash flows, coupled with a Debt Service Coverage Ratio exceeding 10. However, the current projected statement of cash flows does not satisfy the bank's criteria for lending. The directors have told the bank that the company is in an excellent financial position, the financial results and cash flow projections will meet the criteria and the chartered accountant will submit a report to this effect shortly. The chartered accountant has recently joined Alaap Ltd. and has openly stated that he cannot afford to lose his job because of financial commitments.

Required:

Discuss the potential ethical conflicts which may arise in the above scenario and the ethical principles which would guide how the chartered accountant should respond to the situation

## 4. Illustration

Sunshine Ltd., a listed company in the cosmetics industry, has debt covenants attached to some of its borrowings which are included in Financial Liabilities in the Balance Sheet. These covenants mandate the company to repay the debt in full if Sunshine Ltd. fails to maintain a liquidity ratio and operating margin above the specified limit.

The directors along with the CFO of the Company who is a chartered accountant are considering entering into a fresh five-year leasing arrangement but are concerned about the negative impact any potential lease obligations may have on the above-mentioned covenants. Accordingly, the directors and CFO propose that the lease agreement be drafted in such a way that it is a series of six ten-month leases rather than a single five-year lease in order to utilize the short-term lease exemption available under Ind AS 116, Leases. This would then enable accounting for the leases in their legal form. The directors believe that this treatment will meet the requirements of the debt covenant, though such treatment may be contrary to the accounting standards.

Required:
Discuss the ethical and accounting implications of the above issue from the perspective of CFO.

## 5. Illustration

Agastya Ltd. is a listed company engaged in the manufacturing of automotive spare parts. The company is preparing the financial statements for the year ended 31 March 20X3. The directors of Agastya Ltd. are entitled to an incentive based on the operating profit margin of the company. You have been appointed as a consultant to advise on the preparation of the financial statements, and you notice the following issue:
Issue:
On 1 April 20X2, Agastya Ltd.'s defined benefit pension scheme was amended to increase the pension entitlement from 12% of final salary to 18.5% of final salary. This amendment was made due to the salary cuts made on account of the pandemic. The chartered accountant has shown such increase in the pension entitlement (amounting to ₹ 85 crores) under the head 'Employee Benefits' forming part of the operating profit. The directors are unhappy with this presentation. They believe that the pension scheme is not integral to the operations of the company since it is paid post-retirement of the employees, and thus insist that such presentation would be misleading in computing the operating profit or loss. Accordingly, the directors propose a change in accounting policy so that all such gains or losses on pension scheme would be recognized under Other Comprehensive Income. The directors believe that this policy choice will make the financial statements more consistent, understandable thereby justifying the same on grounds of fair presentation as defined in the Framework. The pension scheme of Agastya Ltd. is currently in deficit.

Required:

Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate from the perspective of the consultant.

## 6. Illustration

The directors of Spinz Ltd. are eligible for an incentive computed as a percentage of 'Cash Generated from Operations' as defined in Ind AS 7, Statement of Cash Flows in accordance with the terms of their appointment. Due to the onset of the pandemic, the company has not performed well, and it has, in fact, lost Cash from Operations. In order to meet the cash requirements, the directors of Spinz Ltd. are planning to dispose of under-utilized equipment and investments (not subsidiaries or associates). The directors opine that since the cash generated from sale of such equipment and investments would be used for operations, the inflows on such sale would be presented in the Statement of Cash Flows under 'Cash from Operations'. The directors are concerned about meeting the targets in order to ensure security of their jobs and feel that this treatment would enhance the 'cash flow picture' of the business. The inflows on sale of such equipment and investments have the potential to make the 'Cash from Operations' figure positive.
Required:
Discuss the ethical responsibility of Spinz Ltd.'s Chartered Accountant who is an employee to ensure that the manipulation of the Statement of Cash Flows, as suggested by the directors, does not occur.

## 7. Illustration

Infostar Ltd. is a listed company engaged in the provision of IT services in India. The directors are paid a bonus based on the profits achieved by the company during the year as per the bonus table given below:

| Range of Profit after tax | Bonus (% of Net Profits) |
|---|---|
| Less than ₹ 1 crore | 0% |
| ₹ 1 crore to < ₹ 5 crores | 2% |
| ₹ 5 crores to < ₹ 10 crores | 4% |
| ₹ 10 crores to < ₹ 20 crores | 6% |

₹ 20 crores to < ₹ 30 crores 8%
₹ 30 crores and above 10%

The draft Statement of Profit and Loss for the year ended 31 March 20X2 currently shows a profit of ₹ 2 crores.
Issue:

Issue:
The employees of Infostar Ltd. have historically been paid an individual-performance-based discretionary incentive for the last 15 years. Based on the past trends and performance, the bonus amount for the year 20X1-20X2 would be ₹ 3 crores. In view of the possibility of the directors not receiving the bonus on account of the company's poor performance, Infostar Ltd.'s Chief Financial Officer (CFO), who is a chartered accountant, has suggested that the discretionary incentive usually payable to the employees could be avoided in the current year, which would result in the company reporting profits. As a part of its annual report, Infostar Ltd. reports employee satisfaction scores, staff attrition rates, gender equality and employee absenteeism rates as non- financial performance measures. The CFO has also told the directors over mail that no stakeholder reads the non-financial information anyway, and thus his aforesaid suggestion of not paying the discretionary incentive would not impact the company greatly.

Required:

Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate from perspective of CA. Sushil Bhupathy.

## 8. Illustration

Agastya Ltd. is a listed company engaged in the manufacturing of automotive spare parts. The company is preparing the financial statements for the year ended 31 March 20X3. The directors of Agastya Ltd. are entitled to an incentive based on the operating profit margin of the company. You have been appointed as a consultant to advise on the preparation of the financial statements, and you notice the following issue:
Issue:
The draft financial statements include an amount of ₹ 75 lakhs given as loan to a director. The loan has no specific repayment terms; the same is repayable on demand. The directors have included such loan under the heading 'Cash and Cash Equivalents'. They have reasoned that since such loan, which is advanced to one of the directors, is repayable on demand, it is readily convertible to cash. Further the directors opine that such presentation should not be a problem even under the Ind AS Framework as financial statements are essentially prepared in accordance with accounting policies which is the choice of the company, and in this case, Agastya Ltd. has made a policy choice to show such loan as a cash equivalent.

**Required:**
Discuss the ethical and accounting implications of the above issues, referring to the relevant Ind AS wherever appropriate.

## 9. Illustration

As at 31 March 20X4, Mitra Ltd. had a plan to dispose off its 75% subsidiary Dosti Ltd. This plan had been approved by the board and was reported in the media as well as to the Stock Exchange where Mitra Ltd. was listed. It is expected that Jaya Ltd., the non-controlling shareholder in Dosti Ltd. holding 25% stake, will acquire the 75% equity interest as well. The sale is expected to be completed by October 20X4. Dosti Ltd. is expected to have substantial trading losses in the period up to the sale. Mr. X, a chartered accountant, who is an employee in the finance department of Mitra Ltd., wishes to show Dosti Ltd. as held for sale in the financial statements and to create a restructuring provision to include the expected costs of disposal and future trading losses. However, the Chief Operating Officer (COO) does not wish Dosti Ltd. to be categorized as held for sale nor to provide for the expected losses. The COO is concerned as to how this may affect the sales and would surely result in bonus targets not being met. He has argued that as the management, it is his duty to secure a high sales price to maximize the return for shareholders of Mitra Ltd. He has also hinted that Mr. X's job could be at stake if such a provision were to be made in the financial statements. The expected costs from the sale are as follows:

Future Trading Losses: ₹ 20 crores
Various legal costs of sale ₹ 1.5 crores
Redundancy costs for Dosti Ltd.'s employees ₹ 4 crores Impairment losses on Property, Plant and Equipment ₹ 7 crores Required:

(a) Discuss the accounting treatment which Mitra Ltd. should adopt to address the issue above for the financial statements.

(b) Discuss the ethical issues which may arise in the above scenario, including any actions which Mitra Ltd. and Mr. X should take

# ACCOUNTING AND TECHNOLOGY

## 1 Introduction

### 1.1 Introduction

Accounting is a critical function for all businesses, as it enables them to track and manage their financial transactions, budgets, and investments.

This chapter deals with

- the various technologies that have had a significant impact on the accounting profession. Eg: cloud computing, artificial intelligence, and cybersecurity etc.
- Benefits of each technology and how they have changed the way accountants perform their tasks. Eg: cloud computing has made it possible for accountants to access financial data from anywhere in the world.
- the challenges that accounting professionals face in adapting to new technologies. Eg: the implementation of new technologies can be costly, and many businesses may not have the resources to invest in them. Additionally, some accounting professionals may be resistant to change, preferring to stick with the traditional methods they are comfortable with.
- Concludes with the importance of accounting professionals staying up-to- date with the latest technologies
- the need for ongoing education and training to ensure that accounting professionals have the skills they need to succeed in an increasingly digital world

### 1.2 Evolution of Accounting

**Early Accounting System**

- Accounting originated in ancient civilizations like Egypt, Greece, and Rome, focusing on tax record-keeping and managing government resources.
- Early accounting systems were manual and paper-based, requiring labor-intensive processes.
- In India, Chanakya's 'Arthashastra' during the Mauryan Empire detailed aspects of maintaining accounts for a sovereign state.
- Luca Pacioli, an Italian, is recognized as The Father of accounting; he introduced double-entry bookkeeping in Italy.
- Double-entry bookkeeping allowed businesses to create balance sheets, marking a significant milestone in the history of accounting.
- Pacioli's contributions laid the foundation for modern-day accounting practices. Accounting originated in ancient civilizations like Egypt, Greece, and Rome, focusing on tax record-keeping and managing government resources.
- Early accounting systems were manual and paper-based, requiring labor-intensive processes.

**Industrial Revolution**

- Accounting underwent significant changes due to machines and mass production, necessitating more detailed financial transaction records.
- The accounting profession rose with the establishment of the first professional organizations, starting with the Institute of CA of Scotland in 1854.
- Other 19th-century organizations include the Institute of CA in England and Wales, CPA Australia, American Institute of CPA, and Chartered Accountants Ireland.
- In the 20th century, the Association of Chartered Certified Accountants was established, followed by organizations like the ICAI and the Institute of Singapore CA.

**Post Industrial Revolution**

- Technological advancements, particularly computers, transformed accounting by automating manual processes, improving speed, and accuracy.
- Examples include the automation of interest calculations in banks, once done manually, now system-driven, reducing time and minimizing errors.

**Current State**

- Cloud computing and artificial intelligence are further revolutionizing the accounting profession, enhancing efficiency and accuracy.
- Despite benefits, these technologies pose challenges for accountants, requiring adaptation to new systems and processes to stay competitive.

## 2 Current State of Technology in Accounting

It discusses the various technologies used in accounting and their impact on the profession, including

- Automation,
- Cloud computing, and
- Artificial intelligence

### 2.1 Automation Process

Automation is the use of software and other tools to automate manual processes, making them faster and more accurate. We can understand this with the help of the below example:

For instance, let us consider the activities involved in the process of procuring groceries from a departmental store such as Walmart or Reliance Smart Bazaar **at the Front-End.**

- **Step I:** The customer picks his/her groceries and reach the billing counter.
- **Step II:** The person at the counter merely scans the item's barcode.
- **Step III:** The scanning automatically reads the data and inputs the item procured and the correspondin g selling price.
- **Step IV:** By scanning the barcode of each item, the bills are generated within a couple of minutes.
- **Step V:** The customer makes the payment, and the bill is printed and handed over to the customer.

However, **at the backend, the below activities take place:**

| Action | Simultaneous effect | Impact on Books of accounts | Reconciliation |
|---|---|---|---|
| As and when the barcode of an item is scanned at the billing counter | the inventory of the said item at the departmental store is simultaneously updated recording the issue/sale of the same. | This ensures accuracy in maintenance of inventory data. | A periodical physical check of inventory will give conclusive evidence of the correctness of data generated by the system, thereby giving comfort on the management assertions of accuracy, valuation and existence of the inventory |
| In certain cases, the software is so programmed to calculate taxes | that the indirect taxes (GST) levied on the sale value as per the invoice is updated simultaneously, | which can get uploaded on the GST portal at the end of the day by the accounting team in the backend. | This ensures accuracy in returns uploaded, thereby minimizing the need for manual reconciliation and data maintenance. |

| Action | Simultaneous effect | Impact on Books of accounts | Reconciliation |
|---|---|---|---|
| Software are also programmed | to ensure that the bill amount is automatically displayed on the Point of Sale Machine, through which the customer makes the payment either through debit/credit card or through UPI. | In case the customer opts to make payment in cash, entering the amount on the Screen will open the cash drawer in which the cash paid is deposited. | Since the cash drawer is opened through the system only after logging in by the concerned person, in case of mismatch in cash balances, the concerned person can be identified, thereby reducing the chances of misappropriation of cash. |

## Benefits of Automation Process

1. **Streamlining Data Entry:**

Automation tools (such as optical character recognition (OCR) or barcode recognition technology)

- can help to automate the entry of data from source documents such as receipts and invoices,
- reduce the time and effort required for manual data entry &
- minimise for human error.

2. **Accelerating Data Processing:**
   - Automation helps to process large amounts of data / large volumes of transactions more quickly and accurately than manual methods.
   - Eg: software can automatically categorize transactions into the appropriate accounts, calculate tax amounts, and generate financial statements (FS), among other tasks.

3. **Enhancing Accuracy:**
   - By automating tasks such as data entry and calculations
     - reduce errors and discrepancies in accounting processes.
     - Improving the accuracy and reliability of their financial data.

4. **Improving Decision-Making**

By Providing real-time insights into financial data,

- Time spent on routine tasks is greatly minimized and
- enabling businesses
  - to make informed decisions more quickly
  - to gain deeper insights into their financial performance,
  - identify trends and patterns, and
  - adjust their strategies accordingly.

5. **Saving Time and Money:**

Saving on staffing costs and increases productivity and enabling accountants to focus on higher-level tasks such as analysis and planning by automating data entry and reconciliations.

6. **Facilitating Compliance:**
   - Compliant with regulations and standards by ensuring accounting practices meet necessary requirements.
   - Automation ensures accurate data for the purposes of return filing.
   - Further, in case the systems are so programmed, reporting tools can generate FS that meet the criteria of Ind AS or Indian GAAP as the case may be.
   - This would ensure minimizing the risk of non-compliance and potential penalties.

### Challenges in Automation Process

- Need for ongoing training and education to keep up with the latest technology.
- Risk of data breaches and cyber-attacks → compromise the security and confidentiality of financial data.
- Potential loss of jobs → mitigated by ensuring appropriate training to the workforce to remain updated with the technology.
- Note: To summarize, automation helps businesses achieve efficiency, accuracy and decision-making in accounting while saving time and money and facilitating compliance with regulations and standards.

### Robotic Process Automation

- RPA is an emerging technology that revolutionizes financial reporting processes.
- It utilizes software robots or "bots" to automate manual and repetitive tasks in financial data processing, analysis, and reporting.
- By mimicking human interactions with digital systems, RPA bots can extract and consolidate data, perform calculations, generate reports, and ensure compliance with accounting standards.
- The adoption of RPA in financial reporting improves accuracy, enhances efficiency, and frees up valuable time for finance professionals to focus on more strategic activities.
- It enables organizations to achieve timely reporting, cost savings, and increased data integrity, ultimately leading to more reliable and insightful financial information.

## 2.2 Cloud Computing

**Cloud computing** refers to the delivery of computing services over the internet. It allows accountants to access their data and software from any device with an internet connection.

In the COVID-19 pandemic,

- The continuous lockdowns severely impacted businesses, and operations
- led to viewing cloud computing as a serious alternative compared to traditional client-server architecture in physical locations controlled by the entities themselves.
- With the advent of **cloud computing**, persons could
  - access the systems from their respective locations,
  - work remotely during the lockdown and
  - ensure that the accounting process and reporting requirements did not suffer adversely.

### Common Applications / Cases of Cloud Computing

1. **Cloud Storage:**
   - Services (like Dropbox, Google Drive, and Microsoft OneDrive) offer cloud storage solutions that allow users to store and access their files and data from anywhere with an internet connection.
   - Users can save documents, photos, videos, and other files in the cloud and synchronize them across multiple devices.
2. **Software as a Service (SaaS):**
   - SaaS platforms provide cloud-based software applications that users can access and utilize via the internet.
   - Eg: Salesforce for customer relationship management (CRM), Slack for team collaboration, and QuickBooks Online for accounting and financial management.
3. **Infrastructure as a Service (IaaS):**
   - IaaS providers offer virtualized computing resources, including servers, storage, and networking infrastructure, on a pay-as-you-go basis.
   - Eg: Amazon Web Services (AWS), Microsoft Azure, and Google Cloud Platform.
   - These platforms allow businesses to scale their IT infrastructure based on demand without the need for physical hardware.
4. **Platform as a Service (PaaS):**

- PaaS providers offer cloud-based platforms that enable developers to build, deploy, and manage applications without the complexity of infrastructure management.
- Eg: Microsoft Azure App Service, and Google App Engine.

5. **Cloud-based Communication and Collaboration:**
   - Applications (like Microsoft Teams, Google Workspace (formerly G Suite), and Zoom) provide cloud-based communication and collaboration tools that facilitate real-time messaging, video conferencing, file sharing, and project management.
6. **Cloud-based E-commerce:**
   - Few platforms enable businesses to set up and manage online stores using cloud infrastructure.
   - These platforms provide features like product catalogues, payment processing, inventory management, and customer analytics.
7. **Big Data Analytics:**
   - Cloud computing enables organizations to process and analyse large volumes of data efficiently.
   - Services (like Amazon Redshift, Google BigQuery, and Microsoft Azure Data Lake Analytics) provide scalable infrastructure for big data processing and analytics, empowering businesses to derive valuable insights from their data.

### Benefits of Cloud Computing (Cloud-based accounting software)

a. **Improved accessibility:**
   - It allows users to access their financial data from any location with an internet connection.
   - increased accessibility and flexibility for accountants and business owners, allowing them to work remotely and collaborate in real-time.

b. **Enhanced security:**
   - It providers typically offer advanced security features such as encryption, firewalls, and multi-factor authentication helping in the protection of sensitive financial data from cyber threats and data breaches.

c. **Increased scalability:**
   - It allows businesses to easily scale up or down based on their changing needs.
   - As a business grows, it can easily add new users and features without having to invest in additional hardware or software.

d. **Reduced costs:**
   - It requires less upfront investment in hardware and software, also ongoing maintenance costs.
     - Which helps businesses save money on IT expenses and redirect those funds to other areas of the business.
     - Eg: the costs of installing Microsoft Office Suite on a laptop or desktop is far more expensive than subscribing to the Office 365 Suite, which is a web-based download, (provides the options of continuous free updates unlike its Office Suite offline counterpart.)

e. **Streamlined collaboration:**
   - It allows multiple users to collaborate in real-time, reducing the need for manual data entry and communication.
   - This can help to streamline workflows and reduce errors caused by miscommunication.\

f. **Improved reporting and analytics:**
   - Cloud-based accounting software often includes powerful reporting and analytics tools that allow businesses to gain deeper insights into their financial performance.
   - This can help businesses make more informed decisions and identify areas for improvement.

### Challenges in Cloud Computing

- Prone to hackers who could 'steal' data or passwords or compromise the integrity of the processed data, thereby causing disruptions to the businesses.

- Strong net connectivity is a must for cloud-computing to be a success.
- Though there has been a huge surge in network and mobile connectivity in the past decade → connectivity in non-metros, tier-2 or tier-3 cities is not well-developed, which could create accessibility issues to the users of the cloud-based accounting software.

## 2.3 Enterprise Resource Planning (ERP)

ERP is a type of software that organizations use for managing day- to-day business activities like procurement, project management, accounting, risk management, compliance, and supply chain operations.

It connects and corelates a multitude of business processes and enable the flow of data between them. It collects an organization's shared transactional data from multiple sources and thus eliminate data duplication and provide data integrity with a single source of authentication.

Nowadays, ERP systems are used by many organisations as it is critical for managing thousands of businesses of varied sizes covering all industries. Cloud-based ERP applications are embedded with next-generation technologies, such as AI, machine learning (ML), and digital assistants.

ERP systems are designed around a single, defined data structure (schema) that typically has a common database. This helps to ensure that the information used across the enterprise is normalized and based on common definitions and user experiences.

These core constructs are then interconnected with business processes driven by workflows across business departments (e.g. finance, human resources, engineering, marketing, and operations), connecting systems and the people who use them.

Since data is the lifeblood of every modern company, ERP makes it easier to collect, organize, analyze, and distribute this information to every individual and system that needs it to best fulfill their role and responsibility. ERP also ensures that these data fields and attributes roll up to the correct account in the company's general ledger so that all costs are properly tracked and represented.

A key ERP principle is the central collection of data for wide distribution. With a secure and centralized data repository, everyone in the organization can be confident that data is correct, up- to-date, and complete. Data integrity is assured for every task performed throughout the organization, from a quarterly financial statement to a single outstanding receivables report.

### Benefits of ERP

As enterprise data and processes are caged into ERP systems, businesses can align separate departments and improve workflows, resulting in significant bottom-line savings.

Examples of specific business benefits include:

- Improved business insight from <u>real-time information</u> generated by reports
- <u>Less operational costs</u> through streamlined business processes and best practices
- <u>Enhanced collaboration of users</u> sharing data in contracts, requisitions, and purchase orders
- Better efficiency through a <u>common user experience</u> across many business functions and well-defined business processes
- <u>Consistent infrastructure</u> from the back office to the front office
- <u>Increased user-adoption rates</u> from a common user experience and design
- <u>Reduction in risk</u> through improved data integrity and financial controls
- <u>Less management and operational costs</u> through uniform and integrated systems

### How does an ERP system work?

ERP systems work by using a defined, standard data structure. Information entered by one department is immediately available to authorized users across the business. This uniform structure helps keep everyone on the same page.

Real-time data is then woven into business processes and workflows across departments. Managers check if one location is doing significantly better than another site and can figure out why. Finance department can use ERP for comparison of sales, profits and other financial data to help executives in understanding the performance of the organisation and also for setting new targets.

ERP systems deliver the most value when a company has modules for each major business function and ensures timely and accurate data entry. When a company uses business systems from multiple vendors, integrations are generally possible to make data automatically flow into the ERP. This real-time data can then be used throughout the ERP instance to benefit any process or workflow.

### Illustrative steps for Integrating Internal Control Over Financial Reporting with an ERP

- ICOFR with an ERP system offers the key advantage of streamlining financial processes, ensuring data integrity, and promoting effective internal controls.
- By automating and standardizing procedures, the ERP system reduces manual effort and minimizes the risk of errors.
- It enables segregation of duties, real-time visibility into financial data, comprehensive audit trails, enhanced reporting capabilities, and proactive risk mitigation.
- This integration strengthens financial control, accuracy, and compliance, ultimately enabling better decision-making and reducing the likelihood of fraud or errors.

**The following are illustrative steps for integrating ICOFR within ERP:**

| S.no | ICOFR with an ERP | Review by Finance team | Example |
|---|---|---|---|
| 1 | Verify that the process includes identification and updating of internal and external financial reporting requirements and deadlines | The finance team regularly reviews the regulatory guidelines and reporting requirements set by the regulators and ensures that the ERP system's financial closing process is aligned with these requirements. | Listed companies to declare quarterly results as per LODR,<br>Filing of periodical returns under GST, Income Tax, Labour laws, etc., |
| 2 | Review the documented process to ensure it aligns with the organization's financial reporting policies and regulatory guidelines. | The finance team reviews the documented process in the ERP system and cross-checks it with the organization's financial reporting policies and regulatory guidelines to ensure consistency. | Accounting polices relating to Property plant and equipment, depreciation, Inventory etc., |
| 3 | Use the ERP system's change management functionality to track and validate changes made to the financial closing and reporting process | › When changes are made to the financial closing and reporting process, the finance team uses the ERP system's change management functionality to track and record these changes.<br>› They review system logs and audit trail for changes made to the financial closing and reporting process are as per defined roles and responsibilities for change control, including change initiators, approvers, and change management teams. | |
| 4 | Verify that changes to the process are authorized by designated individuals with appropriate authority using system logs. | The finance team reviews the system logs, audit trail and confirms that any changes to the financial closing and reporting process were authorized by designated individuals with the appropriate authority, such as the CFO or finance manager. | |

| S.no | ICOFR with an ERP | Review by Finance team | Example |
|---|---|---|---|
| | | | |
| 5 | Review the change requests, approvals, and documentation within the ERP system to ensure proper authorization and validation of process changes. | | |
| 6 | Validate that roles and responsibilities in the financial closing and reporting process are clearly defined within the ERP system by reviewing users access matrix configurations and system logs. | > Review system logs and audit trail with Responsibility assignment matrix (RAM).<br>> RAM is a tool used in project management and enterprise resource planning (ERP) implementations to define and communicate the roles and responsibilities of individuals or teams involved in a project or process.<br>> The matrix clarifies who is responsible, accountable, consulted, and informed for each task or deliverable within the ERP implementation. | |
| 7 | Assess the qualifications and training records of individuals assigned to financial reporting roles within the ERP system. | | |
| 8 | Validate that individuals responsible for financial reporting have the necessary understanding of the organization's operations and appropriate accounting knowledge. | The finance team validates that individuals responsible for financial reporting within the ERP system have a comprehensive understanding of the organization's operations and possess appropriate accounting knowledge. | verify HR records of those involved in accounting have appropriate knowledge |
| 9 | Validate that decisions on alternative accounting treatments for significant events or transactions are documented and approved by management. | > Reviewing the Journal vouchers listing by identifying non routine transactions.<br>> Review the system of Standardizing voucher types.<br>> This involves defining a set of predefined templates or formats for different types of journal entries to ensure consistency and accuracy in recording financial data. | |
| 10 | Review the ERP system for documentation of accounting treatment decisions, including approvals and communication to the audit committee. | Documentation of accounting treatment decisions refers to the process of recording and maintaining comprehensive documentation regarding the | |

| S.no | ICOFR with an ERP | Review by Finance team | Example |
|---|---|---|---|
| | | rationale, analysis, and conclusions related to accounting treatments chosen for specific transactions or events like recognising long term construction projects. | |
| 11 | Review the ERP system's user administration functionality to ensure appropriate individuals have access to the financial reporting process. | Review system logs and audit trail with Responsibility assignment matrix (RAM). | |
| 12 | Review whether proper KYC validation controls are in place for creating account masters and review the process for identifying related party transactions | Separate ledger coding for related parties for auto tabulating transactions to present as per Schedule III of Companies Act, 2013. | |
| 13 | Validate that the ERP system captures and documents the appropriate accounting treatment for each non-routine event, transaction, and account balance by reviewing Journal Vouchers listing. | | |
| 14 | Use the ERP system's audit trail and reporting capabilities to validate that all postings have occurred in the correct accounting period reviewing accounting period configuration controls. | › In an ERP system, the accounting date and transaction date are captured and stored as part of the transactional data.<br>› They are used in various processes, such as journal entry creation, financial statement generation, period-end closing activities, and audit trails.<br>› Understanding the distinction between these dates is important for accurate financial reporting, compliance, and analysis of business transactions within the ERP system. | |
| 15 | Review the system's controls for preventing backdating or unauthorized adjustments to postings by reviewing the posting date and transactions date of entries. | | |

# 3 Cybersecurity in Accounting

## 3.1 Cybersecurity in Accounting

- The impact of cybersecurity breaches on accounting firms and their clients which may range
  - from <u>accessing</u> the financial data of the firm or client,
  - to an extent of <u>modifying</u> the financial statements <u>without the knowledge of the management.</u>
- Protecting financial information is crucial to prevent unauthorized access and data breaches.

- Legal and regulatory frameworks,
    - like the Information Technology Act, 2000 (Amended in 2008), govern the collection, storage, and transmission of financial data.
    - Reporting guidelines of various regulators such as SEBI, RBI etc., address the disclosure of cybersecurity incidents in financial statements.
    - Non-compliance with data protection laws → lead to financial penalties and reputational damage.
- Cybersecurity incidents
    - It can affect financial reporting through
        - financial losses,
        - reputational damage,
        - loss of sensitive client data and
        - legal consequences.
    - Legal and ethical obligations for Organisations to disclose cybersecurity incidents with financial implications

### 3.2 Common cybersecurity threats

a) **Phishing attacks:** A common cybersecurity threat that involves tricking users into clicking on malicious links or providing sensitive information.

b) **Malware attacks:** It involve infecting computers or networks with malicious software that can steal data or disrupt operations.

c) **Ransomware attacks:** It involve encrypting files or locking users out of systems and demanding a ransom payment in exchange for restoring access.

d) **Insider threats:** It involve malicious actions by employees or other insiders who have access to sensitive data.

e) **Denial of Service (DoS) attacks:** It involve overwhelming a system or network with traffic to disrupt operations.

f) **Supply chain attacks:** It involve compromising third-party software or hardware to gain access to system or network.

**Note:** In all the above cases, the aim of the attack would be either stealing sensitive financial data or disrupting operations or demand ransom money

### 3.3 Proactive measures to mitigate cybersecurity risks

a. **Password management:**
    - Strong passwords are critical for protecting sensitive financial data.
    - Accounting professionals should ensure that all passwords are complex and changed regularly.

b. **Encryption:**
    - Encryption can be used to protect sensitive data during transmission and storage.
    - The IT Team of an organization should ensure that all sensitive data is encrypted using appropriate methods.

c. **Access control:**
    - Access control is critical for preventing unauthorized access to financial data.
    - Accounting professionals should ensure that access to sensitive data is limited to authorized personnel and that appropriate access controls are in place.
    - The access controls should be continuously reviewed and updated based on any changes in the management or employee structure.

d. **Network security:**
    - Network security is critical for protecting financial data from cyberattacks.
    - It should be ensured that firewalls and other security measures are in place to prevent unauthorized access to the network.

e. **Employee training:**

- Employee training is critical for ensuring that all staff members are aware of the importance of cybersecurity and understand how to protect sensitive financial data.

f. **Data backup:**
   - Regular data backups are critical for ensuring that financial data is not lost in the event of a cyberattack.
   - Accounting professionals should ensure that data backups are performed regularly and that backups are stored securely.

g. **Incident response planning:**
   - Accounting professionals should have a clear incident response plan in place in the event of a cyberattack.
   - This plan should include procedures for detecting, containing, and mitigating the impact of a cyberattack.

**Note:** Overall, cybersecurity is a critical concern for accounting professionals, and it is essential to take appropriate measures to protect sensitive financial data

# 4 The Future of Technology in Accounting

## 4.1 Blockchain technology

- It is revolutionizing the financial landscape, and its impact on financial statement preparation is undeniable.
- As a CA involved in financial reporting, understanding blockchain is crucial for staying ahead in this rapidly evolving digital era.

### Key impacts of blockchain on financial reporting

1. **Enhanced Transparency:**
   - It provides a decentralized and immutable ledger, where transactions are recorded and stored in a transparent and tamper-proof manner.
   - This increased transparency ensures that financial data is accurately captured and can be easily audited, promoting trust and reliability in financial reporting.
2. **Improved Data Integrity:**
   - Blockchain's distributed ledger ensures that each transaction is verified and encrypted, preventing unauthorized modifications or tampering.
   - enhances data integrity, reducing the risk of fraudulent activities and errors in financial reporting.
3. **Streamlined Audit Processes:**
   - It enables real-time access to financial data, eliminating the need for time-consuming and manual data reconciliation processes.
   - Auditors can directly access the blockchain ledger to verify transactions, reducing audit time and enhancing efficiency in financial reporting.
4. **Enhanced Security:**
   - It incorporates advanced cryptographic algorithms, making it highly secure against unauthorized access or data breaches.
   - Financial data stored on the blockchain is encrypted and protected, minimizing the risk of data manipulation or unauthorized disclosure, thus strengthening the security of financial reporting
5. **Simplified Reconciliation:**
   - Blockchain's decentralized ledger eliminates the need for reconciling multiple versions of data across different systems.
   - With a single shared source of truth, financial reporting processes become more streamlined, reducing reconciliation efforts and potential errors.
6. **Cost Reduction:**

By eliminating the need of following, Blockchain reduces the costs associated with traditional financial reporting processes.

- third-party verification and reconciliation,
- intermediaries and
- central authorities,

7. **Enhanced Audit Trail:**
   - It maintains a comprehensive and immutable audit trail of all transactions, providing a transparent and traceable record of financial activities.
   - This audit trail simplifies the identification and investigation of any irregularities or discrepancies, improving the accuracy and reliability of financial reporting.

8. **Real-time Financial Reporting:**
   - With blockchain's real-time data availability and consensus mechanism, financial reporting can be performed more frequently and with greater accuracy.
   - Organizations can generate up-to-date financial statements, enabling stakeholders to make informed decisions based on the most current financial information.

## 4.2 Artificial Intelligence (AI)

Artificial Intelligence (AI) and Machine Learning (ML)

- Technologies that enable computers to learn and perform tasks without being explicitly programmed to do so.
- Simulation of human intelligence in machines, enabling them to perform tasks that would typically require human intervention.
- To analyse large amounts of data and make predictions about future trends (forecasting financial performance and identifying potential risks)

While AI has the potential to **transformed the Accounting Profession** by enabling accountants

- to provide more accurate and timely financial information to their clients,
- automate routine tasks,
- improve decision-making processes, and
- reduce errors.

It also presents **Challenges to Accounting Profession**:

- the need for ongoing training and education,
- the risk of data breaches, and
- the potential loss of jobs due to automation.

It also presents **Opportunities for Accounting Profession:**

- to expand their skill sets,
- offer new services to clients, and
- automate routine activities thereby freeing up human resources for tasks requiring greater application of knowledge and skill sets.

### Benefits of AI and ML when used in accounting

1. **Automated Data Entry:**
   - AI and ML algorithms can process and extract data from invoices, receipts, and other documents, reducing the need for manual data entry.
   - If programmed, AI and ML algorithms can also review bank statements and pass entries in the system, followed by a bank reconciliation, thereby automating the entire process, saving time and improving efficiency.

2. **Fraud Detection:**
   - AI can help detect fraud by analysing large amounts of data and identifying patterns that may indicate fraudulent activity.

3. **Financial Forecasting (Predictive Analysis):**

- ML can be used to develop predictive models
  - that can forecast financial performance based on historical data, market trends, and other factors,
  - Highly advantage - where estimates are required to be made in financial reporting.
- Example:

  where a store sells goods and offers a voucher giving the customer a discount on subsequent purchases,
  - Ind AS 115 requires a degree of estimation of the likelihood of availing such discount to record Revenue.
  - Predictive models can track customers' preferences and likelihood of availing the voucher, in which case the estimation of revenue as required under Ind AS 115 becomes more realistic.

4. **Accounting Automation:**
   - AI can analyse financial statements and other data to identify errors or inconsistencies, making accounting more efficient and accurate.
5. **Tax Compliance:**
   - AI can help automate tax compliance by analysing financial data and identifying tax obligations, ensuring that businesses remain compliant with tax regulations.

### Challenges with Artificial Intelligence

1. Data privacy
2. Security concerns
3. Technical complexity
4. Need to train employees in an organization to extract capabilities of AI from the system

## 5 Indian Accounting Standards (Ind AS) and Information Technology

Ind AS
- principle-based framework.
- consists of specific principles for various accounting topics, such as revenue recognition, leasing, financial instruments, employee benefits, consolidation, and many more.
- These principles provide detailed guidance on how to account for transactions in accordance with the principles of measurement and recognition.

For implementation of Ind AS

Technology will play key role in automating the process of validating while generating the reports.

Using of technology

before generating the reports

configuration at the Account level with rule-based validation

implements pre-defined validation rules within the system to identify discrepancies or non-compliance with Ind AS.

after generating the reports

By applications such as Microsoft Excel or Google Sheets → to perform such validations from the Ind AS point of view and then generate the report

dependent on human intelligence rather than on technology,

(except for the cases where Artificial Intelligence is involved with proper training using machine learning)

## 1. Illustration

A listed company's financial transactions are carried out in ERP. Following financial reporting weaknesses were observed during internal control over financial reporting:

1. There is no appropriate documented process with respect to financial closing and reporting, including the identification and updating of internal and external financial reporting requirements and deadlines.
2. Changes made to the financial closing and reporting process are not valid and properly authorised.
3. Roles and responsibilities in the financial closing and reporting process are not clearly defined, documented, updated, and not communicated to appropriate departments and individuals on a timely basis.
4. Individuals in financial reporting roles do not have the necessary understanding of the organisation's operations and appropriate accounting knowledge to properly perform their assigned responsibilities.
5. When alternative accounting treatments are available for a significant event or transaction, the decisions on which treatments to select are not documented, approved by management, and are not communicated to the audit committee.
6. General policies are not established and documented regarding permissible overrides of existing policies and procedures for the financial closing and reporting process.
7. User profiles (on General Ledger (G/L) system) are not monitored / maintained to ensure that appropriate individuals have access to financial reporting process.
8. The appropriate accounting treatment is not specified for each non-routine event, transaction, and account balance, including those requiring the use of accounting estimates and judgment in the selection and application of accounting principles.
9. Relevant, sufficient, and reliable data necessary to record, process, and report each non- routine event or transaction is not captured.
10. There are no procedures to ensure all postings have occurred in the correct period.
11. The application of the entity's accounting policies to each non-routine event or transaction is not performed on a timely basis and appropriately documented by knowledgeable and qualified personnel using approved methods and formats.
12. All non-routine events and transactions are not accurately processed in the appropriate accounting period.
13. There is no independent review of application of the entity's accounting policies to each non- routine event or transaction for appropriateness and absence of bias by an individual with the appropriate level of authority and experience.
14. There is no basis for significant estimates and judgments associated with each non-routine event or transaction.
15. No analysis is prepared accurately and consistently in accordance with the entity's defined financial closing process and in the appropriate accounting period.
16. All sources of information for routine and non-routine events and transactions are not identified and analysed.
17. There are no reconciliations for all significant accounts and no independent review of such reconciliation.
18. All intercompany transactions and balances are not identified, reconciled, and appropriately eliminated in consolidation in the appropriate accounting period.
19. All suspense accounts are not identified and monitored.
20. The trial balance(s) used to prepare the financial statements are not generated from the final general ledger(s).
21. All trial-balance accounts are not appropriately and consistently grouped for presentation in the financial statements for accounting periods presented.
22. There are no restrictions to access and to run transactions in the automated consolidation software which may compromise the integrity of financial data

23. All related-party events and transactions are not identified and authorised, appropriately accounted for, and disclosed in the appropriate accounting period.
24. There are no procedures to ensure all postings have occurred in the correct period.
25. Entries recorded directly to the financial statements are not valid.
Provide illustrative steps for Financial Closing and Reporting.

## 2. Illustration

Company XYZ is a manufacturing company that implements Ind AS 2 and wants your advice on utility of an ERP system for inventory management. They also aim to integrate ICOFR controls into their ERP system to ensure accurate inventory valuation, minimize the risk of inventory fraud, and enhance process efficiency and accordingly they need your guidance in integrating ICOFR in ERP system.
Also, advice the steps to be followed if the company cannot afford a ERP system but still want to ensure proper implementation of Ind AS 2 to the extent possible.

## 3. Illustration

Company Z is engaged in the business of importing oil seeds for further processing as well as trading purposes. It enters into the following types of contracts as on 1st October 20X1:

| Particulars | Contract 1 | Contract 2 | Contract 3 |
|---|---|---|---|
| Nature of Contract | Import of oil seeds from a foreign supplier | Purchase of oil seeds from a domestic producer / supplier | Contract to sell oil seeds on the commodity exchange |
| Quantity and rate | 100 MT at USD 400 per MT to be delivered as on 31st March 20X2 | 50 MT at Rs. 30,000 per MT to be delivered as on 31st January 20X2 | 50 MT at USD 450 per MT, maturing as on 15th January 20X2 |
| Net settlement clause included in the contract | Yes | Yes | Yes |
| Net settlement in practice for similar contracts | There have also been several instances of the oil seeds being sold prior to or shortly after taking delivery.<br>These instances of net settlement constitute approximately 30 per cent of the value of total import contracts. | Yes – company Z has net settled some of the domestic purchase contracts.<br>However, these instances constitute only 1 per cent of the total domestic purchase contracts in value.<br>The remaining contracts are settled by taking delivery of oil seeds which are used for further processing. | Yes – these contracts are required to be net settled with the exchange on the maturity date.<br>Company Z enters into these types of derivative contracts to hedge the risks on its domestic oil seeds purchase contracts |

Company Z wants to determine if the contracts entered into for purchase and sale of oil seeds are derivatives within the scope of Ind AS 109 or are executory contracts outside the scope of Ind AS 109. Though the Company Z is using an ERP accounting package it is not properly configured to provide the required reports for above said decision making. Therefore, Company Z requires your advice on whether such process of determining the nature of contracts is possible through use of external sources of technology.

## 4. Illustration

An entity provides broadband services to its customers along with voice call service. Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.
Comment on how to identify whether the performance obligations under the contract is distinct by using an automated process?

## 5. Illustration

1. T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:
- Segment 1: Local Route
- Segment 2: Inter-city Route
- Segment 3: Contract Hiring

The characteristics of each segment are as under:

Segment 1: The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.

Segment 2: T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).

Segment 3: T Ltd also leases buses to schools under a long-term arrangement.

While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under 'Operating Segment'.

Required
What are the steps involved to automate the process to determine whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'?

## 6. Illustration

New Way Ltd. decides to enter a new market that is currently experiencing economic difficulty and expects that in future the economy will improve. New Way Ltd. enters into an arrangement with a customer in the new region for networking products for promised consideration of ` 12,50,000.
At contract inception, New Way Ltd. wants to

(i) Define criteria for identifying contracts with customers, such as enforceable rights and obligations, agreement terms, and consideration.

(ii) Establish rules to link relevant transactions to specific contracts and assign unique identifiers to each contract

Required

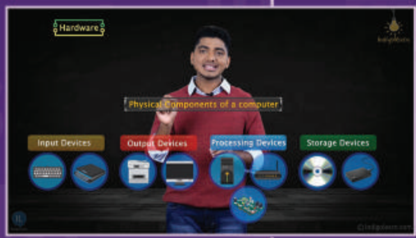
Advice the steps to automate the process to perform the above tasks on behalf of New Way Ltd.

## Our Approach

We go to great lengths to ensure that we deliver a quality learning experience to our students. Right from pedagogy design to faculty selection, video recording and animation, at evaery stage our goal is to ensure that the final output is the BEST and it meets the requirements of the learners. It is our laser sharp focus on maintaining HIGH QUALITY and setting new benchmarks in the CA education domain, that make our efforts stand out and help our students to succeed in their examinations.

## A Glimpse of our e-learning modules

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