CA-FINAL
FINANCIAL REPORTING

Module-3 :
(As per Latest Amendments Made by ICAI & MCA)

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BABA VISHAN PURI JI MAHARAJ
BABA LAKSHMAN PURI JI MAHARAJ
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Interim financial Reporting applies when an entity prepares an interim financial report. In AS 34 does not mandate an entity as when to prepare such a report. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash, flows and its financial conditions and liquidity. Permitting less information to be reported than in annual financial statements (on the basis of providing an update to those financial statements), the standard outlines the recognition, measurement and disclosure requirements for interim reports.

The objective of this standard is to prescribe

a) the minimum content of an interim financial report

b) the principles for recognition and measurement in complete or condensed financial statements for an interim period.

This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period.

This standard applies if an entity is required or elects to publish an interim financial report in accordance with Indian Accounting Standards (Ind AS)

Each financial report, annual or interim, is evaluated on its own for conformity to Ind AS. The fact that an entity may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not prevent the entity's annual financial statements from conforming to Ind AS if they otherwise do so.

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.
CONCEPT 4: DEFINITIONS

1. **Interim period** is a financial reporting period shorter than a full financial year.

2. **Interim financial report** means a financial report containing either a complete set of financial statements (as described in Ind AS 1, Presentation of financial Statements, or a set of condensed financial statements (as described in this Standard) for an interim period.

CONCEPT 5: CONTENTS OF AN INTERIM FINANCIAL REPORT

- An interim financial Report shall include the following:

  | A condensed balance sheet |
  | A condensed statement of profit and loss |
  | A condensed statement of changes in equity |
  | A Condensed statement of cash flows |
  | Notes, comprising significant accounting policies and other explanatory information |

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

- The interim financial report focuses on new activities, events, and circumstances and does not duplicate information previously reported.

- Nothing in this Standard is intended to prohibit or discourage an entity from publishing a complete set of financial statements (as described in Ind AS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. Nor does this Standard prohibit or discourages an entity from including in condensed interim financial statements more than the minimum line items or selected explanatory notes as set out in this Standard.

**Significant events and transactions**

- An entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance or the entity since the end of the last annual reporting period.

- Information disclosed in relation to those events and transactions shall update the relevant information presented in the most recent annual financing report.
A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore, it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report.

The following is a list of events and transactions for which disclosures would be required if they are significant: the list is not exhaustive.

1. the write-down of inventories to net realisable value and the reversal of such write-down;
2. recognition of a loss from the impairment of financial assets, property, plant and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;
3. the reversal of any provisions for the costs restructuring;
4. acquisitions and disposals of items of property, plant and equipment;
5. commitments for the purchase of property, plant and equipment;
6. litigation settlement;
7. corrections of prior period errors;
8. 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;
9. any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period;
10. related party transactions;
11. transfers between levels of the fair value hierarchy used in measuring the fair value of financial instrument;
12. changes in the classification of financial assets as a result of a changes in the purpose or use of those assets; and
13. Changes in contingent liabilities or contingent assets.

Individual Ind AS provide guidance regarding disclosure requirements for many of the items listed above. When an event of transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of and an update to the relevant information included in the financial statements of the last annual reporting period.
Other disclosures

The information shall normally be reported on a financial year-to-date basis. In addition to disclosing significant events and transactions, an entity shall include the following information, in the notes to its interim financial statements. The following disclosures shall be given either in the interim financial statements or incorporated by cross-reference from the interim financial statements to some other statement (such as management commentary or risk report) that is available to users to the financial statements on the same terms as the interim financial statements and at the same time. If users of the financial statements do not have access to the information incorporated by cross-reference on the same terms and at the same time, the interim financial report is incomplete.

a) a statement that the same accounting policies and methods of computation are followed in the interim financial statement. 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 asset, 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 amount reported in financial years.

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):

i. revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.

ii. Intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker.

iii. a measure of segment profit or loss.

iv. a measure of total assets and liabilities of a particular reportable segment if such amount are regularly provided to the chief operating decision maker and if there has been a material change from the amount disclosed in the last annual financial statements for that reportable segment.
v. a 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.

vi. a 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. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segment’s measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation.

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 combination, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operation. In the case of business combinations, the entity shall disclose the information required by Ind AS 103, Business Combinations.

j) for financial instrument, 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.

**Periods for which interim financial statements are required to be presented**

Interim reports shall include interim financial statements (condensed or complete) for periods as follows:

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

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

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

(d) statements of cash flows cumulatively for the financial year to date, with a comparative statement of the comparable year-to-date period of the immediately preceding financial year.
For an entity whose business is highly seasonal, financial information for the twelve months up to the end of the interim period and comparative information for the prior twelve-month period may be useful.

### Concept 6: Recognition and Measurement

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Criteria</th>
<th>Recognition and Measurement</th>
</tr>
</thead>
</table>
| 1      | Same accounting policies as annual                                        | 1. An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.  
2. The frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results.  
3. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.  
4. Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements. |
| 2      | Revenues received cyclically, occasionally or seasonally                  | 1. Revenues that are received seasonally, cyclically, or occasionally within a financial year shall not be anticipated or deferred as an interim date if anticipation or deferral would not be appropriate at the end of the entity’s financial year. Examples include dividend revenue, royalties, and government grants.  
2. Certain entities earn more revenue in certain interim periods of a financial year than other interim periods. Such revenues are recognised when they occur. Example seasonal revenues of retailers. |
Costs incurred unevenly during the financial year shall be anticipated or deferred for interim reporting purposes if, and only if, it is also appropriate to anticipate or defer that type of cost at the end of the financial year.

**EXAMPLES:**

**Employer payroll taxes and insurance contributions**

If employer payroll taxes or contributions to government-sponsored insurance funds are assessed on an annual basis, the employer’s related expense is recognized in interim period using an estimated average annual effective payroll tax or contribution rate, even though a large portion of the payments may be made early in the financial year. A common example is an employer payroll tax or insurance contribution that is imposed up to a certain maximum level of earnings per employee. For higher income employees, the maximum income is reached before the end of the financial year, and the employer makes no further payments through the end of the year.

**Provisions**

A provision is recognized when an entity has no realistic alternative but to make a transfer of economic benefits as a result of an event that has created a legal or constructive obligation. The amount of the obligation is adjusted upward or downward, with a corresponding loss or gain recognized in profit or loss, if the entity’s best estimate of the amount of the obligation changes.

This Standard requires that an entity apply the same criteria for recognizing and measuring a provision at an interim date as it would at the end of its financial year. The existence or non-existence of an obligation to transfer benefits is not a function of the length of the reporting period. It is a question of fact.

**Year-end bonuses**

The nature of year-end bonuses varies widely. Some are earned simply by continued employment during a time period. Some bonuses are earned on a monthly, quarterly, or annual measure of operating result. They may be purely discretionary, contractual, or based on years of historical precedent. A bonus is anticipated for interim reporting purposes if, and only if, (a) the bonus is a legal obligation or past practice would make the bonus a
constructive obligation for which the entity has no realistic alternative but to make the payments, and (b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance.

**Intangible assets**

An entity will apply the definition and recognition criteria for an intangible asset in the same way in an interim period as in an annual period. Costs incurred before the recognition criteria for an intangible asset are met are recognised as expense. Costs incurred after the specific point in time at which the criteria are met are recognised as part of the cost of an intangible asset. Deferring costs as assets in an interim balance sheet in the hope that the recognition criteria will be met later in the financial year is not justified.

**Vacations, holidays, and other short-term compensated absences**

Accumulating compensated absences are those that are carried forward and can be used in further periods if the current period's entitlement is not used in full. Ind AS 19, Employee Benefits requires that an entity measure the expected cost of and obligation for accumulating compensated absences at the amount the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the report period. That principle is also applied at the end of interim financial reporting periods. Conversely, an entity recognised no expense or liability for non-accumulating compensated absences at the end of an interim reporting period, just as it recognises none at the end of an annual reporting period.

**Measuring interim income tax expense**

Interim period income tax expense is accrued using the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

This is consistent with the basic concept set out in the Standard that the same accounting recognition and measurement principles shall be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Interim period Income tax expense is calculated by applying to an interim period's pre-tax income the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate. That estimated average annual rate would reflect a blend of the progressive tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. Ind AS 12, Income Taxes
provides guidance on substantively enacted changes in tax rates. Consistent with paragraph 28 of this Standard. The Standard requires disclosure of a significant changes in estimate. To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. Similarly, if different income tax rates apply different categories of income (such as capital gains or income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all case and a weighted average of rates across jurisdictions or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates.

Depreciation and amortisation

Depreciation and amortisation for an interim period is based only on assets owned during that interim period. It does not take into account asset acquisitions or dispositions planned for late in the financial year.

Inventories

Inventories are measured for interim financial reporting by the same principles as at financial year- end. Ind AS 2, Inventories establishes standards for recognising and measuring inventories. Inventories pose particular problems at the end of any financial reporting period because of the need to determine inventory quantities, cost, and net realisable values. Nonetheless, the same measurement principals are applied for interim inventories. To save cost and time, entities often use estimates to measure inventories at interim dates to a greater extent than at the end of annual reporting periods. Following are examples of how to apply the net realisable value test at an interim date and how to treat manufacturing variances at interim dates.

Net realisable value of inventories

The net realisable value of inventories is determined by reference to selling prices and related costs to complete and dispose at interim dates. An entity will reverse a write-down to net realisable value in a subsequent interim period only if it would be appropriate to do so at the end of the financial year.
QUESTION 1

Company A has reported Rs 60,000 as pre 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 of 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.

SOLUTION:

Amount of income tax expense reported in each quarter would be as below:

<table>
<thead>
<tr>
<th></th>
<th>Q 1</th>
<th>Q 2</th>
<th>Q 3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
<td>60,000</td>
<td>(15,000)</td>
<td>(15,000)</td>
<td>(15,000)</td>
</tr>
<tr>
<td>Tax expense</td>
<td>12,000</td>
<td>(3,000)</td>
<td>(3,000)</td>
<td>(3,000)</td>
</tr>
</tbody>
</table>

INTERIM FINANCIAL REPORTING AND IMPAIRMENT

An entity is required to assess goodwill for impairment at the end of each reporting period, and, if required, to recognise an impairment loss at that date in accordance with Ind AS 36. However, at the end of a subsequent reporting period, conditions may have so changes that the impairment loss would have been reduced or avoided had the impairment assessment been made only at that date.

Accordingly, an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill.

QUESTION 2

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) Extraordinary loss of Rs 3,00,000 incurred during the quarter has been fully recognised in this quarter.
(iii) Additional depreciation of ₹ 4,50,000 resulting from the change in the method of depreciation.

(iv) ₹ 5,00,000 expenditure on account of administrative expenses pertaining to the third quarter is deferred on the argument that the fourth quartet will have more sales; therefore fourth quarter should be debited by higher expenditure. The expenditures are uniform throughout all quarters.

Ascertain the correct net profit to be shown in the Interim Financial of third quarter to be presented to the Board of Directors.

**SOLUTION:**

In the instant case, the quarterly net profit has not been correctly stated.

As per Ind AS 34, Interim Financial reporting, the quarterly net profit should be adjusted and restated as follows:

Bad debts of ₹ 1,00,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) ₹ 50,000 to the next quarter. This treatment is not correct as the expenses incurred during an interim reporting period should be recognised in the same period unless conditions mentioned in paragraph 39 of Ind AS 34 are fulfilled. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.

The treatment of extra-ordinary loss of ₹ 3,00,000 being recognised in the same quarter is correct.

Recognising additional depreciation of ₹ 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.

AS per Ind AS 34 the income and expense should be recognised when they are earned and incurred respectively. As per para 39 of Ind AS 34, the costs should be anticipated to deferred only when:

(i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and  
(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the treatment done relating to deferment of ₹ 5,00,000 is not correct as expenditures are uniform throughout all quarters.

Thus considering the above, the correct net profit to be shown in interim financial Report of the third quarter shall be ₹ 14,50,000 (₹ 20,00,000 - ₹ 5,00,000 - ₹ 50,000).
**QUESTION 3**

On 30.6.2020, Jatin Ltd. incurred Rs. 2,00,000, Net Loss from disposal of a business segment. Also, on 30.7.2020, the company paid Rs. 60,000 for Property taxes Assessed for the calendar year 2020. How the above transactions should be included in determination of Net Income of Jatin Ltd. for the six months interim period ended on 30.9.2020.

**SOLUTION:**

According IND AS 34 “Interim Financial Reporting”, Jatin Ltd., would report the entire Rs. 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period.

A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since Rs. 60,000 Property Tax payment relates to entire calendar year 2020, Rs. 30,000 would be reported as an expense for six months ended on 30th September, 2020.

**QUESTION 4**

An enterprise’s financial reporting year ends 30 September and its reports quarterly. Its year as per taxation laws ends 31 March. For the financial year that begins 1 October, Year 1 ends 30 September of Year 2 the enterprise earns rs. 100 lakhs pre-tax each quarter. The estimated weighted average annual income tax rate is 30 per cent in Year 1 and 40 per cent in Year 2. Calculate amount of tax expenses for each quarter.

**QUESTION 5**

Intelligent Corp. (I-Corp.) is dealing in seasonal products. The quarterly sales pattern of the products is given below:

<table>
<thead>
<tr>
<th>Quarter Ending on</th>
<th>Qtr. - I</th>
<th>Qtr. - II</th>
<th>Qtr. - III</th>
<th>Qtr. - IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>31st March</td>
<td>30th June</td>
<td>30th September</td>
<td>31st December</td>
<td></td>
</tr>
<tr>
<td>% of Sales</td>
<td>15%</td>
<td>15%</td>
<td>50%</td>
<td>25%</td>
</tr>
</tbody>
</table>

For the First Quarter ending 31st March, 2020, I-Corp. gives you the following information:

<table>
<thead>
<tr>
<th>Rs. Crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
</tr>
<tr>
<td>Salary and other expenses</td>
</tr>
<tr>
<td>Advertisement expenses (routine)</td>
</tr>
<tr>
<td>Administrative and selling expenses</td>
</tr>
</tbody>
</table>
While preparing interim financial report for the first quarter 'I-Corp.' wants to defer Rs. 21 crore expenditure to third quarter on the argument that third quarter is having more sales, therefore third quarter should be debited by higher expenditure. Considering the seasonal nature of business, the expenditure are uniform throughout all quarters.

Calculate the result of first quarter as per IND AS 34 and comment on the company’s view.

**QUESTION 6**

How should the following be recognized and measured in the interim financial statements:

(i) Year end bonus
(ii) Income-tax expense
(iii) Provisions
(iv) Foreign currency translation gains and losses.

**SOLUTION:**

(i) Year end bonus: - Anticipate only, if there is a legal or other obligation and a reliable estimate can be made.

(ii) Income-tax expense: - Apply estimated average annual effective income-tax rate to the pre-tax income of the interim period.

(iii) Provisions: - Same criteria as is used for year end estimates.

(iv) Foreign currency translation gains and losses: - Apply same principles as are applied at year end.

**QUESTION 7**

ABC India Ltd. has Rs. 1,02,000 net income for the quarter ended 31 December, 2020 including the following items:

(a) Rs. 60,000 extraordinary gain received on July 30, 2020, was allocated equally to the second, third and fourth quarter of financial year 2020-2021.

(b) Rs. 16,000 cumulative effect loss resulting from during change in method of inventory valuation method was recognized on November 2, 2020. Out of this loss Rs. 10,000 relates to the previous quarters.

Compute the profit as per IND AS 34 for the quarter ended 31st December, 2020 of ABC India Ltd.
QUESTION 8

Kataka Ltd. shows Net profit of Rs. 7,20,000 for Quarter III after incorporating the following -

(1) Bad debts of Rs. 40,000 incurred during this period, 50% of the bad debts have been deferred to the next quarter.

(2) Extra-ordinary Loss of Rs. 35,000 incurred during the quarter has been fully recognised in this quarter.

(3) Additional Depreciation of Rs. 45,000 resulting from the change in the method of charge of depreciation.

Ascertain the correct quarterly income.

QUESTION 9

Jatin limited expects to receive dividend income of Rs. 100 crores on its investments in the quarter October to December, 2020. It proposes to recognise Rs. 25 crores dividend income in interim financial statement of each quarter. Is this justified.

QUESTION 10

An enterprise reports quarterly, earns Rs. 150 lakhs per-tax profit in the first quarter but expects to incur losses of Rs. 50 lakhs in each of the three remaining quarters (thus having zero income for the year), and is governed by taxation laws according to which its estimated average annual income tax rate is expected to be 35 per cent. Calculate amount of tax expense for each quarter.

QUESTION 11

The accounting year of X Ltd. ends on 30th September, 2020 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1.10.2019 and ends on 30.9.2020, the quarterly income is as under:-

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Quarter ending 31.12.2019</td>
<td>Rs. 200 crores</td>
</tr>
<tr>
<td>2nd Quarter ending 31.3.2020</td>
<td>Rs. 200 crores</td>
</tr>
<tr>
<td>3rd Quarter ending 30.6.2020</td>
<td>Rs. 200 crores</td>
</tr>
<tr>
<td>4th Quarter ending 30.9.2020</td>
<td>Rs. 200 crores</td>
</tr>
<tr>
<td>Total</td>
<td>Rs. 800 crores</td>
</tr>
</tbody>
</table>

Weighted Average tax rate for the financial year ending on 31.3.2006 is 20% and for financial year ending 31.3.2007 is 30%. Calculate tax expense for each quarter.
**TEST YOUR KNOWLEDGE**

**Practical Question**

Company A expects to earn ₹ 15,000 pre-tax profit each quarter and has a corporate tax slab of 20 percent on the first ₹ 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.

**Answer to practical question**

The following table shows the amount of income tax expense that is reported in each quarter:

<table>
<thead>
<tr>
<th></th>
<th>Q1</th>
<th>Q3</th>
<th>Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
<td>₹15,000</td>
<td>₹15,000</td>
<td>₹15,000</td>
</tr>
<tr>
<td>Tax expense</td>
<td>₹5,000</td>
<td>₹5,000</td>
<td>₹5,000</td>
</tr>
</tbody>
</table>

Expected total Income = ₹15,000 × 4 = ₹60,000

Expected Tax as per slabs = ₹20,000 × 20% + ₹40,000 × 40% = ₹20,000

Average annual Income tax rate = ₹20,000/ ₹60,000 × 100 = 33.33%
**NEW QUESTIONS ADDED IN STUDY MATERIAL**

**QUESTION 1**

Fixed production overheads for the financial year is ₹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 ₹2,500.

<table>
<thead>
<tr>
<th>Actual production achieved</th>
<th>Quantity (in MT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First quarter</td>
<td>400</td>
</tr>
<tr>
<td>Second quarter</td>
<td>600</td>
</tr>
<tr>
<td>Third quarter</td>
<td>500</td>
</tr>
<tr>
<td>Fourth quarter</td>
<td>400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,900</strong></td>
</tr>
</tbody>
</table>

Presuming that there are 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.
GUIDANCE NOTE ON MEASUREMENT OF INCOME TAX EXPENSE FOR INTERIM FINANCIAL REPORTING

Income tax expense is an important item of interim and annual financial reports. Hence, correct measurement of income tax expense is very important for reporting purposes. This Guidance Note deals with various aspects in the measurement of income tax expense for the purpose of interim financial reporting.

General principles for recognition and measurement as per AS 25

- An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.

- Requiring an enterprise to follow the same accounting principle in interim financial statements as in its annual financial statements suggest that each interim period may be considered as a standalone reporting period.

- Income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

Measurement of income tax expense

The various steps involved in the measurement of income tax expense for the purpose of interim financial reports are as below:

STEP 1: ESTIMATE THE ANNUAL ACCOUNTING INCOME

- Estimate the annual accounting income.
- Take into account all the probable future events and transactions expected to occur during the financial year.

Such an estimate would be on prudent basis, for e.g.- depreciation on expected expenditure on acquisition of fixed assets, profits from sale of fixed assets/investments, etc.
Such future events and transactions should be taken into account only if there is a reasonable certainty that the same would take place during the financial year.

**STEP 2: ESTIMATE THE NET TAX LIABILITY FOR THE FINANCIAL YEAR**

- Estimate the taxable income for the year.
- Apply the enacted or the substantively enacted tax rate on the taxable income, to arrive at an estimate of the current tax for the year.
- The estimates of tax liability should be based on the estimated deductions, allowances, etc., provided there is a reasonable certainty for the same.
- Estimate deferred tax assets/liabilities as per AS 22

**Special considerations**

(a) Where brought forward losses exist from the previous financial year (when deferred tax asset was not recognised on considerations of prudence as per AS 22):
   In such a situation, for estimating the current tax liability, the brought forward losses would have to be deducted from the estimated annual accounting income.
   Since such carried forward losses will get set-off during the year, these would not have any tax consequence in future periods.

(b) Where brought forward losses exist (when deferred tax asset was recognised on the considerations of prudence as per AS 22):
   In such a situation, current tax would be computed in the same manner as explained in (a) above.
   However, in the determination of deferred tax, the tax expense arising from the reversal of the deferred tax asset recognised previously, to the extent of reversal of deferred tax asset in the current year, would also be considered.

**STEP 3: CALCULATE THE WEIGHTED AVERAGE ANNUAL EFFECTIVE TAX RATE**

- Determine the weighted average annual effective tax rate by dividing the estimated tax expense (calculated in Step 2 above) by the estimated annual accounting income (calculated in Step 1 above).
- Where different tax rates are applicable to different portions of the estimated annual accounting income, e.g., normal tax rate and a different tax rate for capital gains, calculate the weighted average annual effective tax rate separately for such portions of estimated annual accounting income.
Step 4: Determine Income Tax Expense for Interim Financial Reports

Apply the weighted average annual effective tax rate to the accounting income for the interim period for determining the income tax expense to be recognised in the interim financial reports.

Note:

Tax expense recognised under AS 25 ‘Interim Financial Statement’ is based on Integral approach ie. the interim period is part of the whole accounting year. According to this approach, the said rate is determined on the basis of the taxable income for the whole year, and applied to the accounting income for the interim period in order to determine the amount of tax expense for that interim period.

Question 1: When progressive rates of tax are applicable

Estimated annual income: ₹ 1 lakh

Tax Rates:

- On first ₹ 40,000: 30%
- On the balance income: 40%

Estimated income of each quarter is ₹ 25,000

Determine the amount of tax expense to be recognised in each of the quarterly financial reports.

Question 2: When different rates of tax are applicable to different portions of the estimated annual accounting income

Estimated annual income: ₹ 1 lakh

(inclusive of Estimated Capital Gains (earned in Quarter II) ₹ 20,000)

Tax Rates On Capital Gains: 10%

On other income:

- First ₹ 40,000: 30%
- Balance income: 40%

Estimated income of each quarter is ₹ 25,000

Income of ₹ 25,000 for 2nd Quarter includes capital gains of ₹ 20,000.

Assuming there is no difference between the estimated taxable income and the estimated accounting income, calculate the tax expense for each quarter.
question no 1

An entity starts a business in July 2005. The business was small in nature and therefore the entity did not follow any specific accounting standards for valuation of inventory. Over the decade the entity flourishes, becomes a big company and decided to apply Ind AS 2 on inventories from the financial year 2016-2017. It decided to follow the weighted average method for valuation of inventory. Now following questions will arise.

i. Shall entity do such valuation retrospectively or prospectively?
ii. What is meant by retrospective application?
iii. If it is to be applied as if it was applied from July 2005, then what about the accounts already presented? Does entity need to change all the accounts?
iv. How would the effect be given?

Solution

(i) It will depend upon whether the company is following the standard as per the new guidelines of institute or is to applying voluntarily? In the above case. The entity itself is taking the decision to apply the standard and therefore it will be treated as voluntary application. If it falls under voluntary application then, the Ind AS 8 states that the policy should be applied retrospectively.

(ii) As per definition, retrospective application assumes that the policy had always been applied. If does not state any specific period. 'Had always been applied' indicates that policy was applied right from the day 1, i.e. from July 2005.

(iii) The entity is not supposed to change the accounts which are already presented. However it needs to give the effect of the change in policy while presenting the accounts for the year in which new policy is adopted. In the current case, the new policy is adopted from the F.Y. 2016-2017. Therefore, the effect will be given to the concerned items, in the financial statements of F.Y. 2016-2017.

(iv) Ind AS 8 states that 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.

When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable.
Retrospective application to a period period is not practicable unless it is practicable to
determine the cumulative effect on the amounts in both the opening and closing balance
sheets for that period.

The amount of the resulting adjustment relating to periods before those presented in the
financial statements is made to the opening balance of each affected component of equity
of the earliest prior period presented. Usually the adjustment is made to retained earnings.
However, the adjustment may be made to another component of equity to comply with an
Ind As.

Any other information about prior periods, such as historical summaries of financial data, is
also adjusted as far back as is practicable.

**QUESTION NO 2**

Continuing the above illustration, assume that company might be following the weighted
average method of valuation of stock right from July 2005. In reality, company might have
applied other methods like specific identification, LIFO or FIFO etc. company might have
changed also the method during the period as it was not following any specific standard
at that time. However, now, in F.Y. 2016-2017, the company decided to follow Ind AS and
accordingly decides the weighted average method of valuation. Analyse

**SOLUTION**

The company needs to calculate the closing inventory of every year since 2005-2006
assuming that it was following the said method from day 1.

This will change the figure of gross profit and net profit as inventory valuation will make
direct impact on the profits of the company. Net profits will affect the equity as well.
Similarly, the closing balances of inventory from year to year will also change. Thus, company
will make the calculations from the year 2005-2006 to 2015-2016.

The provisions further state that company will adjust the opening balances of equity and
other related amounts for the **earliest prior period presented**. It means, if company is
presenting the accounts for F.Y. 2016-2017, it need to give comparative figures for F.Y.
2015-2016 also. Therefore, the earliest prior period presented will be F.Y. 2015-2016 in
the above mentioned case. Thus the net effect on profit of last 11 years (from F.Y. 2005-
2006 to F.Y. 2015-2016) will be adjusted through the equity and inventory balances of the
year 2015-2016.

Thereafter the new policy will be continued and every year the valuation of inventory will be
done using weighted average method.
QUESTION 3

1. During 2012, Beta Ltd. discovered that some products that had been sold during 2011 were incorrectly included in inventory at March 31, 2011 at ₹ 6,500.

2. Beta's accounting records for 2012 shows sales of ₹ 1,04,000, cost of goods sold of ₹ 86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

3. In 2011, Beta Ltd. reported:
   * Sales of ₹ 73,500
   * Cost of goods sold of ₹ 53,500
   * Profit before income taxes of ₹ 20,000
   * Income taxes of ₹ 6,000
   * Profit of ₹ 14,000

4. 2011 opening retained earnings was ₹ 20,000 and closing retained earnings of ₹ 34,000

5. Beta's income tax rate was 30 per cent for 2012 and 2011. It had no other income or expenses.

6. Beta Ltd. had ₹ 5,000 of share capital throughout, and no other components of equity except for retained earnings. Its shares are not publicly traded and it does not disclose earnings per share.

SOLUTION

You are required to prepare relevant extract from the statement of profit and loss and statement of changes in equity. Also what should be disclosed in the notes.

Beta ltd.
Extract from the statement of profit and loss.

(Amount in ₹)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>Restated 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>104,000</td>
<td>73,500</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>80,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Profit before income taxes</td>
<td>24,000</td>
<td>13,500</td>
</tr>
<tr>
<td>Income taxes</td>
<td>7,200</td>
<td>4,050</td>
</tr>
<tr>
<td>Profit</td>
<td>16,800</td>
<td>9,450</td>
</tr>
</tbody>
</table>
Beta Ltd.

Statement of changes in equity

(Amount in ₹)

<table>
<thead>
<tr>
<th></th>
<th>Share Capital</th>
<th>Retained Earnings</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as at March 31, 2010</td>
<td>5,000</td>
<td>20,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Profit for the year ended March 31, 2011 as restated</td>
<td>--------</td>
<td>9,450</td>
<td>9,450</td>
</tr>
<tr>
<td>Balance as at March 31, 2011</td>
<td>5,000</td>
<td>29,450</td>
<td>34,450</td>
</tr>
<tr>
<td>Profit for the year ended March 31, 2012</td>
<td>--------</td>
<td>16,800</td>
<td>16,800</td>
</tr>
<tr>
<td>Balance as at March 31, 2012</td>
<td>5,000</td>
<td>46,250</td>
<td>51,250</td>
</tr>
</tbody>
</table>

TEST YOUR KNOWLEDGE

QUESTION 1

During 2012, Delta Co. 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 2012, Delta’s asset records were not sufficiently detailed to apply a components approach fully. At the end of 2011, 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 2012. 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’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 2012. 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’s new policy prospectively from the start of 2012.

Additional information:

(i) Delta’s tax rate is 30 per cent
(ii) Particulars Property, plant and equipment at the end of 2011:

Cost: ₹ 25,000
Depreciation: ₹ 14,000
Net book value: ₹ 11,000

(iii) Prospective depreciation expenses for 2012 (old basis): ₹ 1,500

(iv) Some results of the engineering survey:

Valuation: ₹ 17,000
Estimated residual value: ₹ 3,000
Average remaining asset life: 7 Years
Depreciation expense on exiting property, plant and equipment for 2012 (new basis): ₹ 2,000

You are required to prepare relevant note for disclosure in accordance with Ind AS 8

ANSWER

Extract from the notes

From the start of 2012, Delta Co. 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. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 2012 because it was not practicable to estimate the effects of applying the policy either retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years. The effect on the current year is to increase the carrying amount of property, plant and equipment at the start of the year by ₹ 6,000; increase the opening deferred tax provision by ₹ 1,800; create a revaluation surplus at the start of the year of ₹ 4,200; increase depreciation expense by ₹ 500; and reduce tax expense by ₹ 150.
QUESTION 1

Can an entity voluntarily change one or more of its accounting policies?

SOLUTION

A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8.

As per para 14 of Ind AS 8, entity shall change an accounting policy only if the change:

(a) is required by an Ind As; or

(b) Results in the financial statements providing reliable and more relevant information about the effects or transactions. Other events or conditions on entity’s financial position, financial performance or cash flows.

Para 15 of the standard states that the users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the above criteria.

Paragraph 14 (b) lays down two requirements that must be complied with in order to make a voluntary change in an accounting policy. First, the information resulting from application of the changed (i.e., the new accounting policy must be reliable. Second, the changed accounting policy must result in more relevant information being presented in the financial statements.

Whether a changed accounting policy results in reliable and more relevant financial information is a matter of assessment in the particular facts circumstances of each case in order to ensure that such an assessment is made judiciously (such that a voluntary change in an accounting policy does not effectively become a matter of free choice), paragraph 29 of Ind AS requires an entity making a voluntary change in an accounting policy to disclose, inter alia, the reasons why applying the new accounting policy provides reliable and more relevant information.

QUESTION 2

Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 20X1 - X2. During the financial year 20X2 - X3, it relocated the office to a new building and leased the said building to a third party, Following the change in the usage of the building entity ABC reclassified it from PPE
to investment property in the financial year 20X2 X3. Should Entity ABC account for the change as a change in policy?

**SOLUTION**

Paragraph 16 (a) of Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 16, property, plant and equipment are tangible items, that:

(a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) Are expected to be used during more than one period

As per Ind 40, investment property is property (land or a building or part of building or both) held (by owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:

(a) Use in the production or supply or goods of services or for administrative purposes; or

(b) Sale in the ordinary course of business.

As per the above definitions whether a building is an ties of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity it is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa. Whether a building is in the nature of PPE of investment Property is determined by applying the definitions of these terms from the perspective of that entity Thus, the classification of a building as an item of property plant and equipment or as an investment property is not a matter of an accounting policy choice. Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is **not** a change in an accounting policy.

**QUESTION 3**

Whether change in functional currency of an entity represents a change in accounting policy?

**SOLUTION**

Paragraph 16 (a) of Ind AS 8 provides that the application of an accounting policy for transactions other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.
As per Ind AS 21, functional currency is the currency of the primary economic environment in which the entity operates.

Paragraphs 9-12 of Ind AS 21 list factors to be considered by an entity in determining its functional currency. It is recognized that there may be cases where the functional currency is not obvious. In such cases, Ind AS 21 requires the management to use its judgments to determine the functional currency that most faithfully represents the economic effects to the underlying transactions, events, and conditions.

Paragraph 13 of Ind AS 21 specifically notes that an entity's functional currency reflects the underlying transactions, events, and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events, and conditions. Thus, functional currency of an entity is not a matter of an accounting policy choice.

In view of the above, a change in functional of an entity does not represent a change in accounting policy, and Ind AS 8, therefore, does not apply to such a change. Ind 21 requires that when there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

**QUESTION 4**

An entity developed one of its accounting policies by considering a pronouncement of an overseas national standard-setting body in accordance with Ind AS 8. Would it be permissible for the entity to change the said policy to reflect a subsequent amendment in that pronouncement?

**SOLUTION**

In the absence of an Ind AS that specifically applies to a transaction, other event of condition, management may apply an accounting policy from the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy. As such a change is a voluntary change in accounting policy, it can be made only if it results in information that is reliable and more relevant (and does not conflict with the sources in Ind AS 8).
QUESTION 5

Whether an entity can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?

SOLUTION

Paragraph 29 of Ind AS 16 provides that an entity shall chose either the cost model or the revaluation model as its accounting policy for subsequent measurement of an entity class of PPE.

A change from revaluation model to cost model for a class of PPE can be made only if it meets the condition specified in Ind AS 8 paragraph 14 (b) i.e. the change results in the financial statements providing reliable and more relevant information to the users of financial statements. For example, an unlisted entity planning IPO may change its accounting policy from revaluation model to cost model for some or all classes of PPE to align the entity's accounting policy with that of listed markets participants within the industry so an to enhance the comparability of its financial statement with those of other listed market participants within the industry. Such a change- from revaluation model to cost model is not expected to be frequent.

Where the change in accounting policy from revaluation model to cost model is considered permissible in accordance with Ind AS 8 paragraph 14 (b), it shall be accounted for retrospectively, in accordance with Ind AS 8.

QUESTION 6

Whether an entity is required to disclose the impact of any new Ind AS which is issued but not yet effective in its financial statements as prepared as per Ind AS?

SOLUTION

Paragraph 30 of Ind AS 8 Accounting Policies, Changes in Accounting Estimate and Errors, states as follows:

"When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose;

(a) This fact; and

(b) Known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS have on the entity's financial statement in the period of initial application.

Accordingly, it may be noted that an entity is required to disclose the impact of Ind AS which has been issued but is not yet effective."
**QUESTION 7**

Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

**SOLUTION**

As per Ind AS 8, accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. Further, paragraph 36 (a) of Ind AS 2, Inventories, specifically requires disclosure of cost formula used as a part of disclosure of accounting policies adopted in measurement of inventories. Accordingly, a change in cost formula is a change in accounting policy.

**QUESTION 8**

An entity has presented certain material liabilities as non-current in its financial statements for periods upto 31st March, 20X1. While preparing annual financial statements for the year ended 31st March, 20X2, management discovers that these liabilities should have been classified as current. The management intends to restated the comparative amounts for the prior period presented (i.e., as at 31st March, 20X1). Would this reclassification of liabilities from non-current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

**SOLUTION**

As per paragraph 41 of Ind AS, errors can arise in respect of the recognition measurement, presentation or disclosure of elements of financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flow. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 20X2, the comparative amounts as at 31st March, 20X1 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatements has a material effect on the information in the balance sheet at the beginning of the preceding period.
Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period i.e., 1\textsuperscript{st} April, 20X0 in addition to the comparatives for the financial year 20X0-X1.

**QUESTION 9**

An entity charged off certain expenses as fiancé costs in its financial statements for the year ended 31\textsuperscript{st} March, 20X1. While preparing annual financial statements for the year ended 31\textsuperscript{st} March, 20X2 management discovered that these expenses should have been classified as other expenses instead of finance cost, 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 31\textsuperscript{st} March, 20X1). Would this reclassification of expenses from fiancé costs to other expenses in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

**SOLUTION**

As per paragraph 41 of Ind AS 8 errors can arise in respect of the recognition, measurement, presentation of disclosure of elements of financial statements. Financial statements do not comply with Ind AS if they contain either material errors or immaterial errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period and these period errors are corrected in the comparative information presented in the financial statements for the subsequent period.

In accordance with the above, the reclassification of expenses from finance cost to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31\textsuperscript{st} March, 20X2 the comparative amounts for the year ended 31\textsuperscript{st} March, 20X1 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1\textsuperscript{st} April, 20X0). Therefore, the entity is not required to present to present a third balance sheet.
**QUESTION 10**

While preparing the annual financial statements for the year ended 31\textsuperscript{st} March 20X3 an entity discovers that a provision for constructive obligation for payments 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 31\textsuperscript{st} March, 20X1 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31\textsuperscript{st} 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?

**SOLUTION**

As per paragraph 41 of Ind 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statement. Financial statements do not comply with Ind AS if they contain either material errors made intentionally to achieve a particular presentation of an entity’s financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

As per paragraph 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the retrospective restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, expenses for the year ended 31\textsuperscript{st} March 20X1 and liabilities as at 31\textsuperscript{st} March, 20X1 were understated because of non-recognition of bonus expense and related provision. Expenses for the year ended 31\textsuperscript{st} March, 20X2, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for the year ended 31\textsuperscript{st} March, 20X3 the entity should:

(a) Restate the comparative amounts (i.e. those for the year ended 31\textsuperscript{st} March, 20X2) in the statement of profit and loss, and

(b) Present a third balance sheet as at the beginning of the preceding period (i.e., as at 1\textsuperscript{st} April, 20X1) wherein it should recognise the provision for bonus and restate the retained earnings.
QUESTION 11

While preparing interim financial statements for the half-year ended 30th September, 20X1 an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 20X1 the amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is not need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management’s view is acceptable?

SOLUTION

Paragraph 41 of Ind AS 8, inter alia, states that financial statements do not comply with Ind AS if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position financial performance or cash flows.

As regards the assessment of materiality of an item in preparing interim financial statements, paragraph 25 of Ind AS 34, interim Financial Statements, states as follows:

While judgement is always required in assessing materially, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understand ability of the interim figures. Thus, for example, unusual terms, changes in accounting policies or estimates, and errors are recognises and disclosed on the basis of materiality in relation to interim period date to avoid misleading inferences that might result from nondisclosure. The overriding goal is to ensure that an interim financial report included all information that is relevant to understanding an entity’s financial position and performance during the interim period.

As per the above while materially judgements always involve a degree to subjectivity, the overriding goal is to ensure that an interim financial report includes all the information that is relevant to an understanding of the financial position and performance of the entity during the interim period. It is therefore not appropriate to base quantitative assessments of materiality on projected annual figures when evaluating errors in interim financial statements.

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in reaction on to interim period date.
QUESTION 12

ABC Ltd has an investment property with an original cost of ₹ 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 20X1. 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, the property has useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil. For simplicity, ignore tax effects.
**QUESTION 1**

A carpet retail outlet sells and fits carpets to the general public. It recognizes revenue when the carpet is fitted, which on an average is six weeks after the purchase of the carpet.

It then decides to sub-contract the fitting of carpets to self-employed fitters. It now recognizes revenue at the point-of-sale of the carpet.

Whether this change in recognizing the revenue is a change in accounting policy as per the provision of Ind AS 8?

**SOLUTION:**

This is not a change in accounting policy as the carpet retailer has changed the way that the carpets are fitted.

Therefore, there would be no need to retrospectively change prior period figures for revenue recognized.

**QUESTION 2**

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 the 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 ₹ 10 million
- 31st March, 20X2 - Increase of ₹ 15 million
- 31st March, 20X3 - Increase of ₹ 20 million

Profit or loss under the FIFO valuation model are as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X2-20X3</th>
<th>20X1-20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>324</td>
<td>296</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>(173)</td>
<td>(164)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>151</td>
<td>132</td>
</tr>
<tr>
<td>Expenses</td>
<td>(83)</td>
<td>(74)</td>
</tr>
<tr>
<td>Profit</td>
<td>68</td>
<td>58</td>
</tr>
</tbody>
</table>
Retained earnings at 31st March, 20X1 were ₹ 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.

**SOLUTION**

Profit or loss under weighted average valuation method is as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X2-20X3</th>
<th>20X1-20X2 (Restated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>324</td>
<td>296</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>(168)</td>
<td>(159)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>156</td>
<td>137</td>
</tr>
<tr>
<td>Expenses</td>
<td>(83)</td>
<td>(74)</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>73</td>
<td>63</td>
</tr>
</tbody>
</table>

**Statement of changes in Equity** (extract)

<table>
<thead>
<tr>
<th></th>
<th>Retained earnings</th>
<th>Retained earnings (Original)</th>
</tr>
</thead>
<tbody>
<tr>
<td>At 1st April, 20X1</td>
<td>423</td>
<td>423</td>
</tr>
<tr>
<td>Change in inventory valuation policy</td>
<td>10</td>
<td>—</td>
</tr>
<tr>
<td>At 1st April, 20X1 (Restated)</td>
<td>433</td>
<td>—</td>
</tr>
<tr>
<td>Profit for the year 20X1-20X2</td>
<td>63</td>
<td>58</td>
</tr>
<tr>
<td>At 31st March, 20X2</td>
<td>496</td>
<td>481</td>
</tr>
<tr>
<td>Profit for the 20X2-20X3</td>
<td>73</td>
<td>68</td>
</tr>
<tr>
<td>At 31st March, 20X3</td>
<td>569</td>
<td>549</td>
</tr>
</tbody>
</table>
MEANING OF STATEMENTS OF CASH FLOWS

Cash flow statement, in simple is a statement, which provides the details about how the cash is generated by entity during the particular reporting period and how it is applied. While doing so, it takes into consideration the opening balances of cash and cash equivalents, adds the cash generated, deducts the cash payments and reconciles it with closing balances of cash and cash equivalents. The cash flows are classified into following three main categories:

(a) Cash flow from Operating Activities
(b) Cash flow from investing Activities
(c) Cash flow from Financing Activities

OBJECTIVE

Ind AS 7, has specified the following objectives of Statements of Cash Flows:

**to provide information about historical changes in cash and cash equivalents**
Cash flow statement aims at providing the information about how the cash has been generated during the year and for what purpose has it been utilised. The information will be provided for current year and immediate previous year.

**to assess the ability to generate cash and cash equivalents**
Cash flow statement is intended to provide the stakeholders about the efficiency of the company in generating cash and cash equivalents. Some companies' may look profitable as per profit and loss account but whether they have enough cash for payment of their debts and creditors has to be assessed by using cash flow statement.
To understand the timing and certainty of their generation
The historical analysis of statements of cash flow can set a trend regarding the years in which company could generate fair amount of cash flows and the probability of generating it.

**BENEFITS OF CASH FLOW STATEMENT**

*Provides information enabling evaluation of changes in net assets and financial structure (Liquidity and solvency)*

Cash flow statement reconciles the opening balances of cash and cash equivalents with the closing balances of cash and cash equivalents, giving the reasons for the changes happened during the year. Thus it provides a clear picture of cash inflows and outflows that have taken place during the reporting period.

*Assesses the ability to manage the cash*

The stakeholders get an idea about what is the source of generation of cash and how it is used for. The information gives a fair idea about the efficiency and ability of the company to generate cash.

For example, suppose there is negative cash flow from operations. It denotes that company is unable to generate cash from its main business activity, which is not a favourable situation.

Cash flow statements can also throw light on whether company could generate sufficient cash or not.

For example, company wants to expand its production capacity. The cash flow statements can indicate whether company could generate the required cash from their operations, or whether company has generated the funds from share capital or whether company has taken a loan for the same.

*Assess And compare the present value of future cash flows*

The past trends of cash flows will help the company to predict about future cash flows. Such information is useful while evaluating the projects on capital budgeting or valuation of shares. Thus it forms the base for future projects and can be discounted using discounting techniques.
Compares the efficiency of different entities

Accounting profits of various entities may have different assumptions, policies and definitions. However, cash flows will be calculated by using the same technique and finally all differing assumptions across the companies will melt down and entity will reach to a common comparable base of cash and cash equivalents.

**SCOPE**

An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements of each period for which financial statements are presented.

The Standard requires all entities to present a statement of cash flows.

Every organisation, whether it is small or big in size, whether it’s a manufacturing organisation or trading concern or service organisation, needs cash for running its business. The cash is also needed for future investments. Cash would be needed for payment of dividends, repayment of loans as well. Thus any organisation is required to generate the cash continuously.

Banks and Financial institutions are also not an exception to the same. Even if they deal with financial products, accept deposits and give loans day in and day out, they need to generate the cash profit for their own organisation. They need to make investments in terms of new branches, set ups etc. thus statement of cash flow is equally important for banking and Financial Institutions as well.

**DEFINITIONS**

The following terms are used in this Standard with the meanings specified:

1. **Cash** comprises cash on hand and demand deposits.
2. **Cash equivalents** are short-term, highly liquid investments that are readily convertible to know amount of cash and with are subject to an insignificant risk of changes in value.
3. **Cash flows** are inflows and outflows of cash and cash equivalent.
4. **Operating activities** are the principal revenue-producing activates of the entity and other activities that are not investing or financing activities.
5. **Investing activities** are the acquisition and disposal of loan-term assets and other investments not included in cash equivalents.
6. **Financing activities** are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.
CASH AND CASH EQUIVALENTS

Cash Equivalent means which is actually not in a form of cash in hand but can assumed as cash for the purpose of statement of cash flows, depending upon its nature and purpose.

1. **Purpose:** Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

2. **Liquidity and Risk:** For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say three months or less from the date of acquisition.

3. **Equity investments** are excluded from cash equivalents unless they are, in substance, cash equivalents.

For example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

4. **Bank borrowings** are generally considered to be financing activities. However, 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.

5. **Cash Management:** Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

**QUESTION 1**

Company has provided the following information regarding the various assets held by company on 31st March 2017. 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:

<table>
<thead>
<tr>
<th>Sr.no.</th>
<th>Name of the Security</th>
<th>Additional Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Fixed deposit with SBI</td>
<td>12% 3years maturity on 1st Jan 2020</td>
</tr>
<tr>
<td>2.</td>
<td>Fixed deposit with HDFC</td>
<td>10%, original term was for 2 years, but due for maturity on 30.06.2017</td>
</tr>
</tbody>
</table>
3. Redeemable preference shares in ABC Ltd
   - The redemption is due on 30\textsuperscript{th} April 2017

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 O/d, which is payable on demand

8. Treasury Bills
   - 90 days maturity

**SOLUTION:**

<table>
<thead>
<tr>
<th>Sr. no.</th>
<th>Name of the Security</th>
<th>Additional Information</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Fixed deposit with SBI</td>
<td>12%, 3 years maturity on 1\textsuperscript{st} Jan 2020</td>
<td>Not to be considered</td>
</tr>
<tr>
<td>2.</td>
<td>Fixed deposit with HDFC</td>
<td>10%, original term was for 2 years, but due for maturity on 30.06.2017</td>
<td>Not to be considered</td>
</tr>
<tr>
<td>3.</td>
<td>Redeemable preference shares in ABC Ltd</td>
<td>The redemption is due on 30\textsuperscript{th} April 2017</td>
<td>Include as due in 90 days</td>
</tr>
<tr>
<td>4.</td>
<td>Cash balances at various banks</td>
<td>All branches of all banks in India</td>
<td>Include</td>
</tr>
<tr>
<td>5.</td>
<td>Cash balances at various banks</td>
<td>All international branches of Indian banks</td>
<td>Include</td>
</tr>
<tr>
<td>6.</td>
<td>Cash balances at various banks</td>
<td>Branches of foreign banks outside India</td>
<td>Include</td>
</tr>
<tr>
<td>7.</td>
<td>Bank overdraft of SBI Fort branch</td>
<td>Temporary O/d, which is payable on demand</td>
<td>Include</td>
</tr>
<tr>
<td>8.</td>
<td>Treasury Bills</td>
<td>90 days maturity</td>
<td>Include</td>
</tr>
</tbody>
</table>
The statement of cash flows shall cash flows during the period classified by operating, investing and financing activities.

Operating Activities

- Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity. Therefore, they are, in general, the result of the transactions and events that enter into the determination of profit or loss.

Examples of cash flows operating activities are:

<table>
<thead>
<tr>
<th>Operating Cash Inflows</th>
<th>Operating Cash Outflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash receipts from sale of goods and the rendering of services</td>
<td>Cash payments to suppliers for goods and services</td>
</tr>
<tr>
<td>Cash receipts from royalties, fee, commission and other revenue</td>
<td>Cash payments to and on behalf of employees</td>
</tr>
<tr>
<td>Cash receipts and cash payment of an insurance entity for premiums and claims, annuities and other policy benefits</td>
<td>Cash payment or refunds of income taxes unless they can be specifically identified with financing and investing activities</td>
</tr>
<tr>
<td>Cash receipts and payments from contracts held for dealing or trading purposes</td>
<td></td>
</tr>
</tbody>
</table>
### QUESTION 2

From the following transactions, identify with transactions will be qualified for the calculation of operating cash flows, if company is into the business of trading of mobile phones

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Nature of transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Receipt from sale of mobile phones</td>
</tr>
<tr>
<td>2</td>
<td>Purchases of mobile phones from various companies</td>
</tr>
<tr>
<td>3</td>
<td>Employees expenses paid</td>
</tr>
<tr>
<td>4</td>
<td>Advertisement expenses paid</td>
</tr>
<tr>
<td>5</td>
<td>Credit sales of mobile</td>
</tr>
<tr>
<td>6</td>
<td>Misc. charges received from customers for repairs of mobiles</td>
</tr>
<tr>
<td>7</td>
<td>Warranty claims received from the companies</td>
</tr>
<tr>
<td>8</td>
<td>Loss due to decrease in market value of the closing stock of mobile phones</td>
</tr>
<tr>
<td>9</td>
<td>Payment to suppliers of mobile phones</td>
</tr>
<tr>
<td>10</td>
<td>Depreciation on furniture of sales showrooms</td>
</tr>
<tr>
<td>11</td>
<td>Interest paid on cash credit facility of the bank</td>
</tr>
<tr>
<td>12</td>
<td>Profit on sale of old computers and printers, in exchange of new laptop and printer</td>
</tr>
<tr>
<td>13</td>
<td>Advance received from customers</td>
</tr>
<tr>
<td>14</td>
<td>Sales Tax and excise duty paid</td>
</tr>
<tr>
<td>15</td>
<td>Proposed dividend for the current financial year</td>
</tr>
</tbody>
</table>

### SOLUTION:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Nature of Transaction</th>
<th>Included/Excluded with reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Receipt from sale of mobile phones</td>
<td>Include—main revenue generating activity</td>
</tr>
<tr>
<td>2</td>
<td>Purchase of mobile phones from various companies</td>
<td>Included—expenses related to main operations of business</td>
</tr>
<tr>
<td>3</td>
<td>Employees expenses paid</td>
<td>Include—expenses related to main operations of business</td>
</tr>
<tr>
<td>4</td>
<td>Advertisement expenses paid</td>
<td>Include—expenses related to main operations of business</td>
</tr>
<tr>
<td></td>
<td>Description</td>
<td>Include/Exclude Notes</td>
</tr>
<tr>
<td>---</td>
<td>----------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>5</td>
<td>Credit sales of mobile</td>
<td>Do not include - Credit transaction will not be included in cash flow (receipts from customers will be included)</td>
</tr>
<tr>
<td>6</td>
<td>Misc. Charges received from customers for repairs of mobiles</td>
<td>Include - supplementary revenue generating activity</td>
</tr>
<tr>
<td>7</td>
<td>Warranty claims receive form the companies</td>
<td>Include - supplementary revenue generating activity</td>
</tr>
<tr>
<td>8</td>
<td>Loss due to decrease in market value of the closing stock of old mobile phones</td>
<td>Do not include - Non cash transaction</td>
</tr>
<tr>
<td>9</td>
<td>Payment to supplies of mobile phones</td>
<td>Include - cash outflow related to main operations of business</td>
</tr>
<tr>
<td>10</td>
<td>Depreciation on furniture of sales showrooms</td>
<td>Do not include - non cash item</td>
</tr>
<tr>
<td>11</td>
<td>Interest paid on cash credit facility of the bank</td>
<td>Do not include - cost of finance</td>
</tr>
<tr>
<td>12</td>
<td>Profit on sale of old computers and printers, in exchange of new laptop and printer</td>
<td>Do not include - non cash item</td>
</tr>
<tr>
<td>13</td>
<td>Advance received from customers</td>
<td>Include - Related to operations of business</td>
</tr>
<tr>
<td>14</td>
<td>Sales tax and excise duty paid</td>
<td>Include - related to operations of business</td>
</tr>
<tr>
<td>15</td>
<td>Proposed dividend for the current financial year</td>
<td>Do not include - cost of finance</td>
</tr>
</tbody>
</table>

- The amount of cash flows arising from operating activities is a key indicator of the extent of which the operations of the entity have generated sufficient cash flows or not. If the cash flow from operations is positive, it will be treated as positive indicator whereas negative cash flow from operations will denote that company's ability to generate the revenue from its main operations is very weak. The companies in the initial stage of their business or the companies which are facing economic problems will generally have the negative cash flow from operations.

- Cash flow from operations are used to maintain the operating capability of the entity, pay dividends and make new investments without recourse to external sources of financing. Therefore, it is necessary to assess how much cash is generated by the business from operations? Are they sufficient to take care of their future investment plans? Can loans
be repaid in time without default from such cash flows? Is there sufficient amount for payment of preference dividend? Is anything left for equity shareholders after making all these payments? Answers to all these questions well depend on whether the entity has generated enough cash or not.

CERTAIN SPECIFIC ISSUES

1. **Profit / Loss on Sale of Assets**: Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised or loss. The cash flows relating to such transactions are cash flows investing activities.

2. **Properties built for let out**: Cash payment to manufacture or acquire assets held for rental to other and subsequently held for sale are flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

3. **Operations of Financial companies and Banks**: An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

INVESTING ACTIVITY

Investment means sacrifice of current resource in a view to get more returns in future. All entities need some amount of investment for their future survival.

Ind AS 7 states that investing activities represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognised asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

<table>
<thead>
<tr>
<th>Cash Inflow from Investing Activities</th>
<th>Cash Outflow from Investing Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash receipts from of property, plant and equipment, intangibles and other long-term assets</td>
<td>Cash payments to acquire property, plant equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, Plant and equipment</td>
</tr>
</tbody>
</table>
Cash receipts from sales of equity or debt instrument of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes) | Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution) | Cash advances and loans made to other parties (other than advances and loans made by a financial institution);

Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purpose, or the receipts are classified activities | Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities.

When a contract is accounted for as hedge of an identifiable position the cash flows ot the contract are classified in the same manner as the cash flows of the position vein hedged.

**QUESTION 3**

From the following transactions taken from a private sector bank operating in India, identify which transaction will be classified as operating and which would be classified as Investing activity.

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Nature of transaction paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Interest received on loans</td>
</tr>
<tr>
<td>2</td>
<td>Interest paid on Deposits</td>
</tr>
<tr>
<td>3</td>
<td>Deposits accepted</td>
</tr>
<tr>
<td>4</td>
<td>Loans given to customers</td>
</tr>
<tr>
<td>5</td>
<td>Loans repaid by the customers</td>
</tr>
<tr>
<td>6</td>
<td>Deposits repaid</td>
</tr>
<tr>
<td>7</td>
<td>Commission received</td>
</tr>
<tr>
<td>8</td>
<td>Lease rentals paid for various branches</td>
</tr>
<tr>
<td>9</td>
<td>Service tax paid</td>
</tr>
<tr>
<td>Sr. No.</td>
<td>Nature of transaction paired</td>
</tr>
<tr>
<td>---------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1</td>
<td>Interest received on loans</td>
</tr>
<tr>
<td>2</td>
<td>Interest paid on Deposits</td>
</tr>
<tr>
<td>3</td>
<td>Deposits accepted</td>
</tr>
<tr>
<td>4</td>
<td>Loans given to customers</td>
</tr>
<tr>
<td>5</td>
<td>Loans repaid by the customers</td>
</tr>
<tr>
<td>6</td>
<td>Deposits repaid</td>
</tr>
<tr>
<td>7</td>
<td>Commission received</td>
</tr>
<tr>
<td>8</td>
<td>Lease rentals paid for various branches</td>
</tr>
<tr>
<td>9</td>
<td>Service tax paid</td>
</tr>
<tr>
<td>10</td>
<td>Furniture for new branches</td>
</tr>
<tr>
<td>11</td>
<td>Implementation of upgraded banking software</td>
</tr>
<tr>
<td>12</td>
<td>Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi</td>
</tr>
<tr>
<td>13</td>
<td>New cars purchased from Honda dealer, in exchange of old cars</td>
</tr>
<tr>
<td>14</td>
<td>Provident fund paid for the employees</td>
</tr>
<tr>
<td>15</td>
<td>Issued employee stock options</td>
</tr>
</tbody>
</table>
Financing Activity

Drying the life time of the entity, it needs money for long term investment as well as for working capital purpose. Company can raise the capital by any of equity or loans, Thus the cash flows related to raising of funds and redemption of funds will be covered under Cash flows from financing activities. The cost of capital is also generally covered under the Financing Activity.

Ind AS 7 states that the cash flows from Financing activity are useful in predicting claims on future cash flows by providers or capital to the entity.

<table>
<thead>
<tr>
<th>Cash Inflows from financing Activity</th>
<th>Cash outflows from Financing Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash proceeds from issuing shares or other equity instrument;</td>
<td>Cash payments to owners to acquire or redeem the entity’s shares;</td>
</tr>
<tr>
<td>Cash proceeds from issuing debentures, Loans, note, bonds, mortgages and other</td>
<td>Cash repayments of amount borrowed; and</td>
</tr>
<tr>
<td>Short - term or loan-term borrowings;</td>
<td>Cash payment by a lessee for the reduction of the outstanding liability relating to</td>
</tr>
<tr>
<td></td>
<td>A finance lease.</td>
</tr>
</tbody>
</table>

**QUESTION 4**

From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transaction will be classified as operating investing and financing:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Nature of Transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Issued preference shares</td>
</tr>
<tr>
<td>2</td>
<td>Purchased the shares of 100% subsidiary company</td>
</tr>
<tr>
<td>3</td>
<td>Dividend received from shares of subsidiaries</td>
</tr>
<tr>
<td>4</td>
<td>Dividend received from shares other companies</td>
</tr>
<tr>
<td>5</td>
<td>Bonus shares issued</td>
</tr>
<tr>
<td>6</td>
<td>Purchased license for manufacturing of special drugs</td>
</tr>
<tr>
<td>7</td>
<td>Royalty received from the goods patented by the company</td>
</tr>
<tr>
<td>8</td>
<td>Rent received from the let out building (letting out is not main business)</td>
</tr>
<tr>
<td>9</td>
<td>Interest received from the advance given</td>
</tr>
<tr>
<td>Sr.No.</td>
<td>Nature of transaction</td>
</tr>
<tr>
<td>--------</td>
<td>---------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1</td>
<td>Issued preference shares</td>
</tr>
<tr>
<td>2</td>
<td>Purchased the shares of 100% subsidiary company</td>
</tr>
<tr>
<td>3</td>
<td>Dividend received from other of subsidiary company</td>
</tr>
<tr>
<td>4</td>
<td>Dividend received from other companies</td>
</tr>
<tr>
<td>5</td>
<td>Bonus shares issued</td>
</tr>
<tr>
<td>6</td>
<td>Purchased license for manufacturing of special drugs</td>
</tr>
<tr>
<td>7</td>
<td>Royalty received from the goods patented by the company</td>
</tr>
<tr>
<td>8</td>
<td>Rent received from the let out building (letting out is not main business)</td>
</tr>
<tr>
<td>9</td>
<td>Interest received from the advances given</td>
</tr>
<tr>
<td>10</td>
<td>Dividend paid</td>
</tr>
<tr>
<td>11</td>
<td>Interest paid on security deposits</td>
</tr>
<tr>
<td>12</td>
<td>Purchased goodwill</td>
</tr>
<tr>
<td>13</td>
<td>Acquired the assets of a company by issue of equity shares (not parting any cash)</td>
</tr>
<tr>
<td>14</td>
<td>Interim dividends paid</td>
</tr>
<tr>
<td>15</td>
<td>Dissolved the 100% subsidiary and received the amount in final settlement</td>
</tr>
</tbody>
</table>
An entity shall report cash flows from operating activities using either:

(a) the direct method; whereby major classes of gross cash receipts and gross cash payments and disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effect of transaction of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payment may be obtained either

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charge for a financial institution) and other items in the statement of profit and loss. For:

(i) changes during the period in inventories and operating receivable and payables;

(ii) other non-cash items; and

(iii) other items for which the cash effect are investing or financing cash flows.
Analysis
Direct method starts with cash revenue/income/receipts of the company. All the cash expenses will deducted from such cash revenue. The cash profit will be adjusted for the cash flows arising from investing and financing activities. Non-cash expenses/losses/gains will not be considered. The payments to suppliers and receipts from customers are also taken into consideration. The resultant figure would cash flows from operating activity. The exercise would be similar to converting the income and expenditure account (accrual system) into receipt and payment (cash system), with the difference effect on investment and liabilities will not be considered. Thus if we consider the vertical operating statement, direct method will (TOP down) approach of presentation.

- Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:
  (a) changes during the period in inventories and operating receivables and payables;
  (b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and
  (c) all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flows operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Analysis
Indirect method is reverse of direct method. It starts with the accounting profit after tax as given in profit and loss account. Thereafter, the profit will be adjusted for non-cash items, losses and gains on investing and financing activities, interest and dividends, collection and payments to debtors/creditors etc. Accordingly, the cash from, operating activity will derived, Thus indirect method will have (Bottom up) approach.

**Note:** Under both the methods the amount of cash flow from Operating activities need to be necessarily same. It's only the approach for presentation which differs.

**QUESTION 5**

Find out the cash from operations by direct method and indirect method from the following information:
Operating statement of ABC Co for the year ended 31.3.2017

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>500,000.00</td>
</tr>
<tr>
<td>Less: Cost of goods sold</td>
<td>350,000.00</td>
</tr>
<tr>
<td>Administration &amp; Selling Overheads</td>
<td>55,000.00</td>
</tr>
<tr>
<td>Depreciation</td>
<td>7,000.00</td>
</tr>
<tr>
<td>Interest Paid</td>
<td>3,000.00</td>
</tr>
<tr>
<td>Loss on sale of asset</td>
<td>2,000.00</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>83,000.00</td>
</tr>
<tr>
<td>Tax</td>
<td>(30,000.00)</td>
</tr>
<tr>
<td>Profit After Tax</td>
<td>53,000.00</td>
</tr>
</tbody>
</table>

Balance Sheet as on 31st March

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders’ Funds</td>
<td>60,000.00</td>
<td>50,000.00</td>
</tr>
<tr>
<td>Non-current Liabilities</td>
<td>25,000.00</td>
<td>30,000.00</td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td>12,000.00</td>
<td>8,000.00</td>
</tr>
<tr>
<td>Creditors for Expenses</td>
<td>10,000.00</td>
<td>7,000.00</td>
</tr>
<tr>
<td>Provisions</td>
<td>8,000.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>115,000.00</td>
<td>100,000.00</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>75,000.00</td>
<td>65,000.00</td>
</tr>
<tr>
<td>Investment</td>
<td>12,000.00</td>
<td>10,000.00</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>12,000.00</td>
<td>13,000.00</td>
</tr>
<tr>
<td>Debtors</td>
<td>10,000.00</td>
<td>7,000.00</td>
</tr>
<tr>
<td>Cash</td>
<td>6,000.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>115,000.00</td>
<td>100,000.00</td>
</tr>
</tbody>
</table>
REPORTING 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 cash flows are permitted to be reported on a net basis.

REPORTING CASH FLOWS ON A NET BASIS

If nothing is specifically mentioned, then as per Ind AS 7, the cash flows will be presented on Gross Basis. Gross basis means the receipts would be shown separately and the payments will be shown separately.

Example:

If in the year 20X1 - 20X2, some land is purchased for ₹ 2.5 crores and another land is sold for ₹ 3.5 crores then while presenting the information, entity shall show separately outflow of ₹3.5 crores and inflow of ₹3.5 crores.

The above base has following exceptions

1. Cash flows arising from the following operating, investing or financing activities may be reported on a 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 of cash receipts and payments referred to in paragraph 22 (a) are:
   • The acceptance and repayment of demand deposit of a bank;
   • Funds held for customers by an investment entity; and
   • 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 of cash receipts and payments referred to in paragraph 22(b) are advances made for, and the repayment of:
   • Principal amounts relating to credit card customers;
   • The purchase and sale of investments; and
   • other short-term borrowing, for example, those which have a maturity period of three months or less.
2. Cash flow arising from each of the following activities of a financial institution may be reported on a net basis:
   (a) cash receipts and payment for the acceptance and repayment of deposits with a fixed maturity date;
   (b) the placement of deposits with and withdrawal of deposits from other financial institutions; and
   (c) cash advances and loans made to customers and the repayment of those advances and loans.

**FOREIGN CURRENCY CASH FLOWS**

- Cash flows arising from transactions in a foreign currency shall be recoded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency the date of the cash flow.
- The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

**Example:**
Suppose the money is received on account of exports on 15\textsuperscript{th} January 2017 in US $. The company prepares the accounts in ₹ In such case the exchange rate between USD and Rupee as on 15\textsuperscript{th} January 2017 need to be applied for conversion.

- Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rate.

**INTEREST AND DIVIDENDS**

Cash flows from interest and dividends received and paid shall each be disclosed separately.

<table>
<thead>
<tr>
<th></th>
<th>Financing company</th>
<th>Other company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest paid</td>
<td>Cash flows arising from operating activities</td>
<td>Cash flows from financing activities</td>
</tr>
</tbody>
</table>
Interest and dividends received | Cash flows arising from operating activities | Cash flows from investing activities
---|---|---
Dividends paid | Cash flows from financing activities | Cash flows from financing activities

**QUESTION NO 6**

A firm invests in a five year bond of another company with a face a value of ₹10,00,000 by paying ₹5,00,000. The effective rate is 15% the firm recognises proportionate interest income its income statement throughout the period of bond.

Based on the above information answer the following question:

a) How the interest income will be treated in cash flow statement during the period of bond?

b) On maturity, the receipt of ₹10,00,000 should be split between interest income and receipts from investment activity.

**SOLUTION:**

Interest Income will treated as income over the period of bond in the income statement. However, there will be no cash flow in these years because no cash has received. On maturity, receipt of ₹10,00,000 will be classified as investment activity with a bifurcation of interest income & money received on redemption of bond.

**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.

Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the cash flow is classified as an investing or fencing activity as appropriate.
**QUESTION 7**

X Limited has paid an advance tax amounting to ₹ 5,30,000/- during the current year. Out of the above paid tax, ₹ 30,000 is paid for tax on long term capital gains.

Under which activity the above said tax be classified in the cash flow statement of X Limited?

**SOLUTION:**

Cash flows arising from taxes on income should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. In the case of X Limited, the tax amount of ₹ 30,000 is specifically related with investing activities.

₹ 5,00,000 to be shown under operating activities. ₹ 30,000 to be shown under investing activities.

**QUESTION 8**

**INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES**

When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends, to dividends and advances.

An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investment in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.

**QUESTION 9**

X Limited acquires fixed asset of ₹ 10,00,000 from Y Limited by accepting the liabilities of ₹ 8,00,000 of Y Limited and balance amount it paid in cash. How X Limited will treat all those items in its cash flow statements?

**SOLUTION:**

Investing and financing transactions that do not require the use of cash and cash equivalents shall be excluded from a statement of cash flows. X Limited should classify cash payment of ₹ 2,00,000 under investing activities. The non-cash transactions -liabilities and asset should be disclosed in the notes to the financial statements.
**QUESTION 9**

An entity has bank balance in foreign currency aggregating to USD 100 (equivalent to ₹ 4,500) at the beginning of the year. Presuming no other transaction taking place, the entity reported a profit before tax of ₹ 100 on account of exchange gain on the bank balance in foreign currency at the end of the year. What would be the closing cash and cash equivalents as per the balance sheet?

**SOLUTION:**

For the purpose of statement of cash flows, the entity shall present the following:

<table>
<thead>
<tr>
<th>Amount ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
</tr>
<tr>
<td>Less: Unrealised exchange gain</td>
</tr>
<tr>
<td>Cash flow from operating activities</td>
</tr>
<tr>
<td>Cash flow from investing activities</td>
</tr>
<tr>
<td>Cash flow from financing activities</td>
</tr>
<tr>
<td>Net increase in cash and cash equivalents during the year</td>
</tr>
<tr>
<td>Add: Opening balance of cash and cash equivalents</td>
</tr>
<tr>
<td>Cash and cash equivalents as at the year end</td>
</tr>
</tbody>
</table>

**Reconciliation of cash and cash equivalents**

<table>
<thead>
<tr>
<th>Amount ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents as per statement of cash flows</td>
</tr>
<tr>
<td>Add: Unrealised gain on cash and cash equivalents</td>
</tr>
<tr>
<td>Cash and cash equivalents as per the balance sheet</td>
</tr>
</tbody>
</table>

- If any changes in the policies take place, that will be dealt with as per the provisions of IND AS 8
## Practical Questions

1. Use the following data of ABC Ltd. to construct a statement of cash flows using the direct and indirect methods:

<table>
<thead>
<tr>
<th>(Amount in ₹)</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>4,000</td>
<td>14,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>25,000</td>
<td>32,500</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>5,000</td>
<td>7,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>37,000</td>
<td>34,000</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>3,16,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>(45,000)</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Total Assets</td>
<td>3,42,000</td>
<td>3,27,500</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>18,000</td>
<td>16,000</td>
</tr>
<tr>
<td>Wages Payable</td>
<td>4,000</td>
<td>7,000</td>
</tr>
<tr>
<td>Debentures</td>
<td>1,73,000</td>
<td>1,60,000</td>
</tr>
<tr>
<td>Equity Shares</td>
<td>88,000</td>
<td>84,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>59,000</td>
<td>60,500</td>
</tr>
<tr>
<td>Total Liabilities &amp; Equity</td>
<td>3,42,000</td>
<td>3,27,500</td>
</tr>
</tbody>
</table>

| 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 dividends of ₹ 2,500. During 20X2, ABC Ltd. paid ₹ 46,000 in cash to acquire new fixed assets. The accounts payable was used only of inventory. No debt was retired during 20X2.
2. From the following summary cash account of XYZ Ltd, Prepare cash flow statement for the year ended March 31, 20X1 in accordance with Ind AS 7 using direct method.

**Summary of Bank Account for the year ended March 31, 20X1**

<table>
<thead>
<tr>
<th>Description</th>
<th>₹ ’000</th>
<th>Description</th>
<th>₹’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance on 1.4.20X0</td>
<td>50</td>
<td>Payment to creditors</td>
<td>2,000</td>
</tr>
<tr>
<td>Issue of Equity Shares</td>
<td>300</td>
<td>Purchase of fixed Assets</td>
<td>200</td>
</tr>
<tr>
<td>Receipts from customers</td>
<td>2,800</td>
<td>Overhead Expenses</td>
<td>200</td>
</tr>
<tr>
<td>Sale of Fixed Assets</td>
<td>100</td>
<td>Payroll</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax payment</td>
<td>250</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Dividend</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Repayment of Bank loan</td>
<td>300</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balance on 31.3. 20X1</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td>3,250</td>
<td></td>
<td>3,250</td>
</tr>
</tbody>
</table>


# Extra Questions on IND -7

## Question 1

Following is the balance sheet of Kuber Limited for the year ended March 31, 20X2

(₹ in lacs)

<table>
<thead>
<tr>
<th></th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>13,000</td>
<td>12,500</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>50</td>
<td>30</td>
</tr>
<tr>
<td>Other financial assets</td>
<td>145</td>
<td>170</td>
</tr>
<tr>
<td>Deferred Tax Asset (net)</td>
<td>855</td>
<td>750</td>
</tr>
<tr>
<td>Other non-current assets</td>
<td>800</td>
<td>770</td>
</tr>
<tr>
<td>Total Non-current assets</td>
<td>14,850</td>
<td>14,220</td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>2,300</td>
<td>2,500</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>220</td>
<td>460</td>
</tr>
<tr>
<td>Other current assets</td>
<td>195</td>
<td>85</td>
</tr>
<tr>
<td>Total Current assets</td>
<td>2,715</td>
<td>3,045</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>17,565</td>
<td>17,265</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EQUITY AND LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Other equity</td>
<td>12,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Total equity</td>
<td>12,300</td>
<td>8,300</td>
</tr>
<tr>
<td>Liabilities</td>
<td>Non-current liabilities</td>
<td></td>
</tr>
<tr>
<td>-----------------------------</td>
<td>-------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>Long-term borrowings</td>
<td>2,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Other non-current liabilities</td>
<td>2,740</td>
<td>3,615</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>4,740</strong></td>
<td><strong>8,615</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade payables</td>
<td>150</td>
<td>90</td>
</tr>
<tr>
<td>Bank Overdraft</td>
<td>75</td>
<td>60</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>300</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>525</strong></td>
<td><strong>350</strong></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>5,265</strong></td>
<td><strong>8,965</strong></td>
</tr>
<tr>
<td><strong>Total Equity and Liabilities</strong></td>
<td><strong>17,565</strong></td>
<td><strong>17,265</strong></td>
</tr>
</tbody>
</table>

**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 operation 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.
QUESTION 2

Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US $ 100,000 and US $ 102,000 respectively. The exchange rate on December 31, 2017 was US $ 1 = ₹ 45. The same on 31.12.2018 was US $ 1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 2017. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7?

SOLUTION:

The profit and loss account was credited by ₹ 1,00,000 (US$ 2000 x ₹ 50) towards interest income. It was credited by the exchange difference of US$ 100,000 x (₹ 50 - ₹ 45) that is ₹ 500,000 in preparing the cash flow statements. ₹ 500,000 the exchange difference should be deducted from the net profit before taxes, and extraordinary item. However, in order to reconcile the opening balance of the cash and cash equivalents with its closing balance, the exchange difference ₹ 500,000 should be added to the opening balance in note to cash flow statement.

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.
**Ind AS -7: CASH FLOW STATEMENTS**

**NEW QUESTIONS ADDED IN STUDY MATERIAL**

**QUESTION 1**

The relevant extracts of consolidated financial statements of A Ltd. are provided below:

**Consolidated Statement of Cash Flows**

<table>
<thead>
<tr>
<th></th>
<th>For the year ended (₹ in Lac)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>31&lt;sup&gt;st&lt;/sup&gt; March 20X2</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>4,750</td>
</tr>
<tr>
<td>Investment in Associate</td>
<td>800</td>
</tr>
<tr>
<td>Financial Assets</td>
<td>2,150</td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>1,550</td>
</tr>
<tr>
<td>Trade Receivables</td>
<td>1,250</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>4,650</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
</tr>
<tr>
<td>Trade Payables</td>
<td>1,550</td>
</tr>
</tbody>
</table>

**Extracts from Consolidated Statement of Profit and Loss**

for the year ended 31<sup>st</sup> March 20X2

<table>
<thead>
<tr>
<th></th>
<th>12,380</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>(9,860)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>2,520</td>
</tr>
<tr>
<td><strong>Other Income</strong></td>
<td>300</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td>(450)</td>
</tr>
<tr>
<td><strong>Other expenses</strong></td>
<td>(540)</td>
</tr>
<tr>
<td><strong>Interest expenses</strong></td>
<td>(110)</td>
</tr>
<tr>
<td><strong>Share of Profit of Associate</strong></td>
<td>120</td>
</tr>
<tr>
<td><strong>Profit before Tax</strong></td>
<td>1,840</td>
</tr>
</tbody>
</table>
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 1\textsuperscript{st} 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:

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and Equipment</td>
<td>140 Lac</td>
</tr>
<tr>
<td>Inventories</td>
<td>60 Lac</td>
</tr>
<tr>
<td>Trade Receivables</td>
<td>30 Lac</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>20 Lac</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>250 Lac</td>
</tr>
<tr>
<td>Less : Trade Payables</td>
<td>(50 Lac)</td>
</tr>
<tr>
<td><strong>Net Assets on acquisition</strong></td>
<td>200 Lac</td>
</tr>
</tbody>
</table>

A Ltd.'s property, plant and equipment comprise the following:

- **Carrying amount on 1\textsuperscript{st} April 20X1**: 4,650 Lac
- **Addition (at cost) including assets in S Ltd.**: 800 Lac
- **Revaluation Surplus**: 80 Lac
- **Disposal (Sale) of Assets**: (490 Lac)
- **Depreciation for the year**: (290 Lac)
- **Carrying Amount on 31\textsuperscript{st} March 20X2**: 4,750 Lac

A Ltd. constructed a machine that is a qualifying asset and incurred construction costs of ₹ 40 Lac that has been charged to other expenses. Of the interest cost of ₹ 110 Lac charged to profit or loss statement, ₹ 10 Lac 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.

3. A Ltd. purchased 30\% interest in an Associate (G Ltd.) for cash on 1\textsuperscript{st} April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.
4. Impairment test was conducted on 31st March 20X2. The following were impaired as under:

- Goodwill impairment loss: ₹ 265 Lac
- Intangible Assets impairment loss: ₹ 900 Lac

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.

**QUESTION 2**

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.

**QUESTION 3 (RTP MAY 2020 Q. 2................DISCUSSED IN RTP)**

(SAME QUESTION ASKED IN NOV 2020 EXAMS)

Entity A acquired a subsidiary, Entity B, during the year. Summaries 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**

<table>
<thead>
<tr>
<th></th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>3,80,000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(2,20,000)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>1,60,000</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Assets</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>8,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>54,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>30,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>1,60,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>18,000</td>
<td>—</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>2,70,000</strong></td>
<td><strong>1,70,000</strong></td>
</tr>
</tbody>
</table>

| 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’ equity** | **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:

<table>
<thead>
<tr>
<th></th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventories</td>
<td>4,000</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>8,000</td>
</tr>
</tbody>
</table>
Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2,000</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>1,10,000</td>
</tr>
<tr>
<td>Trade payables</td>
<td>(32,000)</td>
</tr>
<tr>
<td>Long term debt</td>
<td>(36,000)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>18,000</td>
</tr>
<tr>
<td>Cash consideration paid</td>
<td>74,000</td>
</tr>
</tbody>
</table>
CONCEPT 1: OBJECTIVE

The objectives of the standard are divided mainly in three points.

1. **Guidelines for taking a decision** regarding adjusting or not adjusting the financial statements for the events after the reporting period.

2. **Guidelines regarding the disclosures** that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period.

3. **Ensuring that the going concern is not hampered during the reporting period**: the standard requires an entity should not prepare its financial statements on a going concern if events after the reporting period indicate that the going concern assumption is not appropriate.

CONCEPT 2: SCOPE

The standard is mainly applicable in respect of the following two things:

1. **Accounting** for events after reporting period
2. **Disclosure** of events after the reporting period.

CONCEPT 3: DEFINITIONS AND EXPLANATIONS

We have seen above that the main focus of the standard is events after the reporting period. Therefore, it is necessary to understand the meaning of it.

**Events after Reporting period**

Event after the reporting period is the period between the end of the reporting period and the date when the financial statements are approved.

**EXAMPLE**

The financial year of an entity ends on 31st March 20X2. If the boards of directors approve the accounts on 15th May 20X2, the events after the reporting period will a period from 1st April, 20X2 to 15th 20X2.
Approval of financial Statements

The definition says that the last date of the concerned period is the date of approval of accounts. Now the question comes what is meant by approval of accounts? When can one say the accounts are approved? Which body needs to be considered as approving authority? If there is a hierarchy of approvals, at what level, one can assume that the accounts are approved?

As per the standard,

(i) **In case of company**: The accounts will be said as approved when board of directors approve the statements.

(ii) **Any other entity**: The accounts will be said as approved when corresponding approving authority approves the statements. The standard does not mention specifically what will constitute the approving authority in case of other entity. But form the word “corresponding” one can construe that it is the body which is Authorised to manage the entity on behalf of all members.

(iii) **If shareholders’ approval is must**, then should the approval date be considered as the date on which the shareholders approve it?

Even though shareholders’ approval is needed, yet for the purpose of deciding the event after the reporting period, the date of approval will be considered as the date of approval by the board of directors only.

**Example**

The Board of Directors of ABC Limited its meeting on May 5, 20X1, reviews and approves the accounts for the year ended 31st March, 20X1 and issues then to the shareholders. The accounts are adopted by the shareholders in the annual general meeting on June 23, 20X1. The date of approval of financial statements for the purpose of this standard is May 5, 20X1.

(iv) What date should be considered, if in some cases, the management of an entity is requisite 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.

**Example**

On 18 March 20X2, the management of an entity approves financial statements for issue to its supervisory board. The supervisory board is made up solely of non-executives and may include representatives of employees and other outside interests. The supervisory board approves the financial statements on 26 March 20X2. The financial statements are made available to shareholders and others on 1 April 20X2.
The shareholders approve the financial statements at their annual meeting on 15 May 20X2 and the financial statements are then filed with a regulatory body on 17 May 20X2. The financial statements are approved for issue on 18 March 20X2 (date of management approval for issue to the supervisory board).

**Should the company report only unfavorable events?**
The standard clearly states that events can be favorable as well as unfavorable.

**CONCEPT 4: TYPES OF EVENTS**
The 'events after the reporting period' are classified into two categories

(i) **Adjusting Events**: those that provide **evidence** of conditions that existed **at the end the reporting period** (adjusting events after the reporting period); and

(ii) **No Adjusting Events**: those that are **indicative** of conditions that arose **after the reporting period** (non-adjusting events after the reporting period).

**CONCEPT 5: RECOGNITION AND MEASUREMENT**

**AND DISCLOSURE OF ADJUSTING EVENTS**

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period.

**Examples of adjusting events after the reporting period**
The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) The settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with Ind As 37, provisions, Contingent Liabilities and contingent Assets of recognise a new provision.

The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of Ind AS 37.
QUESTION 1

A case is going on between ABC & Co and Tax department on claiming the exemption for certain goods, for the year 20X1-20X2. The court has issued the order on 15th April rejecting the claim of the company. Accordingly, company is liable to pay the additional tax. Shall the company account for such tax in the year 20X1-20X2 or shall it account for it in the year's 20X2-20X3?

SOLUTION

To decide whether the event is adjusting or not adjusting two conditions need to be satisfied,

(a) There has to be evidence

(b) The event must have been related to period ending on reporting date. Here both the conditions are satisfied. Court order is conclusive evidence and the liability is related to earlier year. Therefore, the event will be considered as adjusting event and accordingly the amounts will be adjusted in accounts.

(b) The receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:

(i) The bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period:

Example

An allowance for bad debt of 50% of the amount due from a customer was made at the year end. Subsequent liquidation order on the customer proceeds indicated that nothing could be received from the customer. This confirms that a loss existed at the end of the reporting period on the trade receivable and that the need to adjust the carrying amount of the trade receivable.

(ii) The sale of inventories after the reporting period may give evidence about their net realisable value at the end the reporting period.

While making the valuation of closing inventory, Ind AS 2, states the general principal that the closing stock need to be valued at cost or net realizable value, whichever is less. In such cases, net realizable value will be after reporting period only. However, that would be the most realistic value to be applied to the closing stock. Therefore, in such cases, the value which is available after reporting period will be used to for valuation of closing inventory of earlier years.

Example

Entity A values its inventory at cost or NRV, whichever is less. Entity A has 10 pieces of item a in its Stock at the year end. Each item costs ₹ 500. All
these items are sold subsequently at ₹ 450 per piece. The sale of inventories the reporting period provides evidence about their net realisable value at the end of the reporting period.

**QUESTION 2**

Company has 100 finished cars on 31st March, 20X2, which is having a cost of ₹ 4,00,000 each, on 30th of April, new guidelines of pollution control are implemented (which was already expected to come) and as per as per the new government rules, the cars which do not satisfy the conditions of using new engines which emit less carbon-dioxide are totally banned for the sale. Therefore, the demand for such cars drops drastically and selling price came down to ₹ 3,00,000. The accounts of the company for the year 20X1-20X2 are not yet approved. Shall company value its stock at ₹ 4,00,000 each or shall value at ₹ 3,00,000 each?

**SOLUTION**

Since the changed conditions provide the evidence about the net realizable of the cars therefore the amount of ₹ 3,00,000 should be considered for the valuation of stock.

(c) The determination after the reporting period of the cost of assets purchased, of the proceeds from assets sold, before the end of the reporting period,

Same principle can be applied for sale of asset as well.

**Example**

The actual sale of asset took place in March 20X2. However, the sales proceed of the transaction was collected after 31st March 20X2, i.e., on 10th May 20X2 (which was the date of approval of accounts). In such a situation, sale value recognized in the books as on 31st March, 20X2 shall be adjusted.

**QUESTION 3**

ABC Ltd. has purchased the 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, has not yet submitted the final bills for the same.

The supplier company sent the bills on 10th April 20X2, when the accounts were not yet approved. Shall the company include the amount of capitalization in the year 20X1-20X2 or in the year 20X2-20X3?

**SOLUTION**

As per the above provisions, the cost of Installation and training of new machine was an integral part of the cost of asset purchased. Therefore, even in the details are available after reporting period, they provide proof the circumstances that existed at the end of reporting period, Therefore, the will be considered for the year 20X1-20X2.
(d) The determination after the reporting period of the amount of profit-sharing or bonus payment, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events that date (see Ind AS 19, Employee Benefits).

The careful reading of the above provision brings forth following two points

(i) There is a legal or constructive obligation at the end of reporting period
(ii) The obligation is based on profit sharing or bonus payments.

Here one would understand that unless the year is closed, one cannot determine the amount of profit. Unless one determines the final amount of profit, one cannot finalise the amount of profit sharing as both the things are interconnected. Therefore, such events must be considered for the adjustments in accounts, provided, the contract already exists on the last day of reporting period.

(e) The discovery of fraud or errors that show that the financial statements are incorrect.

Ind AS 8, deals with errors and frauds separately along with the errors that occurred in the previous period. However, Ind 10 focuses on the errors or the errors or frauds those are revealed after reporting period. In any case, the entity is not supposed to present any misstatement, to the stakeholders, in spite of knowing that is not true. Therefore, if error or any fraud is detected after the reporting period, which is related to the reporting period, then company must adjust the accounts and rectify the error.

**CONCEPT 6: ACCOUNTING TREATMENT AND DISCLOSURE OF NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD**

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

An example of a non-adjusting event after the reporting period is a decline in fair value of investments between the end of the reporting period and the date when the financial statements are approved for issue. The decline in fair value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure.

The major difference between the adjusting event and non-adjusting events are as follows
DIVIDENDS DECLARED

- If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, financial instruments: presentation) after the reporting period, the entity shall not recognise those dividends as a liability at end of the reporting period.
- If dividends are declared after the reporting period but financial statements are approved for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, presentation of financial Statements.
- The crux of adjusting and on-adjusting event lies in the fact whether the event existed at the end of reporting period or not.

QUESTION 4

ABC co declares the dividend on 15th 20x2 as the results of year 20X1-20X2 as well as Q 1 ending 30th June 20X2 are better than expected. The accounts of the company are approved on 20th July 20X2 for the financial year ending 31st March 20X2. State, whether the dividend will be accounted in F. Y. 20X2-20X3 or will it be considered as proposed dividend and accounted in the year 20X2?

SOLUTION

As per the interpretation of the provision of Ind As 10, the dividend is declared in the year 20X2-20X3. Therefore, the event did not exist on the end date of reporting period i.e. on 31st March 20X2. Therefore, it will be accounted in the year 20X2-20X3 and not in 20X1-20X2, even if accounts of 20X1-20X2? Were approved after the declaration of dividend.
**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. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

**DISCLOSURE OF NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD**

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic disclosure that could influence the economic decisions that users make on the basis of the financial statements. Accordingly an entity shall disclose the following for each material of non-adjusting event after the reporting period:

(a) The nature of the event; and

(b) An estimate of its financial effect or a statement that such an estimate cannot be made.

Examples of non-adjusting events after the reporting period resulting in disclosure

(a) A major business combination after the reporting period (Ind 103, Business Combinations, requires specific disclosures in such cases) or disposing of a major subsidiary;

(b) Announcing a plan to discontinue an operation;

(c) Major purchases of assets, classification of assets as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, other disposals of assets, or expropriation of major assets by government;

(d) The destruction of a major production plant by a fire the reporting period;

(e) Announcing, or commencing the implementation of, a major restructuring (see Ind AS 37);

(f) Major ordinary share transactions and potential ordinary share transactions after the reporting period (Ind AS 33, Earnings per share, requires an entity to disclose a description of such transactions, other than when such transactions involve capitalisation or bonus issues, share splits or reverse share splits all of which are required to be adjusted under Ind AS 33);
(g) Abnormally large changes after the reporting period in asset prices or foreign exchange rates;

(h) Changes in tax rates or tax laws enacted or announced after the reporting period that have a significant effect on current and deferred tax and liabilities (see Ind AS 12, Income Taxes);

(i) Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and

(j) Commencing major litigation arising solely out of events that occurred after the reporting period.

CONCEPT 8: DISTRIBUTION OF NON-CASH ASSETS OF OWNERS

Sometimes an entity distributes non-cash assets as dividends to its equity holders. An entity may also give equity holders a choice of receiving either non-cash assets or a cash alternative.

Ind AS 1 requires an entity to present details of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements but does not prescribe how to measure it.

Applicability

• it applies to the following types of non-reciprocal distributions of assets by entity to its owners acting in their capacity as owners;

(a) distributions of non-cash assets (e.g., items of property, plant and equipment, businesses as defined in Ind AS 103, ownership interests in another entity or disposal groups as defined in Ind AS 105); and

(b) Distributions that give owners a choice of receiving either non-cash or a cash alternative.

• It applies only to distributions in which all owners of the same class of equity instruments are treated equally.

Non-applicability

• This Appendix does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution.

• This exclusion applies to the separate, individual and consolidated financial statements of an entity that makes the distribution.

• For a distribution to be outside the scope on the basis that the same parties control the asset both before and after the distribution, a group of individual shareholders
receiving the distribution must have, as a result of contractual arrangements, such ultimate collective power over the entity making the distribution.

- It does not apply when an entity distributes some of its ownership interests in a subsidiary but retains control of the subsidiary. The entity making a distribution that results in the entity recognising a non-controlling interest in its subsidiary accounts for the distribution in accordance with Ind as 110.

- This Appendix addresses only the accounting by an entity that a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

**Accounting principles**

When an entity declares a distribution and has an obligation to distribute the assets concerned to its owners, it must recognise a liability for the dividend payable.

**When to recognise a dividend payable**

The liability to pay a dividend shall be recognised when the dividend is appropriately Authorised and is no longer at the discretion of the entity, which is the date:

(a) When declaration of the dividend, e.g. by management or the board of directors, is approved by the relevant authority, e.g. the shareholders, if the jurisdiction requires such approval, or

(b) When the dividend is declared, e.g. by management or the board of directors, if the jurisdiction does not require further approval.

**Measurement of a dividend payable**

- An entity shall measure a liability to distribute non-cash assets as dividend to its owners at the fair value of the assets to be distributed.

- If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.

- At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with changes, in the carrying amount of the dividend payable recognised in equity in as adjustments to the amount of the distribution.

Accounting for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when an entity settles the dividend payable.
• When an entity settles the dividend payable. It shall recognise the difference, if any between the carting amounts of the assets distributed and the carrying amount of the dividend payable in profit or loss.

Presentation and disclosures
An entity shall present the difference described in paragraph 14 as a separate line item in profit or loss.

An entity shall disclose the following information, if applicable:

(a) the carrying amount of the dividend payable at the beginning and end of the period; and

(b) the increase of 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:

(a) The nature of the asset to be distributed;
(b) The carrying amount of the asset to be distributed as the end of the reporting period; and
(c) The fair value of the asset to be distributed as of end of the reporting period, if it is different from its carrying amount, and the information amount the method(s) used to measure that fair value.

TEST YOUR KNOWLEDGE

1. ABC Ltd. has announced its Interim results for Quarter 1, ending 30th June 20X2 on 5th July 20X2. However, till that time AGM for the year 20X1-20X2 was not held. The accounts for 20X1-20X2 were approved by the board of directors on 15th July 20X2. What will be the period after the reporting date as per the definition of Ind AS 10?
2. ABC Ltd. is in the legal suit with the excise department. Company gets a court order in its favors, on 15th April, 20X2 which resulted into reducing the excise liability as on 31st March 20X2. The management has not considered the effect of the transaction as the event is favorable to the company. Company’s view is favorable events after the reporting date should not be considered as it would hamper the realization Concept of accounting. Comment In the light of Ind AS 10?
3. ABC Ltd. is trading company in Laptops. On 31st March 20X2 company has 50 laptops which were purchased at ₹ 45,000 each. Company has considered the same price for calculation of closing inventory. 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 ₹ 35,000 each. Company does not want to value the stock as ₹ 35,000 as the event of reduction took place after the 31st march 20X2 and the reduced prices were not applicable as on 31st March 20X2. Comment.

4. JCB manufactures and sales earth moving machines. The machines are dispatched on 25th March 20X2 for exports. The machines reached the customer on 15th April 20X2. The details of the price of sale, foreign exchange rates etc. are available on 4th April 20X2. The accounts were approved by the management on 15th May 20X2. Shall company consider it as the sale of 20X1-20X2 and adjust the accounts for the information received on 4th April or not?

ANSWERS

1. As per Ind AS 10, even if partial information is published, still the reporting period will be considered as the period end date of reporting period and approval of accounts. In the above case the accounts are approved on 15th July. Therefore, the period after the reporting date would be 31st March to 15th July.

2. As per Ind AS 10, even favourable event needs to be considered. What is important is whether the conditions exist as on the end of the reporting and there is a conclusive evidence for the same.

3. As per Ind AS 10, the decrease in the net realizable value of the stock after reporting period should be considered as adjusting event.

4. As per Ind As 10, any information received after the reporting period for determining purchase of cost or sale of asset, related, to earlier financial year, should be considered as adjusting event.
**EXTRA QUESTIONS ON IND AS - 10**

**QUESTION 1**

What is the date of approval for issue of the financial statements prepared for the reporting period from April 1, 20X1 to March 31, 20X2, in a situation where following dates are available? Completion of preparation of financial statements May 28, 20X2 Board reviews and approves it for issue 19,20X2

<table>
<thead>
<tr>
<th>Available to shareholders</th>
<th>July 01, 20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual General Meeting</td>
<td>September 15, 20X2</td>
</tr>
<tr>
<td>Filed with regulatory authority</td>
<td>October 16, 20X2</td>
</tr>
</tbody>
</table>

Will your answer differ if the entity is a partnership firm?

**SOLUTION**

As per Ind AS 10 the date of approval for issue of financial statements is the date on which the financial statements share approved by the Board of Directors in case of a company, and by corresponding approving authority in case of any other entity. Accordingly, in the instant case, the date of approval is the date on which the financial statements are approved by the Board of Directors of the company, i.e., June 19, 20X2.

In the case of an entity is a partnership firm, the date of approval will be the date when relevant approving authority of such entity approves the financial statements for issue i.e. the date when the partner(s) of the firm approve(s) the financial statements.

**QUESTION 2**

ABC Ltd. Prepared interim financial report for the quarter ending June 30, 20X1. The interim financial report was approved for issue by the Board of Directors on July 15, 20X1. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between July 1, 20X1 and July 15, 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 June 30, 20X1?

**SOLUTION**

Paragraph 3 of Ind AS 10, inter alia, defines Events after the reporting Period as 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.
What is reporting period has been dealt with in Ind AS 10, Absence of any specific guidance regarding period implies that any terms for which reporting is done by preparing financial statements is the reporting period of the purpose of Ind AS 10. Accordingly, financial reporting done for interim period by preparing either complete set of financial statements or by preparing condensed financial statements will be treated as reporting period for purpose of Ind AS 10.

Paragraph 2 of Ind AS 34, inter alia, provides that each financial report, annual or interim, is evaluate on its own for conformity with Ind AS Further, paragraph 19 Ind AS 34, provides that an interim financial report shall not be described as complying with Ind As unless it complies with all of the requirements of Ind AS.

In accordance with the above, an entity describing that its interim financial report is in compliance with Ind AS, has to comply with all the Ind AS including Ind AS 10.

In order to comply with the requirements of Ind AS 10, each interim financial report should be adjusted for the adjusted events occurring between end of the interim financial report and the date of approval by Board of Directors. Therefore, in the instant case, events occurring between July, 1, 20X1 and July 15, 20X1 that provide evidence of conditions that existed at the end of the interim reporting period should be adjusted in the interim financial report ending June 30, 20X1

**QUESTION 3**

The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 20X1 -2 for issue on June 15, 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 June 30, 20X2. What is the date of approval for issue as per Ind AS 10 in the given case?

**SOLUTION**

Date of approval is the date on which 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. In the given case, there are two dates of approval by Board of Directors. The financial statements were reopened for further adjustments subsequent to initial approval. The date of approval should be taken as the date on which financial statements are finally approved by the Board of Directors. Therefore, in the given case, the date of approval for issue as per Ind AS 10 should be considered as June 30, 20X2.
**QUESTION 4**

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 15\textsuperscript{th} 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 15\textsuperscript{th} 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?

**SOLUTION**

An event after the reporting period is an adjusting event, if it provides evidence of a condition existing at the end of the reporting period. Here this condition is satisfied. Court order received after the reporting period provides the evidence of the liability existing at the end of the reporting period. Therefore, the event will be considered as an adjusting event and, accordingly, the amounts will be adjusted in financial statements for 20X1-20X2.

**QUESTION 5**

While preparing its financial statements for the year ended 31\textsuperscript{st} 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 ₹ 2 Lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy Considering the events 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 become bankrupt, Can XYZ Ltd. Provide for the full loss arising out of in solvency of the debtor in the financial statements for the year ended 31\textsuperscript{st} March, 20X1?

Would the answer be different if earthquake had taken place after 31\textsuperscript{st} 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?

**SOLUTION**

As per the definition of Events after the Reporting Period and paragraph 8 of Ind AS 10, Events after the Reporting Period, Financial statements should be adjusted for events occurring after the reporting period that provide evidence of conditions that existed at the end of the reporting period. In the instant case, the earthquake took place before the end of the reporting period, i.e., in February 20X1. Therefore, the condition exists at the end of the reporting date though the debtor is declared insolvent after the reporting period. Accordingly, full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the bankruptcy of the debtor in the financial statements for the year ended March 31, 20X1. Since provision for bad debts on account of amount due
from that particular debtor was made @ 50% XYZ Ltd should provide for the remaining amount as a consequence of declaration of this debtor as bankrupt.

In case, the earthquake had taken place after the end of the reporting period, i.e., after 31st March, 20X1 and XYZ Ltd. Had not made any specific provision for the debtor who was declared bankrupt later on, since the earthquake occurred after the end of the reporting period no condition existed at the end of the reporting period. The company had made only general provision for bad debts in the ordinary business course and not to recognise the catastrophic situation of an earthquake Accordingly, bankruptcy of the debtor in this case in a non-adjusting event.

As per para 21 of Ind AS 10, if non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements Accordingly, an entity shall disclose the following for each material category of non-adjusting events after the reporting period.

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.”

If the amount of bad debt is considered to be material, the nature of this no-adjusting event, i.e., event of bankruptcy of the debtor should be disclosed along with the estimated financial effect of the same in the financial statements.

QUESTION 6:

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-X5 have been approved by the Board of Directors on July 10, 20X5 whether it is appropriate to prepare financial statements on going concern basis?

SOLUTION:

With regard to going concern basis to be followed for preparation of financial statements, paras 14 & 15 of Ind AS 10 states that-

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 that entity or to cease trading. Or that it has no realistic alternative but to do so.
Deterioration in operating results and financial portion after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting rather than an adjustment to the amount recognised within the original basis of accounting.

In accordance with the above an entity needs to change the basis of accounting if the effect of deterioration in operating results and financial position is so pervasive that 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.

In the instant case, since contract is expiring on 31st December 20X5 and it is conferrment on 23rd April, 20X5 i.e., after the end of the reporting period and before the approval of the financial statements, that no further contract is secured implies that the entity’s operations are expected to come to an end. Accordingly, if entity’s operation are expected to come to an end, the entity needs to make a judgement as to whether it has any realistic possibility to continue or not, in case, the entity determines that it has no realistic alternative of continuing the business, preparation of financial statements for 20X4-X5 and thereafter on going concern basis may not be appropriate.

**QUESTION 7**

In the plant of PQR Ltd. There was a fire on 10.05.20X1 in which the entire plant was damaged and the loss of ₹ 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of ₹ 27,00,000 is expected.

The financial statements for the year ending 31.03.20X1 were approved by Board of Directors on 12th June 20X1. Show how should it be disclosed?

**SOLUTION**

In the instant case, since fire took place after the end of the reporting period, it is a non-adjusting. However, in accordance with paragraph 21 of Ind AS 10, disclosures regarding non-adjusting event should be made in the financial statements, i.e., the nature of the event and the expected financial effect of the same.

With regard to going concern basis followed for preparation of financial statements, the company needs to determine whether it is appropriate to prepare the financial statements on going concern basis, since there is only one plant which has been damaged due to fire, if the effect of deterioration in operating.

Results and financial position is so pervasive that 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, preparation of financial statements for the F.Y
20X0-X1 on going concern assumption may not be appropriate. In that case, the financial statements may have to be prepared on a basis other than going concern.

However, if the going concern assumption is considered to be appropriate even after the fire, no adjustment is required in the financial statements for the year ending 31.03.20X1.

**QUESTION 8**

What would be the treatment for dividends declared to redeemable preference shareholders after the reporting period but before the financial statements are approved for issue for the year 20X1-X2 Whether Ind AS 10 prescribes any accounting treatment for such dividends?

**SOLUTION**

Paragraph 12 of Ind AS 10 prescribes accounting treatment for dividends declared to holders to equity instruments, if entity declares dividends to holders of equity instruments (as defined in Ind AS 32, Financial Instruments: Presentations) after the reporting period, the entity shall not recognise those dividend as liability at the end of the reporting period.

However, Ind AS 10 dies no prescribe accounting treatment for dividends declared to Redeemable preference shareholders. As per the principles of Ind 32, Financial Instruments: Presentation, a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability Thus dividend payments to such preference shares are recognised as expanse in the same way as interest on a bond. Since interest will be charge on time basis, the requirements of Ind AS 10 regarding date of declaration of dividend not relevant for its recognition.

**QUESTION 9**

XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at ₹ 200 Crores. Execution of the project started during 20X1-X2 and continued in the next financial year also. During the course the course of execution of the work on May 29, 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 ₹ 50 Crores. 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?
SOLUTION

In the instant case, the execution of work started during the F.Y. 20X1-X2 and the rocky surface was there at the end of the reporting period though the existence of rocky surface is confirmed after the end of the reporting period as a result of which it become evident that the cost may escalate by ₹ 50. Crores. In accordance with the definition of Events after the Reporting Period, therefore, it is an adjusting event. The cost of the project and profit should be accounted for accordingly.

QUESTION 10

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-X2 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 Statements of profit and Loss as an expense for the year 20X1-X2?

SOLUTION

In the instance case, A Ltd. approached the arbitrator before the end of the reporting period, who decided the award after the end of the reporting period but before approval of the financial statements for issue. Accordingly, the conditions were existing at the end of the reporting date because A Ltd. had approached the arbitrator before the end of the reporting period whose outcome has been confirmed by the award of the arbitrator. Therefore it is an adjusting event.

Accordingly, the measurement of the provision is required to be adjusted for the event occurring after the reporting period. As far as the recovery of the cost by A Ltd. from the other party is concerned this right to recover was a contingent asset as at the end of the reporting period.

As per para 35 of Ind AS 37 contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it was 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. If an inflow of economic benefits has become probable an entity discloses the contingent asset.
On the basis of the above, a contingent asset should be recognised in the financial statements of the period in which the realisation of asset and the related income becomes virtually certain. In the instant case, the recovery of cost becomes certain when the arbitrator decided the award during F.Y 20X2-X3.

Accordingly, the recovery of cost should be recognised in the financial year 20X2-X3.

**QUESTION 11**

A company manufacturing and supplying process control equipment is entitled to duty drawback if its turnover exceeds 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 drawback credit. For the year 20X1-X2, 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 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. Whether duty drawback credit should be treated as an adjusting event?

**SOLUTION**

In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled for the duty drawback but the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback is discretionary in the hands of the Department. Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period, which may be realised if the Department credits the same.

As per para 35 of Ind AS 37, 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 benefit will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an discloses the contingent asset.

In accordance with the above the duty drawback credit which was contingent asset for the F.Y 20X1-X2 should be recognised as asset and related income should be recognised in the reporting period in which the change occurs. i.e., in the period in which realisation becomes certain virtually i.e., F.Y. 20X2-X3.
QUESTION 12

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 ₹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?

SOLUTION

As per Ind AS 115, if the consideration promised in a contract included a variable amount, 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.

In the instant case, the condition that sales have been made exists at the end of the reporting period and the receipt of payments with 15 days’ time after the end of the reporting period and before the approval of the financial statements confirms that the discount is to be provide on those sale. Therefore, it is an adjusting event. Accordingly, XYZ Ltd. should adjust the sales made to ABC Ltd. with respect to discount of 5% on the list price of the goods.

QUESTION 13

Whether the fraud related to 20X1-X2 discovered after the end of the reporting period but before the date of approval of financial statements for 20X3-X4 is an adjusting event?

SOLUTION

In the instant case, the fraud is discovered after the end of the reporting period of 20X3-X4 which related to F.Y 20X1-X2 since the fraud has taken place before the end of the reporting period, the condition was existing which has been confirmed by the detection of the same after the end of the reporting period but before the approval of financial. Therefore, it is an adjusting event.

Moreover, Ind AS 10 in paragraph 9 specifically provides that the discovery fraud or error after the end of the reporting period, that shows that financial statements are incorrect, is an adjusting event. Such a discovery of fraud should be accounted for in accordance with Ind AS 8, if it meets the definition of prior period error.
**QUESTION 14**

X Ltd. was having investment in from 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 statement 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-X2?

**SOLUTION**

Since it has been detected that a fraud has been made by committing an intentional error and as a result of the same financial statements present an incorrect picture, which has been detected after the end of the reporting period but before the approval of the financial statements The same is an adjusting event. Accordingly, the value of investments in the financial statements should be adjusted for the fraudulent error in computation of value of investments.
CONCEPT 1: OBJECTIVE

The objective of the standard is to establish principles regarding revenue recognition - it includes

- Nature, amount, timing and uncertainty of revenue recognitions; and
- Cash flows arising from a contract with a customer.

This Standard specifies the accounting for an individual contract with a customer.

An entity can apply this for a portfolio of contracts when

- Contracts have similar characteristics; and

CONCEPT 2: SCOPE

This Standard applies to ALL CONTRACTS with customers, except the following.

(a) Revenue from lease contracts (discussed in Ind AS 17- Leases);
(b) Revenue from Insurance contracts which are covered by Ind AS 104 - Insurance Contracts;
(c) Financial instruments and other contractual rights or obligations within the scope of Ind AS 109, Financial Instruments, Ind AS 110, consolidated Financial Statements, Ind AS 111, Joint Arrangements, Ind AS 27, Separate Financial Statement and Ind AS 28, Investments in Associated and Joint Ventures; and
(d) Non-monetary exchanges between entities in the same line of business to facilitate sale to customers or potential customers.

For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil (Exchanging same items is not called as barter) to fulfill demand from their customers in different specified locations on a timely basis. As the items exchanged are same, there is no commercial substance - hence it will not treated as transaction.
**Example**

A Ltd. and B Ltd. both are engaged in manufacturing of homogeneous bottles. A Ltd. operates in northern, eastern and central parts of India. B Ltd. operates in western and southern parts of India. Company A Ltd. fulfills the demands of its customers based on western and southern India by using the bottles manufactured by B Ltd. Similarly, B Ltd. fulfills the demands of customer based on northern, eastern and central parts of India by delivering bottles manufactured by A Ltd. How A Ltd. and B Ltd. should recognize the revenue?

In industries with homogeneous products, it is common for entities in the same line of business to exchange products in order to sell them to customers of potential customers other than parties to exchange.

It is to be noted that all contracts (including contract for non-monetary exchanges) should have commercial substance before an entity can apply the other requirements in the revenue recognition model prescribed in Ind AS 115.

In this case, the exchange of bottles qualifies as non-monetary exchange between customers in the same line of business. Accordingly, A Ltd. and B Ltd. should not recognise any revenue on account of exchange of goods as Ind AS 115 will not apply to the contract.

**CONCEPT 3: DEFINITIONS**

This standard is applicable ONLY to the contracts with customers. It means if it is a contract with other than customer- this standard is NOT applicable and the entity needs to refer other relevant standard for those transactions.

Let us understand what meanings of contracts & customers are.

**What is a contract?**

Contract is an agreement between two or more parties that creates enforceable rights and obligations. The contract can be written, oral or as per other customary business practices.

Enforceability of the rights and obligations in a contract is matter of law.

**Who is a customer?**

A Party that has contracted (entered into an agreement) with an entity to obtain goods or services for consideration. These goods or services are an output of the entity's ordinary activities.
Management needs to identify whether the counterparty to the contract is customer, since contracts that are not with customers are outside the scope of the revenue standard.

Based on this, Dividends—counterparty is not customer (it is shareholder) (Dealt by Ind AS 109), Contributions/Donations and increase in fair value of biological assets (Ind AS 41), investment property (Ind AS 40), etc. are scoped OUT of this standard.

**What is Income?**
Income is an increase in inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants. (Refer chapter - Framework for detailed discussion)

This definition is broad—it includes all kinds of income i.e. Profit on sale of property, plant and equipment (PPE), Profit on sale on investments, revaluation gain, extinguishment of debt, revenue from sale of goods or services etc., it includes profit and gains. It includes realized and unrealized.

**What is Revenue?**
Revenue is an income arising in the course of an entity's ordinary activities:

It is a subset of income. It arises from sale of goods or rendering of services as part of an entity's ongoing major on central activities i.e. ordinary activities. Transactions that do not arise in the course of an entity's ordinary activities do not result in revenue. For example, from the disposal of the entity's PPE are not included in revenue.

**EXAMPLE**
A car dealer makes one of the cars as a test drive car (demonstration cars). These cars are used for more than one year and then sold as used cars. The dealership sells new and used cars. Whether the sale of test drive car is considered as revenue or gain from sale of PPE?

**Suggested answer**
The car dealership is in the business of selling new and used cars. The sale of demonstration cars is therefore revenue, since selling used cars is part of the dealership's ordinary activities.
When a car is classified as test drive car - it should be classified as PPE as its cost. It should be depreciated as usual as per Ind AS 16. When the management intends to sell it in the ordinary course of business, the same car should be reclassified as inventory i.e. it should be reclassified as its carrying amount. The sale of such car should be recognised as Revenue i.e. sale of goods -as the Car dealer's primary business is selling new and used cars.

Say if the entity decides to sell its used "Laptop - PPE - It cannot be treated as revenue as sale of laptops is not its ordinary activity.

CONCEPT 4: RECOGNITION & MEASUREMENT

The entire recognition process can be divided into five steps.

**Step 1:** Identifying the contracts with the customer;

**Step 2:** Identify the separate performance obligations;

**Step 3:** Determine the transaction Price;

**Step 4:** Allocate the transaction price to the performance obligation;

**Step 5:** Recognise revenue when performance obligation is satisfied.

Learning each step is very important. Read slowly and revise it at least once before going to the next step.
Step 1: Identifying the contracts with the customer:

This Standard is applicable only when a contract meets ALL the following condition:

1. The contract has been approved by the parties to the contract and are committed to perform the obligations:
2. The entity can identify each party’s rights regarding the goods or services to be transferred;
3. The entity can identify the payment terms;
4. The contract has commercial substance (i.e. the risk, timing or amount of the entity’s future cash flows is expected to change, as a result of the contract); and
5. It is probable that entity will collect the consideration due. For determining collectability, consider the ability and intention of the customer when it becomes due.

QUESTION 1 (COLLECTION OF CONSIDERATION)

New way limited decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New way enters into an arrangement with a customer in the new region for networking products for promised consideration of ₹1,250,000. At contract inception, new way expects that is may be able to collect the full amount from the customer.

Determine how New way will recognize this transaction?

SOLUTION:

Assuming the contract meets the other criteria covered within the scope of the model in Ind AS 115, New way need to assesses whether collectability is probable.

In the given case, it is probable that New Way limited expects the full amount collections from customer. So, Revenue can be recognized under IND AS 115

QUESTION 2 (ENFORCEABLE RIGHTS)

A company provides free trial services for two months to encourage the customers for non-cancellable paid services for a year. Does it need to recognize revenue during the free period?

SOLUTION:

No, During the free trial period the parties are not committed, hence the entity should not recognize the revenue during this period if the customer signs a non-cancellable agreement for 12 months.
**QUESTION 3 (ENFORCEABLE RIGHTS)**

Continuation to the above concept capsule

If customer signs the agreement one month before expiring free trial. Can the entity recognize revenue for 13 months?

**SUGGESTED ANSWER:**

No, Revenue will be recognized still for 12 months.

---

**COMBINATION OF CONTRACT**

An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if the following conditions are satisfied:

(a) The contracts are negotiated as a package with a single commercial objective &

(b) The amount of consideration to paid in one contract depends on the price or performance of the other contract &

(c) The goods or services promises in the contracts (or some goods or services promises in each of the contracts) are a single performance obligation discusses below.

---

**QUESTION 4 (COMBINATION OF CONTRACT)**

Government of Andhra Pradesh invited tenders for construction of roads in five routes. All five routes are to be awarded to one contractor as a package price. Tender should be submitted with estimations of all routes. Rama Constructions Ltd got the contract. Can we combine these contracts as a single contract and account for?

**SOLUTION:**

Based on the given information, it can be understood that it is negotiated as a single package and contractor doesn’t have an option to select the routes. So the company should select the entire contract based on overall profit margin. Hence it is appropriate to treat all five routes as single construction contract for accounting purposes. Submission of estimations for each route does not change the single commercial objective.
QUESTION 5 (COMBINATION OF CONTRACTS)

Mr. Bhargav is a construction contractor undertakes constructions of Villas. He undertook a contract to construct 25 villas from a real estate company. Each villa is different in its specifications, hence has separate proposal of each unit to be constructed and subject to separate negotiations. He was able to identify the costs and revenue attributable to each unit. Should he each unit as a separate contract or consider all villas as a single contract for accounting revenue under Ind AS 115?

SOLUTION:

As per Ind AS 115, contracts shall be combined if the contracts satisfy the conditions as discussed above.

In the given case,-

(a) The contracts are not negotiated as a package;
(b) Consideration of one contract is no dependent on performance or price of another;
(c) Each one has a separate performance obligations.

As the above conditions are not satisfied —
the entity cannot combine the contracts because all villas are different.

QUESTION 6 (COMBINATION OF CONTRACTS)

Manufacture 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 manufacture enters into a separate contract to supply parts for existing planes at other bases.

Would these contracts be combined?

SOLUTION:

Contracts were negotiated at the same time, but they appear to have separate commercial objectives. Manufacturing and supply contracts are not dependent on one another, and the planes and the parts are not a single performance obligation. Therefore, contracts for supply of fighter planes and supply of parts shall not be combined and instead, they shall be accounted separately.
QUESTION 7 (TERMINATION OF CONTRACT)

A gymnasium enters into a contract with a new member to provide access to its gym for a 12-month period at ₹ 4,500 per month. The member can cancel his or her membership without penalty after three months. Specify the contract term.

SOLUTION:

The enforceable rights and obligation of this contract are for three months, and therefore the contract term is three months.

QUESTION 8 (TERMINATION OF CONTRACTS)

A party has unilateral right to terminate the entire wholly unperformed contract. Will it be considered as contract as per Ind AS 115.

SOLUTION:

The standard considers that there is NO contract when the parties have the right to terminate the unperformed contract. A contract is wholly unperformed if both of the following criteria are met:

(a) the entity has not yet transferred any promised goods or services to the customer; and

(b) the entity has yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

QUESTION 9 (TERMINATION OF CONTRACT)

A maintenance service provider enters into a contract with a customer to provide monthly services for a three-year period. Customer can terminate the contract at the end of any month for any reason without compensating other party (that is, there is no penalty for terminating the contract early.) What is the contract term in this case?

SOLUTION:

The contract should be treated as a month-to-month contract in the three-year stated term. It means contract period is one month. The parties do not have enforceable rights and obligations beyond the month.
QUESTION 10 (TERMINATION OF CONTRACT)

Continuation to the above concept capsule

If the contract can be terminated only by paying penalty? What would be contract period?

SOLUTION

The answer depends on the substantive i.e. materiality of the penalty amount. If it is a substantive amount, it automatically creates enforceable rights and obligation for the three years of the contract. **Then contract period is 3 years.** If the penalty amount is nominal - it will be treated as month on month contract as discusses in the above concept capsule.

MODIFICATIONS

A contract modification is *Change in the scope or price* (or both) of a contract that is *(approved)* by the parties to the contract.

A modification should be approved by the parties in writing, by oral agreement or implied by customary business practices. If the modification is not approved, the entity should account only the existing contract as per this Ind AS.

Such modification may be accounted as a separate contract or modification to the existing contract. This depends on the facts and circumstances of each case.

An entity shall account for a *contract modification as a separate contract*, if both the conditions are satisfied

a) Modification leads to addition of goods or services which *distinct* from existing contract; and

b) It is priced at their *stand alone selling prices*;

What is “Stand alone selling price”?

It is a price at which an entity would sell a promised good or service separately to a customer. *For example*, an entity might provide a discount to a *recurring customer* that is would not provide to new customers. The objective is to determine whether the pricing reflects the amount that the entity would have negotiated independent of other existing contracts.

If the goods or services are prices at a discount to the stand-alone selling price, management will need to evaluate the reason for the discount, because this might be an indicator the new contract is modification of the existing contract.
QUESTION 11 (MODIFICATION OF CONTRACTS)

An entity promises to sell 120 products to a customer for ₹120,000 (₹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 ₹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?

SOLUTION:

When the contract is modified, the price of the contract modification for the additional 30 products is an additional ₹28,500 or ₹950 per product. The pricing for the additional products reflects the stand-alone selling price or the products at the time of the contract modification and the additional products are distinct from the original products.

Accordingly, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract and ₹950 per product for the 30 products in the new contract.

QUESTION 12 (MODIFICATION OF CONTRACTS)

On 1 April, 20X1, KLC Ltd. enters into a contract with Mr. K to provide
- A machine for ₹2.5 million
- One year of maintenance services for ₹55,000 per month

On 1 October 20X1, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from ₹55,000 per month to 45,000 per month.

Determine the effect of change in the contract?

SOLUTION:

In the given question, modification will be accounted as per cumulative catch up adjustment because there is no addition of distinct goods or services. There is only price revision in the services. The original period of services was 12 months which is same in modification as well. So, we should apply cumulative catch up adjustment in this case....
Total revenue which is expected in 12 months:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>55,000x6months</td>
<td>3,30,000</td>
</tr>
<tr>
<td>45,000x6months</td>
<td>2,70,000</td>
</tr>
<tr>
<td></td>
<td>6,00,000</td>
</tr>
</tbody>
</table>

Average monthly revenue as CCM=6,00,000/12MONTHS 50,000 P.M.

REVENUE ALREADY BOOKED IN BOOKS IN FIRST 6MONTHS @55000

REVENUE SHOULD HAVE BEEN BOOKED AS PER CCM @50,000 3,00,000

REVENUE SHOULD BE REVERSED (RETROSPECTIVE ADJUSTMENT) 30,000

Note: Solution given in icai material is wrong bcz icai is considerining the given modification as distinct service which is completey wrong.

QUESTION 13(MODIFICATION OF CONTRACTS)

Growth Ltd enters into an arrangement with a customer for infrastructure outsourcing deal.

Based on its experience, Growth Ltd determines that customizing 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?

SOLUTION:

Considering that the remaining goods or services are not distinct, the modification will be accounted for on a cumulative catch up basis, as given below:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Hours</th>
<th>Rate (₹)</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial contract amount</td>
<td>200</td>
<td>150</td>
<td>30,000</td>
</tr>
<tr>
<td>Modification in contract</td>
<td>50</td>
<td>100</td>
<td>5,000</td>
</tr>
<tr>
<td>Contract amount after modification</td>
<td>250</td>
<td>140*</td>
<td>35,000</td>
</tr>
<tr>
<td>Revenue to be recognized</td>
<td>100</td>
<td>140</td>
<td>14,000</td>
</tr>
</tbody>
</table>
**QUESTION 14 (MODIFICATIONS)**

Anju Ltd. provides accounting services. It enters into a 3-year service contract with customer for ₹ 6,00,000 (Rs. 2,00,000 per year) is the SSP for the service at inception. At the end of the second year, the parties agree to modify the contract as follows: (1) the fees for the third year are reduced by ₹ 90,000 and (2) the contract is extended for another 3 years at ₹ 7,50,000 per year (₹ 2,50,000 per year). The SSP of the services at the time of modification is ₹ 2,30,000. How should this modification be accounted for?

**SOLUTION:**

The modification is accounted for prospectively; as if the existing arrangement is terminated and a new contract is entered into Anju Ltd. should reallocate the remaining services to be provided. Anju Ltd. will recognize a total of ₹ 8,60,000 (₹ 7,50,000 + ₹ 1,10,000) over the remaining 4 years’ service period (One year remaining under the original contract plus three additional years), or ₹ 2,15,000 per year.

**QUESTION 15**

Anju Ltd. provides accounting services. It enters into a 2-year service contract with customer for ₹ 6,00,000 (₹ 3,00,000 per year) is the SSP for the service at inception. At the end of the first year, both the parties agree that the fees should be ₹ 3,50,000 per year for the years because the volumes were much larger than expected. How should this modification be accounted for?

**SOLUTION:**

In the given case, services are not distinct and only transaction price is increasing - Hence the entity should recognize ₹ 50,000 as cumulative catch-up adjustment i.e., recorded immediately, as soon as the modification is approved by the customer.
**Step 2: Identifying the Performing Obligation**

**Question:** What is performance obligation?

**Answer:** Performance obligation is promise in a contract to transfer to the customer either:

(a) A goods or service (or a bundle of goods or services) that is distinct; or

(b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Once the contract has been identified, an entity needs to evaluate the terms and customary business practices to identify the promised goods or services which need to be accounted as performance obligation.

**Question:** When should performance obligation be identified?

**Answer:** At contract inception itself - an entity should identify what are the goods or services to be delivered as per the contract.

**Question:** When can we say goods or services are distinct?

**Answer:** Goods or services that are promised to a customer are distinct if both conditions are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer; and

(b) the entity’s promise to transfer the good or service to the customer is separately identifiable other promises in the contract.

**Example:** In case of IT Hardware Company sells printers and laptops that compatible with each other and compatible with other laptops and printers available in the market. The company would consider the printer and laptop as separate performance obligation under the contract, as it can sell the laptop and the printer independently.

**QUESTION 16**

A software developer enters into a contract with a customer to transfer a software license, perform installation and provide software updated and technical support for five years. He sells the license, installation, updates and technical support separately to other customers. How many performance obligations exist in this contract?
SUGGESTED ANSWER:

As understood, a contract may have one or more performance obligations. Performance obligation is a promise to transfer a distinct goods services to the customer.

Goods or services are distinct if they are separately identifiable and customer can get benefit from the goods or service with on its own or together with other resources that the customer has.

In the given case, goods are separately identifiable because the developer is selling separately to other customers. Delivery of software is different from installation, updates and support and it works without updates and technical support. So we can say that the customer gets the benefit from each goods or services on its own.

On this basis, we can conclude this contract has the four following performance obligations:

- Software license;
- Installation service;
- Software updates;
- Technical support.

Hint: All the services are distinct because customer can avail all services separately & can be benefited from each service separately. It means that each service is not inter related.

QUESTION 17

Continuation to the above concept capsule

What would be your answer if installation services are critical to produce customized software required by the customer?

SUGGESTED ANSWER:

In that situation, there are only performance obligations i.e. software and installation services will be treated as one performance obligation as the installation services significantly modify and customize the software.

Hint: Now, software licence & installation service are to be considered one performance obligation because both the services are inter related.
**QUESTION 18**

A customer approaches a contractor to design and build a house for him. For this purpose, the contractor will have to provide different services such as designing, site preparation, electrical, plumbing, civil work and carpentry. The contractor also provides these services individually to other customers also. So what are the performance obligations in the contract?

**SUGGESTED ANSWER:**

In the given context, all the components will be treated as one single performance obligation because the contractor provides a significant service of integrating the various goods and services into a home. The customer has contracted to purchase the home rather than the individual services that make up the home. Another way of looking at this is, when goods or services are highly dependent or interrelated with each other, they would constitute a single performance obligation.

**Hint:** In the given case, all services are required to be integrated to build a house. It can be said that all services are interrelated. The customer has entered into a contract for a home, but not for each service separately. So, it has been considered as a single performance obligation.

**QUESTION 19**

A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all aspects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components.

Determine whether the company has single or multiple performance obligations under the contract?

**SOLUTION:**

In order to determine how many performance obligations are present in the contract, the company applies the guidance above. While the customer may be able to benefit from each promised good or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as result will be treated as a single performance obligation.
This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection or related components and services.

**Hint:** In the given case, customer has entered into a contract for construction of a water purification plant. All services like project management, design, site preparation or construction are to be considered as inter related. So there is a single performance obligation.

**QUESTION 20**

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 services or both.

Are the performance obligations under the contract distinct?

**SOLUTION:**

Entity promises to customer to provide

- Broadband Service
- Voice Call services
- Modem

Entity's promise to provide goods and services is distinct if

- Customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and
- Entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract

For broadband and voice call services-

- Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependent or interrelated. Also the customer can benefit on its own from the services received.
For sale of modem-
- Customer can either buy product from entity or third party. No significant Customisation or modification is required for selling product.

Based on the evaluation we can say that there are three separate performance obligation:-
- Broadband Service
- Voice Call services
- Modem

**Hint:** All services have been considered as different performance obligation because all services are not inter related & inter dependant. The customer can avail all services separately.

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**QUESTION 21**

Could the series requirement apply to hotel management services where day to day activities vary, involve employee management, procurement, accounting, etc?

**SOLUTION:**

The series guidance requires each distinct good or service to be “substantially the same”

Management should evaluate this requirement based on the nature of its promise to customer. For example, a promise to provide hotel management services for a specified contract term may meet the series criteria. This is because the entity is providing the same service of “hotel management” each period, even though some on underlying activities may vary each day. The underlying activities for e.g. reservation services, property maintenance services are activities to fulfill the hotel management service rather than separate promises. The distinct service within the series is each time increment of performing the service.

**Hint:** Hotel management includes all activities from zero to hundered (i.E., Day to activities, employee management, property management, accounting etc.). So all activities should be considered as single obligation because all activities are inter related as a part of hotel management.
ENTITY A, a specialty construction firm, enters into a contract with ENTITY B to design and construct a multi-level shopping center with a customer car parking facility located in sub-levels underneath the shopping center. ENTITY B solicited bids from multiple firms on both phases of the project—design and construction.

The design and construction of the shopping Centre and parking facility involves multiple goods and services from architectural consultation and engineering through procurement and installation of all of the materials. Several of these goods and services could be considered separate performance obligation because ENTITY A frequently sells the services, such as architectural consulting and engineering services, as well as standalone construction services based on third party design, separately. ENTITY A may require to continually alter the design of the shopping Centre and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project.

Determine how many performance obligations does the entity A have?

**SOLUTION:**

ENTITY A analyses that is will be required to continually alter the design of the shopping center and parking facility during construction as well as continually assess the propriety of the materials initially selected for the project. Therefore, the design and construction phases are highly dependent on one another (i.e., the two phases are highly interrelated). ENTITY A also determines that significant Customisation and modification of the design and construction services is required in order to fulfill the performance obligation under the contract. As such, ENTITY A concludes that design and construction services will be bundled and accounted for as one performance obligation.

**Hint:** We have considered it as single performance obligation because continuous alteration is expected in this contract due to which services of design & construction are to be assumed as inter related & interdependant.
Step 3: Identifying the Transaction Price

“The 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, GST etc.).”

The transaction price may be effected by the following reasons:

1. Variable consideration
2. Significant finance component
3. Non cash consideration
4. Consideration payable to customer

The standard says estimate the variable consideration should be estimated.

How to estimate? Is there any method suggested?

Yes. There are two methods suggested by the standard:

<table>
<thead>
<tr>
<th>Estimation methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Expected Value</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The Expected Value</th>
<th>The Most likely amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is a sum of probability-weighted average amounts in range of possible consideration amounts.</td>
<td>It is the single most likely amount in a range of possible consideration amount (i.e. the single most likely outcome of the contract)</td>
</tr>
</tbody>
</table>

When can this be used?

<table>
<thead>
<tr>
<th>When can this be used?</th>
<th>When the contract has only two possible outcomes (e.g. entity either achieve a performance bonus or does not)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only if an entity has a large number of contracts with similar characteristics;</td>
<td></td>
</tr>
</tbody>
</table>

There is no free choice to the entity is using either method; the method selected should be used consistently. A single contract may have more than one variable consideration - in this case, entity can use expected value method for one variable consideration and most likely amount method for other variable consideration.
In estimating the variable consideration, the entity should use all available information i.e. historical, current and forecast. The information should be similar to the information which is used at the time of bid and proposal process for establishing the prices.

**Constraining estimates of variable consideration**

Variable consideration is included in the transaction price ONLY IF it is highly probable that the amount will not result in a significant revenue reversal of cumulative recognised when the uncertainty associated with the variable consideration is subsequently resolved (i.e. *it is highly probable that is will not be reversed*). For this purpose, entity should consider both the likelihood and magnitude of the revenue reversal.

In some contracts, penalties are specified. In such cases, penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration For example, where an entity agrees to transfer control of a good or service in a contract with customer at the end of 30 days for ₹1,00,000 and if it exceeds 30 days, the entity is entitled to receive only ₹95,000 the reduction on ₹5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.

**Reassessment of variable consideration**

At the end of each reporting period, an entity shall update the estimate transaction price (including updating constraints) to represent faithfully the circumstance present at the end of the reporting period and the changes in circumstances during the reporting period.

Let us discuss few variable consideration estimation basis in the following table:

<table>
<thead>
<tr>
<th>Variable consideration</th>
<th>Estimation basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume discounts</td>
<td>These are incentives to encourage additional purchases and customer loyalty. This is generally given to a customer to purchase a specified amount of goods or services, after which the price is either reduced prospectively for additional goods or services purchased in the future OR retrospectively reduced for all purchases during the specific period. Retrospective value discounts included the variable consideration as the transaction price for the current purchases are not known till the uncertainty of discount is resolved Management should use experience and other information to make a reasonable</td>
</tr>
<tr>
<td>Variable consideration</td>
<td>Estimation basis</td>
</tr>
<tr>
<td>----------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Price concessions</strong></td>
<td>Price concessions are adjustment to the initial contract and provided for a variety of reasons.</td>
</tr>
<tr>
<td></td>
<td>For Example, a vendor might accept a lover payment than the amount contractually due form a customer, to encourage the customer pay for previous purchase and continue making future purchases. Price concessions are also sometime provided where a customer has experienced some level of dissatisfaction with that good or service (other than items covered by warranty). Management should <strong>assets the likelihood of offering price concession.</strong> An entity that expects to provide a price concession or practice of doing so, <strong>should reduce the transaction price</strong> to reflect the consideration to which is expects to be entitled after the concession is provided.</td>
</tr>
<tr>
<td><strong>Prompt payment discounts</strong> (Cash discounts)</td>
<td>Customer purchases frequently include a discount of early payment For example, an entity might offer a 2% discount if an invoice is paid within 10 days of receipt. A portion of the Consideration is variable in this situation, because there is uncertainty as to whether the customer will pay the invoice within the discount period. Management need to <strong>make an estimate of the consideration</strong> that is expect to be entitled to as a result of offering this incentive. Experience with similar customers and similar transactions should be considered in determining the number of customers that are expected to receive the discount.</td>
</tr>
<tr>
<td><strong>Rebate-Cash receipt in the future when achieved the target purchases</strong></td>
<td>Customers typically pay full for goods or services at contract inception and then receive a cash rebate in the future. This cash rebate is often tied to an aggregate level of purchases. Management needs to consider the volume of expected sales and expected rebated in such cases to determine the revenue to be recognises n each, sale. The consideration is variable in these situations, because it is based on the value of eligible transactions. It should only include amounts in the</td>
</tr>
</tbody>
</table>
### Variable consideration

<table>
<thead>
<tr>
<th>Estimation basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>transaction price for arrangements with rebates if it is highly probable that a significant reversal in the amount if cumulative revenue reasonably will not occur if estimates of rebates change. Where management cannot reasonable estimate the amount of rebates that customers are expected to earn, it still need to consider whether there is a minimum amount of variable consideration that should not be constrained.</td>
</tr>
</tbody>
</table>

### Price based on a Formula

- A contract could include variable consideration if pricing is based on a formula or a contractual rate per unit of outputs and there is an undefined quantity of outputs. The transaction price is variable because it is based on an unknown number of outputs. For example, a hotel is management entity enters into an arrangement to manage properties on behalf of a customer for a 5-year period. Contract consideration is based on a defined percentage of daily receipts. The consideration is variable for this contract as it will be calculated based on daily receipts. The promise to the customer is to provide management services for the terms of the contract; therefore, the contract contains a variable fee as opposed to an option to make future purchases.

### Price protection and price matching

- Price protection clauses allow a customer to obtain a refund if the seller reduces the product's price to any other customers during a specified period.

  *Say one customer bought at ₹100 per unit and subsequently due any reason the product price is reduced to ₹90 during the year. In this case, if the customer has price protection he gets back ₹10.*

- Price matching provisions require an entity to refund a portion of the transaction price if a competitor lowers its price on a similar product.

  *In this case, if the market price of the item, i.e., even competitor reduces the price to ₹90, the entity should pay ₹10 to the customer.*

  *In addition, some arrangements allow for price protection only on the goods that remain in a customer's inventory. It means this rule is applicable to the unsold stock of the customer.*

- Both of these provisions create a possibility of subsequent adjustments to the stated transaction price.
<table>
<thead>
<tr>
<th>Variable consideration</th>
<th>Estimation basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management needs to estimate the number of units to which the price protection guarantee applies in such cases, to determine the transaction price, as the reimbursement does not apply to unit already sold by the customer.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-cash consideration</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Non-cash consideration should be measured at FAIR VALUE</td>
<td></td>
</tr>
<tr>
<td>• If the entity cannot reasonably measure - Stand alone selling price of goods or services is the value of non-cash consideration;</td>
<td></td>
</tr>
<tr>
<td>• If non-cash consideration varies for reasons other than only the form of it apply the constraining requirements;</td>
<td></td>
</tr>
<tr>
<td>• If customer gives goods or services like materials' equipment of labour-Assess whether entity obtains controls over it -If Yes, recognise revenue.</td>
<td></td>
</tr>
</tbody>
</table>

**Time value of money/significant financing component/deferred credit period**

Normally credit period in many industries is 1 to 6 months (max.) If an entity is providing a credit period for a longer period (Say more than one year ) i.e. called as deferred period It is apparent that invoice amount includes inters element (that means there is a financing arrangement between the parties). That interest should be separated (deducted) from the transactions price and recognised in the statement of P&L as expense.

- If there is a significant financing component in the contract, it should be considered whether it is explicitly mentioned in the agreement or it is implicit;

- In determining the interest element the entity should consider the following:
  - Difference between promised consideration and Cash selling price; and
  - Combined effect of the deferred period & interest rates prevailing in the market.

**What rate should be used for discounting?**

**Ans:** The entity should use the rate that reflects the credit characteristics of the party and any collateral or security provided by the customer or the entity, including assets transferred in the contract. The rate can be determined by identifying the rate that discounts the nominal amount of the promised consideration to Cash selling price i.e. IRR between the promised consideration and cash price (effective rate of return).
After contract inception, an entity shall not update the discount rate for changes in interest rates on other circumstances (such as a change in the assessment of the customer's credit risk).

As a practical expedient, an entity NEED NOT apply this concept if the deferred is less than or equal to a year.

**Consideration payable to a customer/customer loyalty programs**

Consideration payable to a customer includes

- Cash amount e.g. cash back offers;
- A credit or other items e.g. a coupon or voucher;

Consideration payable to a should be reduced from the transaction price unless the entity received a distinct goods or services from the customer.

If the consideration payable to a customer include a variable amount, an entity shall estimate the transaction price (including considering the constraints);

Payments made by an entity to its customer's customer are assessed and accounted for the same as those paid directly to the entity's customer.

If the consideration paid to a customer for supplying a distinct goods of services to the entity?

If it is paid for a distinct good or service from the customer account for the purchase in the same way that is accounts for other purchases from suppliers.

If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service received from the customer, then such an excess amount should be reduced from the transaction price.

**When (timing) to recognise the reduction in transaction price?**

**Ans:** Recognise the reduction of revenue at the later of the following events occur (whoever is later)

(a) The entity recognises revenue for the transfer of the related goods or services to the customer; and

(b) The entity pays or promises to pay the consideration (even if the conditional on future event). That promise might be implied by the entity's customary business practices.
QUESTION 23 – ESTIMATING VARIABLE CONSIDERATION

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₹ Crores, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31 March 20X1 that the asset is incomplete, the promised consideration is reduced by ₹ 1 lakh. For each day before 31 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 entitled to an incentive bonus of ₹ 15 lakhs.

SOLUTION:

In determining the transaction price, the entity prepares a separate estimate for each element of variable consideration to which the entity will be entitled using the estimation methods described in paragraph 53 of Ind AS 115.

(a) The entity decides to use the expected value method to estimate the variable consideration associated with daily penalty or incentive (i.e. ₹ 2.5 cores, plus or minus ₹ Lakh per day). This is because it is the method that entity expects to better predict the amount of consideration to which it will entitled.

(b) The entity decides to use the most likely amount to estimate the variable consideration associated with the incentive bonus. This is because there are only two possible outcomes (₹ 15 lakhs or ₹ Nil) and it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

QUESTION 24- ESTIMATING VARIABLE CONSIDERATION

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 cores.

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 ₹ 2 crores if 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.

**SOLUTION:**

In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus.

AST Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes and the entity has experience with a large number of similar contract that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. AST’s best estimate of the early completion bonus is ₹ 2.13 crores, calculated as shown in the following table:

<table>
<thead>
<tr>
<th>Bonus%</th>
<th>Amount of bonus (₹ in crores)</th>
<th>Probability</th>
<th>Probability-weighted Amount (₹ in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>3.75</td>
<td>25%</td>
<td>0.9375</td>
</tr>
<tr>
<td>10%</td>
<td>2.50</td>
<td>40%</td>
<td>1.00</td>
</tr>
<tr>
<td>5%</td>
<td>1.25</td>
<td>15%</td>
<td>0.1875</td>
</tr>
<tr>
<td>0%</td>
<td>-</td>
<td>20%</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>2.125</strong></td>
</tr>
</tbody>
</table>

AST Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (₹ 2 crores or ₹ Nil) and this method would best predict the amount of consideration associated with the equality bonus. AST Limited believes the most likely amount of the equality bonus is ₹ 2 crores.

**QUESTION 25- VOLUME DISCOUNT INCENTIVE**

HT Limited enters into a contract with a customer on 1 April 20X1 to sell product X for ₹ 1,000 per unit. If customer purchases more than 100 units of product A in financial year, the contract specifies that price per unit is retrospectively reduced to ₹ 900 per unit. Consequently, the consideration in the contract is variable.
For the first quarter ended 30 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 purchase is known).

Further, in May 20X1, the customer acquires another company and in the second quarter ended 30 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 recognised by HT Ltd. For the quarter ended 30 June 20X1 and 30 September 20X1.

**SOLUTION:**

The entity recognises revenue of ₹ 10,000 (10 units x ₹ 1,000 per unit) for the quarter ended 30 June 20X1.

HT Limited recognises revenue of ₹ 44,000 for the quarter ended 30 September 20X1. That amount is calculated from ₹ 45,000 for the sale of 500 units (50 units x ₹ 900 per unit) less the change in transaction price of ₹ 1,000 (10 units x ₹ 100 price reduction) for the reduction of revenue relating to unit sold for the quarter ended 30 June 20X1.

**QUESTION 26- MEASUREMENT OF VARIABLE CONSIDERATION**

An entity has a fixed fee contract for ₹ 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ₹ 950,000. 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:

<table>
<thead>
<tr>
<th>Weight (kg)</th>
<th>Award % of fixed fee</th>
<th>Incentive fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>951 or greater</td>
<td>0%</td>
<td>-</td>
</tr>
<tr>
<td>701-950</td>
<td>10%</td>
<td>₹ 100,000</td>
</tr>
<tr>
<td>700 or less</td>
<td>25%</td>
<td>₹ 250,000</td>
</tr>
</tbody>
</table>

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternative 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 confident 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 include 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 recognised 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 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 I the year four because, at this point, is probable that a significant reversal in the amount of cumulative revenue recognised will not occur including the entire variable consideration in the transaction price.

Evaluate the impact of changes in variable consideration when cost incurred is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>50,000</td>
</tr>
<tr>
<td>2</td>
<td>1,75,000</td>
</tr>
<tr>
<td>3</td>
<td>4,00,000</td>
</tr>
<tr>
<td>4</td>
<td>2,75,000</td>
</tr>
<tr>
<td>5</td>
<td>50,000</td>
</tr>
</tbody>
</table>

**SOLUTION:**

[Note: For simplification purposes, the table calculates revenue for the year independently based on costs incurred during the year divided by total expected cost, with the assumption that expected costs do not change.]

<table>
<thead>
<tr>
<th>Fixed consideration</th>
<th>A</th>
<th>1,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated costs to complete*</td>
<td>B</td>
<td>950,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>100,000</td>
<td>1,00,000</td>
<td>100,000</td>
<td>250,000</td>
<td>250,000</td>
</tr>
</tbody>
</table>
### Consideration

<table>
<thead>
<tr>
<th>Consideration</th>
<th>52,632</th>
<th>184,211</th>
<th>421,053</th>
<th>289,474</th>
<th>52,632</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed revenue</td>
<td>D=A x H/B</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable revenue</td>
<td>E= C x H/B</td>
<td>5,263</td>
<td>18,421</td>
<td>42,105</td>
<td>72,368</td>
</tr>
<tr>
<td>Cumulative revenue adjustment</td>
<td>F (See below)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>99,370</td>
</tr>
<tr>
<td>Total revenue</td>
<td>G = D + E+ F</td>
<td>57,895</td>
<td>202,632</td>
<td>463,158</td>
<td>461,212</td>
</tr>
<tr>
<td>Costs</td>
<td>H</td>
<td>50,000</td>
<td>175,000</td>
<td>400,000</td>
<td>275,000</td>
</tr>
<tr>
<td>Operating profit</td>
<td>I = G - H</td>
<td>7,895</td>
<td>27,632</td>
<td>63,158</td>
<td>186,212</td>
</tr>
<tr>
<td>Margin (rounded off)</td>
<td>J = I/G</td>
<td>14%</td>
<td>14%</td>
<td>14%</td>
<td>14%</td>
</tr>
</tbody>
</table>

For simplicity, it is assumed three is no change to the estimated costs to complete throughout the contract period.

- In practice, under the cost-to-cost measure of progress, total revenue for each period is determined by multiplying the total transaction price (fixed and variable) by the ratio of cumulative costs incurred total estimated costs to complete, less revenue recognised to date.

**Calculation of cumulative catch-up adjustment:**

<table>
<thead>
<tr>
<th>Updated variable consideration</th>
<th>L</th>
<th>250,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent complete in Year 4: (rounded off)</td>
<td>M=N/O</td>
<td>95%</td>
</tr>
<tr>
<td>Cumulative costs through year 4</td>
<td>N</td>
<td>900,000</td>
</tr>
<tr>
<td>Estimated costs to complete</td>
<td>0</td>
<td>950,000</td>
</tr>
<tr>
<td>Cumulative variable revenue through Year 4:</td>
<td>P</td>
<td>138,130</td>
</tr>
<tr>
<td>Cumulative catch up adjustment</td>
<td>F = L x M - P</td>
<td>99,370</td>
</tr>
</tbody>
</table>

**QUESTION 27 - RIGHT OF RETURN**

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for ₹50 (1,000 total products x ₹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. The entity's cost of each product is ₹30.
The entity applies the requirement 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 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.

**SOLUTION:**

The entity also considers the requirements in paragraphs 56-58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimates amount of variable consideration of ₹ 48,500 (₹ 50 x 970 products not expected to be returned) can be included in the transaction price. The entity considers the factors in paragraph 57 of Ind AS 115 and determines that although the returns are outside the entity’s influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (i.e. the 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. ₹ 48,500) will not occur as the uncertainty is resolved (i.e. over the return period).

The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at profit.

Upon transfer of control of the 1,000 products, the entity not recognise revenue for the 30 products that it expects to be returned. Consequently, in accordance with paragraphs 55 and B21 of Ind AS 115, the entity recognises the following:

(a) Revenue of ₹ 48,500 (₹ 50 x 970 products not expected to be returned);

(b) a refund liability of ₹ 1,500 (₹ 50 refund x 30 products expected to be retuned); and

(c) an assets of ₹ 900 (₹ 30 x 30 products for its right to recover products from customers on setting the refund liability).
QUESTION 28

Financing component: significant or insignificant?

A commercial airplane component supplier enters into a contract with a customer for promised consideration of ₹ 7,000,000. Based on an evaluation of the facts and circumstances, the supplier concluded that ₹ 140,000 represented an 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 ₹ 1,400,000 represented the financing component based on an analysis of the facts and circumstances.

SOLUTION:

The entity may conclude that ₹ 140,000, or 2 percent of the contract price, is not significant, and the entity may not need to adjust the consideration in determining the transaction price.

However, when the advance payment was larger and received further in advance such that the entity may conclude that ₹ 1,400,000 represents the financing component based on an analysis of the facts and circumstances. In such a case, the entity may conclude that ₹ 1,400,000, or 20 percent of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

Note: In this illustration, the entity’s conclusion that 2 percent of the transaction price was not significant and 20 percent was significant is a judgment based on the entity’s facts and circumstances. An entity may a different conclusion on its facts and circumstances.

QUESTION 29

Accounting for significant financing component

NKT Limited sells a product to a customer for ₹ 121,000 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 ₹ 100,000 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 ₹ 121,000 to the cash selling price of ₹ 100,000). Analyse the above transaction with respect to its financing component.

**SOLUTION:**

The contract includes a significant component. This is evident from the difference between the amount of promised consideration of ₹ 121,000 and the cash selling price of ₹ 100,000 at the date that the goods are transferred to the customer.

The contract includes an implicit rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of ₹ 121,000 to the cash selling price of ₹ 100,000). The entity evaluates the rate concludes that is commensurate with the rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception.

Until the entity receives the cash payment from the customer, interest revenue would be recognised in accordance with Ind AS 109. In determining the effective interest rate in accordance with Ind AS 109, the entity would consider the remaining contractual term.

**QUESTION 30 – DETERMINING THE DISCOUNT RATE**

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 the transaction price when

Case A - Contractual discount rate reflects the rate in separate financing transaction

Case B – Contractual discount rate does not reflect the rate in a separate financing transaction i.e. 14%

**SOLUTION:**

**Case A - Contractual discount rate reflects the rate in a separate financing transaction**

In evaluating the discount rate in the contract that contains a significant financing component, VT Limited observes that the 10% contractual rate of interest reflects the that would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% reflects the credit characteristics of the customer).

The market terms of the financing mean that the cash selling price of the equipment is ₹ 1 crore. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity account for the receivable in accordance with Ind AS 109.
Case B - Contractual discount rate does reflect the rate in a separate financing transaction

In evaluating the discount rate in the contract that contains a significant financing component, the entity observes that the 10% contractual rate of interest is significantly lower than the 14% interest rate would be used in a separate financing transaction between the entity and its customer at contract inception (i.e. the contractual rate of interest of 10% does not reflect the credit characteristics of the customer). This suggests that the cash selling price is less than ₹ 1.

VT Limited determines the transaction price by adjusting the promised amount of consideration to reflect the contractual payments using the 14% interest rate reflects the credit characteristics of the customer. Consequently, the entity determines that transaction price is ₹ 9,131,346 (60 monthly payments of ₹ 212,470 discounted at 14%). The entity recognizes revenue and a loan receivable for that amount. The entity accounts for the loan receivable in accordance with Ind AS 109.

QUESTION 31

Advance payment and assessment of discount rate

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 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.
SOLUTION

Journal Entries showing accounting for the significant financing component:

(a) Recognise a contract liability for the ₹4,000 payment received at contract inception:

\[
\begin{align*}
\text{Cash} & \quad \text{Dr.} \quad ₹4,000 \\
\text{To Contract liability} & \quad ₹4,000
\end{align*}
\]

During the two years from contract inception until the transfer of the asset, the entity adjusts the promises amount of consideration and accretes the contract liability by recognising interest on ₹4,000 at 6% for two years:

(b) Interest expense \quad \text{Dr.} \quad ₹494*

\[
\begin{align*}
\text{To Contract liability} & \quad ₹494 \\
₹494 = ₹4,000 \text{ contract liability} \times (6\% \text{ interest per year for two years}).
\end{align*}
\]

(c) Recognise revenue for the transfer of the asset.

\[
\begin{align*}
\text{Contract liability} & \quad \text{Dr.} \quad ₹4,494 \\
\text{To Revenue} & \quad ₹4,494
\end{align*}
\]

QUESTION 32- WITHHELD PAYMENTS ON A LONG-TERM CONTRACT

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 the entity the building is complete.

Analyse whether the contract contains any financing component.

SOLUTION:

ABC Limited concludes that the contract does not include a significant financing component since the milestone payments coincide with its performance and the contract requires amounts to be retained for reasons other than the provision of finance. The withholding of a specified percentage of each milestone payment is intended to protect the customer from the contractor failing to adequately complete its obligations under contract.
QUESTION 33 - ADVANCE PAYMENT

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.

SOLUTION:

Due to this customer’s rating, the customer pays in advance for the three-year term. Because there is no difference between the amount of promised consideration and the cash selling price (that is, the customer does not receive a discount for paying in advance), the vendor requires payment in advance only to protect against customer non-payment, and no other factors exist to suggest the arrangement contains a financing, the vendor concludes this contract does not provide the customer or the entity with a significant benefit of financing.

QUESTION 34 - SALES BASED ROYALTY

A software vendor enters into a contract with a customer to provide a license solely in exchange for a sales-based royalty.

Analyse whether there is any significant financing component in the contract or not.

SOLUTION:

Although the payment will be made in arrears, because the total consideration varies based on the occurrence or non-occurrence of a future event that is not within the control of the customer or the entity, the software vendor concludes the contract does provide the customer or the entity with a significant benefit or financing.

QUESTION 35 - PAYMENT IN ARREARS

An EPC contractor enters into a two-year contract to develop customised machine for a customer. The contractor concludes that goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, the contractor determines that is transfers control over, time, and recognised revenue based on an input method best reflecting the transfer of control to the customer. The customer agree 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.
SOLUTION:

There is no difference between the amount of promised consideration and the cash selling price (that is, the customer did not pay a premium a portion of the consideration in arrears). The payment terms included a holdback payment only to ensure successful completion of the project, and no other factors exist to suggest the arrangement contains a financing. Hence, the contractor does not provide the customer or the contractor with a significant benefit of financing.

QUESTION 36 – PAYMENT IN ARREARS

Company Z is a developer and manufacture 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, specialised missiles for use in one 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 ₹100 crores. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such cost. However, the ₹100 crores award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the contract is executed.

The contract specifies Company Z will earn up to ₹100 crores 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 under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of ₹80 crores in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognised 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.

SOLUTION:

The intention of the parties in negotiating the award fee upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to producer high functioning missiles that achieved successful scoring from Company X. Therefore, it was determined the contract does not contain a significant financing component, and Company Z should not adjust the transaction price.
As per Ind AS 115.63, as practical expedient, an entity need not adjust the promised amount of consideration for the effects of significant financing component if the entity expects, at contract inception, that the period between:
(a) When the entity transfers a promised good or service to a customer and
(b) When the customer pays for the good or service will be one year or less.

**QUESTION 37 - APPLYING PRACTICAL EXPEDIENT**

Company H enters into a two-year contract to develop customised software for Company C. Company H concludes that goods and services in this contract constitute a single performance obligation.

Based on the terms of the contract, Company H determines that it transfers control over time. And recognised revenue based on an input method best reflecting the transfer of control to Company C.

Company C agrees to provide Company H monthly progress payments. Based on the expectation of the timing of costs to be incurred, Company H concludes that progress payments are being made such that the timing between the transfer of control and payment is never expected to exceed one year.

Analyse whether there is any significant financing component in the contract or not.

**SOLUTION:**

Company H concludes it will not need to further whether a significant financing component is present and does adjust the promised consideration in determining the transaction price, as they applying the practical expedient under In AS 115.

As per Ind AS 115.65 an entity shall present the effects of financing (interest revenue or interest expenses) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a contract asset (or receivable) or a contract liability is recognised in accounting for a contract with a customer.

**QUESTION 38 - ENTITLEMENT TO NON- CASH CONSIDERATION**

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 signal 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 par week of service a (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.

**SOLUTION:**

The entity measures its progress towards complete satisfaction of the performance obligation as each week of service is complete. To determine the transaction price (and the amount of revenue to be recognised), the entity has to measure the fair value of 100 shares that are received upon completion of each weekly service. The entity shall not reflect any not reflect any subsequent changes in the fair value of the shares received (or receivable) in revenue.

**QUESTION 39**

Fair of non-cash consideration varies for reasons other than the form of the consideration

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 crores for the project. RT Limited will receive a bonus of 10 lakhs equity shares of AT Limited if is completes construction of the office building within one year. Assume a fair value of ₹ 100 per share at contract inception.

Determine the transaction price.

**SOLUTION:**

The ultimate value of nay shares the might receive could change for two reasons:

1) The entity earns or does not earn the shares and

2) The fair value per share may change during the contract term.

When determining the transaction price, the entity would reflect changes in the number of shares to be earned. However, the entity would not reflect changes in the fair value per share. Said another way, the share price of ₹ 100 is used to value the potential bonus throughout the life of the contract.

As a result, if the entity earns the bonus, its revenue would be ₹ 350 crores plus 10 lakhs equity shares at ₹ 100 per share for total consideration of ₹ 360 crores.
**QUESTION 40 – CUSTOMER PROVIDED GOODS OR SERVICES**

MS Limited is a manufacturer 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 crores 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?

**SOLUTION:**

As a result, at contract inception, SK Limited includes the fair value of the tooling in the transaction price at contract inception, which it determines to be ₹27 crores (₹25 crores for the steering systems and ₹2 crores for the tooling).

**QUESTION 41 – CONSIDERATION PAYABLE TO A CUSTOMER**

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 crores of products during the year. The contract also requires the entity to make a non-refundable payment of ₹1.5 crores to the customer at the inception of the contract. The ₹1.5 crores 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 any rights to the customer’s shelves.

Determine the transaction price.

**SOLUTION:**

The entity considers the requirements in paragraphs 70-72 of Ind AS 115 and concludes that the payment to the customer is not in exchange for a distinct good or service that transfers to the entity. This is because the entity does not obtain control of any rights to the customer’s shelves. Consequently, the entity determines that, in accordance with paragraph 70 of Ind AS 115, the ₹1.5 crores payment is a reduction of the transaction price.

The entity applies the requirement in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by
10 per cent \([\frac{\text{ ₹ 1.5 crores}}{\text{ ₹ 15 crores}}]\) Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of ₹ 1.125 crores (₹ 1.25 Crores invoiced amount less ₹ 0.125 crore of consideration payable to the customer).

**QUESTION 42 (DISCOUNT)**

A seller offers a cash discount for immediate or prompt payment (i.e. earlier than required under the normal credit terms). A sale is made for ₹ 100 with the balance due within 90 days. If the customer pays within 30 days, the customer will receive a 10% discount on the total invoice. The seller sells a large volume of similar items on these credit terms (i.e. this transaction is part of a portfolio of similar items). How should the seller account for this early payment incentive- if discount is taken by 40% of transactions.

**SOLUTION:**

In the circumstances described, revenue is ₹ 100 if the discount is not taken and ₹ 90 if the discount is taken. As a result, the amount of consideration to which the entity will entitled is variable.

Under Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity should estimate the amount of variable consideration to which it will be entitled by (1) using either the expected value or the most likely amount method (whichever method the entity expects would better predict the amount of consideration to which it will be entitled), and then (2) considering the effect of the constraint.

Therefore, the seller should recognises revenue net of the amount of cash discount expected to be taken, measured as described in the precious paragraph.

Expected value will be calculate as follows (₹ 100x 60%) + (₹ 90 X 40) = ₹ 96

**QUESTION 43 (CONTINUATION WITH Q.42)**

Continuation to the above concept capsule

What if the proportion of transactions for which the discount is taken varies significantly which will result in the recognition of less revenue. Based on historical, although the term average is 40% there is great variability from month to month and that the proportion of transactions for which the discount is taken is frequently as high as 70% (but never higher than). How to account revenue under these circumstances?
SOLUTION:

In such a scenario, the seller might conclude that only 30% of the variable consideration should be included, because inclusion of a higher amount might result in significant revenue reversal. In that case, the amount of revenue recognised would be restricted to the following (conservative)

\[(\text{₹}100 \times 30) + (\text{₹} 90 \times 70\%) = \text{₹} 93\]

QUESTION 44 (CONSIDERATION PAID TO CUSTOMER)

Lubes Ltd. Sells lubes in containers to its customer, which in this case is the distributor. These containers carry a cash coupon, which is placed inside the container. The cash coupons are received by the ultimate customer, which for example, is either the grange or mechanic that actually opens the lube container. The ultimate customer is reimbursed by Lubes Ltd. A batch of containers was sold to distributors at ₹ 5,20,000. These containers carried cash of coupons of ₹ 20,000 what is the transaction price in this case?

SOLUTION:

Transaction price will be ₹ 5,20,000 – 20,000 = ₹ 5,00,000. As per the standard, it does not matter whether incentive is provided to the customer (distributor) or customer’s (mechanic or garage). Both will have impact of reducing the transaction price.

QUESTION 45 (NON CASH CONSIDERATION)

A Ltd., a telecommunication company, entered into an agreement with B Ltd. Which is engaged in generation supply of power, the agreement provide that A Ltd. Will provide 1,00,000 minutes talk time free to employees of B Ltd. In exchange for getting free power equivalent to 20,000 units. A of Ltd. normally charges ₹ 0.50 per minute and B Ltd. charges ₹ 3 per unit. How to measure revenue of A Ltd. And B Ltd.?

SOLUTION:

As per Ind AS 115, when non-cash consideration is received Revenue should be measured at Fair value of goods/services received/ adjusted by any cash equivalents transferred;

In the given case, as power per unit rate is clearly available, sales should be recorded at ₹ 60,000 (i.e. 20,000 units x ₹ 3 per unit) in the books of A Ltd. Revenue in the books of B Ltd. Would be ₹ 50,000 (i.e. 1,00,000 units x ₹ 0.5 per minute);
QUESTION 46 (NON CASH CONSIDERATION)

X Ltd. A dealer of garments, got the renovation of one shop carried out by Y Ltd. In turn, it gave 100 T-Shirts and ₹ 3,000 to Y Ltd. As full payment of the renovation work. Y Ltd. would normally charge ₹ 15,000 for the work done. X Ltd. Usually sells T-Shirts at ₹ 120 each. How both X Ltd. Y Ltd. Will account for the above transactions?

SOLUTION:

X Ltd. Books:
It received service (non-cash consideration) in exchange of goods. In this case, the revenue is measured at the fair value of the goods or services received, adjust by the amount of any cash or cash equivalents transferred.

The fair value of service received is ₹ 15,000 (i.e. the amount that Y Ltd. normally charge for the same work) and also X Ltd. Has transferred cash of ₹ 3,000 to Y Ltd. So X Ltd. Will recognise revenue from sale of goods (T-shirts) as 12,000 (₹ 15,000 - ₹ 3,000).

If assume renovation work is capitalised-

PPE a/c Dr 15,000
To Sales a/c 12,000
To Cash a/c 3,000

Y Ltd. Books:
It will recognise revenue (from renovation activities) as ₹ 15,000 (₹ 120 x 100) + 3,000]

QUESTION 47 (FINANCING COMPONENT)

X Ltd. Is engaged in manufacturing and selling of designer furniture. It sells goods extended credit On 1st April, 2018, it sold furniture for ₹ 48,40,000 to a customer, the payment against which was receivable after 24 months. He sells the same furniture at ₹ 40,00,000 to other customer who pays cash on the date of sale. How will X Ltd. Recognise revenue for the above transaction?

SOLUTION:

In the give case, the credit period is a deferred credit period. There is significant financing component involved and not mentioned explicitly in the contract. The entity should account for the time value of money as interest income.
Interest element = Promised consideration - cash selling price = ₹ 48,40,000 - ₹ 40,00,000 = ₹ 8,40,000.

Internal rate of rerun between ₹ 48,40,000 & ₹ 40,00,000 is 10% The interest revenue should be accounted for using the same rate.

The following journal entry should be recoded

<table>
<thead>
<tr>
<th>Date</th>
<th>Journal entry</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st April 2018</td>
<td>Customer A/c..................Dr</td>
<td>40,00,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Sales (Revenue) A/c</td>
<td></td>
<td>40,00,000</td>
</tr>
<tr>
<td></td>
<td>(Being revenue is recognised at fair value)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31st Mar 2019</td>
<td>Customer A/c..................Dr</td>
<td>4,00,000</td>
<td>4,00,000</td>
</tr>
<tr>
<td></td>
<td>To Interest Income A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being finance income is recognised at effective Rate i.e. ₹ 40,00,000 x 10%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31st Mar 2020</td>
<td>Customer A/c..................Dr</td>
<td>4,40,000</td>
<td>4,40,000</td>
</tr>
<tr>
<td></td>
<td>To Interest Income A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being finance income is recognised at effective Rate i.e. ₹ 44,00,00 x 10%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Receivable amount as at 31st March 2020</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>= ₹ 40,00,000 - ₹ 4,00,000 + 4,40,000 ₹ 48,40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31st Mar 2020</td>
<td>Cash A/c..................Dr</td>
<td>₹ 48,40,000</td>
<td>₹ 48,40,000</td>
</tr>
<tr>
<td></td>
<td>To Customer</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being receipt of consideration is accounted)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** If customer paid advance consideration and the timing of the transfer of those goods or services is at the discretion of the customer -the entity should not consider any interest revenue in this case.
Step 4: ALLOCATION OF TRANSACTION PRICE

QUESTION 48 – ALLOCATION METHODOLOGY

An entity enters into a contract with a customer to sell products A, B and C in exchange for ₹ 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.

Because the stand-and selling prices for Products B and C are not directly observable, the entity must estimate them. 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. In making those estimates, the entity maximises the use of observable inputs.

The entity estimates the stand-alone selling prices as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand – alone selling price (₹)</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>5,000</td>
<td>Directly observable</td>
</tr>
<tr>
<td>Product B</td>
<td>2,500</td>
<td>Adjusted market assessment approach</td>
</tr>
<tr>
<td>Product C</td>
<td>7,500</td>
<td>Expected cost plus a margin approach</td>
</tr>
<tr>
<td>Total</td>
<td>15,000</td>
<td></td>
</tr>
</tbody>
</table>

Determine the transaction price allocated to each product.

SOLUTION:

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (₹ 15,000) exceeds the promised consideration (₹ 10,000) the entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Allocated transaction price (to nearest ₹ 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₹</td>
</tr>
<tr>
<td>Product A</td>
<td>3,300 (₹ 5,000 ÷ ₹ 15,000 x ₹ 10,000)</td>
</tr>
<tr>
<td>Product B</td>
<td>1,700 (₹ 2,500 ÷ ₹15,000 x ₹ 10,000)</td>
</tr>
<tr>
<td>Product C</td>
<td>5,000 (₹ 7,500 ÷ ₹ 15,000 x ₹ 10,000)</td>
</tr>
<tr>
<td>Total</td>
<td>10,000</td>
</tr>
</tbody>
</table>
QUESTION 49 (ALLOCATING A DISCOUNT)

An entity regularly sells Products X, Y and Z individually, thereby establishing the following stand-alone selling prices:

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand-alone selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product X</td>
<td>₹ 50,000</td>
</tr>
<tr>
<td>Product Y</td>
<td>₹ 25,000</td>
</tr>
<tr>
<td>Product Z</td>
<td>₹ 45,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>₹ 1,20,000</strong></td>
</tr>
</tbody>
</table>

In addition, the entity regularly sells Products Y and Z together for ₹ 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 ₹ 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 ₹ 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Products Alpha to different customers for a broad range of amounts (₹ 15,000 - ₹ 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

SOLUTION:

Case A - Allocating a discount to one or more performance obligations

The contract includes a discount of ₹ 20,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand-alone selling price method.

However, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has evidence that the entire discount should be allocated to the promises to transfer Products Y and Z in accordance with paragraph 82 of Ind AS 115.

If the contract requires the entity to transfer control of Products Y and Z together, then the allocated amount of ₹ 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of ₹ 25,000) and Product Z (stand-alone selling price of ₹ 45,000) as follows:
## ACCOUNTS

<table>
<thead>
<tr>
<th>Product</th>
<th>Allocated transaction price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product Y</td>
<td>₹ 17,857 (₹ 25,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)</td>
</tr>
<tr>
<td>Product Z</td>
<td>₹ 32,143 (₹ 45,000 ÷ ₹ 70,000 total stand-alone selling price × ₹ 50,000)</td>
</tr>
<tr>
<td>Total</td>
<td>₹ 50,000</td>
</tr>
</tbody>
</table>

### Case B – Residual approach is appropriate

Before estimating the stand-alone selling price of Product Alpha using the residual approach, the entity determines whether any discount should be allocated to the other performance obligations in the contract.

As in Case A, because the entity regularly sells Products Y and Z together for ₹ 50,000 and Product X for ₹ 50,000, it has observable evidence that ₹ 100,000 should be allocated to those three product and a ₹ 20,000 discount should be allocated to the promises to transfer Products Y and Z in Accordance with paragraph 82 of Ind As 115.

Using the residual approach, the entity estimated the stand-alone selling price of Product Alpha to be ₹ 30,000 as follows:

<table>
<thead>
<tr>
<th>Product</th>
<th>Stand-alone selling price</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product X</td>
<td>₹ 50,000</td>
<td>Directly observable</td>
</tr>
<tr>
<td>Product Y and Z</td>
<td>₹ 50,000</td>
<td>Directly observable with discount</td>
</tr>
<tr>
<td>Product Alpha</td>
<td>₹ 30,000</td>
<td>Residual approach</td>
</tr>
<tr>
<td>Total</td>
<td>₹ 130,000</td>
<td></td>
</tr>
</tbody>
</table>

The entity observes that the resulting ₹ 30,000 allocated to Product Alpha is within the range of its observable selling price (₹ 15,000- ₹ 45,000).

### QUESTION 50- ALLOCATING OF VARIABLE CONSIDERATION

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 obligation each satisfied at a point in time. The stand-alone selling prices of Licences A and B are ₹ 1,600,000 and ₹ 2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.
The price stated in the contract for Licence A is a fixed amount of ₹ 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-bases royalties (i.e. the variable consideration) to be ₹ 2,000,000. Allocate the transaction price.

**SOLUTION:**

To allocate the transaction price, the entity considers the criteria in paragraph 85 and concludes that the variable consideration (i.e. the sales-based royalties) should be allocated entirely to Licence B. The entity concludes that the criteria are met for the following reasons:

(a) The variable payment related specifically to an outcome from the performance obligation to transfer Licence B (i.e. the customer's subsequent sales of products that use License B).

(b) Allocating the expected royalty amounts of ₹ 2,000,000 entirely to Licence B is consistent with the allocation objective in paragraph 73 of Ind AS 115. This is because the entity's estimate of the amount of sales-based royalties (₹ 2,000,000) approximates the stand-alone selling price of Licence B and the fixed amount of ₹ 1,600,000 approximates the stand-alone selling price of Licence A. The entity allocated ₹ 1,600,000 to Licence A. This is because, based on an assessment of the facts and circumstances relating to both licences, allocating to Licence B some of the fixed consideration in addition to all of the variable consideration would not meet the allocation objective in paragraph 73 of Ind As 115.

**QUESTION 51 – ALLOCATING A CHANGE IN TRANSACTION PRICE**

On 1 April 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for ₹ 2 crores. The consultant can earn ₹ 20 lakhs bonus if it completes the software implementation by 30 September 20X0 or ₹ 10 lakhs bonus if it completes the software implementation by 31 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 - ₹ 80 lakhs
- Valuation - ₹ 20 lakhs
- Software implementation - ₹ 1 crore
At contract inception, the consultant believes it will complete the software implementation by 30 January 20X1. After considering the factors in Ins 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 bonus in its estimated transaction price at contract inception.

On 1 July 20X0, the consultant notes that the project has progressed better than expected and believes that implementation will be completed by 30 September 20X0 based on a revised forecast. As a result, the consultant updates its estimated transaction price to reflect a bonus of ₹ 20 lakhs.

After reviewing its progress as of 1 July 20X0, the consultant determines that it is 100 per cent complete in satisfying its performance obligations for due diligence and valuation and 60 per cent complete in satisfying its performance obligation for software implementation.

Determine the transaction price.

**SOLUTION:**

On 1 July 20X0, the consultant allocates the bonus of ₹ 20 lakhs to the software implementation performance obligation, for total consideration of ₹ 1.2 crores allocated to that performance obligation, and adjusts the cumulative revenue to date for the software implementation services to ₹ 72 lakhs (60 per cent of ₹ 1.2 crores).
**Step 5: SATISFYING THE PERFORMANCE OBLIGATION**

**QUESTION 52**

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 revenue?

**SOLUTION:**

Payroll processing is a single performance obligation. On a monthly basis, as Microtek Ltd carries out the payroll processing-

- The customer, i.e. ABC Limited simultaneously receives and consumes the benefits of the entity’s performance in processing each payroll transaction
- Further, once the services have been performed for a particular month, in case of termination of the agreement before maturity and contract is transferred to another entity, then such new entity will not need to re-perform the services for expired months.

Therefore, it satisfied the first criterion, i.e. services completed on a monthly basis are consumed by the entity at the same time and hence, revenue shall be recognised over the period of time.

**QUESTION 53**

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 Srilanka through sea. The voyage is expected to take 20 days Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Combo port.

Whether T&L’s performance obligation is met over period of time?

**SOLUTION:**

T&L has a single performance to ship the goods form one port to another. The following factors are critical for assessing how services performed by T&L are consumed by the customer-

- As the voyage is performed, the service undertaken by T&L is progressing such that no other entity will need to re-perform the service till so far as the voyage has been performed, if T&L was to deliver only part-way.
- The customer is directly benefiting from the performance of the voyage as & when it progresses.

Therefore, such performance obligation is said to be met over a period of time.
**QUESTION 54**

AFS Ltd. Is a risk advisory firm and enters into a contract with a company WBC Ltd provide audit service that results in AFS issuing an audit opinion of 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?

**SOLUTION:**

AFS has a single performance to provide an opinion on the professional audit services proposed to be provided under the contract with the customer. Evaluating the criterion for recognising revenue over a period of time or at a point in time, Ind AS 115 requires one of the following criterion to be met-

- **Criterion (a)** - whether the customer simultaneously receives and consumes the benefits from services provided by AFS: Company shall benefit only when the audit opinion is provided upon completion. And in case the contract was to be terminated, and other firm engaged to perform similar services will have to substantially re-perform.

  Hence, this criterion is not met.

- **Criterion (b)** - An asset created that customer controls: This is service contract and no asset created, over which customer acquires control.

- **Criterion (C)** - no alternate use to entity and right to seek payment:
  - The services provided by AFS are specific to the company WBC and do not have any alternate use to AFS
  - Further, AFS has a right to enforce payment if contract was early terminated, for reasons other than AFS’s failure to perform. And the profit margin approximates what entity otherwise earns.

Therefore, criterion (c) is met such performance obligation is said to be met over a period of time.

**QUESTION 55**

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.

**SOLUTION:**

While evaluating the pattern of transfer of control to the customer, the Company shall evaluate condition laid in para 35 of Ind AS 115 as follows:

- **Criterion (a)** whether the customer simultaneously and consumes the benefits Customer can benefit only when the satellite is fully constructed and no benefits are consumed as its constructed. Hence, this criterion in not met.
- **Criterion (b)** - An asset created that customer controls: per provided facts, the customer does not acquire control
- **Criterion (c)** - no alternate use to entity and right to seek payment:
  - The asset is being specifically created for the customer. The asset is customised to customer’s requirements such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being to alternate use
  - Further, Space Ltd. Has a right to enforce payment if contract was early terminated, for reasons other than Space Ltd. s failure to perform.

Therefore, criterion (c) is met and such performance obligation is said to be met over a period of time.

### QUESTION 56: UNINSTALLED MATERIALS

On 01 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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction price</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Expected costs:</td>
<td></td>
</tr>
<tr>
<td>(a) Elevators</td>
<td>1,500,000</td>
</tr>
<tr>
<td>(b) Other costs</td>
<td>2,500,000</td>
</tr>
<tr>
<td>Total</td>
<td>4,000,000</td>
</tr>
</tbody>
</table>
The entity purchases the elevators and they are delivered to the 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 March 31, 20X1.

How will the Company recognise revenue, if performance obligation is met over a period of time?

**SOLUTION:**

Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method -

The measure of progress should be made based on percentage of costs incurred relative to the budgeted costs.

- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognised to the extent of costs incurred.

The revenue to be recognised is measured as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction Price</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Costs incurred:</td>
<td></td>
</tr>
<tr>
<td>(a) Cost of elevators</td>
<td>1,500,000</td>
</tr>
<tr>
<td>(b) Other costs</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Measure of progress:</td>
<td>5,00,000/2,500,000 = 20%</td>
</tr>
<tr>
<td>Revenue to be recognised:</td>
<td></td>
</tr>
</tbody>
</table>
| (a) For costs incurred (other than elevators) | Total attributable revenue = 3,500,000 of work completed = 20%  
Revenue to be recognised = 700,000 |
(b) Revenue for elevators 1,500,000 (equal to costs incurred)
Total revenue to be recognised 1,500,000 + 7,00,000 = 2,200,000

Therefore, for the year ended 31 March 20X1, the Company shall recognise revenue of ₹ 2,200,000 on the project.

CONCEPT 5: VARIOUS SITUATIONS

QUESTION 57 (REPURCHASE AGREEMENT)

An entity enters into a contact with a customer for the sale of a tangible asset on 1 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 December 31, 20X1.

How would the entity account for this transaction?

SOLUTION:

In the above, where the entity has a right to call back the goods upto a certain date-

- The customer cannot be said to have acquired control, owing to the repurchase right with the seller entity
- Since the original selling price (₹ 1 million) is lower than the repurchase price (₹ 1.1 million,) this is construed to be a financing arrangements and accounted as follows:
  
  (a) Amount received shall be recognised as 'liability'
  (b) Difference between sale price and repurchase price to be recognised as finance cost and recognised over the repurchase term.

QUESTION 58 (REPURCHASE AGREEMENT)

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for ₹ 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for ₹ 9,00,000 on or before December 31, 20X1. The market price for such goods is expected to be ₹ 750,000.

How would the entity account for this transaction?

SOLUTION:

In the above case, where the entity has an obligation to buy back the goods up to certain date-
• The entity shall evaluate if the customer has a significant economic incentive to return the goods, Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.

• Therefore, company determines that control of goods is not transferred to the customer till 31 December 20X1, i.e. Till the put option expires

• Against payment of ₹1,000,000 the customer only has a right to use the asset and put it back to the entity for 900,000. Therefore, this will be accounted as a lease transaction in which difference between original selling price (i.e. ₹1,000,000) and repurchase price (i.e. ₹900,000) shall be recognised as lease income over the period of lease.

**QUESTION 59 (BILL & HOLD)**

An entity enters into a contract with a customer on 1 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 31 March 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accept the spare part, the customer requires 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?

**SOLUTION:**

In the facts provided above, the entity has made sale of two goods- machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to the spare parts for the customer for a period or 2-4 years, which is a separate performance obligation therefore, total transaction price shall be divided amongst 3 performance obligations-

(i) Sale of machinery

(ii) Sale of spare parts
(iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- Sale of machinery: Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31 March 20X3. Accordingly, revenue for sale of machinery shall be recognised on 31 March 20X3.

- Sale of spare parts: the customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity In this regard, the company shall evaluate if revenue can be recognised on bill-n hold basis if all below criteria are met:

<table>
<thead>
<tr>
<th>(a)</th>
<th>The reason for the bill and – hold arrangement must be substantive (for example, the customer has requested the arrangement);</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer’s factory</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(b)</th>
<th>The product must be identified separately as belonging to the customer;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The spare parts have been specifically identified and inspected by the customer</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(c)</th>
<th>The entity cannot have the ability to use the product or to direct it to another customer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Spares have been segregated and cannot be redirected to any other customer.</td>
</tr>
</tbody>
</table>

Therefore, all conditions of bill-and-hold are met hence, company can recognise revenue for sale of spare parts on 31 march 20X3.

- Custodial services: Such services shall be given for a period of 2 to 4 years form 31 March 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognised on a straight line basis over a period of time.

**QUESTION 60 (CONTRACT COST)**

Customer outsources its information technology data center

Term= 5 years plus two 1yr renewal options

Average customer relationship is 7 years

Entity spends ₹ 4,00,000. designing and building the technology platform needed to accommodate out- sourcing contract:
How should such costs be treated?

**SOLUTION:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost (₹)</th>
<th>Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Design services</td>
<td>50,000</td>
<td>Assess under Ind AS 115. Resulting Asset would be amortised over 7 years (i.e. include renewals)</td>
</tr>
<tr>
<td>Hardware</td>
<td>140,000</td>
<td>Account for asset under Ind AS 16</td>
</tr>
<tr>
<td>Software</td>
<td>100,000</td>
<td>Account for asset under Ind AS 38</td>
</tr>
<tr>
<td>Migration and testing of data centre</td>
<td>110,000</td>
<td>Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>400,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

**QUESTION 61 (AMORTISATION)**

An entity enters into a service contract with a customer and incurs incremental cost to obtain the contact and costs to fulfil the contract. These costs are capitalised as assets in accordance with Ind AS 115. The initial term of the contract is five years buy it can be renewed for subsequent one- year periods up to a maximum of 10 years. The average contract term of similar contracts entered into entity is seven years.

Determine appropriate method of amortisation?

**SOLUTION:**

The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one year renewals) because that is the period over which the entity expects to provide serviced under the contract to which the capitalised costs relate.
QUESTION 62 (SERVICE CONCESSION ARRANGEMENTS)

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 crores as on 31st December, 20X1. Under IGAAP, The Company has recorded such expenses as Intangible Assets in the book account. The brief details of the Concession Agreement are as follows:

- Total Expenses estimated to be incurred on the project ₹ 100 crores;
- Fair Value of the construction services is ₹ 110 crores;
- Total Cash Flow guaranteed by the Government under the concession agreement is ₹ 200 crores;
- Finance revenue over the period of operation phases is ₹ 15 crores;
- Other income relates to the services provide 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 ₹ 100 crores. The fair value of such construction cost in approximately ₹ 200 crores. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGGAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Assets.

Required:

(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.

QUESTION 63 (CONSIGNMENT AGREEMENT)

Manufacture M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's Stores. Retailer A is obligated to pay Manufacture M ₹ 20 per dress when the dress is sold to an end customer.
During the consignment period, Manufacture M has contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacture M is also required to accept the return of the inventory. State when the control is transferred.

**SOLUTION:**

Manufacture M determines the control has been transferred to Retailer A on delivery, for the following reasons:

(a) Retailer A does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;

(b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and

(c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses.

Manufacturer M recognizes revenue as the dressers are sold to the end customer.

**QUESTION 64 (UPFRONT FEES)**

Customer buy a new data connection from, the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection.

The customer will be charged based on the usage of the data services of the connection on monthly basis.

Are the performance obligations under the contract distinct?

**SOLUTION:**

By selling a new connection, the entity promises to supply data services to customer. Customer will not be able to benefit from just buying a data card and data services form third party. The activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation.

Entity’s obligation is to provide data service and hence activation is not separate performance obligation.
EXTRA QUESTIONS FOR SELF READING ON IND AS 115

QUESTION 65 (ALLOCATION OF TRANSACTION PRICE)

An entity sells boats for ₹ 30,000 each. The entity also provides mooring facilities for ₹ 5,000 per annum. The entity sells these goods and services separately. If a purchaser of a boat contracts to buy mooring facilities for a year there is a discount on the whole package. Thus the 'package' costs ₹ 32,500. How should revenue be recognized?

SUGGESTED ANSWER:

As per the standard, transaction price should be allocated between the performance obligations in the ratio of SSPs.

In the given contract, there are two performance obligations i.e. sale of boats and mooring facility.

SSP is very clearly observable in the given question. Hence the transaction price of ₹ 32,500 should be allocated in the ratio of ₹30,000 : ₹ 5,000

Sale value of boats = ₹ 27,857 (₹ 32,500 × 35,000/₹35,000); and
Sale value of mooring facility = ₹ 4,643 (₹ 32,500 × ₹ 5,000/₹35,000).

The revenue recognized on the sale (₹28,857) of the boat should, therefore, be recognized on delivery of the boat. The revenue recognized for the mooring facilities is ₹ 4,643, which will be recognized evenly over the year for which the mooring facility is provided.

QUESTION 66

Continuation to the above question

Assume an entity X generally sells the boats in range between ₹ 29,000 and ₹ 32,500.

The entity enters into a contract to sell a boat and one year of mooring services to a customer. The stated contract prices for the boat and the mooring services are ₹ 31,000 and ₹ 1,500 respectively?

How should entity X allocate the total transaction price of ₹ 32,500 to each performance obligation?

SUGGESTED ANSWER:

The contract price for the boat (₹ 31,000) falls within the range entity X established for stand-alone selling price: therefore, entity X could use the stated contract price for the boat as the stand-alone selling price in the allocation.

Boat : ₹ 27,986 (₹ 32,500 × (₹ 31,000/₹ 36,000))
Mooring services : ₹ 4,514 (₹ 32,500 × (₹ 5,000/₹ 36,000))
QUESTION 67

Continuation to the above question

What is the contract price of the boat did not fall within the range like ₹ 28,000?

SUGGESTED ANSWER:

Entity X would need to determine a price within the range to use as the stand-alone price of the boat in the allocation, such as the midpoint. Entity X should apply a consistent method for determining the price within the range to use the stand-alone selling price.

QUESTION 68

A seller enters into a contract with a customer to sell products A, B and C for a total transaction price of ₹ 1,00,000. The seller regularly sells product A for ₹ 25,000 and product B for ₹ 45,000 on a stand-alone basis. Product C is a new product that has not been sold previously, has no established price and is not sold by competitors in the market. Products A and B are not regularly sold together at a discounted price. Product C is delivered on 1st March, and products A and B are delivered on 1st April.

How should the seller determine the stand-alone selling price of product C?

SUGGESTED ANSWER:

The seller can use the residual approach to estimate the stand-alone selling price of product C, because the seller has not previously sold or established a price for product C.

Prior to using the residual approach, the seller should assess whether any other observable data exists to estimate the stand-alone selling price.

For example, although product C is a new product, the seller might be able to estimate a stand-alone selling price through other methods, such as using expected cost plus a margin.

The seller has observable evidence that products A and B sell for ₹ 25,000 and ₹ 45,000 respectively, for a total of ₹ 70,000. The residual approach results in an estimated stand-alone selling price of ₹ 30,000 for Product C (₹ 100,000 total transaction price less ₹ 70,000).

QUESTION 69 (RIGHT TO RETURN)

ABC Ltd. Sole 10,000 @ ₹ 1,000 limited on customary terms of right to return within a month without any penalty. On the basis of past experience, ABC Ltd. assesses that 10% refund is expected but it will be able to sale the returned goods at a profit. Cost of goods is ₹ 700 per unit. Suppose 1,000 units are returned within the specified time and customer gets replacement. Show necessary accounting entries.
As discussed above, the entity should recognise revenue to the extent it expects to be entitled, a refund liability and an asset & corresponding adjustment to cost of sales - this is because the entity has right to recover the product.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Dr. ₹</th>
<th>Cr. ₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>At the time of sale</td>
<td>Bank a/c..........Dr</td>
<td>1,00,00,000</td>
<td>90,00,000</td>
</tr>
<tr>
<td></td>
<td>To Sales a/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Refund liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(90% of the revenue recognized on the basis of expected value method of the amount of variable consideration and 10% is recognised as refund liability)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Refund liability</td>
<td>10,00,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td>At the time of sale</td>
<td>Stock on sale or return a/c........Dr</td>
<td>7,00,000</td>
<td>7,00,000</td>
</tr>
<tr>
<td></td>
<td>To Stock of finished goods</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Inventories with the customer are recognised and respect of goods expected to be refunded at cost i.e. 1,000 units x 700)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>After the goods are replaced by entity</td>
<td>Refund liability a/c............... Dr.</td>
<td>10,00,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td></td>
<td>To Sale of goods a/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Revenue recognised after the replacement of the returned goods- 1000 units and refund liability is extinguished)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>After the goods are replaced by entity</td>
<td>Stock of finished goods a/c.......Dr</td>
<td>7,00,000</td>
<td>7,00,000</td>
</tr>
<tr>
<td></td>
<td>To Stock on sale or return a/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Entries in respect of stock goods with the customer reversed after return of goods by customer)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
On 1st Jan, ABC Ltd enters into a non-cancellable contract with TVC Ltd for the sale of an excavator for ₹ 3,50,000. The excavator will be delivered to TVC Ltd on 1st April. The contract required TVC Ltd to pay ₹ 3,50,000 in advance on 1st Feb and TVC Ltd makes the payment on 1st March. Prepare the journal entries that would be used by ABC Ltd to account for this contract.

SUGGESTED ANSWER:

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st Feb</td>
<td>Receivable</td>
<td>Dr 3,50,000</td>
<td>3,50,000</td>
</tr>
<tr>
<td></td>
<td>To contracts liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being ABC Ltd recognises receivable because it has an unconditional rights to the consideration (i.e. the contract is non-cancellable))</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st March</td>
<td>Cash</td>
<td>DR 3,50,000</td>
<td>3,50,000</td>
</tr>
<tr>
<td></td>
<td>To receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being TVC makes the payment ABC recognise the cash collection)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st April</td>
<td>Contract liability</td>
<td>DR 3,50,000</td>
<td>3,50,000</td>
</tr>
<tr>
<td></td>
<td>To revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Being ABC recognises revenue when excavator is delivered to TVC)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
EXTRA QUESTIONS ON CONSTRUCTION CONTRACTS

QUESTION 1

Wisdom Ltd., a limited liability company that designs and builds race courses, commenced a four-year contract early in 2015. The price was initially agreed at ₹1,20,00,000.

Revenue is recognized over the term of the contract as the performance obligation is satisfied over time. Wisdom recognizes revenue based on the percentage of costs incurred to date compared to total expected costs. Relevant figures are as follows:

(Amt. in ₹'000)

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs incurred in year</td>
<td>2,750</td>
<td>3,000</td>
<td>4,200</td>
<td>1,150</td>
</tr>
<tr>
<td>Anticipated future costs</td>
<td>7,750</td>
<td>7,750</td>
<td>1,550</td>
<td>-</td>
</tr>
<tr>
<td>Cash received to date</td>
<td>3,000</td>
<td>5,000</td>
<td>11,000</td>
<td>12,000</td>
</tr>
</tbody>
</table>

Required: Show how the above would be disclosed in the financial statements of Wisdom for each of the four years.

QUESTION 2

BGC Ltd. commenced work on three long-term contracts during the financial year to 31st March 2018. The first contract with NP commenced on 1st July 2017 and had a total sales value of ₹36 lakhs. It was envisaged that the contract would run for two years and that the total expected costs would be ₹30 lakhs. On 31st March 2018 BGC revised its estimate of the total expected cost to ₹31 Lakhs on the basis of the additional rectification costs of ₹100,000 incurred during the current financial year. An independent surveyor has estimated at 31st March 2018 that the contract is 40% complete. BGC has incurred costs up to 31st March 2018 of ₹15 lakhs and has received payments on accounts of ₹12 lakhs.

The second contract with HP commenced on 1st Oct 2017 and was for a two year period. This contract was relatively small and has a total sales value of ₹60,000. The expected costs were ₹48,000. A valuation has been carried out by an independent surveyor. The directors of the company estimated at 31st March 2018 that the contract was 30% complete. The costs incurred to date were ₹19,000 and payments on account received were ₹21,000. A non-current asset which had cost ₹8,000 and had been purchased specifically for the project was considered to be obsolete as at 31st March 2018. The cost of Asset was included in the amount of the costs incurred.
The third contract with KP commenced on 1\textsuperscript{st} Nov 2017 and was for 1.5 years. The total sales value of contract was ₹ 24 lakhs and the total expects costs ₹ 20. Lakhs, payments on account already received were ₹ 10 lakhs and total costs incurred to date were ₹ 700,000. BGC had insisted on a large deposit from KP because the companies had not traded together prior to the contract. The independent surveyor estimated that at 31\textsuperscript{st} March 2018 the contract was 25\% complete.

The three contracts meet the requirements of Ind AS- 115 Revenue from Contracts with Customer’ to recognize revenue over time as the performance obligations are satisfied over time.

Required:

Draft financial statements extract for BGC in respect for the three construction contract for the year ending 31\textsuperscript{st} March 2018.

\textbf{QUESTION 3}

Comfort Ltd. enters into an agreement to construct a commercial building for a customer on customer owned land for a consideration as follows:

<table>
<thead>
<tr>
<th></th>
<th>₹ 80 Lakhs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction Price</strong></td>
<td>₹ 80 Lakhs</td>
</tr>
<tr>
<td><strong>Bonus</strong></td>
<td>₹ 5 Lakhs</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>₹ 85 Lakhs</td>
</tr>
</tbody>
</table>

The bonus is for on time completion of the construction. The construction is agreed to be completed by 18 - months. At the inception, the company estimates cost of ₹ 60 lakhs to complete the contract.

The entity accounts for the promised bundle of goods and services as a single performance obligation satisfied over time on accordance with Ind AS -115 because the customer controls the building during the construction. The entity determines that the input measure, on the basis of costs incurred provided an appropriate measure of progress towards complete satisfaction of the performance obligation. It does not include the bonus at the inception since it concludes that it is highly probable that there will be significant reversal as the construction may not be complete within the specified Time.

At the end of the first year, the company incurred cost of ₹ 45 lakhs (i.e., 75\% of the total cost) and therefore recognized 75\% of the transaction price (₹ 60 lakhs) as revenue. Comfort Ltd. assessed that the constraint of recognising variable consideration still exists.

The agreement was modified at the beginning of the year 2. The work specification has been changed and the transaction price is increased by ₹ 15 lakhs. Comfort Ltd. has revised the cost estimate by additional ₹ 10 lakhs. The completion time been extended by another
6 months, Comfort Ltd. has assesses that will be able to complete the contract within the specified time. How should Comfort Ltd. recognise the effect of contract modification.

**QUESTION 4**

Sun Led. Enters into construction contract with Moon Ltd. contract price is ₹ 100 lakh. Sun Ltd has estimated costs to complete the work amounting to ₹ 80 lakhs. It has concluded that cost incurred is appropriate measure of recognise progress of the work AS on 31 March, the reporting date it has incurred cost of ₹ 10 lakhs, But Moon Ltd. terminated the contract because it wished to get out the contract, demolish, the construction and pursue alternative design. As per terms and conditions, Sun Ltd. is entitled to het cost plus reasonable profit. Can Sun Ltd recognise revenue?

**QUESTION 5**

On 1st July 2018 Zed Ltd. enters into a contract to construct a building as per the following details:

<table>
<thead>
<tr>
<th>₹ in lakhs</th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.4.2018</td>
<td>18-19</td>
<td>19-20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tendering costs</td>
<td>3</td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Negotiation expenses</td>
<td>8</td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Costs of obtaining the contract</td>
<td>11</td>
<td></td>
<td></td>
<td>11</td>
</tr>
<tr>
<td>Estimated costs to fulfil the contract obligation:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Material</td>
<td>4,000</td>
<td>5,000</td>
<td>9,000</td>
<td></td>
</tr>
<tr>
<td>Labour</td>
<td>1,000</td>
<td>1,300</td>
<td>2,300</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2</td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Design</td>
<td>25</td>
<td></td>
<td></td>
<td>25</td>
</tr>
<tr>
<td>Technical assistance and approval</td>
<td>25</td>
<td>15</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Depreciation on tangible assets used in the construction</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>100</td>
<td>100</td>
<td>200</td>
<td></td>
</tr>
</tbody>
</table>
Allocated expenses:

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Administrative expenses</td>
<td>100</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Borrowing costs</td>
<td>50</td>
<td>55</td>
<td>105</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Borrowing costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

It has been agreed that the designing, technical service and assistance shall be provided at a stand-alone price of ₹ 81.25 which merged in the transaction price but payment shall be made in two instalment at the end of year 1 ₹ 50 lakhs and the balance on complete of the contract.

The customer has agreed for the following payments terms for supply of material and other contract services linked to progress in the construction.


Assuming that budgeted and actual expenses are the same, Prepare a worksheet showing year-wise and performance obligation - wise allocation of revenue profit and contract asset

**QUESTION 6**

Sky Ltd. is building a multi - units residential complex. Last year Sky Ltd entered into a contract with a customer for a specific unit that is under construction. This 3- year contract is expected to be completed next year. Company has determined the contract to single performance obligation satisfied over time. Company gathered the following information during the current year (i.e., second year of the contract).

<table>
<thead>
<tr>
<th></th>
<th>Year end 31st December (₹ In lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost to date</td>
<td>1,500</td>
</tr>
<tr>
<td>Future expected costs</td>
<td>1,000</td>
</tr>
<tr>
<td>Work certified to date</td>
<td>1,800</td>
</tr>
<tr>
<td>Expected sales value</td>
<td>3,200</td>
</tr>
<tr>
<td>Revenue recognized in earlier year</td>
<td>1,200</td>
</tr>
<tr>
<td>Cost recognized in earlier year</td>
<td>950</td>
</tr>
</tbody>
</table>
Calculate the figures to be recognized in the statement of profit or loss in respect of revenue and cost for the year ended 31st December on both:

(i) A sale basis (an output method); and
(ii) A cost basis (an input method)

**QUESTION 7**

Bob Ltd. a construction company, enters into a contract on 15th April, 2017 to construct a commercial building for Lee Ltd. on the land owned by Lee Ltd. for a consideration of ₹20,00,000. The expected cost of construction is ₹14,00,000. As per the agreed terms, if the building is complete within 24 months, i.e., 14th April, 2019, then the Bob Ltd. is entitled for a performance bonus of ₹4,00,000.

As at year ended March 2018, Bob Ltd. has satisfied 60 per cent of its performance obligation on the basis of costs incurred to date. In June 2018, Bob Ltd. and Lee Ltd. agreed to modify the contract by changing the floor plan to the building. As a result, the fixed consideration and expected costs increase by ₹3,00,000 and ₹2,40,000 respectively.

In addition, the allowable time for achieving the performance bonus of ₹4,00,000 is extended by 6 months (i.e., form 24 months to 30 months viz. 14th October 2019 from the original contract inception date.

How should Bob Ltd. account for this contract modification?
**IND AS 115: REVENUES FROM CUSTOMER**

**NEW QUESTIONS ADDED IN STUDY MATERIAL**

**QUESTION 1**
Contractor P enters into manufacturing contract to produce 100 specialised CCTV Cameras for Customer Q for a fixed price of ₹ 1,000 per sensor. Customer Q can cancel the contract without a penalty after receiving 10 CCTV Cameras. Specify the contract units.

**SOLUTION:**
P determines that because there is no substantive compensation amount payable by Q on termination of the contract - i.e. no termination penalty in the contract - it is akin to a contract to produce 10 CCTV Cameras that gives Customer Q an option to purchase an additional 90 CCTV Cameras. Hence, contract is for 10 units.

**QUESTION 2**
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?

**SOLUTION**
M concludes that the said two contracts should be combined because, among other things, P is a related party of Q, the contracts were entered into at nearly the same time and the contracts were negotiated as a single commercial package, which is clearly evident from the fact that discount is being offered if both the parties purchases the security system, thereby also making the consideration in one contract dependent on the other contract.

**QUESTION 3**
Telco T Ltd. Enters into a two-year contract for internet services with Customer C. C also buys a modem and a router from T Ltd. And obtains title to the equipment. T Ltd. Does not require customers to purchase its modems and routers and will provide internet services to customers using other equipment that is compatible with T Ltd.’s network. There is a secondary market in which modems and routers can be bought or sold for amounts greater than scrap value.

Determine how many performances obligations does the entity T Ltd. Have?
SOLUTION:

T Ltd. Concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation:

**Criterion 1 : Capable of being distinct**

- T can benefit from the modem and router on their own because they can be resold for more than scrap value.
- T can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set-up, they could be bought from alternative retail vendors or the internet service could be used with different equipment.

**Criterion 2 : Distinct within the context of the contract**

- T Ltd. Does not provide a significant integration service.
- The modem, router and internet services do not modify or customise one another.
- T could benefit from the internet services using routers and modems that are not sold by T Ltd. Therefore, the modem, router and internet services are not highly dependent on or highly inter-related with each other.

**QUESTION 4**

V Ltd. Grants Customer C a three-year licence for anti-virus software. Under the contract, V Ltd. Promises to provide C with when-and-if-available updates to that software during the licence period. The updates are critical to the continued use of the anti-virus software. Determine how many performance obligations does the entity have?

**SOLUTION:**

V Ltd. Concludes that the licence and the updates are capable of being distinct because the anti-virus software can still deliver its original functionally during the licence period without the updates. C can also benefit from the updates together with the licence transferred when the contract is signed.

However, V Ltd. Concludes that the licence and the updates are not separately identifiable because the software and the service are inputs into a combined item in the contract - i.e. the nature of V Ltd.'s promise is to provide continuous anti-virus protection for the term of the contract. Therefore, V Ltd. Accounts for the licence and the updates as a single performance obligation.
QUESTION 5

Media Company P Ltd. Offers magazine subscriptions to customers. When customers subscribe, they receive a printed copy of the magazine each month and access to the magazine’s online content.

Determine how many performance obligations does the entity have?

SOLUTION:

P evaluates whether the promises to provide printed copies and online access are separate performance obligations. P determines that the arrangement includes two performance obligations for the following reasons:

• The printed copies and online access are both capable of being distinct because the customer could use them on their own.
• The printed copies and online access are distinct within the context of the contract because they are different formats so they do not significantly customise or modify each other, nor is there any transformative relationship into a single output.

QUESTION 6: IMPLIED PROMISE TO RESELLER’S CUSTOMERS

Software Company K Ltd. enters into a contract with reseller D, which then sells software products to end users. K Ltd. has a customary business of providing free telephone support to end users without involving the reseller, and both reseller and the customer expect K Ltd. to continue to provide this support.

Determine how many performance obligations does the entity K Ltd. have?

SOLUTION:

In evaluating whether the telephone support is a separate performance obligation, K Ltd. notes that the promise to provide telephone support free of charge to end users is considered a service that meets the definition of a performance obligation when control of the software product transfers to D. As a result, K Ltd. accounts for the telephone support as a separate performance obligation in the transaction with D.

QUESTION 7 – IMPLIED PERFORMANCE OBLIGATION

Carmaker N Ltd. has a historical practice of offering free maintenance services – e.g. oil changes and tyre rotation – for two years to the end customers of dealers who buy its vehicles. However, the two years’ free maintenance is not explicitly stated in the contract with its dealers, but it is typically stated in N’s advertisements for the vehicles.

Determine how many performance obligations does the entity have?
**SOLUTION:**

The maintenance is treated as a separate performance obligation in the sale of the vehicle to the dealer. Revenue from the sale of the vehicle is recognised when control of the vehicle is transferred to the dealer. Revenue from the maintenance services is recognised separately as and when the maintenance services are provided to the retail customer.

**QUESTION 8**

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.

Determine the amount of revenue to be recognised in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

**SOLUTION:**

Allocated price per unit (year) is calculated as follows:

- Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175
- Total consideration is ₹ 12,00,000 \((100 \times 7,500) + (50 \times 6,000) + (25 \times 6,000)\)
- Allocated price per membership is ₹ 6,857 approx. \(\frac{12,00,000}{175}\)

Basis on above, it is to be noted that although entity has collected ₹ 7,500 but revenue can be recognised at ₹ 6,857 approx. per membership and remaining ₹ 643 should be recorded as contract liability against option given to customer for renewing their membership at discount.

**QUESTION 9**

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?

**SOLUTION:**

D Ltd. is primarily responsible for fulfilling the promise to provide advertising services. Although F Ltd. delivers the placement service, D Ltd. directly works with customers to ensure that the services are performed to their requirements. Even though D Ltd. does not bear inventory risk and does not have discretion in setting the price, it controls the advertising services before they are provided to the customer. Therefore, D Ltd. is a principal in this case.

**QUESTION 10: WARRANTY**

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 ₹ 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are ₹ 32,000 and ₹ 4,000, respectively. The inventory value of the computer is ₹ 14,400. Furthermore, the entity estimates that, based on its experience, it will incur ₹ 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty.

Pass required journal entries.

**SOLUTION:**

The entity will record the following journal entries:

<table>
<thead>
<tr>
<th>Description</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash / Trade receivables</td>
<td>Dr. 36,000</td>
<td></td>
</tr>
<tr>
<td>Warranty expense</td>
<td>Dr. 2,000</td>
<td></td>
</tr>
<tr>
<td>To Accrued warranty costs (assurance-type warranty)</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>To Contract liability (service-type warranty)</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>To Revenue</td>
<td>32,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dr.</td>
<td>₹</td>
</tr>
<tr>
<td>------------------------</td>
<td>-----</td>
<td>------</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>14,400</td>
<td>14,400</td>
</tr>
<tr>
<td>To Inventory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The entity derecognises the accrued warranty liability associated with the assurance-type warranty as actual warranty costs are incurred during the first 90 days after the customer receives the computer. The entity recognises the contract liability associated with the service-type warranty as revenue during the contract warranty period and recognises the costs associated with providing the service-type warranty as they are incurred. The entity had to determine whether the repair costs incurred are applied against the warranty reserve already established for claims that occur during the first 90 days or recognised as an expense as incurred.

**QUESTION 11: WARRANTY**

Entity sells 100 ultra-life batteries for ₹ 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 ₹ 1,70,000 of the ₹ 2,00,000 transaction price should be allocated to the batteries and ₹ 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 ₹ 1 per battery.

Pass required journal entries.

**SOLUTION:**

The entity will record the following journal entries:

Upon delivery of the batteries, the entity records the following entry:

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>₹</th>
<th>Dr.</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash / Receivables</td>
<td>2,00,000</td>
<td></td>
<td>1,70,000</td>
<td></td>
</tr>
<tr>
<td>To Revenue</td>
<td></td>
<td></td>
<td>To Contract liability (service warranty)</td>
<td>30,000</td>
</tr>
<tr>
<td>To Contract liability (service warranty)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Warranty expense</td>
<td>10,000</td>
<td></td>
<td>To Accrued warranty costs (assurance warranty)</td>
<td>10,000</td>
</tr>
<tr>
<td>To Accrued warranty costs (assurance warranty)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The contract liability is recognised as revenue over the service warranty period (years 2-5). The costs of providing the service warranty are recognised as incurred. The assurance warranty obligation is used / derecognised as defective units are replaced / repaired during the initial year of the warranty. Upon expiration of the assurance warranty period, any remaining assurance warranty obligation is reversed.

**QUESTION 12: NON-CASH CONSIDERATION – FREE ADVERTISING**

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.

**SOLUTION:**

Y determines that the transaction price is ₹ 1,600, comprising of ₹ 1,000 fixed amount plus the fair value of the advertising slots i.e. ₹ 600.

If the fair value of the advertising slots could not be reasonably estimated, then the transaction price would be ₹ 1,500 i.e. Y would use the stand-alone selling price of the goods or services promised for the non-cash consideration.

**QUESTION 13: CREDITS TO A NEW CUSTOMER**

Customer C is in the middle of a two-year contract with Talco B Ltd., its current wireless service provider, and would be required to pay an early termination penalty if it terminated the contract today. If C cancels the existing contract with B Ltd. and signs a two-year contract with Telco D Ltd. for ₹ 800 per month, then D Ltd. promises at contract inception to give C a non-time credit of ₹ 2,000 (referred to as a ‘port-in credit’). The amount of the port-in credit does not depend on the volume of service subsequently purchased by C during the two-year contract.

Determine the transaction price.

**SOLUTION:**

D Ltd. determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to D Ltd. Since, D Ltd. does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction in the transaction price ₹ 17,200 [(₹ 800 × 24 months) - ₹ 2,000]. D Ltd. will recognise the reduction in the transaction price as the promised goods or services are transferred.
QUESTION 14: DISCRETIONARY CREDIT

Telco G Ltd. grants a non-time credit of ₹ 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?

SOLUTION:

G Ltd. concludes that this is a change in the transaction price and not a variable consideration. Since, the credit does not relate to a satisfied performance obligation, the change in transaction price resulting from the credit is accounted for a contract modification and recognised over the remaining term of the contract. If, in this example, rather than providing a one-time credit, G Ltd. granted a discount of ₹ 5 per month for the remaining contract term, then also G Ltd. would conclude that it was a change in the transaction price. It would apply the contract modification guidance and recognise the credit over the remaining term of the contract.

QUESTION 15

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?

SOLUTION:

The entity assesses the goods or services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of Ind AS 115. The entity concludes that its only performance obligation is to grant the licence. The entity does not have any contractual or implied obligations to change the licensed recording. The licensed recording has significant stand-alone functionality (i.e. the ability to be played) and, therefore, the ability of the customer to obtain the benefits of the recording is not substantially derived from the entity's ongoing activities. The entity therefore determines that the contract does not require, and the customer does not reasonably expect, the entity to undertake activities that significantly affect the licensed recording. Consequently, the entity concludes that the nature of its promise is transferring the licence is to provide
the customer with a right to use the entity’s intellectual property as it exists at the point in time that it is granted. Therefore, the promise to grant the licence is a performance obligation satisfied at a point in time. The entity recognises all of the revenue at the point in time when the customer can direct the use of, and obtain substantially all of the remaining benefits from, the licensed intellectual property.

**QUESTION 16:**

**Assessing the nature of software licence with unspecified upgrades**

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 functionally of the software.

Determine the nature of license.

**SOLUTION:**

Based on the facts given in question it can be concluded that, although the updates and upgrades will change the functionality of the software, they are not activities considered in determining the nature of the entity’s promise in granting the licence. The activities of X to provide updates or upgrades are not considered because they transfer a promised good or service to Y – i.e. updates or upgrades are distinct from the license. Therefore, the software licence provides a right to use the IP that is satisfied at a point in time.

**QUESTION 17:**

**Assessing the nature of a film licence and the effect of marketing activites**

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.

**SOLUTION:**

C would probably conclude that the licence provides a right to use its IP and, therefore, is transferred at a point in time. There is no expectation that C will undertake activities to change the form or functionality of the film. Because the IP has significant stand-alone functionality. C's marketing activities do not significantly affect D’s ability to obtain benefit from the film, nor do they affect the IP available to D.
QUESTION 18:
Assessing the nature of a team name and logo

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?

SOLUTION:

(i) The nature of D’s promise in this contract is to provide M with the right to access the sports team’s IP and, accordingly, revenue from the licence will be recognised over time. In reaching this conclusion, D considers all of the following facts:

- M reasonably expects D to continue to undertake activities that support and maintain the value of the team name and logo by continuing to play games and field a competitive team throughout the licence period. These activities significantly affect the IP’s ability to provide benefit to M because the value of the team name and logo is substantially derived from, or dependent on, those ongoing activities.

- The activities directly expose M to positive or negative effects (i.e. whether D plays games and fields a competitive team will have a direct effect on how successful M is in selling its products featuring the team’s name and logo).

- D’s ongoing activities do not result in the transfer of a good or a service to M as they occur (i.e. the team playing games does not transfer a good or service to M).

(ii) Based on B’s customer business practices, Apparel Maker M probably does not reasonably expect B to undertake any activities to change the form of the IP or to support or maintain the IP. Therefore, B would probably conclude that the nature of its promise is to provide M with a right to use its IP as it exists at the point in time at which the licence is granted.
QUESTION 19

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for ₹ 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 ₹ 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 owned is not recovered from the machinery. The cost of the machinery for G Ltd. is ₹ 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 Ind AS 115?

SOLUTION:

In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.’s ability to pay may be uncertain due to the following reasons:

(a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.’s little experience);

(b) P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and

(c) P Ltd.’s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

In the given case G Ltd. should account for the non-refundable deposit of ₹ 1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract in accordance with
paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

**QUESTION 20**

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 at least ₹ 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?

**SOLUTION:**

Entity I is likely to provide a price concession and accept an amount less than ₹ 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is ₹ 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for ₹ 1.75 million and therefore contract exists.

**QUESTION 21**

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:

<table>
<thead>
<tr>
<th>Price per container</th>
<th>Cumulative sales volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹ 100</td>
<td>1 - 1,000,000 containers</td>
</tr>
<tr>
<td>₹ 90</td>
<td>1,000,001 - 3,000,000 containers</td>
</tr>
<tr>
<td>₹ 85</td>
<td>3,000,001 containers and above.</td>
</tr>
</tbody>
</table>

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 31\textsuperscript{st} March 20X8 for a contract price of ₹ 100 per container.

How should entity J determine the transaction price?

**SOLUTION:**

The transaction price is ₹ 90 per container based on entity J’s estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of ₹ 90. Entity J concludes that based on a transaction price of ₹ 90 per container, it is highly probable that a significant reversal in amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of ₹ 90 per container as each container is sold. Entity J will recognise a liability for cash received in excess of the transaction price for the first 1 million containers sold at ₹ 100 per container (that is, ₹ 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.

For the quarter ended 31\textsuperscript{st} March, 20X8, entity J recognizes revenue of ₹ 63 million (700,000 containers × ₹ 90) and a liability of ₹ 7 million [700,000 containers × (₹ 100 - ₹ 90)]. Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

**QUESTION 22**

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 it estimates of the rebates change.

How should entity K determine the transaction price?

**SOLUTION:**

Entity K records sales to the retailer at a transaction price of ₹ 47.50 (₹ 50 less 25% of ₹ 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.
QUESTION 23

A manufacturer enters into a contract to sell goods to a retailer for ₹ 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract.

Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.

How should the manufacturer determine the transaction price?

SOLUTION:

The transaction price is ₹ 950, because the expected reimbursement is ₹ 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved.

QUESTION 24

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.

<table>
<thead>
<tr>
<th>Price reduction in next six months (₹)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>70%</td>
</tr>
<tr>
<td>₹ 500</td>
<td>20%</td>
</tr>
<tr>
<td>₹ 1,000</td>
<td>10%</td>
</tr>
</tbody>
</table>

Determine the transaction price.
SOLUTION:

After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be ₹4,800 per television - i.e. $(₹ 5,000 \times 70\%) + (₹ 4,500 \times 20\%) + (₹ 4,000 \times 10\%)$.

QUESTION 25

Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either ₹1,10,000 or ₹1,30,000.

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Consideration (₹)</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project completes on time</td>
<td>1,30,000</td>
<td>90%</td>
</tr>
<tr>
<td>Project is delayed</td>
<td>1,10,000</td>
<td>10%</td>
</tr>
</tbody>
</table>

Determine the transaction price.

SOLUTION:

Because there are only two possible outcomes under the contract, C determines that using the most likely amount provides the best prediction of the amount of consideration to which it will be entitled. C estimates the transaction price to be ₹1,30,000, which is the single most likely amount.

QUESTION 26

Franchisor Y Ltd. licenses the right to operate a store in a specified location to Franchisee F. The store bears Y Ltd.’s trade name and F will have a right to sell Y Ltd.’s products for 10 years. F pays an up-front fixed fee. The franchise contract also requires Y Ltd. to maintain the brand through product improvements, marketing campaigns etc. Determine the nature of license.

SOLUTION:

The licence provides F access to the IP as it exists it exists at any point in time in the licence period. That is because:

- Y Ltd. is required to maintain the brand, which will significantly affect the IP by affecting F’s ability to obtain benefit from the brand;
- any action by Y Ltd. may have a direct positive or negative effect on F; and
- these activities do not transfer good or service to F.

Therefore Y Ltd. recognises the up-front fee over the 10-year franchise period.
Example: Penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity.

Similarly, an entity should recognize a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused.

- In contrast, because of commercial pressure or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future.
- The entity can avoid the future expenditure by its future actions (for example by changing its method of operation). In such a case, it has no present obligation for that future expenditure and no provision is recognized.

Example: Fitting smoke filters in a certain type of factory.
Since, the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognized.

Example: Staff retraining as a result of changes in the income tax system
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.

Present obligation as a result of a past obligating event – There is no obligation because no obligating event (retraining) has taken place.

Conclusion – No provision is recognized.

Example: Legal requirement to fit smoke filters
Under new legislation, an entity is required to fit smoke filters to its factories by September 30, 2011. 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, 2011, 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 even either for the cost of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognized for the cost of fitting the smoke filters.

(b) At March 31, 2012, the end of the reporting period

Present obligation as a result of a past obligating event - There is still no obligation for the cost of fitting smoke filters because no obligating even has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating even 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 recognized for the costs of fitting smoke filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed.

Example: Repairs and maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. Ind AS 16, Property, Plant and Equipment gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example: Refurbishment costs - non 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 - There is no present obligation.

Conclusion - No provision is recognized.

The cost of replacing the lignin is not recognized because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognized, the depreciation of the lining takes account of its consumption, i.e. it is depreciated over five years. The re-lining costs then incurred are capitalized with the consumption of each new lignin shown by depreciation over the subsequent five years.
Example: Refurbishment costs – 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 recognized.

The costs of overhauling aircraft are not recognized as a provision for the same reasons as the cost of replacing the lining is not recognized as a provision in Example 14. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity’s future actions – the entity could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognized, the depreciation of the aircraft takes account of the future incidence of maintenance costs, i.e., an amount equivalent to the expected maintenance costs is depreciated over three years.

Example
An entity may not be obliged to remedy the consequences due to causing of environmental damage by it. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

Where details of a proposed new law have yet to be finalized, an obligation would arise only when the legislation is virtually certain to be enacted as drafted. For the purpose of Ind AS 37, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Example: Contaminated land – legislation virtually certain to be enacted
An entity in the oil industry (having 31 March year-end) 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, 2011, 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 recognized for the best estimate of the costs of the clean-up.

**Example: 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 honoring 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 recognized for the best estimate of the costs of clean-up.

**Example: 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 recognized for the best estimate of ninety per cent 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 recognized as a liability when the oil is extracted.

**Example: A Court Case**

After a wedding in 2011-2012, tend 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 2012 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 2013, 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 2012

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 recognized. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 March 2013

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 recognized for the best estimate of the amount to settle the obligation.

Example: A single guarantee

On March 31, 2011, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2011-2012, the financial condition of Entity B deteriorates and at June 30, 2011 entity B files for protection from its creditors. This contract meets the definition of an insurance contract in Ind AS 104, Insurance Contracts, but is within the scope of Ind AS 109, financial Instruments, because it also meets the definition of a financial guarantee contract in Ind AS 109. If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either Ind AS 109 or Ind AS 104 to such financial guarantee contracts. Ind AS 104 permits the issuer to continue its existing accounting policies for insurance contracts if specified minimum requirements are satisfied. Ind AS 104 also permits changes in accounting policies that meet specified criteria. The following is an example of an accounting policy that Ind AS 104 permits and that also complies with the requirements in Ind AS 109 for financial guarantee contracts within the scope of Ind AS 109.
It is assumed that a reliable estimate can be made of any outflows expected.

(a) At March 31, 2011

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - No outflow of benefits is probable at March 31, 2011.

Conclusion - The guarantee is recognized at fair value.

(b) At March 31, 2012

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At March 31, 2012, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation, and (b) the amount initially recognized less, when appropriate, cumulative amortization in accordance with Ind AS 18, Revenue.

- Where there are a number of similar obligations (e.g. Products warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision should be recognized (if the other recognition criteria are met).

Example: Warranties

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 recognized for the best estimate of the cost of making good under the warranty products sold before the end of the reporting period.
Example: Refunds policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. 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, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement – Probable, a proportion of goods are returned for refund.

Conclusion – A provision is recognized for the best estimate of the cost of refunds.

Example

If an entity has an environmental obligation to clean up the drinking water that got contaminated, there might be a number of different ways to carry out this work. Each of these methods would have different probabilities of success and would cost different amounts. In such case, the entity might choose the method which has the most likely possibility of success.

Example

If an entity has to rectify a serious fault in a major plant that it has constructed for a customer, the individual most likely outcome may be for the repair to succeed at the first attempted at a cost of ₹1,000 but a provision for a larger amount is made if there is a significant change that further attempts will be necessary.

**QUESTION 1**

X Shipping Ltd. is required by law to overhaul its shipping fleet once every 3 years. The company’s finance team was of the view that recognizing the cost 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 costs 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?

**SOLUTION:**

A provision is made for a present obligation arising out of a past event. Overhauling does not arise out of past event. Even a legal requirement to overhaul does not make the cost of overhaul a liability, because no obligation exists to overhaul the ships independently of the
company’s future actions - the company could avoid the future expenditure by its future actions for example by selling the ships. So there is no present obligation.

As per the standard, financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to operate in the future. The only liabilities recognized in an entity’s balance sheet are those that exist at the end of the reporting period.

Therefore, the accounting policy of X Shipping Ltd. is not correct. The company should adopt the component approach in Ind AS 16, Property, Plant and Equipment, for accounting for the refurbishment costs.

- An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed.
- A management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.
- An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation.

**QUESTION 2**

X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operation has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made into claims of pollution caused by the entity. If it is found that X Chemical Ltd. has caused contamination, then penalties and fine would be levied on it.

X Chemical Ltd. believes that it has implemented all environmental safety measures to an extent that it is unlikely to cause pollution. Management is not sure whether it has all the information about the entire 20 years. Therefore, neither management nor external experts are able to assess X Chemical Ltd's responsibility until the investigation has completed.

In such situation, how should management of X Chemical Ltd. account for a liability?

**SOLUTION:**

As per the standard in the present case, the available evidence does not support a conclusion that a present obligation exists. However, there is a possible obligation which exists and will be confirmed upon completion of investigations. Therefore, management should disclose the contingent liability for potential penalties and fines that may be imposed if contamination is proved.
QUESTION 3

X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is to be paid if the export incentives are received. As per the accounting policy of X Ltd., it recognizes export incentives when actually realized, on account of the uncertainty in realizing such incentives. Export incentive have not been received for the year 2011-2012, however X Ltd. is hopeful of receiving the export incentives in the year 2012-2013. In the financial statements for 2011-2012, should X Ltd. provide for both base commission and additional commission?

SOLUTION:

So far as the base percentage of sales commission is concerned, it is a present obligation arising out of past events. The obligating event takes place when the sales are made and also since commission is based on percentage of sale, reliable estimation can also be made. Therefore, the base percentage of sales commission should be provided.

However, in respect of additional commission, it is to be paid when the export incentives are recognized and export incentives are recognized only when it is received. Therefore, the obligating event will arise only when export incentives are received. Hence, no provision for additional commission is to be made in financial year 2011-2012. The expectation of X Ltd. to received the export incentives in next year would not make any difference as on 31 March 2012.

QUESTION NO 4

X Sugars Ltd. has entered into a sale contract of ₹ 3,00,00,000 with Y Chocolates Ltd. for the supply of sugar during 2011-2012. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to delivery within the schedule, X Sugars Ltd has to pay 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 Sugar 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?
SOLUTION:

As per the standard, 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 in Ind AS 37.

So X Sugars Ltd. would need to disclose the contingent asset of ₹ 2,12,50,000 (₹ 2,50,00,000 × 85%) at the end of the financial year 2011-2012.

It would also need to make provision of ₹ 30,00,000 towards the claim of Y Chocolates Ltd.

QUESTION NO 5

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 cost of ₹ 1 million would result. If major defects were detected in all products sold, repair cost 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.

SOLUTION:

The expected value of the cost of repairs is:

\[(75\% \text{ of nil}) + (20\% \text{ of } 1 \text{ m}) + (5\% \text{ of } 4 \text{ m}) = ₹ 4,00,000\]

- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considered other possible outcomes.
- Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

QUESTION 6

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?

**SOLUTION**

The obligation should be measured at the present value of outflows i.e., ₹ 30,00,000. Further a risk adjustment of 5% i.e. ₹ 1,50,000 (₹ 30,00,000 x 5%) would be made. So, the liability will be recognised at = ₹ 30,00,000 + ₹ 1,50,000 = ₹ 31,50,000.

**QUESTION NO 7**

X Chemicals Ltd. Engaged in the chemical industry causes environmental damage by dumping waste in the river near its factory. It does not clean up because there is no environmental legislation requiring cleaning up and X Chemicals Ltd. Is causing damage for last 40 years. As at March 31, 2012 the state Legislature has passed a path breaking legislation requiring all polluting factories to clean-up the river water already contaminated. The formal Gazette notification of the law is pending. How should X Chemicals Ltd. Deal with this situation?

**SOLUTION:**

The obligating event is the contamination of water and because of the virtually certainty of legislation requiring cleaning up, an outflow of resources is certain. It is possible to arrive at best estimated cost for the cleanup activity. So, a provision should be recognized in the books of X Chemicals Ltd. For 2011-2012.

**QUESTION NO 8**

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 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 2011-2012, a claim of ₹ 30,00,000 becomes payable to customers by X Beauty Solutions ltd. Account for the claim that becomes payable?

**SOLUTION:**

X Beauty Solutions Ltd. will get reimbursement of ₹ 9,00,000 (₹ 30,00,000 x 30%) from Y Ltd. So, X Beauty Solutions Ltd. should make a provision of ₹ 21,00,000 (₹ 30,00,00 - ₹ 9,00,000) in financial year 2011-2012 and disclose a contingent liability of ₹ 9,00,000. The contingent liability is recognized keeping in view the fact that in case Y Ltd. does not pay, then X Beauty Solutions Ltd. will be liable for the whole claim.
QUESTION 9

X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor’s opinion is that X Telecom Ltd. will lose the case and estimate that liability of ₹1,00,000 may arise in two years. The liability is recognized on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years. How should X Telecom Ltd. calculate the amount of borrowing cost?

SOLUTION:

The discount factor of 10% for 2 years is 0.827. X Telecom Ltd. will initially recognized provision for ₹82,70,000 (₹1,00,00,000 x 0.827)

The discount factor of 10% at the end of year 1 is 0.909. At the end of year 1, provision amount would be ₹90,90,000 (₹1,00,00,000 x 0.909)

As per the standard, the difference between the two present values i.e. ₹8,20,000 is recognized as a borrowing cost in year 1.

At the end of the Year 2, the liability would be ₹1,00,00,000.

The difference between the two present values i.e. ₹9,10,000 (₹1,00,00,000 - ₹90,90,000) is recognized as borrowing cost in year 2.

QUESTION 10

X Packaging Ltd. has two segments, packing division and paper division. In March 2011, the board of directors approved and announced a formal plan to sell the paper division in June 2011. Operating losses of the paper division are estimated to be approximately ₹50,00,000 during the period from April 1, 2011 to the expected date of disposal. Management of X Packaging Ltd. wants to include the future operating loss of ₹50,00,000 in a provision for restructuring in the financial statements for the period ended March 31, 2011. Can X Packaging Ltd. include these operating losses in a provision for restructuring?

SOLUTION:

Standard states that provision should not be made for future operating losses. Since Ind AS 37 prohibits the recognition of future operating losses, so X Packaging Ltd. should not include these future operating losses in a provision for restructuring even though these losses relate to the disposal group.
QUESTION 11

X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at ₹ 50 per unit at a contract price of ₹ 5,00,000. As per the terms of contract, X Metals Ltd. would have to pay ₹ 60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at ₹ 45 per unit.

How should X Metals Ltd. account for this transaction in its books of account in respect of the above contract?

SOLUTION:

These circumstances do indicate an onerous contract. The only benefit to be derived from the purchase contract costing ₹ 5,00,000 are the proceeds from the sale contract, which are ₹ 4,50,000. Therefore a provision should be made for the onerous element of ₹ 50,000, being the lower of cost of fulfilling the contract and the penal cost of cancellation of ₹ 60,000.

QUESTION 12

X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 2011, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalized and agreed by the board of directors in that meeting, which specified the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create constructive obligation that needs a provision for restructuring?

SOLUTION:

As per Ind AS 37, the conditions prescribed are:
(a) There should be a detailed formal plan of restructuring;
(b) Which should have raised valid expectations in the minds of those affected that the entity would carry out the restructuring by announcing the main features of its plans to restructure.
The board of directors did discuss and formalize a formal plan of winding up the operation in the above said state. This plan was communicated to the parties affected and created a valid expectation in their minds that X Cements Ltd. would go ahead with its plans to close down operations in that state. Thus, there is a constructive obligation that needs to be provided at year-end.

**TEST YOUR KNOWLEDGE**

**QUESTION 1**

In 2017, an entity involved in nuclear activities recognizes a provision for decommissioning costs of ₹ million. The provision is estimated using the assumption that decommissioning will take place in 60-70 years time. However, there is a possibility that it will not take place until 100-110 years' time, in which case the present value of the costs will significantly reduced. Draft the note assuming discount rate 2%.

**SOLUTION:**

A provision of ₹ 300 million has been recognized for decommissioning costs. These costs are expected to be incurred between 2077 and 2087; however, there is a possibility that decommissioning will not take place until 2117-2127. If the cost were measured based upon the expectation that they would not be incurred until 2117-2127 the provision would be reduced to ₹ 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.

**QUESTION 2**

An entity is involved in dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of ₹ 100 million. The entity recognizes a provision for its best estimate of the obligation, but discloses none of the information required by the standard. Draft the note.

**SOLUTION:**

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 100 million. If entity has created reasonable provision on the basis of best estimates then it indicates that enterprise has estimation of probable outflows. So directors should disclose the reasons for such provisions.
**QUESTION 3**

X Ltd. is operating in the telecom industry. During the Financial Year 2011-2012, 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 2010-2011 (Assessment Year 2011-2012) 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 2011-2012 itself, the assessment proceedings were complete 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 2011-2012, the appeal had not been heard. The company is not confident whether it 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 judgments, one in favour of the assesse and one against the assesse. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 2011-2012.

**SOLUTION:**

Ind As 37 provides that in rare cases if not clear whether there is a present obligation, for example, in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity should determine whether a present obligation exists at the end of the reporting period by taking account of all available evidence, For example, the opinion of experts. In the present case, the company is not confident that whether it would win the appeal. By taking into account the opinion of the legal counsel, it is not sure that whether the company would win the appeal. On the basis of such evidence, it is more likely than not that a present obligation exists at the end of the reporting period. Therefore the entity should recognize a provision. The company should provide for a liability of ₹ 1,00,00,000.

**QUESTION 4**

An entity is a telecom operator. Laying of cables across the world is a requirement to enable the entity to run its business. Cables are also laid under the sea and contracts are entered into for the same. By virtue of laws of the countries through which the cable passes, the entity is required to restore the sea bed at the end of the contract period. What is the nature of obligation that the entity has in such a case?
SOLUTION:

Paragraph 14 of Ind AS 37 states “A provision shall be recognised when:

(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. If these conditions are not met, no provision shall be recognised.”

Further, with regard to past event paragraph 17 of Ind AS 37 states “A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to setting 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 entity will discharge the obligation.”

On the basis of the above, provision should be recognised as soon as the obligating event takes place because the entity is under legal obligation to restore the sea bed, provided the other recognition criteria stated in paragraph 14 reproduced above are met. Moreover, the amount of the provision would depend on the extent of the obligation arising from the obligating event. In the instant case, an obligating event is the laying of cables under the sea. To the extent the cables have been laid down under the sea, a legal obligation has arisen and to that extent provision for restoration of sea bed should be recognised.

QUESTION 5

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.

SOLUTION:

Paragraph 14 of Ind AS 37 states “A provision shall be recognised when:

(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 estimated can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised.”

In the instant case, assuming that the entity recognises the entire revenue on the sale of first washing machine, a provision for expected cost of meeting the obligation of selling the second machine at discounted price should be recognised because sale of first washing machine is the past event.

Moreover, past experience indicates that customers generally opt of this scheme, therefore, probability of outflow of resources in more likely than not. **Since it is a normal practice which the entity follows, reliable estimate of the amount of meeting the obligation can also be made.**
NEW QUESTIONS ADDED IN STUDY MATERIAL

QUESTION 1

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 31s' 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 31s1 March, 20X1, requiring recognition of provision.

QUESTION 2

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. The time value of money is considered to be material.

Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.

QUESTION 3

U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31s1 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 totaling ₹ 60 lakhs till 30th April 20X2.

What are the provisions that the Company is required to make as per Ind AS 37?

**QUESTION 4**

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 drawback 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?

**QUESTION 5**

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?

**QUESTION 6**

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.
QUESTION NO 1

(Equity settled Share Based payment-service conditions)

ABC Limited granted to its employees, share options with a fair value of INR 5,00,000 on 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 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?

QUESTION NO 2

(Cash settled Share Based payment-Service conditions)

XYZ issued 10,000 share appreciation rights (SARs) that vest immediately to its employees on 1 April, 20X0. The SARs will be settled in cash. At that date it is estimated, using an option pricing model, that the fair value of a SAR is INR 95. SAR can be exercised any time up to 31 March 20X3. At the end of period on 31 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% will be vested only at the end of the 3rd year. Fair values at the end of each period have been given below:

<table>
<thead>
<tr>
<th>Fair value of SAR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Mar-20X1</td>
<td>112</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>109</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>114</td>
</tr>
</tbody>
</table>

Pass the journal entries?

QUESTION NO 3

(Share- based payment with cash alternative)

On 1 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.
**ACCOUNTS**

**Fair values of the shares are as follows:**

<table>
<thead>
<tr>
<th>Shares alternative fair value (with restrictions)</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant date fair value on 1 Jan 20X1</td>
<td>113</td>
</tr>
<tr>
<td>Fair value on 31 Dec 20X1</td>
<td>120</td>
</tr>
<tr>
<td>Fair value on 31 Dec 20X2</td>
<td>132</td>
</tr>
</tbody>
</table>

The employees exercise their cash option at the end of 20X2.

Pass the Journal entries.

---

**QUESTION NO 4**

*(Share based payment - purchase of goods)*

Indian Inc. issued 995 shares in exchange for purchase of an office building. The title was transferred in the of Indian Inc. on 20X1 and shares were issued. Fair value of the office building was INR 2, 00,000 and face value of each share of Indian Inc was INR 100.

Pass the journal entries?

---

**QUESTION NO 5**

*(Share-based payment - services)*

Reliance limited hired a maintenance company of 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 1 April 20X1 and fair value of the service was estimated using market value of similar contracts for INR 1, 00,000. Nominal value per share is INR 10.

Record the transactions?

---

**QUESTION NO 6**

*(Share- based payment- Cash & equity alterantives)*

Tata industries issued Share-based option to one of its key management personal which can bd exercises either in cash or equity and it has following features:

<table>
<thead>
<tr>
<th>Option 1</th>
<th>Period</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of cash settled shares</td>
<td></td>
<td>74,000</td>
</tr>
<tr>
<td>Service conditon</td>
<td>3 years</td>
<td></td>
</tr>
</tbody>
</table>
### Option 11

<table>
<thead>
<tr>
<th>No of equity settled shares</th>
<th>90,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conditions:</strong></td>
<td></td>
</tr>
<tr>
<td>Service</td>
<td>3 years</td>
</tr>
<tr>
<td>Restriction to sell</td>
<td>2 years</td>
</tr>
<tr>
<td><strong>Fair Values</strong></td>
<td></td>
</tr>
<tr>
<td>Equity price with a restriction of sale for 2 years</td>
<td>115</td>
</tr>
<tr>
<td>Fair value grant date</td>
<td>135</td>
</tr>
<tr>
<td>Fair value</td>
<td></td>
</tr>
<tr>
<td>20X0</td>
<td>138</td>
</tr>
<tr>
<td>20X1</td>
<td>140</td>
</tr>
<tr>
<td>20X2</td>
<td>147</td>
</tr>
</tbody>
</table>

Pass the Journal entries?

### QUESTION NO 7

**Equate settle - Non market conditions**

Ankita Holding Inc. grants 100 to each of its 500 employees on 1\textsuperscript{st} 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 INR 122. In 20X1, earnings increased by 10%, and 29 employees left the organization. The company expects that earnings will continue at a similar rate in 20X2 and expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organization in the year 20X2 and 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 increases to desired level and the performance target has been met.
Required:
Determine the expense for each year and pass appropriate journal entries?

**QUESTION NO 8**

**Equity settled - Non market conditions (Reversals)**

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 INR 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?

**QUESTION NO 9**

**Equity Settled - Market based conditions**

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 INR 120.

How should we recognize the transaction?

**QUESTION NO 10**

**Modifications - Equity - settled based payment**

Marathon Inc. issued 150 share options to each of its 1,000 employees subject to the service conditions of 3 years. Fair value of the option given was calculated at INR 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 INR 50.
After the re-pricing they are worth INR 80, hence expense is expected to increase by INR 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?

**QUESTION NO 11**

**Cancellation-Equity Settled Share based payment**

Anara Fertilisers' Limited issued 2000 share options to its 10 directors for an exercise price of INR 100. The directors are required to stay with the company for company for next 3 years.

- Fair value of the option estimated: INR 130
- Expected no of Directors to vest the option: 8

During the year 2, there was a crisis in the company and management decided to cancel the such scheme immediately. It was estimated further as below-

- Fair value of option at the time of cancellation was
- Market price of the share at the cancellation date was

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 INR 95 per option to each of 9 directors.

How the cancellation would be recorded?
**QUESTION NO 12 (CONDITIONAL SERVICE PERIOD)**

The following particulars in respect of stock options granted by a company are available:

<table>
<thead>
<tr>
<th>Grant date</th>
<th>April 1,2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employees covered</td>
<td>525</td>
</tr>
<tr>
<td>Number options granted per employee</td>
<td>100</td>
</tr>
<tr>
<td>Vesting condition: Continuous employment for 3 years</td>
<td></td>
</tr>
<tr>
<td>Nominal value per share (Rs.)</td>
<td>100</td>
</tr>
<tr>
<td>Exercise price per share (Rs.)</td>
<td>125</td>
</tr>
<tr>
<td>Fair value per share on grant date (Rs.)</td>
<td>149</td>
</tr>
<tr>
<td>Vesting date</td>
<td>March 31,2009</td>
</tr>
<tr>
<td>Exercise</td>
<td>March 31,2010</td>
</tr>
</tbody>
</table>

**Position on 31/03/07**

(a) Estimated annual rate of departure 2%
(b) Number of employees left = 15

**Position on 31/03/08**

(a) Estimated annual rate of departure 3%
(b) Number of employee left = 10

**Position on 31/03/09**

(a) Number of employees left = 8
(b) Number of employees entitled to exercise option = 492

**Position on 31/03/10**

(a) Number of employees exercising the option = 480
(b) Number of employees not exercising the option = 12

Compute expenses to recognize in each year and show important accounts in books of the company.
QUESTION NO 13 (VESTING BASED ON TARGET OF PROFITS)

The following particulars in respect of stock options granted by a company are available.

<table>
<thead>
<tr>
<th>Grant date</th>
<th>Apriil, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employees covered</td>
<td>500</td>
</tr>
<tr>
<td>Number options granted per employee</td>
<td>100</td>
</tr>
<tr>
<td>Fair value of option per share on grant date (Rs.)</td>
<td>25</td>
</tr>
</tbody>
</table>

The vesting period shall be determined as below:

(a) If the company earns Rs. 120 crore or above after taxes in 2006-07, the options will vest on 31/03/07.

(b) If condition (a) is not satisfied but the company earns Rs. 250 crores or above after taxes in aggregate in 2006-07 and 2007-08, the option will vest on 31/03/08.

(c) If conditions (a) and (b)are not satisfied but the company earns Rs. 400 crores or above after taxes in Aggregate in 2006-07, 2007-08 and 2007-09, the options will vest on 31/03/09

Position on 31/03/07

(a) The company earned Rs. 115 crore after taxes in 2006-07
(b) The company expects to earn Rs. 140 crores in 2007-08 after taxes
(c) Expected vesting date: March 31,2008
(d) Number of employees expected to be entitled to option = 474

Position on 31/03/08

(a) The company earned Rs. 130 crore after taxes in 2007-08
(b) The company expects to earn Rs. 160 crores in 2008-09 after taxes
(c) Expected vesting date: March 31,2009
(d) Number of employees expected to be entitled to option = 465

Position on 31/03/09

(a) The company earned Rs. 165 crore after taxes in 2008-09
(b) Number of employees on whom the option actually vested = 450

Compute expenses to recognize in each year.
QUESTION NO 14
(Vesting Based On Target Of Market Price)

The following particular in respect of stock option granted by a company are available:

<table>
<thead>
<tr>
<th>Grant date</th>
<th>April 1, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employees covered</td>
<td>50</td>
</tr>
<tr>
<td>Number options granted per employee</td>
<td>1,000</td>
</tr>
<tr>
<td>Fair value of option per share on grant date (Rs)</td>
<td>9</td>
</tr>
</tbody>
</table>

The option will vest to employees serving continuously for 3 years from vesting date, provided the share price is Rs. 70 or above at the end of 2008-09.

The estimates of number employees satisfying the condition the condition of continuous employment were 48 on 31/03/07, 47 on 31/03/08. The number of employees actually satisfying the condition of continuous employment was 45.

The share price at the end of 2008-09 was Rs.68

Compute expenses to recognize in each year and show important accounts in books of the company.

QUESTION 15 (EMPLOYEES’ STOCK PURCHASE PLAN)

On April 1, 2015, a Company offered 100 Shares to each of its 500 Employees at Rs.40 per Share. The Employees are given a month to decide whether or not to accept the offer. The Shares issued under the plan shall be subject to lock-in on transfer for 3 years from Grant Date. The market price of Shares of the Company on the Grant Date is Rs.50 per share. Due to pot-vesting restrictions on transfer, this Fair Value of Shares issued under the plan is estimated at Rs.48 per share.

On April 30, 2015, 400 Employees accepted the offer and paid Rs. 40 per share purchased. Nominal Value of each Share is Rs.10. Record the issue of Shares in books of the Company under the aforesaid plan.
1. 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 INR 195 each. There is an expectation 97% of the total 1,000 employees will remain in service at end of 1st year. However, at the end of 2nd year the expected employees to remain in service would be 91% out to the total 1,000 employees. Calculate expense for the year 1 & 2?

2. An entity issued 50 shares each to its 170 employees subject to service Conditions of next 2 Years. The settlement is to be made in cash. Grant date fair value of the share is INR 85 each, however, the fair value as at end of Year, 2nd year were INR 80 & 90 respectively. Calculate expense for years 1 and 2?

3. Company p is a holding company for company B.A Group share- based payment is being organized in which parent issues its own equity-shares for the employees of company B. the details are as below-

<table>
<thead>
<tr>
<th>No. of employees of company B</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant date fair value of share</td>
<td>INR 87</td>
</tr>
<tr>
<td>No. of shares to each employee granted</td>
<td>25</td>
</tr>
<tr>
<td>Vesting conditions</td>
<td>Immediately</td>
</tr>
</tbody>
</table>

Pass the journal entry in the books of company p & company B?

4. Plastic manufacturing company “X” enters into an agreement with company “Y” to purchase 100kg of fiber which will be settled in cash at an amount equal to 10 Shares of X. However, X can settle the contract at any time by paying an amount of amount of current share price less market of fiber .there is no intention of taking delivery of such fiber .How the transaction would be evaluated under Ind As 102?

5. Entity X acquired entity Y in a business combination as per Ind AS 103. There is an existing share-based plan in Y with a vesting condition for 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_

<table>
<thead>
<tr>
<th>Acquisition date fair value of share-based payment plan</th>
<th>INR 300</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of years to vest to vest after acquisition</td>
<td>1 year</td>
</tr>
<tr>
<td>Fair Value of award which replaces existing plan</td>
<td>INR 400</td>
</tr>
</tbody>
</table>

Calculate the share-based payment values as per Ind As 102?
6. An entity p issues share-based payment plan to its employees based on the below details

<table>
<thead>
<tr>
<th>No. of employees</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value at grant date</td>
<td>INR 25</td>
</tr>
<tr>
<td>Market condition</td>
<td>Share price to reach at INR 30</td>
</tr>
<tr>
<td>Service condition</td>
<td>To remain in service until market condition is fulfilled</td>
</tr>
<tr>
<td>Expected completion of market condition</td>
<td>4 years</td>
</tr>
</tbody>
</table>

Define expenses related to such-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.

7. Entity X grants 10 shares each to its 1000 employees on the conditions as mentioned below-
- To remain in service & entity’s profit after tax (PAT) shall reach to INR 100 Million.
- It is expected that PAT should reach opt INR 100 million by end of 3 years.
- Fair value at grant date is INR 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?

8. At 1 January 20X1, Ambani limited grants its CEO an option to take either cash amount equivalent to 990 shares or 800 the minimum service requirement is 2 years. There is a condition to keep the shares for 3 years if shares are opted.

<table>
<thead>
<tr>
<th>Fair values of the shares</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share alternative fair value (with restrictions)</td>
<td>212</td>
</tr>
<tr>
<td>Grant date fair value on 1 January, 20X0</td>
<td>213</td>
</tr>
<tr>
<td>Fair value on 31 December, 20X0</td>
<td>220</td>
</tr>
<tr>
<td>Fair value on 31 December, 20X1</td>
<td>232</td>
</tr>
</tbody>
</table>

The key management exercises his cash at the end of 20X2. Pass journal entries.
9. MINDA issued 11,000 share appreciation rights (SARs) that vest immediately to its employees on 1 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 INR 100. SAR can be exercised any time until 31 March 20X3. It is expected that out of the total employees, 94% at the end of period on 31 March 20X1, 91% at the end of next year will exercise the option. Finally when these were vested, i.e. at the end of the 3rd year, only 85% of the total employees exercised the option.

<table>
<thead>
<tr>
<th>Fair value of SAR</th>
<th>INR</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Mar-20X1</td>
<td>132</td>
</tr>
<tr>
<td>31-Mar-20X2</td>
<td>139</td>
</tr>
<tr>
<td>31-Mar-20X3</td>
<td>141</td>
</tr>
</tbody>
</table>
QUESTION 1

P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 20X1 with a fair value ₹ 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 ₹ 210
- 31st March 20X3 ₹ 220
- 31st March 20X4 ₹ 215
- 31st March 20X5 ₹ 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?

QUESTION 2

(ALREADY DISCUSSED IN RTP NOV 2019....QUESTION 3...REFER RTP VIDEO)

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, 30X1, 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 ₹ 1.20. The fair value increased to ₹ 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 ₹ 0.90, the Directors repriced the option and this caused the fair value to increase to ₹ 1.05. Trading conditions improved in the second half of the year and by 31st March, 20X3 the fair value of an option was ₹ 1.25. QA Ltd. decided that additional cost incurred due to re-pricing 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.
**QUESTION 3**

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 has left. The fair value of the shares on grant date is ₹ 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?

**QUESTION 4**

(ALREADY DISCUSSED IN RTP MAY 2020…..QUESTION 19..REFER RTP VIDEOS)

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 ₹ 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:

<table>
<thead>
<tr>
<th>Year</th>
<th>Fair value at year end</th>
</tr>
</thead>
<tbody>
<tr>
<td>31st December 20X5</td>
<td>12</td>
</tr>
<tr>
<td>31st December 20X6</td>
<td>8</td>
</tr>
<tr>
<td>31st December 20X7</td>
<td>13</td>
</tr>
<tr>
<td>31st December 20X8</td>
<td>12</td>
</tr>
</tbody>
</table>

10% of employees left before the end of 20X6. On 31st December 20X7 (when the intrinsic value of each SAR was ₹ 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 ₹ 12).

How much expense and liability is to be recognized at the end each year? Pass Journal entries.
QUESTION NO 1

An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

SOLUTION

Yes, it is possible for an entity to make an unreserved and explicit statement of compliance with Ind AS, even though the auditor's report contain a qualification because of disagreement on application of Accounting Standard(s), as the preparation of financial statements is the prerogative of the management. In case the management has a bonafide reason to believe that it has complied with the all Ind AS, it can make an explicit and unreserved statement of compliance with the Ind AS.

QUESTION NO 2

Entity XYZ is a large manufacturer of plastic for the local market. On 1 April 2016 the newly elected government unexpectedly abolished all import tariffs, including the 40 percent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency (CU(2)) appreciating significantly against most other currencies. The currency appreciating severely reduced the competitiveness of the entity's products.

Before 2016 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ reported a loss of CU 4,000 for the year ended 31 March 2017. At 31 March 2017, entity XYZ's equity was CU 1,000. Management restructured entity B's operations in the second quarter of 2017. That restructuring helped reduce losses for the third and fourth quarters to CU 400 and CU 380, respectively.

In January 2017 the local plastic industry and labor union lobbied government to reinstate tariffs on plastic. On 15 March 2017, the government announced that it would reintroduce limited plastic import tariffs in 2018. However, it emphasized that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the 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 entity XYZ undertook a going concern assessment at 31 March 2017. Management projects/forecasts
that imposition of a 10 percent tariff on the import of plastic product 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 31 March 2017 annual financial statements?

**SOLUTION**

Going concern is a general feature of Presentation of Financial Statements. As per Ind AS 1, when preparing financial statements, management shall make an assessment of an entity’s ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of 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 shall disclose those uncertainties. An entity is required to disclose the facts, if the financial statements are not prepared on a going concern basis. Along with the reason, as to why the financial statements are not prepared on a going concern basis.

While assessing the going concern assumption, an entity is required to take into consideration all factors covering at least but not limited to 12 months from the end of reporting period.

On the basis of Ind AS 1 and the facts and circumstances of this case, the following disclosure is appropriate:

**QUESTION NO 3**

Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

**SOLUTION**

On the basis of the above, net presentation in the given case would not be appropriate, as it would not reflect substance of the transaction and would detract from the ability of users to transaction. The commission received by the company as an agent is the gross revenue of the company. The amount of commission paid by it to the sub-agent should be considered as an expense and should not be offset against commission earned by it.

**QUESTION NO 4**

Inventory or trade receivables of X Ltd. are normally realized in 15 months. How should X Ltd. classify such inventory/trade receivables: current or non-current or non-current if these are expected to be realized within 15 months?
**SOLUTION**

These should be classified as current.

---

### QUESTION NO 5

B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery.

(a) What is the length of operating cycle?
(b) How should it treat its inventory and debtors?

**SOLUTION**

(a) The length of the operating cycle will be 16 months.
(b) Assuming the inventory and debtors will be realized within normal operating cycle, i.e., 16 months, both the inventory as well as debtors should be classified as current.

---

### QUESTION NO 6

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
- Debtors collection period: 5 months

You are requested to compute the operating cycle of X Ltd.

**SOLUTION**

The operating cycle of X Ltd. will be computed as under:

\[
\text{Raw material stock holding period ÷ Work-in progress holding period ÷ Finished goods holding period ÷ Debtors Collection period = 3 ÷ 1 ÷ 5 ÷ 5 = 14 months.}
\]

---

### QUESTION NO 7

Entity A has two different businesses, real estate and manufacture 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 three to four years. With respect to the businesses, how classification into current and non-current be made?
SOLUTION

As per paragraph 66(a) of Ind AS 1, an asset should be classified as current if an entity expects to realize the same, or intends to sell or consume it in its normal operating cycle. Similarly, as per paragraph 69(a) of Ind AS 1, a liability should be classified as current if an entity expects to settle the liability in its normal operating cycle. In this situation, where business have different operating cycles, classification of asset/liability as current/non-current would be in relation to the normal operating cycle that is relevant to that particular asset/liability. It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

QUESTION NO 8

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.

SOLUTION

(a) At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realize the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a non-current asset.

(b) Generally, tender deposit/EMD are paid for participation in various bids. They normally become recoverable if the entity does not win the bid. Bid dates are known at the time of tendering the deposit. But until the date of the actual bid, one is not in a position to know if the entity is winning the bid or otherwise. Accordingly, depending on the terms of the deposit if entity expects to realize the deposit if entity expects to realize the deposit within a period of twelve months, it should be classified as current otherwise non-current.

(c) Classification of GST deposits paid to the government authorities in the event of any legal dispute, which is under protest would depend on the facts of the case and the expectation of the entity to realize the same within a period of twelve months. In the case the entity expects these to be realized within 12 months, it should classify such amounts paid as current else these should be classified as non-current.
QUESTION NO 9

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 payments 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?

SOLUTION

Ind AS 1 provides “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.”

QUESTION NO 10

An entity has taken a loan facility from a bank that is to be paid within a period of 9 months from 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?

SOLUTION

(a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liabilities for at least twelve months after the reporting period, the loan should be classified as non-current.

(b) Yes, the answer will be different if the arrangement for roll over agreed upon the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does
not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.

(c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.

(d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS1, 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.

QUESTION NO 11

In December 2001 an entity entered into a loan agreement with a bank. The loan is repayable in three equal installments starting from December 2005. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24, 2002, failing which the loan becomes payable on demand. As on March 24, 2002, the entity has not been able to get the promoter’s contribution. On March 25, 2002, the entity approached the bank and obtained a grace period up to June 30, 2002 to get the promoter’s contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends of March 31, 2002

(a) As on March 31, 2002, 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 2002, the entity approached the bank and got the compliance date extended up to June 30, 2002 for getting promoter’s contribution. In this case will the loan classification as on March 31, 2002 be different from (a) above?

SOLUTIONS

(a) Paragraph 75 of Ind AS 1, inter alia, provides, “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.” In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 2002, the loan will be classified as current.
(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 2002, i.e. after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 2002, the loan will retain its classification as non-current.

**QUESTION NO 12**

A Limited has prepared the following draft balance sheet as on 31st March 2011:

(₹ in crores)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>March 31, 2011</th>
<th>March 31, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>250</td>
<td>170</td>
</tr>
<tr>
<td>Cash equivalents</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>Non-Controlling interest’s share of profit for the year</td>
<td>160</td>
<td>150</td>
</tr>
<tr>
<td>Dividend declare by A Limited</td>
<td>90</td>
<td>70</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,300</td>
<td>1,800</td>
</tr>
<tr>
<td>Inventory at cost</td>
<td>1,500</td>
<td>1,650</td>
</tr>
<tr>
<td>Inventory at fair value less cost to complete and sell</td>
<td>180</td>
<td>130</td>
</tr>
<tr>
<td>Investment property.</td>
<td>3,100</td>
<td>3,100</td>
</tr>
<tr>
<td>Property, plant and equipment (PPE) at cost</td>
<td>5,200</td>
<td>4,700</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12,850</td>
<td>11,800</td>
</tr>
<tr>
<td><strong>CLAIMS AGAINST ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term debt (₹ 500 crores due on 1st January each year)</td>
<td>3,300</td>
<td>3,885</td>
</tr>
<tr>
<td>Interest accrued on long term debt (due in less than 12 months)</td>
<td>260</td>
<td>290</td>
</tr>
<tr>
<td>Share Capital</td>
<td>1,130</td>
<td>1,050</td>
</tr>
<tr>
<td>Retained earnings at the beginning of the year</td>
<td>1,875</td>
<td>1,740</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>1,200</td>
<td>830</td>
</tr>
<tr>
<td>Non-controlling interest</td>
<td>830</td>
<td>540</td>
</tr>
<tr>
<td>Accumulated depreciation on PPE</td>
<td>1,610</td>
<td>1,240</td>
</tr>
<tr>
<td>Provision for doubtful receivables</td>
<td>200</td>
<td>65</td>
</tr>
</tbody>
</table>
Prepare a balance sheet using current and non-current classification in accordance with Ind AS 1. Assume operating cycle is 12 months.

**SOLUTION**

**A Limited**

**Balance Sheet as at 31st March 2011**

(₹ in crores)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>March 31, 2011</th>
<th>March 31, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Property, plan and equipment (Refer Note 5)</td>
<td>3,590</td>
<td>3,460</td>
</tr>
<tr>
<td>(b) Investment property</td>
<td>3,100</td>
<td>3,100</td>
</tr>
<tr>
<td><strong>Total non-current assets</strong></td>
<td>6,690</td>
<td>6,560</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Inventory (Refer Note 6)</td>
<td>1,680</td>
<td>1,780</td>
</tr>
<tr>
<td>(b) Financial assets Trade and other receivables (Refer Note 7)</td>
<td>2,100</td>
<td>1,735</td>
</tr>
<tr>
<td>(c) Cash and cash equivalents (Refer Note 8)</td>
<td>320</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>4,100</td>
<td>3,715</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>10,790</td>
<td>10,275</td>
</tr>
</tbody>
</table>
## Equity & Liabilities

### Equity attributable to owners of the parent

<table>
<thead>
<tr>
<th></th>
<th>2023</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>1,130</td>
<td>1,050</td>
</tr>
<tr>
<td>Other Equity (Refer Note 1)</td>
<td>2,825</td>
<td>2,350</td>
</tr>
<tr>
<td>Non-controlling interests</td>
<td>830</td>
<td>540</td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td><strong>4,785</strong></td>
<td><strong>3,940</strong></td>
</tr>
</tbody>
</table>

### Liabilities

#### Non-current liabilities

<table>
<thead>
<tr>
<th></th>
<th>2023</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Financial Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Borrowings – Long – term debt (Refer Note 2)</td>
<td>2,800</td>
<td>3,385</td>
</tr>
<tr>
<td>(b) Provisions Long – term provisions (environmental restoration)</td>
<td>765</td>
<td>760</td>
</tr>
<tr>
<td><strong>Total non current liabilities</strong></td>
<td><strong>3,565</strong></td>
<td><strong>4,025</strong></td>
</tr>
</tbody>
</table>

#### Current Liabilities

<table>
<thead>
<tr>
<th></th>
<th>2023</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Financial Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Trade and other payables (Refer Note 3)</td>
<td>895</td>
<td>820</td>
</tr>
<tr>
<td>ii. Current portion of long-term debt (Refer Note 4)</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>iii. Interest accrued on long-term debt</td>
<td>260</td>
<td>290</td>
</tr>
<tr>
<td>(b) Provision</td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Warranty provision</td>
<td>600</td>
<td>445</td>
</tr>
<tr>
<td>ii. Other short-term provision</td>
<td>35</td>
<td>25</td>
</tr>
<tr>
<td>(c) Other current liability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends payable</td>
<td>150</td>
<td>230</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>2,440</strong></td>
<td><strong>2,310</strong></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>6,005</strong></td>
<td><strong>6,335</strong></td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td><strong>10,790</strong></td>
<td><strong>10,275</strong></td>
</tr>
</tbody>
</table>
## Working Notes:

<table>
<thead>
<tr>
<th>Notes</th>
<th>Particulars</th>
<th>Basis</th>
<th>Calculation (₹ crores)</th>
<th>Amount (₹ Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Other Equity</td>
<td>Retained earnings at the beginning of the year add Profit for the year less Non-controlling interest's share of profit for the year less Dividend declared by A Limited</td>
<td>1,875 + 1,200 − 160 − 90 (1,740 + 830 − 150 − 70)</td>
<td>2,825 (2,350)</td>
</tr>
<tr>
<td>2</td>
<td>Long-term debt</td>
<td>Long-term debt less Due on 1st January each year</td>
<td>3,300 — 500 (3,885 — 500)</td>
<td>2,800 (3,385)</td>
</tr>
<tr>
<td>3</td>
<td>Trade &amp; other payables</td>
<td>Trade payables add Accrued expenses</td>
<td>880 + 15 (790 + 30)</td>
<td>895 (820)</td>
</tr>
<tr>
<td>4</td>
<td>Current portion of long-term debt</td>
<td>Due on 1st January each year</td>
<td>-</td>
<td>500 (500)</td>
</tr>
<tr>
<td>5</td>
<td>Property, plant and equipment</td>
<td>Property, plant and equipment (PPE) at cost less</td>
<td>5,200 — 1,610 (4,700 — 1,240)</td>
<td>3,590 (3,460)</td>
</tr>
<tr>
<td>6</td>
<td>Inventory</td>
<td>Inventory at cost add Inventory at fair value less cost to complete and sell</td>
<td>1,500 + 180 (1,650 + 130)</td>
<td>1,680 (1,780)</td>
</tr>
<tr>
<td>7</td>
<td>Trade and other receivables</td>
<td>Accounts receivable less Provision for doubtful receivables</td>
<td>2,300 — 200 (1,800 — 65)</td>
<td>2,100 (1,735)</td>
</tr>
<tr>
<td>8</td>
<td>Cash and cash equivalents</td>
<td>Cash and Cash equivalents</td>
<td>250 + 70 (170 + 30)</td>
<td>320 (200)</td>
</tr>
</tbody>
</table>
TEST YOUR KNOWLEDGE

QUESTIONS

(1) 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?

(2) In December 2XX1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 2XX5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2XX2, failing which the loan becomes payable on demand. As on March 24, 2XX2, the entity has not been able to get the promoter's contribution. On March 25, 2XX2, the entity approached the bank and obtained a grace period upto June 30, 2XX2 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, 2XX2.

(a) As on March 31, 2XX2, 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 2XX2, the entity approached the bank and got the compliance date extended upto June 30, 2XX2 for getting promoter’s contribution. In this case will the loan classification as on March 31, 2XX2 be different from (a) above?

ANSWERS

1. Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same, or intends to sell or consume it in its normal operating cycle.

(a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

(b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal
operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months \([15 \text{ months} + 13 \text{ months}]\). Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

2. (a) Ind AS 1, inter alia, provides, “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.” In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 2XX2, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 2XX2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 2XX2, the loan will retain its classification as non-current.
QUESTION 1
A retail chain acquired a competitor in March, 20X1 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 20X1 annual financial statements. The business combination accounting was finalised in 20X1 - 20X2 and the provisional fair values were updated. As a result, the 20X0-20X1 comparatives were adjusted in the 20X1-X2 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 20X0?

SOLUTION
An additional statement of financial position is no required because the acquisition had no impact on the entity’s financial position at 1st April, 20X0.

QUESTION 2
On 1st April, 20X3 Charming Ltd issued 100,000 ₹ 10 bonds for ₹ 1,000,000. On 1st April, each year interest at the fixed rate of 8 per cent per year is payable on outstanding capital amount of the bonds (i.e., 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 ₹ 10 per bond. In its statement of financial position at 31st March, 20X4 How should this be presented in financial statements?

SOLUTION
Charming Ltd must present ₹ 80,000 accrued interest and ₹ 1,00,000 current portion of the non-current bond (i.e. the portion repayable on 1st April, 20X4) as current liabilities. The ₹ 9,00,000 due late than 12 months after the end of the reporting period is presented as a non-current liability.

QUESTION 3
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
Debtors collection period : months

The trade payables of the Company are paid in 12.5 months. Should these be classified as current or non-current?
In this case, the operating cycle of X Ltd. is 14 months. Since the trade payables are expected to be settled within the operating cycle i.e. 12.5 months, they should be classified as a current.

**QUESTION 4**

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?

**SOLUTION**

The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period.

MN Ltd would classify the loan as current because it does not have the right to defer repayments of more than 12 months, regardless of the intentions of both the parties.

The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

**QUESTIONS 5**

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 no 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.

**SOLUTION**

As per para 74 of Ind AS 1 Presentation of Financial Statements where there is a breach of a material provision of a long term loan arrangements on or before the end of the reporting
period with the effect the a the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed after the reporting Period and before the authorization 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.

In the given case, Company B (the lender) agreed for not to demand payment but only after the reporting date and the financial statements were approved for issuance. The financial statements were approved for issuance in the months of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20X2 but could not agree before June 20X2 when financial statements were approved for issuance.

Hence, the liability should be classified as current in the financial statements as at March 31, 20X2.

**QUESTION 6**

Entity a Has undertaken various transitions in the financial year ended March 31, 20X1, Identify and present the transactions in the financial statement as per Ind AS 1.

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remeasurement of defined benefit plans</td>
<td>2,57,000</td>
</tr>
<tr>
<td>Current service cost</td>
<td>1,75,000</td>
</tr>
<tr>
<td>Changes in revaluation surplus</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Gains and losses arising from translating the monetary assets in foreign currency</td>
<td>75,000</td>
</tr>
<tr>
<td>Gains and losses arising from translating the financial statements of a foreign operation</td>
<td>65,000</td>
</tr>
<tr>
<td>Gains and losses from investments in equity instruments designated at fair value through other comprehensive income</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>35,000</td>
</tr>
<tr>
<td>Share based payment cost</td>
<td>3,35,000</td>
</tr>
</tbody>
</table>
Items impacting the Statement of Profit Loss for the year ended 31\textsuperscript{st} March, 20X1 (₹)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current service cost</td>
<td>1,75,000</td>
</tr>
<tr>
<td>Gains and losses arising from translating the monetary assets in</td>
<td>75,000</td>
</tr>
<tr>
<td>foreign currency</td>
<td></td>
</tr>
<tr>
<td>Income tax expense</td>
<td>35,000</td>
</tr>
<tr>
<td>Share based payments cost</td>
<td>3,35,000</td>
</tr>
</tbody>
</table>

Items impacting the other comprehensive income for the year ended 31\textsuperscript{st} March, 20X1 (₹)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remeasurement of defined benefit plans</td>
<td>2,57,000</td>
</tr>
<tr>
<td>Changes in revaluation surplus</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Gains and losses arising from translating the financial statements of a foreign operation</td>
<td>65,000</td>
</tr>
<tr>
<td>Gains and losses from investments in equity instruments designate at fair value through other comprehensive income</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>
**Ind AS - 01: PRESENTATION OF FINANCIAL STATEMENTS**

**NEW QUESTIONS ADDED IN STUDY MATERIAL**

**QUESTION 1**

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.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Matters</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>There are qualifications in the audit report of the Company with reference to two Ind AS.</td>
</tr>
<tr>
<td>(ii)</td>
<td>Is it mandatory to add the word “standalone” before each of the components of financial statements?</td>
</tr>
<tr>
<td>(iii)</td>
<td>The Company is Indian Company and preparing and presenting its financial statements in ₹. Is it necessary to write in the financial statements that the financial statements has been presented in ₹.</td>
</tr>
<tr>
<td>(iv)</td>
<td>The Company is having turnover of ₹ 180 crores. The Company wants to present the absolute figures in the financial statements. Because for tax audit purpose, tax related fillings and other internal purposes, Company always need figures in absolute amounts.</td>
</tr>
<tr>
<td>(v)</td>
<td>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.</td>
</tr>
</tbody>
</table>

Evaluate the above matters with respect to preparation and presentation of general purpose financial statement.
QUESTION 2

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. It 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?

QUESTION 3

A Company while preparing the financial statements for Financial Year (FY) 20X1-20X2, erroneously booked excess revenue of ₹ 10 Crore. The total revenue reported in FY 20X1-20X2 was ₹ 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?
**QUESTION 4**

XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. This 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 book place during financial year 20X1-20X2.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Items / transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>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.</td>
</tr>
<tr>
<td>(ii)</td>
<td>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.</td>
</tr>
<tr>
<td>(iii)</td>
<td>The Company was awarded a contract of ₹ 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 ₹ 5 crore on March 31, 20X2. The contact 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.</td>
</tr>
<tr>
<td>(iv)</td>
<td>The Company has also given certain contracts to third parties and have received security deposits from them of ₹ 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.</td>
</tr>
</tbody>
</table>

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 ₹ 5 Crore made by the Company with the customers be presented as current?

(iv) Can the security deposit of ₹ 2 Crore taken by the Company from contractors be presented as non-current?
CONCEPT 1: OBJECTIVE

The objective of the standard is to address the accounting for foreign activities which include:

- Transactions in foreign currencies; or
- Foreign operations.

Considering that an entity may present its financial statements in a foreign currency, the standard also seeks to prescribe how to translate financial statements into a presentation currency.

In this contest, the Standard defines foreign currency as a currency other than the functional currency of the entity.

1. **Functional currency** is the currency of the primary economic environment in which the entity operates.
   
   In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates.

2. **Foreign operation** has been defined as an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

3. Presentation currency is the currency in which the financial statements are presented; the presentation currency may be different from the entity’s functional currency.

Types of Currency

- **Foreign currency**
  - A currency other than the functional currency of the entity
- **Functional currency**
  - The currency of the primary economic environment in which the entity operates
- **Presentation currency**
  - The currency in which the financial statements are presented
CONCEPT 2: SCOPE

- **Ind AS Applies to:**
  
  (a) In accounting for transactions and balances in foreign currencies, except for derivative transactions and balances covered by Ind AS 109.

  Foreign currency derivatives not covered by Ind AS 109 (e.g., some foreign currency derivatives that are embedded in other contracts) the scope of this Standard.

  The standard also applies for translation of amounts relating to derivatives form functional currency to presentation currency.

  (b) In translating the results and financial position of foreign operations;

  (c) In translating an entity’s results and financial position into a presentation currency.

- **Ind AS 21 does not apply to:**
  
  (a) Hedge accounting for foreign items, including the hedging of a net investment in a foreign operation; Ind AS 109 should be applied for hedge accounting.

  (b) Presentation of cash flows from transactions in a foreign currency or to translation of cash flows of a foreign operation in the statement of cash flows (refer to Ind AS 7).

- This standard also does not apply to long term foreign currency items for which an entity has opted for the exemption as per Ind AS 101.

- Such an entity may continue to apply the accounting policy as opted for such long term foreign currency monetary items.

CONCEPT 3: FUNCTIONAL CURRENCY

- An entity measures its assets, equity, income and expenses in its functional currency.

- All transactions in currencies other than the functional currency are foreign currency transactions.

**Ind AS 21 requires each entity to determine its functional currency.**

- In determining its functional currency, an entity emphasizes the currency that determines the pricing of the transactions that it undertakes, rather than focusing on the currency in which those transactions are denominated.

- The following are the factors that may be considered in determining an appropriate functional currency:

  (a) The currency that mainly influences sales prices for goods and services; this often will be the currency in which sales prices are denominated and settled;
(b) The currency of the country whose competitive and regulations mainly determine the sales prices of its goods and services; and

(c) The currency that mainly influences labour, material and other costs of providing goods and services; often this will the currency in which these costs are denominated and settled.

(d) Other factors that may provide supporting evidence to determine an entity’s functional currency are:

(e) The currency in which receipts from operating activities are usually retained. If an entity is a foreign operation, additional factors are set out in the standard which should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch associate or joint venture:

(a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy.

If the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it, this will be an example of the former. An example of the latter is when the foreign operations accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency;

(b) Transactions with the reporting entity as a proportion of the foreign operation’s activates;

(c) Impact of cash flows from the activates of the foreign operations on the cash flows of the reporting entity and whether such cash flows are readily available for remittance;

(d) Whether cash flows from the activities of the foreign operation are sufficient of service existing and normally expected debt obligation without funds being made available by the reporting entity.

In practice, the functional currency of a foreign operation that is integral to the group will usually be the same as that of the parent.

• Management will be required to use its judgment to determine the functional currency for which they have to give priority to the primary indicators before considering the other indicators which are designed to provide additional supporting evidence to determine an entity’s functional currency.

**QUESTION 1**

Future Ltd. sells a revitalizing 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 drink are denominated in USD. All
financing activities of future Ltd. are in its local currency ($), future Ltd. are denominated in $ what is the functional currency of future Ltd.?

**SOLUTION**

The functional currency of future Ltd. is the $ looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the $. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

**QUESTION 2**

Small India private Limited a subsidiary of Big Inc., takes orders from Indian customers for Bing's merchandise and then bills and collects for the sale of merchandise. 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. What is Small's functional currency?

**SOLUTION**

Small, although based in India with its cash inflows generated within India, is essentially a “pass through company” established by its parent. Small is totally reliant on big for financing and goods to be sold, despite the fact that goods are sold within India Rupees. Therefore, Small is not a self-contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India private Limited would have the US Dollar as its functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

**BRIEF APPROACH UNDER THE STANDARD**

The following is a summary of the approach under Ind AS 21 to foreign currency translation:

- **Determine the functional currency of the entity**- Each entity, whether a stand-alone entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch) should determine its functional foreign currency transactional (i.e., transactions not in entity's functional currency) are translated into the entity's functional currency at the transaction date.

- **Translation of assets and liabilities denominated in foreign currency at the reporting date**- At the reporting date assets and liabilities denominated in foreign currency are
Monetary items: at the exchange rate at the reporting date i.e., closing date.
Non-monetary items measured at historical cost: not retranslated/restated.
Non-Monetary items measured at value: at the exchange rate on the date of fair value determination.

- A reporting entity may comprise branches, subsidiaries, associates or joint ventures. The functional currency of each entity should be determined separately. This may or may not be the same as the reporting entity.
- The Standard permits an entity to present its financial statements in any currency (or currencies). Accordingly, the financial statements of the parent, branches, subsidiaries, associates and joint ventures to be translated into group presentation currency by any of the following two methods:

  **Step by step method:** Financial operations translated into functional currency of any Intermediate parent which is then translated into functional currency of any intermediate parent which is then translated into functional currency (or presentation currency, if different) of the ultimate parent.

  **Direct method:** Financial operations translated into functional currency (or presentation currency, if different) of the ultimate parent.

- Overall result is the presentation of the financial statements of the entity (or its consolidated financial statements) being presented in functional currency (or presentation currency, if different) of the parent entity.

**CONCEPT 4: ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS**

**Initial Recognition at the Transaction date**

- A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency (i.e., a currency other than the functional currency of the entity), including transactions arising when an entity:
  
  (a) Buys or sells goods or services whose price is denominated in a foreign currency;
  
  (b) Borrows or lends funds with amounts denominated in a foreign currency; or
  
  (c) Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

- A foreign currency transaction is initially recorded by translation in the entity’s functional currency at the exchange rate on the transaction date (or at rate that approximates the actual exchange rate.)
An average exchange rate for a specific period may be used as an approximate rate if the exchange rate does not fluctuate significantly.

Subsequent Recognition at the end of each reporting period

At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:

(a) Monetary items are translated at the exchange rate at the at the reporting date i.e., closing rate;

(b) Non-monetary items measured at historical cost are not retranslated and instead remain at the exchange rate at the date of the transaction; and

(c) Non-monetary items measured at fair value in a foreign currency are translated at the exchange rate on the fair value was determined.

The carrying amount of the item to be translated is determined applying the relevant Accounting Standard.

For example, property, plant and equipment may be measured at fair value or historical cost as per Ind AS 16, property, plant and Equipment.

The carrying amount so determined, be it on the basis of historical cost or fair value, if in foreign currency, is translated into the functional currency in accordance with this Standard.

In some cases, the carrying amount of items is determined by comparing two or more amounts e.g.:

♦ Inventories-measured at lower of cost and net realisable value.
♦ Asset subject to impairment loss-lower of an asset's carrying amount and its recoverable amount.

If such an asset is non-monetary and measured in a foreign currency, then for the comparison:

(a) The cost or carrying amount. As appropriate, is translated at the exchange rate at the date when that amount was determined; and

(b) The net realisable value or recoverable amount. As appropriate, is translated at the exchange rate at date when that value was determined.

The above may result in an impairment loss being recognised in the functional currency but not in the foreign currency. Or versa.

Where a country has multiple exchange rates, the rate used is that is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flow had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.
Recognition of Foreign exchange Gains and Losses

- When an entity directly enters into foreign currency transactions, it is exposed to the cash flow effects of changes in value of the foreign currency. An entity is required to convert foreign currency items into its functional currency for recording those items in its books of account as per the requirements of this standard. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. Once recorded, exchange differences will arise where change in exchange rates affect the recorded balances.

- Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

- When the transaction occurs and settles within the same accounting period, all the exchange entity's net investment in that operation because an associate is not a group entity.

- Exchange differences arising on monetary item that forms part of a reporting entity's net investment in a foreign operation have to be recognised in profit or loss in the separate financial statements of the reporting entity and/or the individual financial statements of the foreign operation, as appropriate:
  - If such an item is denominated in the functional currency of the reporting entity. An exchange difference arises in the foreign operation's individual financial statements.
  - If such an item is denominated in the functional currency of the foreign operation. An exchange difference arises in the reporting entity's separate financial statements.
  - If such an item is denominated in a currency other than the functional currency
of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements.

- In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a subsidiary, associate or joint venture), such exchange differences are recognised initially in other comprehensive income and then reclassified from equity to profit or loss on disposal of the net investment.

**QUESTION NO 3**

Functional currency of parent p is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. AT the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P has lent an amount of EURO 500 to that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

**SOLUTION**

The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was no due for three years (for example) of even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by P on the EURO 500 loan should be recognised in profit or loss in P's separate financial statement, but recognised in other comprehensive income and presented within equity in the consolidated financial statements.

**QUESTION NO 4**

Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P.T gives the loan to S. Where should the exchange differences recognised?

**SOLUTION**

![Diagram](image-url)
Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This in the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T’s functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

**CONCEPT 5: TRANSLATION OF FOREIGN OPERATIONS**

The guidance provided on determining an entity’s functional currency equally applies to determine the functional currency of a foreign operation of the entity.

Effectively, translation procedures those for translating foreign operations are the same as those followed when an entity presents its financial statements in presentation currency that is different from its functional currency;

(a) assets and liabilities are translated at the exchange rate at the reporting date;
(b) items of income and expense are translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;
(c) The resulting exchange differences are recognised in other comprehensive income and are presented in a separate component of equity (generally referred to as the foreign currency translation reserve or currency translation adjustment) until disposal of the foreign operation; and
(d) Cash flows are translated at exchange rates at the dates of the relevant transactions, although an appropriate average rate may be used.

- In addition to the exchange difference as stated above, the foreign currency translation reserve may include exchange differences arising from loans that form part of the parent’s net investment in the foreign operation and gains and losses related to hedges of net investment in a foreign operation.

**DIFFERENCE IN THE REPORTING DATES**

When there is difference in the year end of foreign operation and that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity’s financial statements. When such financial statements are not prepared, Ind AS 27 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. A similar approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with Ind AS 28, Investment in Associates and Joint Venture.
CONCEPT 6: INTRA-GROUP TRANSACTIONS

- Although in intra-group balances are eliminated on consolidation, any foreign exchange gains or losses will not be eliminated, this is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.

- Accordingly, in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra-group transactions in recognised in the statement of profit or loss account unless it arises form on a monetary item that form part of a reporting entity’s net investment in a foreign operation in which case it is taken to other comprehensive income and accumulated in a separate component of equity and reclassified to profit or loss only on disposal of the foreign operation.

QUESTION NO 5

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = EURO 2. At year-end, the amount is still due and the exchange rate is USD 1 = EURO 2.2. How should the exchange differences be accounted for in the consolidated financial statements?

SOLUTION

At year-end, S should revalue its accounts payable to EURO 220 recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P books the balance receivable from S will USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary’s statement of profit and loss has no equivalent gain in the parent’s financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

The reason for this is that intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

Example

Parent P has a functional currency of USD, and Subsidiary S has a functional currency of EURO. P whose reporting date is March 31, lends USD 100 to S on September 30, 2016. S converted the cash received into EURO on Receipt.
\[
\begin{array}{llllllll}
\text{USD} & \text{EURO} \\
\hline
\text{Exchange rate at September 30, 2016} & \ 1 & = & 1.5 \\
\text{Exchange rate at March 31, 2017} & \ 1 & = & 2.0 \\
\text{Entries in the books of account of S} & \text{Debit} & \text{Credit} \\
& (\text{EURO}) & (\text{EURO}) \\
\text{Date} & \text{particulars} & \text{Debit (EURO)} & \text{Credit (EURO)} \\
\text{September 30, 2016} & \text{cash A/c} & \text{Dr.} & 150 \\
& & \text{To Intra-group payable} & 150 \\
& & & (\text{To recognise Intra-group loan}) \\
\text{March 31, 2017} & \text{Exchange loss A/c} & \text{Dr.} & 50 \\
& & & 50 \\
& & & (\text{To recognise exchange loss on intra-group loan}) \\
\end{array}
\]

In S’s second entry, the liability is remeasured at March 31, 2017 and a translation loss is recorded.

The following entry is recorded by P:

\[
\begin{array}{llllllll}
\text{Debit (USD)} & \text{Credit (USD)} \\
\hline
\text{Intra-group receivable} & \text{Dr.} & 100 \\
\text{To Cash} & & 100 \\
\end{array}
\]

(To recognise intra-group loan on issue)

On consolidation at March 31, 2017 the EURO 200 Will convert to USD 100 And the receivable and payable will be eliminated. However, an exchange loss equivalent to EURO 50 For the year ending March 31, 2017 will remain on consolidation, This is appropriate because S will need to obtain USD in order to repay the liability, therefore, the group as a whole has a foreign currency exposure. It is not appropriate to transfer the exchange loss to equity on consolidation unless the loan form part of P’s net investment in S.

**CONCEPT 7: GOODWILL AND FAIR VALUE ADJUSTMENTS ARISING FROM A BUSINESS COMBINATION**

- Goodwill and fair value acquisition accounting adjustments arising from a business combination are treated as assets and liabilities of the foreign operation.
- Hence they are expressed in the functional currency of the foreign operation and should be translated at the closing exchange rate as is the case for other assets and liabilities.
**CONCEPT 8: DISPOSAL OR PARTIAL DISPOSAL OF FOREIGN OPERATIONS**

**Full Disposal**

- A disposal may arise, for example, through sale, liquidation or repayment of share capital. On disposal of the foreign operation, the cumulative exchange difference relating to that foreign operation recognised in other comprehensive income and accumulated separately in equity are reclassified to profit or loss (reclassification adjustment) when the gain or loss on disposal is recognised.

- On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the non-controlling interests forms part of the non-controlling interests that is derecognised and is included in the calculation of the gain or loss on disposal, but it is not reclassified to profit or loss.

- In addition to the disposal on an entity's interest in a foreign operation, the following are accounted for as disposals even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity:
  - The loss of control of a subsidiary that includes a foreign operation;
  - The loss of significant influence over an associate that includes a foreign operation; and
  - The loss of joint arrangement over a jointly controlled entity that includes a foreign operation.

*Example:*

Parent P owns 100 percent of subsidiary S. P sells 70 percent of its investment and loses control of S. The entire balance in the foreign currency translation reserve in respect of S is reclassified to profit or loss.

**Partial disposal**

A partial disposal of an entity's interest in a foreign operation is any an entity's ownership interest in a foreign operation, except for those reductions that are accounted for as disposals.

In the case of the partial disposal of a subsidiary that includes a foreign operation, the entity reattributes the proportionate share of the cumulative amount of the exchange differences recognised in other income to the NCI in that foreign operation.

In any other partial disposal of foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.
Example:–
Parent P owns 100 percent of subsidiary S. P sells 10 percent of its investment and retains control over S. Therefore, 10 percent of the balance in the foreign currency translation reserve is reclassified to NCI.

Example:–
Parent P owns 35 percent of Associate B. P sells a 5 percent stake and retains significant influence over B. Therefore, One- Seventh (5/35) of the balance in the foreign currency translation reserve is reclassified profit or loss.

A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal.

Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

**TAX EFFECT OF ALL EXCHANGE DIFFERENCES**

Ind AS 12 applies to tax effects of gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency.

**Ind AS 21 requires the following disclosures:**

(a) 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;

(b) 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;

(c) If 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;

(d) In case of change in functional currency of either the reporting entity of a significant foreign operation:

   (i) Fact of such change

   (ii) Reason for the change and:

   (iii) Date of change in functional currency:
(e) If presentation currency is different from functional currency, the financial statements can be described as complying with Ind 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:

(i) The information should be clearly identified as supplementary information to distinguish it from the information that complies with Ind AS;

(ii) The currency in which the supplementary information is displayed should be disclose; and

(iii) The entity’s functional currency and the method of translation used to determine the supplementary information should be disclosed.

**TEST YOUR KNOWLEDGE**

1. Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹1,500 lakh. The net assets of S are 1,000 and the NCI in is ₹100 lakhs. The cumulative exchange differences that have arisen during P’s ownership are gains of ₹200 lakhs, resulting in P’s foreign currency translation reserve in respect of S having a credit balance of ₹180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹20 lakhs.

Calculate P’s gain on disposal.

2. 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 is the statement of financial position of InfoTech Global Ltd. prior to translation:

<table>
<thead>
<tr>
<th></th>
<th>USD</th>
<th>L$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>9,35,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>9,85,000</strong></td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>50,000</td>
<td>30,055</td>
</tr>
<tr>
<td>Opening retained earnings</td>
<td>28,000</td>
<td>15,274</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,40,000</td>
<td></td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>47,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td><strong>9,85,000</strong></td>
<td></td>
</tr>
</tbody>
</table>
Required:
Translate the statement of financial position of InfoTech Global Ltd. into L$ 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 2.22
Average rate for the year L$ 1 = USD 1.175
Rate at end of the year L$ = USD 1.13

Answers to practical questions
1. P’s gain on disposal would be calculated in the following manner

<table>
<thead>
<tr>
<th></th>
<th>₹ (in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>1500</td>
</tr>
<tr>
<td>Net assets of S</td>
<td>-1000</td>
</tr>
<tr>
<td>NCI derecognised</td>
<td>100</td>
</tr>
<tr>
<td>Foreign currency translation</td>
<td>180</td>
</tr>
<tr>
<td><strong>Gain on disposal</strong></td>
<td><strong>780</strong></td>
</tr>
</tbody>
</table>

2. Translation of the financial statements

<table>
<thead>
<tr>
<th></th>
<th>USD</th>
<th>Rate</th>
<th>L$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Plant and equipment</td>
<td>50,000</td>
<td>1.13</td>
<td>44,248</td>
</tr>
<tr>
<td>Receivables</td>
<td>9,35,000</td>
<td>1.13</td>
<td>8,27,434</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>9,85,000</strong></td>
<td></td>
<td><strong>8,71,682</strong></td>
</tr>
<tr>
<td>Issued Capital</td>
<td>50,000</td>
<td></td>
<td>30,055</td>
</tr>
<tr>
<td>Opening retained corning’s</td>
<td>28,000</td>
<td></td>
<td>15,274</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>20,000</td>
<td>1.175</td>
<td>17,021</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>8,40,000</td>
<td>1.13</td>
<td>7,43,363</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>47,000</td>
<td>1.13</td>
<td>41,593</td>
</tr>
<tr>
<td><strong>Total equity and liabilities USD</strong></td>
<td><strong>9,85,000</strong></td>
<td></td>
<td><strong>8,47,306</strong></td>
</tr>
<tr>
<td>Foreign Currency</td>
<td></td>
<td></td>
<td>24,376</td>
</tr>
<tr>
<td>Translation reserve (proof below)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total equity and liabilities L$</strong></td>
<td><strong>8,71,682</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Working of the cumulative balance of the FCTR

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Actual Amount at closing</th>
<th>Translated Amount at closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued 30,055</td>
<td>44,274</td>
<td>14,192</td>
</tr>
<tr>
<td>Opening retained earnings</td>
<td>15,274</td>
<td>24,779</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>17,021</td>
<td>17,699</td>
</tr>
<tr>
<td>[Difference of 1 is rounding]</td>
<td>62,350</td>
<td>86,725</td>
</tr>
</tbody>
</table>
**QUESTION 1**

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 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 its cap presume its function currency to be INR?

**SOLUTION**

No, B cannot presume INR to be its function currency on the basis of its location. It needs to consider various factors listed in Ind AS for determination of function currency.

**Primary indicators:**

1. The currency that mainly influences
   
   (a) Sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

   (b) Labour. Material and other cost of providing goods and services. This will often be the currency in which these cost are determinate and settled.

2. Other factors that may provide supporting evidence to determine an entity’s functional currency are **(Secondary indicators):**

   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generate; and

   (b) the currency in which receipts from operating activities are usually retained.

3. If an entity is a foreign operation, additional factors asset set out in Ind AS 21 should be considered to determine whether its function currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:

   (a) Whether the activities of foreign operations are carried out as an extension of the reporting entity rather than being carried out with a significant degree of autonomy:
(b) Whether the transaction with the reporting entity are a high or a low proportion of the foreign operation’s activities;

(c) Whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it

(d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

On the basis of additional factors mentioned in point 3 above, b cannot be said to have functional currency same as that of A Ltd.

Hence primary and secondary indicators should be used for the determination of functional currency of B giving priority to primary indicators. The analysis is given below:

• Its significant revenues and competitive forces are in USD.
• Its significant portion of cost is incurred in INR. Only 30% costs are in USD.
• 78% of its finances have been raised in USD.
• It retains its operating cash flows partially in USD and partially in NAR.

Keeping these factors in view, USD should be considered as the function currency of B.

**QUESTION 2**

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 company also started corporate tie-up and increased its customer base to corporates also. The purchase of the motor cycles are in USD because the vendor(s) from whom these mother cycles are purchased those are all located in US.

All other operation expense 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 cycles in India are difference from those in other countries.

The company is also expecting that in the coming years, its customers based 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?

**SOLUTION**

The functional currency of S Ltd. is INR.

Following factors need to be considered for determination of functional currency:

**Primary indicators**

1. the currency that mainly influences
   - (a) Sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulation mainly determine the sales prices of its goods and services.
   - (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

2. Other factors that may provide supporting evidence to determine an entity’s functional currency are (Secondary indicators):
   - (a) The currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generate; and
   - (b) The currency in which receipts from operating activities are usually retained.

Primary and secondary indicators should be used for the determination of functional currency of S Ltd. giving priority to primary indicators.

The analysis is given below:

Ind AS 21 gives greater emphases to the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.

Sales prices for motor cycles are mainly influenced by the competitive forces and regulation in India. The market for motor cycles depends on the economic situation in India and the company is in competition with importers of other motor cycle brands.

Even though 70% of the revenue of the company is denominated in USD, India economic conditions are the main factors affecting the Prices. This is evidenced by the fact that USD denominated sales prices in India are different from USD denominated sale prices for the same motor cycles in other countries.

Management is able to determine the functional currency because the revenue is clearly influenced by the India economic environment and expenses are mixed.

On the basis of above analysis, INR should be considered as the functional currency of the company.
QUESTION 3

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 the operations of M Ltd are very large 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 ₹ 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 laying as closing stock with G Ltd. What should be the accounting treatment for the above?

Following additional information is available:

Exchange rate on 1st February, 20X1 1 Euro = ₹ 83
Exchange rate on 31st March, 20X1 Euro = ₹ 85

SOLUTION

Accounting treatment in the books of M Ltd
M Ltd will recognise sales of ₹ 996 lacs (12 lacs Euro X 83)
Profit on sale of inventory = 996 lacs - 830 lacs - ₹ 116 lacs.

Accounting treatment in the books of G Ltd
G Ltd will recognise inventory on 1st February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements
Receivable and payable in respect of above mentioned sale/purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be translated at year end resulting in amount of closing stock of ₹ 1,020 lacs (12 lacs Euro X 85).

The restated amount of closing stock includes three components
Restante amount of cost of inventory for ₹ 850 lacs
Profit element of ₹ 166 lacs; and
Translated amount of profit element of ₹ 4 lacs.

At the time of consolidation, the two elements amounting to ₹ 170 lacs will be eliminated from the closing stock.
**QUESTION 4**

Entity A, whose functional currency is ₹ Has a foreign operation, Entity B, with a Euro functional currency. Entity B issues to A perpetual debt (i.e. it has no maturity) denominated in euros with an annual interest rate of 6 per cent. The perpetual debt has no issuer call option on holder put option thus contractually it is just an infinite stream of interest payments in Euros.

In A’s consolidated financial statements, can the perpetual debt be considered, in accordance with Ind AS 21 a monetary item “for which settlement is neither planned nor likely to occur in the foreseeable future’ (i.e. part of A’s net investment in B) with the exchange gains and losses on the perpetual debt therefore being recorded in equity?

**SOLUTION**

Yes, as per Ind AS 21 net investment in a foreign operation is the amount of the reporting entity’s interest in the net assets of that operation.

As per para 15 of Ind AS 21 an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is planned not likely to occur in the foreseeable future is, in substance, a part of the entity’s net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

**Analysis on the basis of above mentioned guidance**

Through the origination of the perpetual debt, A has made a permanent investment in B. The interest payments are treated as interest receivable by A and interest payable by B, no as repayment of the principal debt. Hence, the fact that the interest payments are perpetual does not mean that settlement is planned or likely to occur. The perpetual debt can be considered part of A’s net investment in B.

In accordance with para 15 of Ind AS 21 the foreign exchange gains and losses should be recorded in equity at the consolidated level because sentiment of that perpetual debt is neither planned nor likely to occur.
**IND AS 21: FOREIGN CURRENCY TRANSACTIONS**

**NEW QUESTIONS ADDED IN STUDY MATERIAL**

**QUESTION 1**

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 $ = ₹ 60. The fair value of the machinery determined on 31st March, 20X1 is $5,500. The exchange rate on 31st March, 20X1 is 1$ = ₹ 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = ₹ 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%

**QUESTION 2**

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= ₹ 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 = ₹ 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.

**QUESTION 3**

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 ₹ 72 per USD and ₹ 75 per USD respectively.
UNIT 1:
BUSINESS VS ASSETS ACQUISITION VS 
BUSINESS COMBINATION

BUSINESS COMBINATION

Under Ind AS 103, Business combination occurs when an entity obtains control of a business by acquiring net assets or acquiring its significant equity interest. An entity can obtain control of a business by contract only in which case the acquirer would neither have acquired net assets nor equity interest. In such a case, while preparing balance sheet, controlling interest would be zero and non-controlling interest will be 100%.

• As such, two elements are required for a transaction to be a business combination under Ind AS 103:
  – the acquirer obtains control of an acquiree (“control” as defined in Ind AS 110); and
  – the acquiree is a business

• A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:
  – one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
  – one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
  – all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
  – a group of former owners of one of the combining entities obtains control of the combined entity.

ELEMENTS OF BUSINESS

Definition of Business

As per paragraph B7 of the application guidance of Ind AS 103, a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business.
Analysis: 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.

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.

   Example:
   Non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the 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 creation of outputs.

   Example:
   Strategic management processes, operational processes and resource management processes.
   These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(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.

**FURTHER ASSESSMENT**
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 processes applied to those inputs.
Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.
Substantive Process:
To determine whether acquired process is substantive, following has to be considered:

(1) If a set of activities and assets does not have output at the acquisition date, an acquired process (or group of processes) shall be considered substantive only if-
   (a) It is critical to the ability to develop or convert an acquired input or inputs into outputs; and
   (b) The inputs acquired include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs.

Those other inputs could include-
   (i) Intellectual property that could be used to develop a good or service;
   (ii) Other economic resources that could be developed to create outputs; or

(2) If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) shall be considered substantive if, when applied to an acquired input or inputs, it-
   (a) is critical to the ability to continue producing outputs, and the inputs acquired include an organised workforce with the necessary skills, knowledge, or experience to perform that process (or group of processes); or
   (b) Significantly contributes to the ability to continue producing outputs and-
      (i) Is considered unique or scarce; or
      (ii) Cannot be replaced without significant cost

**QUESTION 1**

Company X is a liquor manufacturer and has traded for a number of years. The company produces a wide variety of liquor and employs a workforce of machine operators, testers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse and machinery and holds raw material inventory and finished products.

On 1st January 2011, Company Y pays USD 80 million to acquire 100% of the ordinary voting shares of Company X. No other type of shares has been issued by Company X. On the same day, the four main executive directors of Company X take on the same roles in Company Y.

Comment on given transaction whether it is a business acquisition or asset acquisition?
SOLUTION:
In this case, it is clear that Company X is a business. It operates a trade with a variety of assets that are used by its employees in a number of related activities. These assets and activities are necessarily integrated in order to create and sell the company’s products. As per definition the above acquisition includes an input (including four executive directors of company X) and thus it can be concluded as the significant process acquired along with the other inputs.
So, it can be said that Y limited as acquired a business.

QUESTION NO 2 (INVESTMENT IN A DEVELOPMENT STAGE ENTITY)
Company D is a development stage entity that has not started revenue-generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.
The value of the identifiable net assets in Company D is INR 750 million. Company A pays INR 600 million in exchange for 60% of the equity of Company D (a controlling interest).

SOLUTION:
Although Company D is not yet earning revenues (an example of ₹ outputs') there are a number of indicators that it has a sufficiently integrated set of activities and assets that are capable of being managed to produce a return for investors. In particular, Company D:

- Employs specialist engineers developing the know-how and design specifications of the technology.
- Is pursuing a viable plan to complete the development work and commence production.
- Has identified and will be able to access customers willing to buy the outputs
So, company D should be presumed as business.

QUESTION NO 3
(Acquisition of an entity holding investment properties)
Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige
Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P’s leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner.

**SOLUTION:**

In most cases, an asset or group of assets and liabilities that are capable of generating revenues, combined with all or many of the activities necessary to earn those revenues, would constitute a business. However, Investment property is a specific case in which earning a return for investors is a defining characteristic of the asset. Accordingly, revenue generation and activities that are specific and ancillary to an investment property and its tenancy agreements should therefore be given a lower 'weighting' in assessing whether the acquiree is a business.

Further process (i.e. Basic maintenance, security services and administration) is not critical to the ability to continue producing outputs. Also process (i.e. Basic maintenance, security services and administration) is not unique and it can be replaced easily without significant cost.

In our view the purchase of investment property with tenants and services that are purely ancillary to the property and its tenancy agreements should generally be accounted for as an asset purchase.

**QUESTION NO 4**

**(Acquisition of an entity holding investment properties)**

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short term rental agreements that oblige company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease managements tasks (eg identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximize the quality of tenants and the rental income.

**SOLUTIONS:**

In this case, Company Q consists of a group of revenue-generating assets, together with employees and activities that clearly go beyond activities ancillary to the properties and their tenancy agreements.
Further process (i.e. identification and selection of tenants: lease negotiation and rent reviews) is critical to the ability to continue producing outputs (i.e. in terms to maximize quality of tenants and the rental income).

These assets and activities are clearly integrated so Company Q is considered a business.

**QUESTION NO 5**

*(Seller retains some activities and assets)*

Company S is a manufacturer of a wide range of products. The company’s payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions.

Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting costs center or any head office functions. Company A is a competitor of Company S.

**SOLUTION:**

In this case, the activities and assets within the operating segments are capable of being managed as a business and so Company A accounts for the acquisition as a business combination. The payroll and accounting cost centre and administrative head office functions are typically not used to create outputs and so are generally not considered an essential element in the assessment of whether an integrated set of activities and assets is a business or not.

**QUESTION NO 6**

Company A is a pharmaceutical company. Since inception, the company had been conducting in house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company’s has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

Required:

Does Company A constitute a business in accordance with Ind AS 103?

**SOLUTION:**

The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.
When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

**QUESTION NO 7**

Modify the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

**SOLUTION:**

Though the sales force has not been taken over, however, if the missing inputs (i.e. sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

**ASSETS ACQUISITION**

As per the provisions of Ind AS 103, the following points to be considered while making accounting adjustment for assets acquisition:

1. There will be no goodwill or capital reserve at the time acquisition for the difference between price paid and fair value of assets.
2. The Purchase Price of assets will be allocated over the acquired assets in the ratio of fair value of assets.

**QUESTION NO 8**

X Limited purchased from Y limited a group of assets comprising of plant and machinery, furniture, equipment and software at a combined price of 400 lacs. Assets do not constitute business as per Ind AS 103. How would X limited measure these assets for the purpose of initial recognition?
The fair value of these assets determined applying IND AS 113 fair value measurement are:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Fair Value (Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant &amp; Machinery</td>
<td>200</td>
</tr>
<tr>
<td>Furniture</td>
<td>30</td>
</tr>
<tr>
<td>Equipment</td>
<td>50</td>
</tr>
<tr>
<td>License</td>
<td>70</td>
</tr>
<tr>
<td>Total</td>
<td>350</td>
</tr>
</tbody>
</table>

**QUESTION 9 (ASSET ACQUISITION)**

An entity acquires an equipment and a patent in exchange for ₹ 1,000 crore cash and land. The fair value of the land is ₹ 400 crore and its carrying value is ₹ 100 crore. The fair values of the equipment and patent are estimated to be ₹ 500 crore and ₹ 1,000 respectively. The equipment and patent to a product that has just recently been commercialised. The market for this product is still developing.

Assumed the entity incurred no transaction costs. For ease of convenience, the tax consequences on the gain have been ignored. How should the transaction be accounted for?

**SOLUTION:**

As per paragraph 2 (b) of Ind AS 103, the standard does not apply to the acquisition of an asset or a group of assets that does not constitute a business. Such a transaction of event does not give rise to goodwill in the given case, the acquisition of equipment and patent does not represent acquisition of a business.

Thus, the fair value of the consideration given, i.e., ₹ 1,400 crore is allocated to the individual assets acquired based on their relative estimated fair values. The entity should record a gain of ₹ 300 crore for the difference between the fair value and carrying value of the land.

The equipment is recorded at its relative fair value (₹ 500 / ₹ 1,500) × 1,400 = ₹ 467 crore.

The patent is recorded at its relative fair value (₹ 1,000 / ₹ 1,500) × ₹ 1,400, = ₹ 933 Crore).
As per paragraph B7A of the application guidance of Ind AS 103, an optional test (the concentration test) has been introduced to permit a simplified assessment of whether an acquired set of activities and assets is not a business.

On the basis of the above test, following will be the consequences:

- **Test is met**
  - Not a business
  - No further assessment is needed

- **Test is not met**
  - Further assessment to be made

Following conditions should be present to meet concentration test:

As per paragraph B7A of the application guidance of Ind AS 103, 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. 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;

(b) the 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.

(c) 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;

(d) if 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 (for example, land and buildings), those assets shall be considered a single identifiable asset;

(e) 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 (that is, the risk characteristics);

(f) 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 in accordance with the criterion in subparagraph (d);
(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.

Notes:
1) Concentration test is optional test and the decision to apply is made on a transaction to transaction basis.
2) Does not prohibit an entity from performing a detailed test assessment using definition of business given in this standard.
3) 3 Step process for concentration test:
   a) Measure the Fair Value of Gross Assets acquired.
   b) Identify the single identifiable assets or group of similar identifiable asset.
   c) Determine if substantially all of the value determined in point (a) is concentrated in the value determined in point (b) then it is an asset acquisition otherwise needs to assess business definition as per Ind AS 103.

Fair value of gross assets shall be determined as follows (i+ii-iii):
   i) Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held)
   ii) Fair value of liabilities assumed.
   iii) Cash and cash equivalent and deferred tax assets and goodwill resulting from DTL’s.

(REFER LAST VIDEO ON THIS CONCEPT....NO NEED TO READ IT FROM BOOK.... JINDAL SIR HAS EXPLAINED IT IN VERY SIMPLE LANGUAGE....)
QUESTION 10 (CONCENTRATION TEST)

Entity A holds 20% interest in Entity B. Subsequently, Entity A further acquires 50% shares in Entity B by paying 300 crores.

The fair value of assets acquired and liabilities assumed are as follows:

- Building: 1000 crores
- Cash: 200 crores
- Financial liabilities: 800 crores
- DTL: 150 crores

Fair value of Entity B 400 crores and fair value of NCI is 120 crores (400x30%)

Fair value of Entity A previous holding is 80 crores (400x20%)

Identify the given transaction as asset acquisition or business acquisition as per concentration test.
UNIT 2: ACQUISITION METHOD

(IF BUSINESS COMBINATION IS IN THE FORM
OF ACQUISITION OF NET ASSETS)

The following key steps are involved in the acquisition accounting for business combinations:

Step 1: Identifying the acquirer.
Step 2: Determining the acquisition date.
Step 3: Purchase Consideration
Step 4: Recognising and measuring the identifiable assets acquired, the liabilities assumed
Step 5: Recognising and measuring goodwill or a gain from a bargain purchase
Step 6: Recognition of other assets & liabilities

STEP 1: IDENTIFICATION OF ACQUIRER

As per the provisions of IND AS 103, identification of Acquirer is very important because application of IND AS 103 is required to be made only on Acquirer. It means that IND AS 103 is not applicable on Acquiree. It can also be said that this statement lays down principles only for the controlling enterprise. The following cases can be considered for the identification of an acquirer:

CASE 1: Acquisitions through payment of cash or incurring of liability

In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

CASE 2: Acquisitions through issue of equity instrument

In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issue its equity interests. However, in some business combinations, commonly called ‘reserve acquisitions’, the issuing entity is the acquiree. Reverse acquisition has been dealt in a separate section of this chapter.

Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

a. The relative voting rights in the combined entity after the business combination: The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity
shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

b. **The 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**—The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

c. The composition of the governing body of the combined entity—The acquirer is usually the 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.

d. The composition of the senior management of the combined entity—The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

e. **The acquirer is usually the combining entity whose relative size** (measured in, for example, assets, revenues or profit) **is significantly greater than that of the other combining entity or entities.** In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

**QUESTION NO 11**

Company A and Company B operate in power industry and both entities are operating entities. Company A has much larger scale of operations than Company B. Company B merges with Company A such that the shareholders of Company B would receive 1 equity share of company A for every 10 shares held in Company B such issue of shares would comprise 20% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of company A hold 80% of the capital in Company A.

**SOLUTION:**

In this transaction, Company A is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, by merging the entire shareholding of company B, Company A has acquired control over Company B. Further, the shareholders of erstwhile Company B do not obtain control over Company A on account of shares received as part of purchase consideration, as they hold only 20% of the paid-up capital of Company A.
QUESTION NO 12

Company A and Company B operate in power industry and both entities are operating entities. Company A has much smaller scale of operations than Company B. Company B merges Company A such that the shareholders of Company B would receive 10 equity share of Company A for every 1 Share held in Company B. Such issue of share would comprise 70% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 30% of capital of Company A. Post - acquisition, the management of Company B would manage the operations of the combined entity.

SOLUTION:

In this transaction, Company B is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, after merger, the shareholders of erstwhile Company B would have a controlling interest and management of the combined entity. As such, in substance, Company B has acquired control over Company A.

It is important to note that the Company B would be considered as an acquirer for accounting purposes only (i.e., accounting acquirer). For legal purposes as well as for reporting purposes, it is the Company A that would be considered as an acquirer (i.e., legal acquirer).

Appropriate identification of an acquirer is relevant, as the net assets of the accounting acquire (rather than that of the accounting acquirer) are recognized at fair value.

QUESTION 13

ABC Ltd. incorporated a company super Ltd. to acquire 100% shares of another entity Focus Ltd (and therefore to obtain control of the Focus Ltd.). To fund the purchase, Supper Ltd. acquired a loan from XYZ Bank at commercial interest rates. The loan funds are used by Super Ltd. to acquire entire voting share of Focus Ltd. at fair value in orderly transaction. Post the acquisition, Super Ltd. has the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd and also Super Ltd.' management is in a power where it will be able to dominate the management of the Focus Ltd. Can Super Ltd. be identified as the acquirer in this business combination?

SOLUTION:

The key drivers of the accounting are identifying the party on whose behalf the new entity has been formed and identifying the business acquired. In this scenario as Super Ltd. the ability to elect or appoint or to remove a majority of the members of the governing body of the Focus Ltd. and has the ability to dominate the management of the Focus Ltd. Accordingly, Super Ltd. will be identified as the acquirer.
**QUESTION 14**

Company A decided to spin off two of its existing businesses (currently housed in two separate entities, Company B and Company C). To facilitate the spin off, Company A incorporate a new entity (Company D) with nominal entity and appoints independent directors to the board of Company D. Company D signs an agreement to purchase companies B & C in cash, conditional on obtaining sufficient funding. To fund these acquisitions, Company D issues a prospectus offering to issue shares for cash.

At the conclusion of the transaction, Company D has owned 99% by the new investors with Company A retaining only a 1% non-controlling interest.

In this situation, a set of new investors paid cash to obtain control of Company D in an arm’s length transaction. Company D is then used to effect the acquisition of 100% ownership of companies B & C by paying cash. Company A relinquishes its control of companies B & C to the new owners of Company D.

**SOLUTION:**

Although Company D is a newly formed company, it is identified as the acquirer not only because it paid cash that also because the new owners of Company D have obtained control of companies B and C from Company A.

**STEP II: DETERMINING THE ACQUISITION DATE**

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

The date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

The acquisition date is a very important step in the business combination accounting because it determines when the acquirer recognises and measures the consideration, the assets acquired and liabilities assumed. The acquiree’s results are consolidated from this date. The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.

The acquisition date is often readily apparent from the structure of the business combinations and the terms of the sale and purchase agreement (if applicable) but this is not always the case.

Acquisition date will be the date on which the acquirer obtains control.
**QUESTION NO 15**

On 9.4.20x2, Shyam limited a listed company started to negotiate with Ram Limited which is an unlisted company about the possibility of merger. On 10.5.20x2, the board of directors of Shyam authorized their management to pursue the merger with Ram limited. On 15.5.20x2, management of Shyam limited offered management of Ram limited 12,000 shares of Shyam limited against their total share outstanding. On 31.5.20x2, the board of directors of Ram limited accepted the offer subject to shareholder vote. On 2.6.20x2 both the companies jointly made a press release about the proposed merger.

On 10.6.20x2, the shareholders of Ram limited approved the terms of merger. On 15.6.20x2, the shares were allotted to the shareholders of Ram limited.

The market price of the shares of shyam limited as was follows:

<table>
<thead>
<tr>
<th>DATE</th>
<th>PRICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.4.20X2</td>
<td>70</td>
</tr>
<tr>
<td>10.5.20X2</td>
<td>75</td>
</tr>
<tr>
<td>15.5.20X2</td>
<td>60</td>
</tr>
<tr>
<td>31.5.20X2</td>
<td>70</td>
</tr>
<tr>
<td>2.6.20X2</td>
<td>80</td>
</tr>
<tr>
<td>10.6.20X2</td>
<td>85</td>
</tr>
<tr>
<td>15.6.20X2</td>
<td>90</td>
</tr>
</tbody>
</table>

What is the acquisition date and what is purchase consideration in the above scenario?

**SOLUTION:**

As per paragraph 8 of this statement, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram limited. Although the shareholders' approval was obtained on 10th june but the shares were issued only on 15th june and accordingly the 90 will be considered as the market price.

**QUESTION 16**

Can an acquiring entity account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?
**SOLUTION:**

No as per the requirement of the standard a non-binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

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**QUESTION 17**

On 1st April, X Ltd. agrees to acquire the share of B Ltd. in an all equity deal. As per the binding agreement X Ltd. will get the effective control on 1st April. However, the consideration will be paid only when the shareholders’ approval is received. The shareholders meeting are scheduled to happen on 30th April. If the shareholders’ approval is not received for issue of new shares, then the consideration will be settled in cash What is the acquisition date?

**SOLUTION:**

The acquisition date in the above case is 1st April. This is because in the above scenario, even if the shareholders don’t approve the shares, consideration will be settled through payment of cash.

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**QUESTION 18**

**BUSINESS COMBINATION WITHOUT A COURT APPROVED SCHEME**

ABC Ltd. acquired all the shares of XYZ Ltd. The negotiations had commenced on 1st January, 20X1 and the agreement was finalised on 1st March 20X1. While ABC Ltd. obtains the power to control XYZ Ltd.’s operations on 1st March, 20X1 the agreement states that the acquisition is effective from 1st January, 20X1 and that ABC Ltd. is entitled to all profits after date. In addition, the purchase price is based on XYZ Ltd.'s net asset position as at 1st January, 20X1. What is the date of acquisition?

**SOLUTION:**

Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further, Ind AS 103 clarifies that the date of which the acquirer obtains control of the acquire is generally the date on which the acquirer legally transfers the consideration acquires the assets and assumes the liabilities of the acquire the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

Therefore, in this case, notwithstanding that the price is based on the net assets at 1st January, 20X1 and it is only on 1st March, 20X1 and not 1st January 20X1 that ABC Ltd. has the power to direct the relevant activities of XYZ Ltd. so as to affect its returns from its involvement with XYZ Ltd. Accordingly, the of acquisition is 1st March, 20X1.
uestion 19 Acquisition Date - Regulatory Approval

ABC Ltd. and XYZ Ltd. are manufacturers of rubber components for a particular type of equipment. ABC Ltd. makes a bid for XYZ Ltd.’s business and the Competition Commission of India (CCI) announces that the proposed transaction is to be scrutinized to ensure that competition laws are not breached. Even though the contracts are made subject to the approval of the CCI, ABC Ltd. and XYZ Ltd. mutually agree the terms of the acquisition and the purchase price before competition authority clearance is obtained. Can the acquisition date in this situation be the date on which ABC Ltd. and XYZ Ltd. agree the terms even though the approval of CCI is awaited (Assume that the approval of CCI is substantive)?

Solution:

Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquirer.

Further, Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquirer is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree - the closing date. However, the acquirer might obtain control on a date that is either or later than the closing date.

Since CCI approval is substantive approval for ABC Ltd. To acquirer of XYZ Ltd.’s operations. The date of acquisition cannot be earlier than the date on which approval is obtained from CCI. This is pertinent given that the approval from CCI is considered to be a substantive process and accordingly, the acquisition is considered to be complete only or receipt of such approval.

Question 20

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Shareholders of Veera Limited and Zeera Limited agreed to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited shareholders and 50 shares to Zeera Limited shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company’s shareholders get the voting rights in Meera Limited based on their respective shareholdings.

Determine the acquirer by applying the principles of Ind AS 103 ‘Business Combinations’
SOLUTION:
The relative voting rights in the combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity.

Based on above mentioned para, acquirer shall be the either of the combining entities (i.e. Veera Limited or Zeera Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence in the above scenario Veera Limited shareholder gets 67% Share \([(100/150) \times 100]\) and Zeera Limited shareholder gets 33.33\% share in Meera Limited. Hence Veera Limited is acquirer as per the principles of Ind AS 103.

QUESTION 21

Company A acquired Business of Company B for cash consideration. The relevant dates are as under:

- Date of shareholder agreement: 1st June, 20X1
- Appointed date as per shareholder agreement: 1st April, 20X1
- Date of obtaining control over the board representation: 1st July, 20X1
- Date of payment of consideration: 15th July, 20X1
- Date of transfer of shares to Company A: 1st August, 20X1

SOLUTION:

In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, 20X1, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as the Company A did not have control over Company B as at that date.

STEP III: DETERMINATION OF THE PURCHASE CONSIDERATION

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the total of the acquisition-date fair values of the assets (including cash) transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.
The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, 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 profit or loss.

This means that if the acquirer has transferred a land as a part of the business combination arrangement to the owners of the acquiree then the fair value of the land will be considered in determining the fair value of the consideration. Consequently, the land will be derecognised in the financial statements of the acquirer and the difference between the carrying amount of the land and the fair value considered for purchase consideration will be recorded in profit and loss.

**STEP IV: RECOGNITION OF ASSETS & LIABILITIES ACQUIRED ON ACQUISITION DATE**

The assets and liabilities recognized based on the aforesaid recognition principles has to be measured based on the following principle:

| The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values. |

**EXCEPTIONS (MEASUREMENT PERIOD)**

Ind AS 103 provides a measurement period window wherein if all the required information is not available on the acquisition date then the entity will be required to do the purchase price allocation on a provision basis.

During the measurement period, the acquirer shall retrospectively 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.

During the measurement period, the acquirer shall also 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. However, the measurement period shall not exceed one year from the acquisition date.
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.

**QUESTION 22**

Entity X acquired 100% shareholding of Entity Y on 1st April, 20X1 and had complete the preliminary purchase price allocation and accordingly recorded net assets of ₹ 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31st March, 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31st March, 20X2. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?
SOLUTION:

No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31st March, 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

QUESTION 23

ABC Ltd. acquires XYZ Ltd. in a business combination on 15th January, 20X1. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract. ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises ₹ 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October, 20X1 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be ₹ 2 crore.

ABC Ltd. continues to receive and evaluate information related to the claim after October, 20X1. Its evaluation doesn’t change till February, 20X2 (i.e. after the measurement period). ABC Ltd. determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February, 20X2 is ₹ 2.2 crore.

How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?

SOLUTION:

The consolidated financial statements of ABC Ltd. for the year ended 31st March, 20X1 should include ₹ 1 crore towards the contingent liability in relation to the customer claim.

When the customer presents additional information in support of its claim, the incremental liability of ₹ 1 crore (₹ 2 crore - ₹ 1 crore) will be adjusted as a part of acquisition accounting as it is within the measurement period.
Therefore, it will disclose that the comparative information for the year ending on 31st March, 20X1 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by ₹ 1 crore, resulting in a corresponding increase in goodwill.

The amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to ₹ 20 lakh (₹ 2.2 crore - ₹ 2 crore) is recognised in profit or loss.

**STEP V: GOODWILL/BARGAIN PURCHASE**

**Goodwill – Recognition and Measurement**

The acquirer shall recognize Goodwill as of the acquisition date measured as the excess of (a) over (b) below:

a) The purchase consideration transferred at acquisition - date fair value;

b) The net of the acquisition - date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Ind AS.

**Bargain Purchase**

In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the net assets value 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 not clear. 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.

The Ind AS standard itself acknowledges that it is very rare that a bargain purchase in a business combination will arise and accordingly the standard re-emphasises the above point by requiring the entities to reassess and identify the clear reason why it is a bargain purchase business combination. For e.g. acquisition of business in a bankruptcy sale, or sale of business due to a regulatory requirement.
**QUESTION 24**

Entity X is one of the largest liquor manufacturing company in the world and it acquires another Entity Y which has significant presence in India and UK. However, the competition commission in UK has issued orders to sell one division of the UK assets of Entity Y in order to comply with the local competition regulation in UK within a specified timeline. Entity Z another boutique liquor manufacturer realizes the opportunity and Purchase the assets of Entity Y from Entity X.

**SOLUTION:**

In the given case above it is more likely than not that there could be an element of bargain Purchase as the entity X was under compulsion to sell the assets within a specified timeline.

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**STEP VI: TREATMENT OF OTHER ASSETS & LIABILITIES**

**CONCEPT 1: PAYMENT FOR FUTURE SERVICES**

If an acquirer has committed to management of acquiree a payment for future services which may be required for smooth running of business then such type of payment will be expensed over the period of service in future but it will not be considered as a part of business combination. It will be treated as an entity is paying remuneration to its employees or management for their normal services.

**QUESTION 25**

X Ltd. plans to acquire Y Ltd. It identifying assets acquired and liability assumed. The company agrees to pay Y Ltd.'s existing management ₹ 10 million for running the business of acquired business under the aegis of X Ltd. for I year during the post-acquisition period and harmonization of post-acquisition activated. Should this agreement be treated as liability assumed in a business combination?

**CONCEPT 2: INDEMNIFICATION OF LIABILITIES & ASSETS**

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 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; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognizes the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts.
QUESTION 26

Company A acquires Company B in a business combination on April 1, 2011. B is being sued by one of its customers for breach of contract. The sellers of B provide an indemnification to A for the reimbursement of any losses greater than ₹100. There are no collectability issues around this indemnification. At the acquisition date, Company A determined that there is a present obligation and therefore the fair value of the contingent liability of ₹250 is recognised by A in the acquisition accounting.

SOLUTION:

In the acquisition accounting A also recognises an indemnification asset of ₹150 (₹250 - ₹100)

50 (₹250 - ₹100).

QUESTION 27

ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage.

PQR Ltd. is being sued for damages of ₹2 crore. XYZ Ltd. has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to ₹1 crore. The fair value of the contingent liability for the court case is ₹70 lakh.

How should ABC Ltd. account for the contingent liability and the indemnification asset? What if the fair value of the liability is ₹1.2 crore instead of ₹70 lakh.

SOLUTION:

In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at ₹70 lakh and also recognises a corresponding indemnification asset of ₹70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil.

However, in the case where the liability’s fair value is more than ₹1 crore ie. ₹1.2 crore, the indemnification asset will be limited to ₹1 crore only.

QUESTION 28

ABC Ltd. pays ₹50 crore to acquire PQR Ltd. from XYZ Ltd. PQR Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass. XYZ Ltd. agrees to indemnify ABC Ltd. for the adverse results of any
court cases up to an amount of ₹ 10 crore. The class actions have not specified amounts of
damages and past experience suggests that claims may be up to ₹ 1 crore each, but that
they are often settled for small amounts.

ABC Ltd. makes an assessment of the court cases and decides that due to the potential
variance in outcomes, the contingent liability cannot be measured reliably and accordingly
no amount is recognised in respect of the court cases. How should indemnification asset be
accounted for?

**SOLUTION:**

Since no liability is recognised in the given case, ABC Ltd. will also not recognise an
indemnification asset as part of the business combination accounting.

**QUESTION 29**

X Ltd. Acquires Y Ltd. Y Ltd. Has trade receivable of 50,00,000 in its books. X limited
estimates 40,00,000 as fair value of Y' trade receivable. But Y guarantee’s minimum
collection of 45,00,000. Comment.

**SOLUTION:**

X limited will recognize indemnified assets of 5,00,000 in the given case.

**CONCEPT 3 : RECOGNITION OF CONTINGENT LIABILITIES**

Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, defines a contingent
liability as:

(a) 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

(b) A present obligation that arises from past events but is not recognized because:

i. It is not probable that an outflow of resources embodying economic benefits will
be required to settle the obligation; or

ii. The amount of the obligation cannot be measured with sufficient reliability

The requirements in Ind AS 37 do not apply in determining which contingent liabilities
to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the
acquisition date a contingent liability assumed in a business combination if it is a present
obligation that arises from past events and its fair value can be measured reliably. Therefore,
contrary to Ind AS 37, the acquirer recognizes a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

**QUESTION 30**

A suit for damages worth ₹ 10 million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligation for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be ₹ 2 million.

**SOLUTION:**

Company A would recognise ₹ 2 million in its financial statements as part of acquisition accounting, even if it is not probable that payment will be required to settle the obligation.

**QUESTION 31**

X Ltd. plans to acquire Y Ltd. It was identifying assets acquired and liabilities assumed. It has analyzed the pending warranty claims. It is observed that that Warranty Claim of ₹ 2 million may mature based on claims of certain customers. There is remote chance of other claims amounting ₹ 5 million (as on acquisition date) to mature and fair value which cannot be reliably measured.

**SOLUTION:**

In the given case, reliable estimate of ₹ 2 million can only be made due to which it can be incorporated as liability, but other claims of 5 million for which reliable estimate is not available should not be recognized as liability.

**QUESTION 32**

X Ltd. plans to acquire Y Ltd. It was identifying assets acquired and liabilities assumed. It has analysed the pending tax cases:

(i) Y Ltd. recognised 20 pending cases amounting to ₹ 15 million as contingent liability of which ₹ 3 million has been provided for; and

(ii) Y Ltd. did not recognise another 2 cases as it could not measure fair value of out of these cases.
X Ltd. assessed that ₹5 million should be the obligation out of 20 pending tax cases. Although it is unlikely that liability against 2 cases would mature but the claim is ₹1 million as on the acquisition date. How should X Ltd. recognise contingent liability?

**CONCEPT 4: ACQUISITION COST INCURRED IN BUSINESS ACQUISITION**

The direct cost of acquisition is not included in determination of the purchase consideration. Cost which include like finder's fees, due diligence cost accounting, legal fees, investment banker fees, even bonuses paid to employees for doing a successful acquisition will not be included in the cost of acquisition.

**QUESTION 33**

Should stamp duty paid on acquisition of land pursuant to a business combination be capitalised to the cost of the asset or should it be treated as an acquisition related cost and accordingly be expensed off?

**SOLUTION:**

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition related costs as expenses in the periods in which the costs are incurred.

Accordingly, stamp duty incurred in relation to land acquired as part of a business combination transaction are required to be recognised as an expense in the period in which the acquisition is completed and given effect to in the financial statements of the acquirer.

**QUESTION 34**

ABC Ltd. acquires PQR Ltd. on 30th June, 20X1. The assets acquired from PQR Ltd. include an intangible asset that comprises wireless spectrum license. For this intangible asset, ABC Ltd. is required to make an additional one-time payment to the regulator in PQR's jurisdiction in order for the rights to be transferred for its use. Whether such additional payment to the regulator is an acquisition-related cost?
SOLUTION:

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received.

The payment to the regulator represents a transaction cost and will be regarded as acquisition related cost incurred to effect the business combination. Applying the requirements of para 53 of Ind AS 103, it should be expensed as it is incurred.

It may be noted that had the right been acquired separately (i.e. not as part of business combination), the transaction cost is required to be capitalised as part of the intangible asset as per the requirements of Ind AS 38, Intangible Assets.

CONCEPT 5: PRE EXISTING RELATIONSHIPS

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. In either situation, 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 acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant Ind AS.

As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement. 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.
QUESTIO NO 35 [TREATMENT OF PER-EXISTING LAW SUIT]

X Ltd. acquired the business of Y Ltd. for ₹ 40 cr. the purchase consideration includes payment for settlement of a law suit against X Ltd. ₹ 30 lakhs. In the books of X Ltd. there is provision for the law suit amounting to ₹ 40 lakhs.

Fair value of identified assets acquired is ₹45 cr. and fair value of liabilities assumed is ₹10cr. Deferred tax liability worked out based on tax base-of acquirer and the fair value is ₹1 cr.

How should the company recognise the business combination transaction and pre-existing relationship?

QUESTION NO 36

Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31st March 2012, Progressive Ltd recognized a INR 10 million liability related to this litigation.

On 30th July 2012, Progressive Ltd acquired the entire equity of Regressive Ltd for INR 500 million. On the date, the estimated fair value of the expected settlement of the litigation is INR 20 million.

SOLUTION:

In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the INR 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

QUESTION 37

Vadapav Limited 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 2012. On the acquisition date, Vadapav determines that the license agreement reflects current market terms.
SOLUTION:
Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

QUESTION 38
ABC Ltd. acquires PQR Ltd. for a consideration of ₹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 ₹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 ₹1,80,000 [₹(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 ₹4,50,000.

How is the license accounted for as part of the business combination?

CONCEPT 6: ASSEMBLED WORKFORCE
The acquirer subsumes into Goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date.

An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized separately from goodwill, any value attributed to it is subsumed into goodwill.

CONCEPT 7: INTANGIBLE ASSETS
An intangible asset should be recorded separately from Goodwill if either the separability criteria is met or it arises out of contractual legal criterion.
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 criterion**

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:**

a. An acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

b. An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future revenue in foreign exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

**Separability Criteria**

The separability criterion means that 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. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.
Example:

An acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

Accordingly, as per the guidance above it follows that identification of intangible asset will be judgemental and will vary in each case.

Following are the possible sources of information and broad indicator to be used to identify any possible intangible separately from goodwill:

A. Internal sources:

• Financial statements of the acquiree-
  ➢ significant R&D cost may be indicator that there may be possible technology related intangible
  ➢ Customer acquisition cost- lot of company spend money to acquire new customers like online e-commerce companies provide incentive to register a customer as a first time user or download their app. That may be a strong indicator of existence of customer list as an intangible

**QUESTION 39**

Company A, FMCG company acquires an online e-commerce company E, with the intention to start its retail business. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?

**SOLUTION:**

In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful to other players and Company E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not. Hence customer list should be recorded as an intangible in a business combination.
QUESTION 40

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.?

SOLUTION:

This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset.

An acquiree’s in-process research and development project meets the definition of an intangible asset when it:

(a) Meets the definition of an asset; and
(b) is identifiable, i.e. is separable or arises from contractual or other legal rights.

In accordance with above,

(i) The fair value of the first drug reflects the probability and the timing of the regulatory approval being obtained. As per the standard, the recognition criterion of probable future economic benefits is considered to be satisfied in respect of the asset acquired accordingly an asset is recognised. Subsequent expenditure on an in-process research or development project acquired separately is to be dealt with in accordance with paragraph 43 of Ind AS 38.

(ii) The rights to the second drug also meet the recognition criteria in Ind AS 8 and are recognised. The approval means it is probable that future economic benefits will flow to ABC Ltd. This will be reflected in the fair value assigned to the intangible asset.

QUESTION 41

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 ₹ 35 crores. The fair value of ABR Ltd.’s net assets was ₹ 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 ₹ 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 ₹ 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 ₹12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at ₹ 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 ₹ 10 crores.

KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS.

CONCEPT 8: CONTINGENT CONSIDERATION

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

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 in accordance with the requirement of Ind AS 32 Financial Instruments: Presentation, or other applicable Indian Accounting Standards. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

Fair value of the assets transferred or liability incurred should be measured on the acquisition date to determine the fair value. Any direct cost of acquisition should be recorded directly in profit and loss account and should not be included in purchase consideration.

Example:
Company A acquires Company B in April 2011 for cash. The acquisition agreement states that an additional ₹ 20 million of cash will be paid to B's former shareholders if B succeeds in achieving certain specified performance targets. A determines the fair value of the contingent consideration liability to be 15 million at the acquisition date. At a later date, the probability of meeting the said performance target becomes lower.
As certain consideration is based on achieving certain performance parameters in future, the consideration is contingent on achieving those parameters. As such, the transaction involves contingent consideration. Further, since the consideration is to be settled for a variable amount in cash, such consideration would be in the nature of financial liability rather than equity.

As at the acquisition date, the acquirer should consider the acquisition date fair value of contingent consideration as part of business combination. Accordingly, such recognition would increase goodwill (or reduce gain on bargain purchase, as the case may be).

In the above example, if the change of meeting the performance criteria becomes less probable, then in such a case, the contingent consideration in the nature of financial liability should be remeasured and the impact for the change in the fair value should be recognised in statement of profit and loss.

**QUESTION 42**

Issuer of fixed number of shares] A Ltd. has completed negotiation with B Ltd. acquiring its business. A Ltd. agrees to issue 1,00,00,000 of its own shares to the shareholders of B Ltd. in exchange of their holding. It also agrees to pay another 20,00,000 shares if revenue from the business of B Ltd. exceeds ₹100 cr. during the first year of post-combination operation.

Fair value of identifiable assets and liabilities of B Ltd. is ₹100 cr. and ₹20 cr. respectively. On the date of acquisition, market price of A Ltd.’s share is ₹100.

The probability analysis of expected revenue of B Ltd.’s business:

Revenue = ₹100 cr. 40%
Revenue > ₹100 cr. 60%

(i) How should the arrangement to issue 20,00,000 shares be classified?

(ii) Find out Goodwill.

(iii) At the end of first half of year 1, the probability revenue generation has been reassessed:

How should the change in fair value be accounted for?

Assume that the arrangement is not linked to providing services. Acquirer’s incremental borrowing rate is 11%.
**QUESTION 43**

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:

(i) 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 INR 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 INR 1 crore.
   i. The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is ₹25 lakhs.
   ii. During the year ended 31 March 20X2, the profit before interest and tax of B Ltd. exceeded ₹1 crore. As on 31 March 20X2, the fair value of shares of A Ltd. is ₹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 ₹40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ₹1 crore. A Ltd. issued shares with ₹40 lakhs after a year.

**CONCEPT 9: CONTINGENT PAYMENTS TO EMPLOYEE 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.

**Continuing employment**—the terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration.
arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

**Duration of continuing employment**—If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

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**QUESTION 44**

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

- the EBIDTA margins of the Company after 2 years post acquisition is 21%.
- the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.

**SOLUTION:**

In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns. Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS.

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**QUESTION 45:**

**Contingent consideration— Payments to employees who are former owners of acquiree**

ABC Ltd. acquires all of the outstanding shares of XYZ Ltd. in a business combination. XYZ Ltd. had three shareholders with equal shareholdings, two of whom were also senior-level employees of XYZ Ltd. and would continue as employee post acquisition of shares by ABC Ltd.
The employee shareholders each will receive ₹ 60,00,000 plus an additional payment of ₹ 1,50,00,000 to 2,00,00,000 based on a multiple of earnings over the next two years.

The non-employee shareholders each receive ₹ 1,00,00,000. The additional payment of each of these employee shareholders will be forfeited if they leave the employment of XYZ Ltd. at any time during the two years following its acquisition by ABC Ltd. The salary received by them is considered reasonable remuneration for their services.

How much amount is attributable to post combination services?

**SOLUTION:**

Ind AS 103 provides an indication that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

In accordance with the above, in the instant case, the additional consideration of ₹ 1,50,00,000 to ₹ 2,00,00,000 represents compensation for post-combination services, as the same represents that part of the payment which is forfeited if the former shareholder does not remain in the employment of XYZ Ltd. for two years following the acquisition - i.e., only ₹ 60,00,000 is attributed to consideration in exchange for the acquired business.

**CONCEPT 10: EMPLOYEES BENEFITS (RETIREMENT BENEFITS)**

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.

**CONCEPT 11: REPLACEMENT OF SHARE BASED PAYMENTS**

The acquirer shall measure a liability or an equity instrument related to share-based payment transactions of the acquiree or the replacement of an acquiree’s share-based payment transactions with share-based payment transactions of the acquirer in accordance with the method in Ind AS 102, Share-based Payment, at the acquisition date.
**QUESTION NO 46**

[Under the replacement awards the employees are required to provide further service after the acquisition date, but vesting period has been completed under the acquiree’s award] Acquired A Ltd. issues a replacement award under a business combination transaction, the market based measurement of which under Ind As 102 is ₹ 10 million. The employees are required to render 2 years service after business combination to be entitled to the award. The original award of acquiree has a market based measure of ₹ 9 million on the date of acquisition, and a vesting period of 5 years which all the employees have completed. Should the additional obligation be treated as liability assumed in a business combination? If not allocate the obligation into pre-combination obligation and post-combination remuneration.

**QUESTION NO 47**

[Under the replacement awards the employees are required to provide further service after the acquisition date, and vesting period has not been completed under the acquiree’s award] Acquirer A Ltd. issues a replacement award under a business combination transaction, the market based measurement of which under Ind As 102 is ₹ 10 million. The employees are required to render 2 years service after business combination to be entitled to the awards. The original award of acquiree has a market based measure of ₹ 9 million on the date of acquisition, and a vesting period of 5 years of which the employees have completed 2 years only. Should the additional obligation be treated as liability assumed in a business combination?

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**Pre-combination period**

Computation- Market-based measure multiplied by ratio of the vesting period completed as on the acquisition date to the greater of -original vesting period or revised vesting period

The value as computed above is included in Purchase consideration.

**Post-combination**

Computation- The difference between the fair value of the award on the date of acquisition date and the value allocated to pre-combination period

The incremental amount is allocated to post combination period as a service cost over the remaining vesting period.
Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd’s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 years (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- Original awards: INR 500
- Replacement awards: INR 600.

As of the acquisition date, all awards are expected to vest.

**CONCEPT 12: NON-REPLACEMENT SHARE BASED PAYMENTS AWARDS**

The acquiree may have outstanding share-based payment transactions that the acquirer does not exchange for its share-based payment transactions. If vested, those acquiree share-based payment transactions are part of the non-controlling interest in the acquiree and are measured at their market-based measure. If unvested, they are measured at their market-based measure as if the acquisition date were the grant date in accordance with paragraphs 19 and 30.

The market-based measure of unvested share-based payment transactions is allocated to the non-controlling interest on the basis of the ratio of the portion of the vesting period completed to the greater of the total vesting period and the original vesting period of the share-based payment transaction. The balance is allocated to post-combination service.

The above means that the acquiree’s existing award will be settled in its own shares and the consequential shareholders will become the Non-controlling shareholders. The above principles can be summarized as follows:

**Vested shares-**

- the value credited to Share based payment reserve is classified as NCI. Unvested-
  - Pre-combination period is considered as a part of NCI
  - Post-combination period- is recorded as employee cost and the credit forms part of the NCI in the balance sheet.
**QUESTION 49**

P, a real estate company acquires Q, another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q’s employees have rendered 2 years of service. None of the award are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is INR 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).

**CONCEPT 13: PURCHASE CONSIDERATION PAID IN OTHER ASSETS**

**QUESTION NO 50**

X Ltd. acquired Y Ltd. by transfer of its retail division (fair value of which is ₹ 360 million) and 10,00,000 equity shares to the previous owners of Y Ltd. Market price of equity share of X Ltd. (par value ₹ 10 each) as on the date of acquisition was ₹ 350 per share. It was decided to pay the purchase consideration to the liquidator of Y Ltd.

Assets and liabilities of retail segment of X Ltd. (Amount in ₹ million)

<table>
<thead>
<tr>
<th></th>
<th>Carrying amount</th>
<th>Acquisition date fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>120</td>
<td>130</td>
</tr>
<tr>
<td>Inventories</td>
<td>120</td>
<td>150</td>
</tr>
<tr>
<td>Receivables</td>
<td>110</td>
<td>110</td>
</tr>
<tr>
<td>Trade payables</td>
<td>30</td>
<td>30</td>
</tr>
</tbody>
</table>

As on the acquisition date assets and liabilities of Y Ltd. were as follows (Amount in ₹ million).

<table>
<thead>
<tr>
<th></th>
<th>Carrying amount</th>
<th>Acquisition date fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and Building</td>
<td>30</td>
<td>50</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>500</td>
<td>600</td>
</tr>
<tr>
<td>Equipment</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Inventories</td>
<td>100</td>
<td>80</td>
</tr>
<tr>
<td>Receivables</td>
<td>100</td>
<td>80</td>
</tr>
<tr>
<td>Cash and Cash Equivalents</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>
Find out purchase consideration and goodwill on business combination. Show accounting entry of acquirer for business combination.

### QUESTION NO 51

AX Ltd. and BX Ltd. amalgamated on and from 1st January 2012. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

**Summarized Balance Sheet as on 31-12-2012**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>AX Ltd</th>
<th>BX Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td></td>
<td>8,500</td>
<td>7,500</td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td>1,050</td>
<td>550</td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td>1,250</td>
<td>2,750</td>
</tr>
<tr>
<td>Trade receivable</td>
<td></td>
<td>1,800</td>
<td>4,000</td>
</tr>
<tr>
<td>Cash and Cash equivalent</td>
<td></td>
<td>450</td>
<td>400</td>
</tr>
<tr>
<td></td>
<td></td>
<td>13,050</td>
<td>15,200</td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of INR 10 each)</td>
<td></td>
<td>6,000</td>
<td>7,000</td>
</tr>
<tr>
<td>Other equity</td>
<td></td>
<td>3,050</td>
<td>2,700</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

Assuming BX ltd is a larger entity and their management will take the control of the entity. The fair value of net assets of AX and BX limited are as follows:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>AX LTD.</th>
<th>BX LTD.</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIXED ASSETS</td>
<td>9500</td>
<td>10,000</td>
</tr>
<tr>
<td>INVENTORY</td>
<td>1300</td>
<td>2,900</td>
</tr>
<tr>
<td>FAIR VALUE OF BUSINESS</td>
<td>11000</td>
<td>14,000</td>
</tr>
</tbody>
</table>

**QUESTION NO 52**

A Ltd. acquired the business of B Ltd. on 1 April, 2015 on which date the acquiree had the following assets and liabilities (₹ million):

<table>
<thead>
<tr>
<th>Assets</th>
<th>Amount</th>
<th>liabilities</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and Equipment at cost less depreciation</td>
<td>100</td>
<td>8% Debentures</td>
<td>100</td>
</tr>
<tr>
<td>Assets under operating Lease at cost less depreciation</td>
<td>100</td>
<td>Trade creditors (after setting off 25 due to A Ltd.)</td>
<td>30</td>
</tr>
<tr>
<td>Investments in Equity Shares</td>
<td>30</td>
<td>Provision for Retirement Benefit of Employees</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Reassessed under Ind As 19 at 50)</td>
<td></td>
</tr>
</tbody>
</table>
### Other information:

(i) B Ltd. has not accounted for self-developed brand name which is valued at 20 million and customer list which is valued at ₹ 10 million;

(ii) It has not recognised a warranty obligation as the company did not consider that there will be cash outflow- the fair value of the obligation is ₹ 2 million. B Ltd. guarantees that loss arising out of warranty obligation will not exceed ₹ 1 million.

Also b Ltd. guarantees collection of 75% of trade receivables.

(iii) A Ltd. has agreed to pay ₹ 5 million to Mr. B, the major shareholder and managing director of B Ltd., for putting his efforts to integrate the functioning of A Ltd. and B Ltd. in post-combination period extending to maximum one year.

There is no employment contract with Mr. B.

(iv) It was agreed that investment in equity shares, short-term investments and cash and cash equivalents will be taken over by Mr. B of B Ltd. at Balance sheet value which is the current market value.

(v) Fair value of property, plant and Equipment : ₹ 220 million;

(vi) A Ltd. agrees to pay upfront ₹ 250 million and additional ₹ 50 million to previous owners of B Ltd. During the first year of acquisition if 80% of the customers are retained. The company expects that it is almost certain to retain existing customers of B Ltd.

Prepare a worksheet detailing out identifiable assets and liabilities and goodwill.
As per the requirement of Ind AS 12, no deferred tax consequence should be recorded on initial recognition of deferred tax except assets and liabilities acquired during business combination. Accordingly, the acquirer shall recognize and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes.

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.

QUESTION 53

On 1.1.2020 entity H acquired 100% share capital of entity S for 15,00,000. The book values and fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with tax bases in entity S’ tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purpose. The tax rates in entity H and entity S jurisdiction are 30% and 40% respectively.

<table>
<thead>
<tr>
<th>Acquisitions</th>
<th>Book values</th>
<th>Tax base</th>
<th>Fair values</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land &amp; buildings</td>
<td>600</td>
<td>500</td>
<td>700</td>
</tr>
<tr>
<td>Plant &amp; machinery</td>
<td>250</td>
<td>200</td>
<td>270</td>
</tr>
<tr>
<td>Inventory</td>
<td>100</td>
<td>100</td>
<td>80</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>150</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td>Cash and cash Equivalents</td>
<td>130</td>
<td>130</td>
<td>130</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>160</td>
<td>160</td>
<td>160</td>
</tr>
<tr>
<td>Retirement benefit obligations</td>
<td>100</td>
<td>-</td>
<td>100</td>
</tr>
</tbody>
</table>

You are required to compute deferred tax on acquisition of business....also compute goodwill on acquisition of business.
**CONCEPT 15: LEASE CONTRACTS ON ACQUISITION DATE**

**ACQUIREE IS A LESSEE**

- The acquirer shall recognise right-of-use assets and lease liabilities for leases identified in accordance with Ind AS 116.
- The acquirer is not required to recognise right-of-use assets and lease liabilities for:
  - (a) leases for which the lease term ends within 12 months of the acquisition date; or
  - (b) leases for which the underlying asset is of low value.
- 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.
- The acquirer shall measure the right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms.

**ACQUIREE IS A LESSOR**

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.

**CONCEPT 16: ASSETS HELD FOR SALE WITH ACQUIREE ON ACQUISITION DATE**

The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, at fair value less costs to sell in accordance with that Ind AS.
UNIT 3: ACQUISITION METHOD
(IF BUSINESS COMBINATION IS IN THE FORM OF ACQUISITION OF SIGNIFICANT EQUITY INTEREST)

NON CONTROLLING INTEREST IN AN ACQUIREE

Ind AS 103 allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares (ie those not held by the acquirer). In other situations, however, a quoted price in an active market for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a non-controlling interest discount) in the per-share fair value of the non-controlling interest if market participants would take into account such a premium or discount when pricing the non-controlling interest.

QUESTION NO 54 (FAIR VALUE METHOD)

A Limited acquires 80% of B Limited at a valuation of ₹ 150.00 crores (excluding control premium) by payment in cash of ₹ 120.00 crores. The value of non-controlling interest is ₹ 30 cores. Value of net assets is 130 crores.

QUESTION NO 55 (PROPORTIONATE SHARE METHOD)

WITH the help of given information as in above, Assume that the value of recognized amount of subsidiary’s identifiable net assets is ₹ 130.00 crores, as determined in accordance with Ind 103.

QUESTION NO 56

In the aforesaid example, if the consideration is ₹ 90
QUESTION NO 57

GOODWILL RECOGNISED DEPENDS ON HOW NCI IS MEASURED.

Ram Ltd. acquires shyam Ltd. by purchasing 60% of its equity for ₹ 15 lakh in cash. The fair value of non-controlling interest is determined as ₹ 10 lakh. The net aggregate value of identifiable assets and liabilities, as measured in accordance with Ind 103 is determined as ₹ 5 lakh.

How much goodwill is recognized based on two measurements based of non-controlling interest (NCI)?

QUESTION NO 58

GAIN ON A BARGAIN PURCHASE WHEN NCI IS MEASURED AT FAIR VALUE

Seeta Ltd. acquires Geeta Ltd. purchasing 70% of its equity for ₹ 15 lakh in cash. The fair value of NCI is determined as ₹ 6.9 lakh. Management have elected to adopt full goodwill method and to measure NCI at fair value. The net aggregate value of identifiable assets and liabilities, as measured in accordance with the standard is determined as ₹ 22 lakh. (Tax consequences being ignored).

QUESTION NO 59

GAIN ON A BARGAIN PURCHASE WHEN NCI IS MEASURED AT PROPORTIONATE SHARE OF IDENTIFIABLE NET ASSETS.

Continuing the facts as stated in the above illustration, except, that seeta. Ltd. chooses to measure NCI using a proportionate share method for this business combination. (Tax consequences have been ignored).

QUESTION NO 60

Measurement of goodwill there is no non-controlling interest

X Ltd. acquired Y Ltd. on payment of ₹ 25 crore cash and transferring a retail business, the fair value of which is ₹ 15 crore. Assets acquired and liabilities assumed in the acquisition are ₹ 36 crore.

Find out the Goodwill.
QUESTION NO 61

Measurement of Goodwill when there is non- non-controlling interest

Raja Ltd. purchased 60% share of Ram Ltd. paying ₹ 525 lakh. Number of issued capital of Ram Ltd. is lakh. Fair value of identifiable assets of Ram of Ram Ltd. is ₹ 640 lakh and that of liabilities is ₹ 50 lakh. As on the date of acquisition, market price share of Ram Ltd. is ₹ 775. Find out the value of goodwill.

QUESTION 62

Company A acquired 90% equity interest in Company B on April 1, 2010 for a consideration of ₹ 85 crores in a distress sale. Company B did not have any instrument recognized 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 ₹ 15 crores and ₹ 100 crores respectively.

Required:

Find the value at which NCI has to be shown in the financial statements by both methods.

QUESTION 63

Company A acquires 70 percent of Company S on January 1, 2011 for consideration transferred of ₹ 5 million. Company A intends to recognize the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitable qualified valuation professional.

A measures the identifiable net assets of B at ₹ 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.

Required:

State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain Purchase gain in the process.

QUESTION 64

Company A acquired 90% equity interest in Company B on 1st April, 20X1 for a consideration of ₹ 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 ₹15 crores and ₹100 crores respectively.

Find the value at which NCI has to be shown in the financial statements

SOLUTION:

In this case Company A has the option to measure NCI as follows:

- **Option 1**: Measure NCI at fair value i.e., ₹15 crores as derived by the valuer;
- **Option 2**: Measure NCI as proportion of fair value of identifiable net assets i.e., ₹10 crores (100 crores x 10%)

**QUESTION 65**

Company A acquires 70 percent of Company S on 1st January, 20X1 for consideration transferred of ₹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 ₹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.

SOLUTION:

- The amount of B’s identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination.
- Following that review, A concludes that the procedures followed and the resulting measurements were appropriate.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Identifiable net assets</strong></td>
<td>1,00,00,000</td>
</tr>
<tr>
<td><strong>Less: Consideration transferred</strong></td>
<td>(50,00,000)</td>
</tr>
<tr>
<td><strong>NCI (10 million x 30%)</strong></td>
<td>(30,00,000)</td>
</tr>
<tr>
<td><strong>Gain on bargain purchase</strong></td>
<td><strong>20,00,000</strong></td>
</tr>
</tbody>
</table>
QUESTION 66: POTENTIAL VOTING RIGHTS

Company P Ltd., a manufacturer of textile products, acquires 40,000 of the equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company P’s two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares. Assess whether control is acquired by Company P.

SOLUTION:

In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 25,000 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered:

- The options are currently exercisable and there are no other required conditions before such option can be exercised.
- If exercised, these options would increase Company P’s ownership to a controlling interest of over 50% before considering other shareholders’ potential voting rights out of a total of 1,25,000 shares.
- Although other shareholders also have potential voting rights, if all options are exercised, Company P will own a majority (65,000 shares out of 1,29,000 shares).
- The premium included in the exercise price makes the option out-of-the-money. However, the fact that the premium is small and the option could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights it has obtained control of Company X.

QUESTION 67:

BUSINESS COMBINATION ACHIEVED BY CONTRACT ALONE

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder’s agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd.
The fair value of Sita Ltd is ₹ 100 crores and fair value of Beta Ltd is ₹ 80 crores. The fair value of net identifiable assets of Beta Limited is ₹ 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

You are required to determine the goodwill to be recognised on acquisition.

**SOLUTION:**

Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

**Part A:**
1) Consideration paid by Acquirer. - Nil
2) Controlling Interest in Acquiree - ₹ 80 crores
3) Acquirer's previously held interest - Nil

**Part B:**
Fair value of net identifiable asset - ₹ 70 crores

Goodwill is recognised as ₹ 10 crores (80 - 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

**QUESTION 68**

On 1st January, 20X1, A Ltd. acquires 80 per cent of the equity interests of B Ltd. in exchange for cash of ₹ 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 ₹ 20 crore and the fair value of the 20 per cent non-controlling interest in B Ltd. at ₹ 4.2 crore. How should A Ltd. recognise the above bargain purchase?

**SOLUTION:**

The amount of B Ltd.'s identifiable net assets i.e., ₹ 20 crore exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in B Ltd. i.e. ₹ 19.2 crore. Therefore, A Ltd. should review the procedures it used to identify and measure the net assets acquired and the fair value of non-controlling interest in B Ltd. and the consideration transferred. After the review, A Ltd. decides that the procedures and resulting measures were appropriate.
A Ltd. measures the gain on its purchase of the 80 per cent interest at ₹ 80 lakh, as the difference between the amount of the identifiable net assets which is ₹ 20 crore and the sum of purchase consideration and fair value of non-controlling interest, which is ₹ 19.2 crore (cash consideration of ₹ 15 crore and fair value of non-controlling interest of ₹ 4.2 crore).

Assuming there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, the gain on bargain purchase of 80 per cent interest calculated at ₹ 80 lakh, which will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve.

If the acquirer chose to measure the non-controlling interest in B Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be ₹ 4 crore (₹ 20 crore × 0.20). The gain on the bargain purchase then would be ₹ 1 crore (₹ 20 crore - (₹ 15 crore + ₹ 4 crore)).
CONCEPT 1: STEP BY STEP ACQUISITION

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date.

Example:

On 31st December 2011, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This transaction is referred as a business combination achieved in stages, sometime also referred to as a step acquisition.

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. As per Ind AS 109 or Ind AS 27, an entity can elect to measure investments in equity instruments at fair value through other comprehensive income. However, once elected all gains and losses on that investment even on sale is recognized in OCI. Therefore, if the investment is designated as fair value through OCI, the resulting gain or loss, if any, will be recognized in OCI.

QUESTION 69

STEP ACQUISITION WHEN CONTROL IS OBTAINED.

Entity D has a 40% interest in entity E, the carrying value of the equity interest. Which has been accounted for as an associate in accordance with Ind As 28 is `40 lakh. Entity D purchases the remaining 60% interest in entity E for `600 lakh in cash. The fair value of the 40% previously held equity interest is determined to be `400 lakh., the net aggregate value of the identifiable assets and liabilities measured in accordance with Ind AS 103 is determined to be identifiable `880 lakh. Tax consequences have been ignored. How entity D account for the business combination?

QUESTION 70

Company A and Company B are in power business. Company A holds 25% of equity share of Company B. On November 1, Company A obtains control of Company B when it acquires of 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 ₹59,00,000 and issues 1,00,000 shares of November 1. The market price of Company A’s shares on the date of issues is ₹10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition equity capital of Company A.

Contingent Consideration: Company A agrees to pay additional consideration of ₹7,00,000 if the cumulative profits of Company B exceed ₹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 ₹3,00,000 at the acquisition date.

Transaction costs: Company A pays acquisition-related costs of ₹1,00,000.

Non-controlling interests (NCI): The fair value of the NCI is determined to be ₹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 ₹6,00,000, accounted for using the equity method; the fair value is ₹20,00,000.

The fair value of Company B’s net identifiable assets at 1st November is ₹60,00,000, determined in accordance with Ind AS 103.

Determine the accounting under acquisition method for the business combination by Company A.

**QUESTION 71**

On 1st April, 20X1, PQR Ltd. acquired 30% of the voting ordinary shares of XYZ Ltd. for ₹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:

<table>
<thead>
<tr>
<th>Share of profit or loss</th>
<th>(₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>700</td>
</tr>
<tr>
<td>Share of exchange difference in OCI</td>
<td>100</td>
</tr>
<tr>
<td>Share of revaluation reserve of PPE in OCI</td>
<td>50</td>
</tr>
</tbody>
</table>

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ₹8,850 crore (8,000 + 700 + 100 + 50).
On 1st April, 20X2, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash ₹ 25,000 crore. The following additional information is relevant at that date:

<table>
<thead>
<tr>
<th></th>
<th>(₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of the 30% interest already owned</td>
<td>9,000</td>
</tr>
<tr>
<td>Fair value of XYZ’s identifiable net assets</td>
<td>30,000</td>
</tr>
</tbody>
</table>

How should such business combination be accounted for?

**Non-controlling interests (NCI):** The fair value of the NCI is determined to be ₹ 7,50,000 at the acquisition date based on market price. 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 November 1, the investment is included in Company A’s consolidated statement of financial position at ₹ 6,00,000, accounted for using the equity method; the fair value is ₹ 20,00,000.

The fair value of Company B’s net identifiable assets at November 1 is ₹ 60,00,000, determined in accordance with IND AS 103.

**Required:**
Determine the accounting under acquisition method for the business combination by Company A.

---

**QUESTION NO 72**

A Ltd. holds 30% shares in B Ltd. which was acquired on 15.7.2012. In separate financial statements, the investment in associate is carried at cost ₹ 200 million. In the consolidated financial statements as at 31 March, 2015, the investment is recognised applying equity method accounting at ₹ 300 million. Changes in equity were recognized as FVOCI.

On 1 April, 2015, A Ltd. acquired another 30% stake of B Ltd. for ₹ 350 million.

AS on the date of acquisition, fair value of identifiable assets and liabilities of B Ltd were determined as ₹ 1200 million and ₹ 200 million respectively. Deferred tax liability has been reassessed based on acquisition date fair value of assets and liabilities at ₹ 40 million.

Market price of previously held 30% interest is ₹ 330 million.

How should A Ltd. recognise the acquisition of controlling stake in B Ltd.?
QUESTION NO 73

X holds 46% of 100 million equity shares issued by Y Ltd. This is recognised as investment in associate in the separate financial statements at cost of ₹ 4600 million. In the consolidated financial statements, the investment is accounted for applying equity method accounting at ₹ 6300 million. The difference of 2300 million has been recognised in the consolidated profit and loss as share of profit form the associate. Fair value of identifiable assets and liabilities of Y Ltd. as on 1.4.2015: Assets (other than cash and cash equivalents) ₹ 14000 million, Cash and cash equivalents ₹ 1800 million, Liabilities ₹ 2000 million.

As on 1 April 2015, Y Ltd. repurchases 10 million equity shares @ ₹ 160 share (i.e for ₹ 1600 million)

This repurchase gives controlling interest to X Ltd.

How should the company recognise the impact of gaining controlling interest in Y Ltd.?
UNIT 4: COMMON CONTROL TRANSACTIONS

(APPENDIX C)

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.

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 AS. 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.

Common control combinations are the most frequent. Broadly, these are transactions in which an entity obtains control of a business (hence a business combination) but both combining parties are ultimately controlled by the same party or parties both before and after the combination. These combinations often occur as a result of a group reorganisation in which the direct ownership of subsidiaries changes but the ultimate parent remains the same. However, such combinations can also occur in other ways and careful analysis and judgement are sometimes required to assess whether some combinations are covered by the definition (and the scope exclusion). In particular:

- an assessment is required as to whether common control is ‘transitory’ (if so, the combination is not a common control combination and Ind AS 103 applies). The term transitory is not explained in the standard. In our view it is intended to ensure that Ind AS 103 is applied when a transaction that will lead to a substantive change in control is structured such that, for a brief period before and after the combination, the entity to be acquired/sold is under common control. However, common control should not be considered transitory simply because a combination is carried out in contemplation of an initial public offering or sale of combined entities.

- when a group of two or more individuals has control before and after the transaction, an assessment is needed as to whether they exercise control collectively as a result of a contractual agreement.
Examples of common control transaction

- Merger between fellow subsidiaries
- Merger of subsidiary with parent
- Acquisition of an entity from an entity within the same group
- Bringing together entities under common control in a corporate legal structure.

**QUESTION 74**

Company X, the ultimate parent of a large number of subsidiaries, reorganizes the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganization, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X’s shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y.

**SOLUTION:**

In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganization, each of the parties are controlled by Company X. After the reorganization, although Company Y are now owned by Company Z, all two companies are still ultimately owned and controlled by Company X. From the perspective of Company X, there has been no change as a result of the reorganization. This transaction therefore meets the definition of a common control combination and is within the scope of Ind AS 103.
QUESTION 75

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. Shareholders B, C and D have entered into a shareholders’ agreement in terms of governance of ABC Ltd. and XYZ Ltd. due to which they exercise joint control.

Whether ABC Ltd. and XYZ Ltd. are under common control?

SOLUTION:

Appendix C to Ind AS 103 defines common control business combination as 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.

In the instant case, both ABC Ltd. and XYZ Ltd. are jointly controlled by group of individuals (B, C and D) as a result of contractual arrangement. Therefore, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

QUESTION 76

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. However, there are no agreements between any of the shareholders that they will exercise their voting power jointly.

Whether ABC Ltd. and XYZ Ltd. are under common control?
SOLUTION:

Appendix C to Ind AS 103 defines 'Common control business combination' as 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.

In the present case, there is no contractual arrangement between the shareholders who exercise control collectively over either company. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

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 recognize any new assets or liabilities. The only adjustments that are made are 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.

The consideration for the business combination 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.

The balance of the retained earnings 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. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves
which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination.

The difference, if any, 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.

The acid test in assessing common control transaction is that before and after the reorganization the entity should be controlled by the same shareholders.

QUESTION NO 77

AX Ltd. and BX Ltd. amalgamated on and from 1st January 2012. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

**Summarized Balance Sheet as on 31-12-2012**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Note No.</th>
<th>AX Ltd</th>
<th>BX Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, Plant and Equipment</td>
<td>8,500</td>
<td>7,500</td>
<td></td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>1,050</td>
<td>550</td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>1,250</td>
<td>2,750</td>
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</tr>
<tr>
<td>Trade receivable</td>
<td>1,800</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Cash and Cash equivalent</td>
<td>450</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>13050</td>
<td>15200</td>
<td></td>
</tr>
<tr>
<td><strong>EQUITY AND LIABILITIES</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity share capital (of face value of INR 10 each)</td>
<td>6,000</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td>Other equity</td>
<td>3,050</td>
<td>2,700</td>
<td></td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

Assuming that both the entities are under common control.

**Question No 78**

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 2012 was as under:

<table>
<thead>
<tr>
<th></th>
<th>Maxi division</th>
<th>Mini division</th>
<th>Total (in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed assets:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost</td>
<td>600</td>
<td>300</td>
<td>900</td>
</tr>
<tr>
<td>Depreciation</td>
<td>500</td>
<td>100</td>
<td>600</td>
</tr>
<tr>
<td>W.D.V. (A)</td>
<td>100</td>
<td>200</td>
<td>300</td>
</tr>
<tr>
<td><strong>Net current assets:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets</td>
<td>400</td>
<td>300</td>
<td>700</td>
</tr>
<tr>
<td>Less: Current liabilities</td>
<td>100</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>(B)</td>
<td>300</td>
<td>200</td>
<td>500</td>
</tr>
<tr>
<td><strong>Total (A+B)</strong></td>
<td>400</td>
<td>400</td>
<td>800</td>
</tr>
<tr>
<td><strong>Financed By:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Funds (A)</td>
<td>-</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

(secured by a charge on fixed assets)
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 ₹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 "shareholders wealth".

**QUESTION NO 79**

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, 2012, the division - wise draft extract of the Balance Sheet was:

(₹ in crores)

<table>
<thead>
<tr>
<th></th>
<th>Laptops</th>
<th>Mobiles</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets cost</td>
<td>250</td>
<td>500</td>
<td>750</td>
</tr>
<tr>
<td>Depreciation</td>
<td>225</td>
<td>500</td>
<td>(625)</td>
</tr>
<tr>
<td>Net Assets (A)</td>
<td>25</td>
<td>100</td>
<td>125</td>
</tr>
<tr>
<td>Current assets:</td>
<td>200</td>
<td>500</td>
<td>700</td>
</tr>
</tbody>
</table>
Division Mobiles along with its assets and liabilities was sold for 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.
A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance above. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, 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. In this example, 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. However, application of the guidance given in above paragraph results in identifying:

a) the public entity as the **acquiree** for accounting purposes (the accounting acquiree); and

b) the private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles of Ind AS 103, including the requirement to recognize goodwill, will apply.

**QUESTION NO 80**

On September 30, 2011 Entity A issue 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 September 30, 2011 is 40. The quoted market price of Entity A's ordinary shares at that date is 16.

The fair values of Entity's A's identifiable assets and liabilities at September 30, 2011 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at September 30, 2011 is 1,500.

The statements of financial position of Entity A and Entity B immediately before the business combination are:
<table>
<thead>
<tr>
<th></th>
<th>Entity A (legal parent accounting acquire)</th>
<th>Entity B (legal subsidiary, accounting acquirer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>500</td>
<td>700</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>1,300</td>
<td>3,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>1,800</td>
<td>3,700</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>300</td>
<td>600</td>
</tr>
<tr>
<td>Non-Current liabilities</td>
<td>400</td>
<td>1,100</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>700</td>
<td>1,700</td>
</tr>
<tr>
<td>Shareholder’s equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>800</td>
<td>1,400</td>
</tr>
<tr>
<td>Issued equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100 ordinary shares</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>60 ordinary shares</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>Total shareholders equity</td>
<td>1,100</td>
<td>2,000</td>
</tr>
<tr>
<td>Total liabilities and shareholders equity</td>
<td>1,800</td>
<td>3,700</td>
</tr>
</tbody>
</table>
### UNIT 6: IND AS 103 VS AS 14

(NOT RELEVANT FOR EXAMS)

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Basic</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Goodwill or capital reserve (gain on bargain purchase)</td>
<td>Gain on bargain purchase is recognised in CAP.RES. If there is sufficient evidence that shows the appropriateness of bargain purchase gain. Goodwill is not amortised but tested for impairment annually (IND AS 38)</td>
<td>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. Goodwill arising on Amalgamation is amortized over its useful life not exceeding five Years unless a longer period is justified. There is no specific guidance on goodwill Arising on subsidiaries acquired which are not amalgamations. In practice, such goodwill is not amortized but tested for impairment.</td>
</tr>
</tbody>
</table>
| 2.    | Contingent consideration | Initially recognized at acquisition date fair value.  
- Initially recognized at acquisition date fair value  
- Subsequent measurement  
- Contingent consideration classified as equity is not remeasured.  
- Contingent consideration classified as liability generally remeasured at fair value | Period end until 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. In other cases the adjustment is recognized in the profit and loss account as and when it becomes determinable.  
**Others:**  
There is no specific guidance. In practice. In practice, contingent consideration is recognized when the contingency is resolved. |
<table>
<thead>
<tr>
<th>S.No.</th>
<th>Basic</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>value with changes at every reporting settlement with changes in fair value recognized in profit or loss.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 3.   | In-process research and development                                  | • Initially recognized at acquisition date fair value  
• Subsequently measured in accordance with Ind AS 38                                                                                                                                            | There is no specific guidance. |
| 4.   | Measurement period                                                   | Ind AS 103 provides for a measurement period after the acquisition date for the acquirer to adjust the provisional amounts recognized to reflect the additional information that existed as at the date of acquisition.  
The measurement period is limited to one year from the acquisition date.                                                                 | There is no specific guidance. |
<p>| 5.   | Business combination achieved in stages (step acquisition)          | Any equity interest in the acquiree held by the acquirer immediately before the obtaining control over the acquiree is adjusted to acquisition-date fair value.                                                                 | If two or more investment 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. |</p>
<table>
<thead>
<tr>
<th>S.No.</th>
<th>Basic</th>
<th>Ind AS</th>
<th>Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Any resulting gain or loss is recognized in the profit or loss</td>
<td>Appendix C to Ind AS 103 provides detailed guidance on which is very similar to the pooling of interest method as specified by AS 14.</td>
<td>There is no specific guidance. In practice, the determined by the scheme approved through a court order.</td>
</tr>
<tr>
<td>6.</td>
<td>Trasactions between entities under common control</td>
<td>Appendix C to Ind AS 103 provides detailed guidance on which is very similar to the pooling of interest method as specified by AS 14.</td>
<td>There is no specific guidance. In practice, the determined by the scheme approved through a court order.</td>
</tr>
</tbody>
</table>
The balance sheet of Professional Ltd. and Dynamic Ltd. as of 31 March 2012 is given below:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Professional Ltd</th>
<th>Dynamic Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-Current Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property plant and equipment</td>
<td>300</td>
<td>500</td>
</tr>
<tr>
<td>Investments</td>
<td>400</td>
<td>100</td>
</tr>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>250</td>
<td>150</td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivable</td>
<td>450</td>
<td>300</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>200</td>
<td>100</td>
</tr>
<tr>
<td>Others</td>
<td>400</td>
<td>230</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2 000</td>
<td>1 380</td>
</tr>
<tr>
<td><strong>Equity and Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital- Equity shares of rs. 100 each</td>
<td>500</td>
<td>400</td>
</tr>
<tr>
<td>Reserve and surplus</td>
<td>810</td>
<td>225</td>
</tr>
<tr>
<td><strong>Non-Current liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term borrowings</td>
<td>250</td>
<td>200</td>
</tr>
<tr>
<td>Long term provisions</td>
<td>50</td>
<td>70</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>40</td>
<td>35</td>
</tr>
<tr>
<td><strong>Current Liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term borrowings</td>
<td>100</td>
<td>150</td>
</tr>
<tr>
<td>Trade payable</td>
<td>250</td>
<td>300</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2 000</td>
<td>1 380</td>
</tr>
</tbody>
</table>
Other Information

1. Professional Ltd. acquired 70% of Dynamic Ltd on 1 April 2012 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 share of Professional Ltd was ₹ 40 per share.

2. The fair value exercise resulted in the following: (all nos in Lakh)
   a. PPE fair value on 1st April 2012 was ₹ 350 lakhs
   b. Professional Ltd also agreed to pay an additional payment that is higher of 35 lakh and 25% of any excess of Dynamic Ltd in the first year after acquisition over its profit in the preceding 12 months. This additional amount will be due after 2 years. Dynamic Ltd. has earned ₹ 10 lakh profit in the preceding year and expects to earn another ₹ 20 lakh.
   c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of ₹ 20 lakh provided he stays with the Company for two year after the acquisition.
   d. 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 wards 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:
      i. Original award ₹ 5 Lakh
      ii. Replacement award ₹ 8 lakh.
   e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of ₹ 50 lakh. Management reliably estimated the fair value of the liability to be ₹ 5 lakh.
   f. 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 2012. Assume 10% discount rate.
QUESTION 82

1. **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.

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.

**SOLUTION:**

**Scenario 1:** The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.

**Scenario 2:** Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, Financial Instruments: Recognition and Measurement, with a corresponding charge to profit or loss; goodwill is not adjusted.
QUESTION 83

(DISCUSSED IN MTP 2….Q1..REFER MTP VIDEOS)

H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

<table>
<thead>
<tr>
<th>Date</th>
<th>Equity stake purchased</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st November, 20X6</td>
<td>15%</td>
<td>The shares were purchased based on the quoted price on the stock exchange on the relevant dates.</td>
</tr>
<tr>
<td>1st January, 20X7</td>
<td>45%</td>
<td></td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Carrying value (₹ in crore)</th>
<th>Fair value (₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-current assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>40.0</td>
<td>90.0</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>20.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Investments</td>
<td>100.0</td>
<td>350.0</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Trade receivables</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>- Cash held in functional currency</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Other current assets</td>
<td>4.0</td>
<td>4.5</td>
</tr>
<tr>
<td>Non-current asset held for sale</td>
<td>4.0</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>208</td>
<td></td>
</tr>
</tbody>
</table>
**EQUITY AND LIABILITIES:**

<table>
<thead>
<tr>
<th>Equity</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Share capital (face value ₹ 100)</td>
<td>12.0</td>
<td>50.4</td>
</tr>
<tr>
<td>(b) Other equity</td>
<td>141.0</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

**Non-current liabilities**

<table>
<thead>
<tr>
<th>(a) Financial liabilities</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Borrowings</td>
<td>20.0</td>
<td>20.0</td>
</tr>
</tbody>
</table>

**Current liabilities**

<table>
<thead>
<tr>
<th>(a) Financial liabilities</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Trade payables</td>
<td>28.0</td>
<td>28.0</td>
</tr>
<tr>
<td>(b) Provision for warranties</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>(c) Current tax liabilities</td>
<td>4.0</td>
<td>4.0</td>
</tr>
</tbody>
</table>

**TOTAL EQUITY AND LIABILITIES**

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>208.0</td>
</tr>
</tbody>
</table>

**Other information:**

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of ₹ 1 crore and fair value of ₹ 1.2 crore. The date of inception of the lease was 1st April, 20X0. On the inception of the lease, S Ltd. had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 20X7 are considered, the lease would be classified as an operating lease.

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 20X7:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Fair value (₹ in crore)</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law suit filed by a customer for a claim of ₹ 2 crore</td>
<td>0.5</td>
<td>It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.</td>
</tr>
<tr>
<td>Income tax demand of ₹ 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.</td>
<td>2.0</td>
<td>It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.</td>
</tr>
</tbody>
</table>
In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of ₹ 1 crore.

₃ 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 ₹ 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 ₹ 10,000 per share.

On 1st January, 20X7, H Ltd. has paid ₹ 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 20X9, H Ltd. will pay ₹ 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 ₹ 22 crore and ₹ 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  ₹ 350 per share
- As on 1st January, 20X7  ₹ 395 per share
- As on 31st March, 20X7  ₹ 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 ₹ 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 ₹ 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?

**QUESTION 84**

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 ₹ 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.

**SOLUTION:**

At the acquisition date A recognises the gain of ₹ 5,000 in OCI as the gain or loss is not allowed to be recycled to income statement as per the requirement of Ind AS 109. A’s investment in B would be at fair value and therefore does not require remeasurement as a result of the business combination. The fair value of the 5 percent investment (1,05,000) plus the fair value of the consideration for the 95 percent newly acquired interest is included in the acquisition accounting.

**QUESTION 85**

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?

**SOLUTION:**

No. This is not a business combination of entities under common control. Mr. Ram’s control of both entities before the business combination was transitory. The substance of the transaction is that entity B has obtained control of entity A. Entity B accounts for this transaction as a business combination under Ind AS 103 using acquisition accounting.

**QUESTION 86**

On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ₹ 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 ₹ 500 and the liabilities assumed are measured at ₹ 100. Alpha Ltd. engages an independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ₹ 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?

**SOLUTION:**

The amount of Beta Pvt. Ltd. identifiable net assets (₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in Beta Pvt. Ltd. (₹ 384 calculated as 300 + 84). Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:
### Question 87

ABC Ltd. prepares consolidated financial statements up to 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 ₹ 6.50 and the market value of an equity share in JKL Ltd. was ₹ 6.

- **On 30th June, 20X2,** ABC Ltd. will make a cash payment of ₹ 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 ₹ 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 ₹ 2,50,00,000. On 31st March, 20X2, the fair value of the contingent consideration was ₹ 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 ₹ 6,00,00,000. On 1st July, 20X1, the fair values of these net assets was ₹ 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.