CA-FINAL

FINANCIAL REPORTING

Module-4 :

(As per Latest Amendments Made by ICAI & MCA)

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Dedicated to

BABA VISHAN PURI JI MAHARAJ

BABA LAKSHMAN PURI JI MAHARAJ

CONTENTS

CONSOLIDATED FINANCIAL STATEMENTS

IMPORTANT DEFINITIONS

- **Associate:** An associate is an entity over which the investor has significant influence.
- **Consolidated Financial Statements:** The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
- **Control over an investee:** An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- **Group:** A parent and its subsidiaries.
- **Joint arrangement:** A joint arrangement is an arrangement of which two or more parties have joint control.
- **Joint control:** Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.
- **Joint operation:** A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- **Joint venture:** A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.
- **Non-controlling interest:** Equity in a subsidiary not attributable, directly or indirectly, to a parent.
- **Parent:** An entity that controls one or more entities.
- **Power:** Existing rights that give the current ability to direct the relevant activities.
- **Separate financial statements:** Separate financial statements are those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with Ind AS 109 'Financial Instruments'.
- **Significant influence:** Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.
- **Subsidiary:** An entity that is controlled by another entity.

CONCEPT 1

EXEMPTIONS FROM CONSOLIDATED FINANCIAL STATEMENTS

OBJECTIVE

The objective of Ind AS 110 ' Consolidated Financial Statements' is to establish principles for the presentation and preparation of consolidated financial statements when an entity (the parent) controls one or more other entities (subsidiaries).

SCOPE

A parent who controls one or more entities is required to present consolidated financial statements.

However, a parent is not required to present consolidated financial statements if it meets all of the following four conditions.

Condition 1: The parent is either a wholly owned subsidiary or a partially owned subsidiary of another entity. Further its other owners (including those not entitled to vote) have been informed and do not object, to the parent not presenting the consolidated financial statements.

Condition 2: The equity instruments or the debt instruments of the parent are not traded in a public market. The public market could be a domestic or foreign stock exchange or an over the counter market including local and regional markets.

Condition 3: The parent has neither filed nor is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market.

Condition 4: The ultimate or any intermediate parent, of the parent (that is required to present consolidated financial statements), produces financial statements that are available for public use and comply with Ind AS, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.

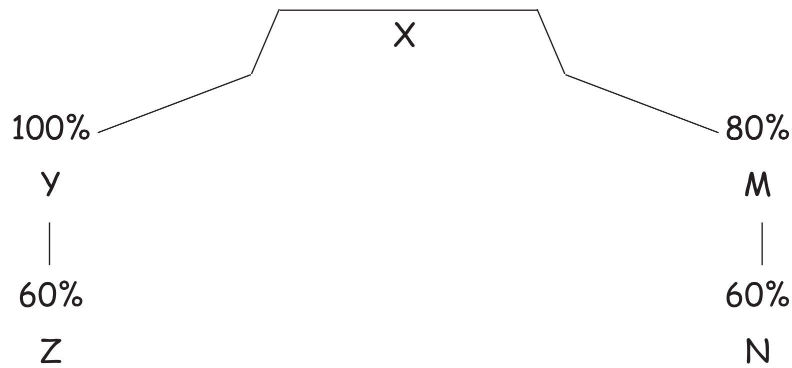
QUESTION 1

Exemption from preparing consolidated financial statements.

Entity X owns the following other entities:

1. 100% interest in entity Y. Entity Y owns 60% interest in entity Z.
2. 80% interest in entity M. Entity M owns 60% interest in entity N.

The structure is illustrated as follows:



Entity X is a listed company and prepares IND AS compliant consolidated financial statements. Entities Y & M do not have their securities publically traded & they are not in the process of issuing securities in public markets. Entity X does not require its subsidiary M to prepare consolidated financial statements.

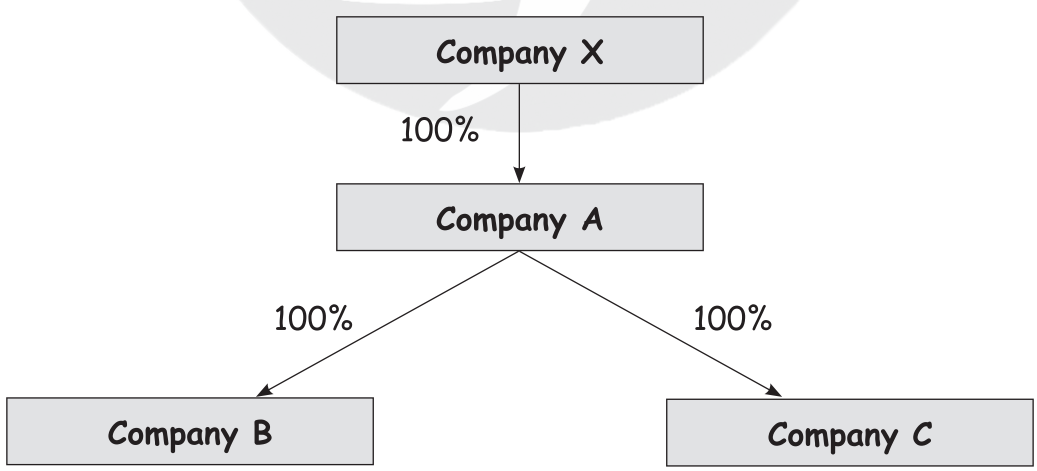
ANALYSE HOW M & Y CAN GET EXEMPTIONS FROM CONSOLIDATION

QUESTION 2:

Exception to prepare consolidated financial statements

Scenario A:

Following is the structure of a group headed by Company X:



Company X is a listed entity in India and prepares consolidated financial statements as per the requirements of Ind AS. Company A is an unlisted entity and it is not in the process of listing any of its instruments in public market. Company X does not object to Company A not preparing consolidated financial statements. Whether Company A is required to prepare consolidated financial statements as per the requirements of Ind AS 110?

Scenario B:

Assume the same facts as per Scenario A except, Company X is a foreign entity and is listed in stock exchange of a foreign country and it prepares its financial statements as per the generally accepted accounting principles (GAAP) applicable to that country. Will your answer be different in this case?

Scenario C:

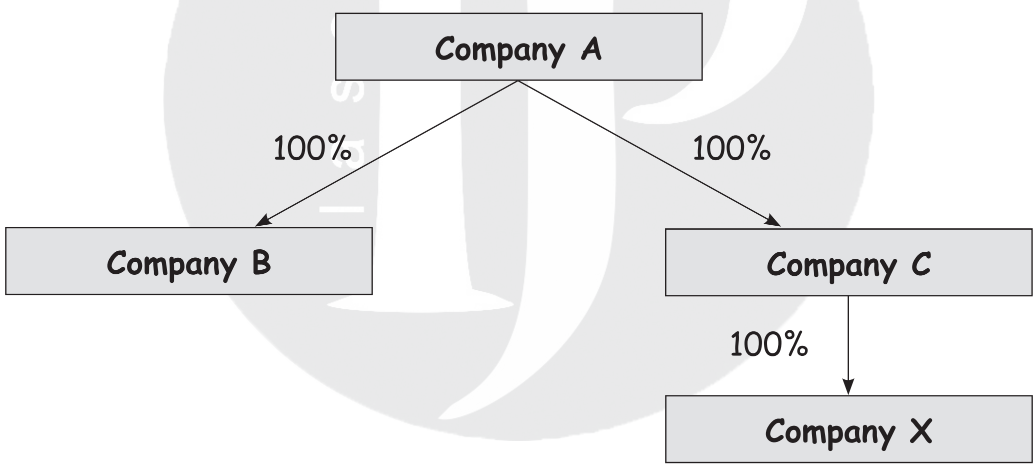
Assume the same facts as per Scenario A except, 100% of the investment in Company A is held by Mr. X (an individual) instead of Company X. Will your answer be different in this case?

QUESTION 3:

Exception to prepare consolidated financial statements

Scenario A:

Following is the structure of a group headed by Company A.



Company A is a listed entity in India and prepares consolidated financial statements as per the requirements of Ind AS. Company C is an unlisted entity and it is not in the process of listing any of its instruments in public market. 60% of the equity share capital of Company C is held by Company A and balance 40% equity share capital is held by other outside investors. Company A does not object to Company C not preparing consolidated financial statements. Whether Company C is required to prepare consolidated financial statements as per the requirements of Ind AS 110?

Scenario B:

Assume the same facts as per Scenario A except, the balance 40% of the equity share capital of Company C is held by Company B.

State whether C Limited is required to inform its other owner B Limited (owning 40%) of its intention to not prepare consolidated financial statements as mentioned in paragraph 4(a)(i)?

EXCEPTION 1

Ind AS 110 does not apply to post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19 'Employee Benefits' applies. Therefore, an entity which has set up such plans should not consolidate them.

Example

Company A has set up an Employee Gratuity Plan trust for the purpose of giving gratuity benefits to its employees. The gratuity benefit given by the company is a post-employee benefit plan which is accounted as per Ind AS 19 (refer Unit 1 of Chapter 9 for the accounting of employee benefit plans as per Ind AS 19). So, Company A is not required to evaluate whether it controls the trust and should not consolidate it.

EXCEPTION 2

An investment entity that is required to measure all of its subsidiaries at fair value through profit or loss need not present consolidated financial statements. This exception is further explained subsequently in this unit.

CONCEPT 2: CONTROL EVALUATION

As per Ind AS 110, an investor needs to determine whether it controls an investee and if yes then the investor would be treated as a parent and the investee would be treated as a subsidiary of the parent.

An investor controls an investee if and only if the investor has **all of the following three elements:**

Power over the investee + Exposure, or rights, to variable returns from the investee + Ability to use power over the investee to affect the investor's returns = Control over the investee

EXPLNATION ON POWER

The first criterion of control evaluation is to determine whether the investor has power over the investee. An investor gets power over an investee if it has three elements:

A. **existing rights** that give it

B. the **current ability**

C. to direct the **relevant activities** of the investee.

How to identify the relevant activities and how the decisions about those activities are made?

Relevant activities are the activities of investee that significantly affect the investee's returns.

There may be range of operating and financing activities that would significantly affect the returns of an investee. Examples of activities related to operating and financing activities that can be relevant activities include, but not limited to:

Selling and purchasing of goods and services	Managing financial assets during their life (including upon default)	Selecting, acquiring or disposing of assets
Researching and developing new products or processes	Determining a funding structure or obtaining funding	Establishing operating and capital decisions of the investee, including budgets

Appointing, terminating and remunerating an investee's key management personnel or service providers

QUESTION 4

Different investors have ability to direct different relevant activities

A Ltd. and B Ltd. have formed a new entity AB Ltd. for constructing and selling a scheme of residential units consisting of 100 units. Construction of the residential units will be done by A Ltd. and it will take all the necessary decision related to the construction activity. B Ltd. will do the marketing and selling related activities for the units and it will take all the necessary decisions related to marketing and selling. Based on above, who has the power over AB Ltd.?

SOLUTION:

In this case, both the investors A Ltd. and B Ltd. have the rights to unilaterally direct different relevant activities of AB Ltd. Here, investors shall determine which activities can most significantly affect the returns of the investee and the investor having the ability to direct those activities would be considered to have power over the investee. Hence, if the investors conclude that the construction related activities would most significantly affect the returns of AB Ltd. then A Ltd. would be said to have power over AB Ltd. On the other hand, if it is concluded that marketing and selling related activities would most significantly affect the returns of AB Ltd. then B Ltd. would be said to have power over AB Ltd.

QUESTION 5

Determining the relevant activities

A Ltd. is an asset manager of a venture capital fund i.e. Fund X. Out of the total outstanding units of the fund, 10% units are held by A Ltd. and balance 90% units are held by other investors. Majority of the unitholders of the fund have right to appoint a committee which will manage the day to day administrative activities of the fund. However, the decisions related to the investments / divestments to be done by Fund X is taken by asset manager i.e. A Ltd. Based on above, who has power over Fund X?

SOLUTION:

In this case, A Ltd. is able to direct the activities that can most significantly affect the returns of Fund X. Hence A Ltd. has power over the investee. However, this does not mean that A Ltd. has control over the fund and consideration will have to be given to other elements of control evaluation as well i.e. exposure to variable returns and link between power and exposure to variable returns.

RIGHTS THAT GIVE POWER TO AN INVESTOR

Power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities.

The rights that give an investor power over an investee can differ investee by investee. Following are some of the examples (not an exhaustive list) of various forms of rights that, either individually or in combination with other rights, can give power to an investor:

Form of right	Illustration
Voting rights or potential voting rights of an investee (this is further explained subsequently in this unit).	An investor holding majority of the equity share capital of an investee. Concepts of power through voting or potential voting rights
Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities.	An investor having right to appoint majority of the members of the Board of Director who have power to take decisions related to relevant activities.
Rights to appoint or remove another entity that directs the relevant activities.	Right with an investor to appoint or remove an asset manager who takes decisions related to investments / divestments by a venture capital fund.

Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.	Right related to relevant activities given to a single investor by all other investors through a shareholders' agreement

SUBSTANTIVE RIGHTS VS PROTECTIVE RIGHTS

For the purpose of determination of power over an investee, an investor shall consider only those rights which are substantive. Protective rights are not considered for the determination of power. Below table summarises the difference between substantive rights and protective rights:

Substantive rights	Protective rights
Substantive rights can give the investor power over the investee.	Protective rights do not give investor power over the investee.
Substantive rights relate to the relevant activities of the investee.	Protective rights relate to protect the interest of the party holding those rights without giving the holder the right over the relevant activities of the investee.

Both the above rights are discussed below in detail.

1. Substantive rights

For a right to be substantive, the holder must have the practical ability to exercise that right.

Assessment of whether the rights are substantive requires judgement taking into consideration all the facts and circumstances. Following are some of the factors (not an exhaustive list) that should be considered while assessing whether the rights are substantive or not:

a) Whether there are any barriers that prevent the holder from exercising the rights. Example of such barriers (not an exhaustive list) can be as follows:

- Financial penalties and incentives
- High exercise or conversion price
- Operational barriers or incentives. For example, in case of a venture capital fund managed by an asset manager, there is absence of other managers willing or able to provide specialised services or provide the services and take on other interests held by the existing manager.

- legal or regulatory requirements. For example, where a foreign investor is prohibited from exercising its rights

b) When the exercise of rights requires agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so. The lack of such a mechanism is an indicator that the rights may not be substantive.

c) Whether the party or parties that hold the rights would benefit from the exercise of those rights. For example, the holder of potential voting rights in an investee shall consider the exercise or conversion price of the instrument. The potential voting rights are more likely to be substantive when the exercise price is lower than the market price or when there are other synergies anticipated between the investor and the investee.

QUESTION 6

Current ability to direct the relevant activities

An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager.

The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee.

The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor.

Based on the above, who has power over the investment vehicle?

SOLUTION:

Managing the investee's asset portfolio is the relevant activity of the investee.

The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value.

The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

QUESTION 7:

VOTING RIGHTS ARE SUBSTANTIVE OR NOT

Scenario A:

Following is the voting power holding pattern of B Ltd.

- 10% voting power held by A Ltd.
- 90% voting power held by 9 other investor each holding 10%

All the investors have entered into a management agreement whereby they have granted the decision-making powers related to the relevant activities of B Ltd. to A Ltd. for a period of 5 years.

After 2 years of the agreement, the investors holding 90% of the voting powers have some disputes with A Ltd. and they want to take back the decision-making rights from A Ltd. This can be done by passing a resolution with majority of the investors voting in favour of the removal of rights from A Ltd. However, as per the termination clause of the management agreement, B Ltd. will have to pay a huge penalty to A Ltd. for terminating the agreement before its stated term.

Whether the rights held by investors holding 90% voting power are substantive?

Scenario B:

Assume the same facts as per Scenario A except, there is no penalty required to be paid by B Ltd. for termination of agreement before its stated term. However, instead of all other investors, there are only 4 investors holding total 40% voting power that have disputes with A Ltd. and want to take back decision-making rights from A Ltd.

Whether the rights held by investors holding 40% voting power are substantive?

SOLUTION:

Scenario A:

If the investors holding 90% of the voting power exercise their right to terminate the management agreement, then it will result in B Ltd. having to pay huge penalty which will affect the returns of B Ltd. This is a barrier that prevents such investors from exercising their rights and hence such rights are not substantive.

Scenario B:

To take back the decision-making rights from A Ltd., investors holding majority of the voting power need to vote in favour of removal of rights from A Ltd. However, the investors having disputes with A Ltd. do not have majority voting power and hence the rights held by them are not substantive.

QUESTION 8:

Potential voting rights are substantive or not

Scenario A:

An investor is holding 30% of the voting power in ABC Ltd. The investor has been granted an option to purchase 30% more voting power from other investors. However, the exercise price of the option is too high compared to the current market price of ABC Ltd. because ABC Ltd. is incurring losses since last 2 years and it is expected to continue to incur losses in future period as well. Whether the right held by the investor to exercise purchase option is substantive?

Scenario B:

Assume the same facts as per Scenario A except, the option price is in line with the current market price of ABC Ltd. and ABC Ltd. is making profits. However, the option can be exercised in next 1 month only and the investor is not in a position to arrange for the require amount in 1 month's time to exercise the option. Whether the right held by the investor to exercise purchase option is substantive?

Scenario C:

Assume the same facts as per Scenario A except, ABC Ltd. is making profits. However, the current market price of ABC Ltd. is not known since the ABC Ltd. is a relatively new company, business of the company is unique and there are no other companies in the market doing similar business. Hence the investor is not sure whether to exercise the purchase option. Whether the right held by the investor to exercise purchase option is substantive?

SOLUTION:

Scenario A:

The right to exercise purchase option is not substantive since the option exercise price is too high as compared to current market price of ABC Ltd.

Scenario B:

The right to exercise purchase option is not substantive since the time period for the investor to arrange for the requisite amount for exercising the option is too narrow.

Scenario C:

The right to exercise purchase option is not substantive. This is because the investor is not able to obtain information about the market value of ABC Ltd. which is necessary in order to compare the option exercise price with market price so that it can decide whether the exercise of purchase option would be beneficial or not.

QUESTION 9:

Removal rights are substantive or not

A venture capital fund is managed by an asset manager who has right to take the investment and divestments decisions related to the fund corpus. The asset manager is also holding some stake in the fund. The other investors of the fund have right to remove the asset manager.

However, in the present scenario, there is absence of other managers who are willing or able to provide specialised services that the current asset manager is providing and purchase the stake that the current asset manager is holding in the fund. Whether the removal rights available with other investors are substantive?

SOLUTION:

If the other investors exercise their removal rights, then it will impact the operations of the fund and ultimately the returns of the fund since there is no substitute of the current asset manager available who can manage the corpus of the fund. Hence the removal rights held by other investors are not substantive.

EXCEPTIONS TO SUBSTANTIVE RIGHTS

For a right to be substantive, it should be exercisable when decisions about the direction of the relevant activities need to be made. In most of the cases a right, to be a substantive right, rights need to be currently exercisable.

However, there may be some situations where a right can be substantive, even though it may not be currently exercisable.

QUESTION 10

In case of an investor currently holding only 30% voting rights in a company has an option to purchase additional 40% voting rights to increase its voting rights to 70%. The option can be exercised within next 25 days. Also, there is a meeting of shareholding scheduled to be held after 30 days to take decision about relevant activities of the company.

SOLUTION:

In such case, even though the investor is not currently holding majority voting power, it can exercise the purchase option and increase its voting power to 70% by the time when the decisions about the relevant activities are to be made. Hence such rights are substantive rights.

2. PROTECTIVE RIGHTS

Protective rights are the rights designed to protect the interest of the party holding those rights **without giving that party power over the entity to which those rights relate.**

Protective rights do not give its holder power or prevent another party from having power over an investee. The examples of protective rights include, but not limited to, following:

- A right exercisable by an investor only in the event of a fraud or default by other investors having power to take decisions about relevant activities
- *A lender's right to appoint its nominee director in the Board of a borrower to ensure the borrower do not engage in any activities that significantly increase the credit risk of borrower
- Rights held by minority shareholders to approve decisions related to capital expenditure greater than required in normal course of business or to approve issue of equity or debt instruments
- A lender's right to seize the assets of a borrower if the borrower defaults in repayment of loan instalments
- Rights of investors to approve or block decisions related to change in the name of the investee, amendment to constitutional documents of the investee to enter into a new business, change in the registered office of the investee, etc.

The effect of substantive and protective rights is summarised below:

Types of rights held by investor	+	Types of rights held by other parties	=	Conclusion on 'power'?
Substantive	+	Protective	=	Investor has power
Protective	+	Substantive	=	Other parties have power
Substantive	+	Substantive	=	Further evaluation needed

FRANCHISES (PROTECTIVE RIGHTS)

Apart from the examples of protective rights mentioned above, one more example can be of rights of a franchisor in a franchise agreement. In a franchise agreement, the investee i.e. the franchisee usually give the franchisor the rights that are related to protect the franchise brand.

QUESTION 11:

Protective rights of a franchisor

ABC Ltd. is a manufacturer of branded garments and is the owner of Brand X. PQR Ltd. has entered into a franchise agreement with ABC Ltd. to allow PQR Ltd. to set up a retail outlet to sell the products of Brand X.

As per the agreement, PQR Ltd. will set up the retail outlet from its own funds, decide the capital structure of the entity, hire employees and their remuneration, select vendors for acquiring capital items, etc. However, ABC Ltd. will give certain operating guidelines like the interior of the retail outlet, uniform of the employees and other such guidelines to protect the brand name of ABC Ltd.

Whether the rights held by ABC Ltd. protective or substantive?

SOLUTION:

The activities that most significantly affect the returns of PQR Ltd. are the funding and capital structure of PQR Ltd., hiring of employees and their remuneration, vendors for capital items, etc.

which are exercisable by PQR Ltd. Further, the retails outlet is being set up by PQR Ltd. without any financial support from ABC Ltd. The rights available with ABC Ltd. are to protect the brand name of ABC Ltd. and such rights do not affect the ability of PQR Ltd. to take decisions about relevant activities. Hence, the rights held by ABC Ltd. are protective rights.

VOTING RIGHTS

POWER THROUGH VOTING RIGHTS

In the most straightforward cases, the investor that holds a majority of voting rights has power over an investee. However, there can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee.

A. Power with a majority of the voting rights

An investor that holds more than half of the voting rights of an investee has power in the following situations:

The relevant activities are directed by a vote of the holder of the majority of the voting rights	OR	A majority of the members of the governing body that directs the relevant activities are appointed by a vote of the holder of the majority of the voting rights

For example, in case of a company where the decisions related to relevant activities are taken by Board of Directors of the company and the Board members are appointed by shareholder holding majority of the voting rights. Then the shareholder holding majority of the voting rights has power over the company.

B. Power without a majority of voting rights

There can be certain cases where an investor can have power even if it holds less than a majority of the voting rights of an investee. Following are the examples of power without majority voting rights:

- Contractual arrangement with other vote holders
- Rights from other contractual arrangements
- The investor's voting rights
- Potential voting rights
- Combination of all of above

Contractual arrangement with other vote holders

An investor, who is not holding voting rights that are sufficient to given it power over the investee, may enter into a contract with other vote holders to give the investor rights to exercise voting rights which are sufficient to have power over the investee. In such case, the investor would direct the other vote holders on how they should vote whereby the investor gets power to direct the decision related to relevant activities.

Rights from other contractual arrangements

Apart from holding voting rights, an investor might be having decisions-making rights related to relevant activities of the investee pursuant to a contractual arrangement. Such contractual rights in combination with voting rights may give investor power to direct the relevant activities like manufacturing process of the investee or other operating and financing activities of the investee.

However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee.

The investor's voting rights

There may be certain situations where even though an investor is not holding majority of the voting rights, but the voting rights held by it are sufficient to give it practical ability to have power over the investee unilaterally. Generally, this is termed as de-facto control.

In assessing the sufficiency of the voting rights of an investor, one should consider the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders. This is interpreted as follows:

Particulars	Higher number or size	Lower number or size
Number of voting rights held by investor	More likely to have power	Less likely to have power
Size of investor's voting rights relative to voting rights held by other holders	More likely to have power	Less likely to have power
Number of parties required to outvote the investor	More likely to have power	Less likely to have power

QUESTION 12:

Voting rights of investor are sufficient to give it power

An investor holds 45% of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Whether the investor holding 45% voting right have power over the investee?

SOLUTION:

On the basis of the absolute size of its holding by the investor and the relative size of the voting rights held by other shareholders, it is more likely that the investor would have power over the investee.

QUESTION 13:

Voting rights of investor are sufficient to give it power

ABC Ltd. holds 40% of the voting rights of XYZ Ltd. The remaining voting rights are held by 6 other shareholders, each individually holding 10% each. Whether the investor holding 40% voting right have power over the investee?

SOLUTION:

In this case, it is less likely that ABC Ltd. will have power over XYZ Ltd. since the size of the number of shareholders required to outvote ABC Ltd. is not so high. Additional facts and circumstances should also be considered to determine whether ABC Ltd. has power or not.

QUESTION 14:

Voting patterns at previous shareholders' meetings

An investor holds 35% of the voting rights of an investee. Three other shareholders each hold 5% of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings—75% of the voting rights of the investee have been cast at recent relevant shareholders' meetings.

Whether the investor's voting rights are sufficient to give it power to direct the relevant activities of the investee?

SOLUTION:

In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

POTENTIAL VOTING RIGHTS

Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options or forward contracts. Those potential voting rights are considered only if the rights are substantive as per the guidance discussed earlier.

When considering potential voting rights, an investor shall consider the purpose and design of the instrument giving those rights as well as any other benefits that the investor would get from the exercise of those rights.

Potential voting rights are to be considered in combination with voting or other decisions-making rights that the investor might have to assess whether investor has power or not.

QUESTION 15:

Potential voting rights

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price. The conversion rights are substantive. If the debt were converted, investor A would hold 60% of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Whether investor A has power over the investee?

SOLUTION:

Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

POWER OTHER THAN THROUGH VOTING RIGHTS

When voting rights cannot have a significant effect on an investee's returns, such as when voting rights relate to administrative tasks only the investor shall consider following factors to determine whether it has power over the investee:

- Purpose and design of the investee
- Contractual arrangements
- Special relation between investor and investee

Purpose and design of the investee

Evaluation of purpose and design of the investee helps in:

- identification of relevant activities of the investee,
- how decisions about the relevant activities are made,
- who has the current ability to direct those activities, and
- who receives returns from those activities.

In assessing the purpose and design of an investee, an investor shall consider its involvement and decisions made at the time of design of the investee and evaluate whether such involvement provide the investor with rights that are sufficient to give it power. Being involved in the design of an investee alone is not sufficient to give an investor control. However, involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee.

QUESTION 16:

Purpose and design of the investee

PQR Ltd. has entered into a contract with a state government to construct a power plant and distribute the electricity generated from the plant to the households of the state. For this, PQR Ltd. has set up a new entity XYZ Ltd. PQR Ltd. was involved in the design of XYZ Ltd. The decisions related to the relevant activities of XYZ Ltd. i.e. how much electricity to generate or the price at which units of electricity to be sold to customers, etc. are not determined by the voting rights. Whether PQR Ltd. has power over XYZ Ltd.?

SOLUTION:

PQR Ltd. was involved in the design of XYZ Ltd. Accordingly, its involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee. However, being involved in the design of XYZ Ltd. alone is not sufficient to give PQR Ltd. control over XYZ Ltd. and hence other facts and circumstances, such as other contractual arrangements, should also be considered.

Contractual arrangements

An investor shall consider contractual arrangements such as call rights, put rights and liquidation rights that give it explicit or implicit decision-making rights that are closely related to the relevant activities of the investee even though they may occur outside the legal boundaries of the investee.

For some investees, decisions about relevant activities are required to be taken only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only those decisions that are required to be taken when those circumstances or events occur would significantly affect its returns and thus be relevant activities. However, it is not necessary for those circumstance or events to actually occur to establish that investor has power over the investee. The fact that the investor has rights to take those decisions whenever required is sufficient to establish power.

QUESTION 17:

Rights contingent upon future events

An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. Following is the relevant fact pattern:

- The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due.
- Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in an agreement between the investee and the investor.
- The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns.
- Managing the receivables before default is not a relevant activity because the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors.

Whether the investor has power over the investee?

SOLUTION:

In this question, the design of the investee ensures that the investor has decision-making power only in case of default of a receivable. The terms of the agreement between investee and investor are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

QUESTION 18:

Commitment to ensure that an investee operates as designed

A Ltd. is a manufacturer of pharmaceutical products. A Ltd. has invested in share capital of B Ltd. which is a manufacturer of packing material for pharmaceutical products. A Ltd.'s requirements of packing materials for its products are entirely supplied by B Ltd. A Ltd. is not purchasing the packing materials from any other vendors because the materials supplied by other vendors are of inferior quality. Whether A Ltd. has power over B Ltd.?

SOLUTION:

A Ltd. would be the most affected by the operations of B Ltd. since it is dependent on B Ltd. for the supply of packing materials. Therefore A Ltd. would be committed to ensure that B Ltd. operates as designed. This can be an indicator of A Ltd. having power over B Ltd. But it has to consider other facts and circumstances as well to conclude whether it control B Ltd. or not.

EXPOSURE, OR RIGHTS, TO VARIABLE RETURNS FROM AN INVESTEE

When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to 'variable returns' from its involvement with the investee.

Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative. It should be noted that the term used is 'returns' and not 'benefits' which are often interpreted as implying only positive returns.

Following are some of the examples of variable returns:

Variable returns from an investee		
Dividends, other distributions of economic benefits from an investee (eg interest from debt securities) Changes in the value of the investor's investment in that investee.	Remuneration for servicing an investee's assets or liabilities Fees and exposure to loss from providing credit or liquidity support Residual interests in the investee's assets and liabilities on liquidation Tax benefits Access to future liquidity	Returns that are not available to other interest holders

Exposure to variable returns is not in itself enough to conclude the assessment of control. An investor should have power over the investee and the ability to use its power to affect the amount of the investor's returns from its involvement with the investee.

For example, it is common for a lender to have an exposure to variable returns from a borrower through interest payments that it receives from the borrower, that are subject to credit risk. However, the lender would not control the borrower if it does not have the ability to affect those interest payments (which is frequently the case).

LINK BETWEEN POWER AND RETURNS

An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)). An investor that is an agent does not control an investee when it exercises decision-making rights delegated to it.

An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly.

A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all the factors below, in determining whether it is an agent:

Rights held by other parties	Remuneration from the investee	Exposure to variable returns from other interests in the investee

Rights held by other parties

Substantive removal or other rights may indicate that the decision maker is an agent.

Removal rights

Removal rights are rights to deprive the decision-maker of its decision making authority. The removal rights held by other should be considered as follows:

Single party holds substantive removal rights and can remove the decision maker **without cause**, this, in isolation, is sufficient to conclude that the decision maker is an **agent.**

↓

If **more than one party holds such rights** (and no individual party can remove the decision maker without the agreement of other parties) those rights are **not, in isolation, conclusive** in determining that a decision maker is an agent.

↓

The **greater the number of parties** required to act together to exercise removal rights and the **greater the magnitude** of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the **less the weighting** that shall be placed on removal rights.

Other substantive rights

If other parties hold substantive rights that can restrict the decision maker from exercising its discretion shall be considered in similar manner to removal right when evaluating whether the decision maker is an agent.

For example, a decision maker that is required to obtain approval from a small number of other parties for its actions is generally an agent.

Consideration of the rights held by other parties shall include an assessment of any rights exercisable by an investee's board of directors (or other governing body) and their effect on the decision-making authority.

Rights to remuneration

The remuneration of the decision maker is **commensurate** with the services provided

- No → Not an agent
- Yes ↓

The remuneration agreement includes only terms, conditions or amounts that are **customarily present** in arrangements for similar services and level of skills negotiated on an arm's length basis.

- No → Not an agent
- Yes → More likely to be an agent but other facts and circumstances should also be considered

Exposure to variable returns from other interests in the investee

A decision maker that holds other interests in an investee (like investments in the investee or provides guarantees with respect to the performance of the investee), shall consider its exposure to variability of returns from those interests in assessing whether it is an agent. Holding other interests in an investee indicates that the decision maker may be a principal.

In evaluating the exposure to variability of returns, the decision maker shall consider the magnitude of variability as follows:

Decision maker is a principal

↑ Higher

The magnitude of, and variability associated with, its economic interests, considering its remuneration and other interests in aggregate

↓ Lower

Decision maker is an agent

It is to be noted that here the decision maker needs to consider the remuneration and other interests in aggregate. Hence, even though in case the decision maker had concluded in the initial assessment about remuneration that it is an agent, it needs to again consider remuneration in the assessment of exposure to variable returns.

The decision maker shall evaluate its **exposure relative to the total variability** of returns of the investee. This evaluation is made primarily on the basis of returns expected from the activities of the investee but **shall not ignore** the decision maker's **maximum exposure to variability** of returns of the investee through other interests that the decision maker holds.

For example, if a variation in investees returns by 1% causes variation in decision maker's returns from investee by less than 1%. However, a variation in investee's returns by ₹ 100 causes variation in decision maker's returns from investee by ₹ 150 because of significant variation in the market price of the equity shares of the investee.

QUESTION 19:

Link between power and returns

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Following is the relevant fact pattern related to fund manager:

- Within the defined parameters, the fund manager has discretion about the assets in which to invest.
- The fund manager has made a 10% pro rata investment in the fund and receives a market- based fee for its services equal to 1% of the net asset value of the fund.
- The fees are commensurate with the services provided.
- The fund manager does not have any obligation to fund losses beyond its 10% investment.
- The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager but can redeem their interests within particular limits set by the fund.

Whether the fund manager controls the fund?

SOLUTION:

Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this case, consideration of the fund manager's exposure to variability of returns from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

QUESTION 20:

Link between power and returns

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market- based fee for its services equal to 1% of assets under management and 20% of all the fund's profits if a specified profit level is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to various scenarios described below. Each scenario is considered in isolation. Determine whether the fund manager control the fund?

Scenario A

The fund manager also has a 2% investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2% investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

Scenario B

The fund manager has a more substantial pro rata investment in the fund but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

Scenario C

The fund manager has a 20% pro rata investment in the fund but does not have any obligation to fund losses beyond its 20% investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

SOLUTION:

Scenario A

The fund manager's 2% investment increases its exposure to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of returns from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Scenario B

In this scenario, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20% investment to be sufficient to conclude that it controls the fund. However, in different circumstances (i.e. if the remuneration or other factors are different), control may arise when the level of investment is different.

Scenario C

Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20% investment together with its remuneration creates exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this scenario, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of returns of the fund from its remuneration and investment, the substantive rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

QUESTION 21:

Link between power and returns

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee.

The transaction was marketed to potential debt investors as an investment in a portfolio of asset- backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio.

On formation, the equity instruments represent 10% of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e. 1% of assets under management) and performance-related fees (i.e. 10% of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35% of the equity in the investee. The remaining 65% of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third-party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

Does the asset manager control the investee?

SOLUTION:

The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35% of the equity and from its remuneration.

Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns - the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its equity interest, which is subordinate to the debt instruments. Holding 35% of the equity creates subordinated exposure to losses and rights to returns of the investee, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls the investee.

QUESTION 22:]

Link between power and returns

A decision maker (the sponsor) sponsors a fund, which issues short-term debt instruments to unrelated third-party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the fund. Each transferor services the portfolio of assets that it sells to the fund and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the fund. The sponsor establishes the terms of the fund and manages the operations of the fund for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the fund, approves the assets to be purchased by the fund and makes decisions about the funding of the fund. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the fund and also provides credit enhancement and liquidity facilities to the fund. The credit enhancement provided by the sponsor absorbs losses of up to 5% of all of the fund's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor. Whether the sponsor has control over the fund?

SOLUTION:

Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of returns from the activities of the fund because of its rights to any residual returns of the fund and the provision of credit enhancement and liquidity facilities (i.e. the fund is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the fund, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that most significantly affect the fund's returns (i.e. the sponsor established the terms of the fund, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the fund (for which new investment must be found on a regular basis)). The right to residual returns of the fund and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of returns from the activities of the fund that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the fund. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

CONCEPT 3

ACCOUNTING FOR SUBSIDIARIES

STATUTORY REQUIREMENTS

The Companies Act, 2013 requirements

Section 129 sub-section (3) & (4) of the Companies Act, 2013 provides for the consolidation of accounts. The relevant text is as under:

- **129 (3) :** Where a company has one or more subsidiaries, it shall, in addition to financial statements provided under sub—section (2), prepare a consolidated financial statement of the company and all its subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub—section (2).

Provided that the company shall also attach along with its financial statement a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in such form as may be prescribed.

Provided further that the Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed.

Explanation: For the purpose of this sub—section, the word 'subsidiary' shall include associate and joint venture.

- **129 (4):** The provisions of this Act, applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements referred to in sub-section (3).

The Companies (Accounts) Rules, 2014

The relevant rules are rules 5 & 6 of the Companies (Accounts) Rules, 2014. The relevant extracts of these rules are reproduced as under:

- **Form of statement containing salient features of financial statements of subsidiaries — Rule 5 :** The statement containing the salient features of the financial statement of a company's subsidiary or subsidiaries, associate company or companies and joint venture or ventures under the first proviso to sub—section (3) of section 129 shall be in Form AOC — 1 (appended as Annexure I at the end of this chapter).
- **Manner of consolidation of accounts — Rule 6:** The consolidation of financial statements of the company shall be made in accordance with the
    - provisions of Schedule III of the Act and
    - the applicable standards.

Provided that in case of a company covered under sub—section (3) of section 129 which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act. (Refer Annexure II at the end of the chapter)

Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:

It is a wholly owned subsidiary or is a partially owned subsidiary of another company

and all its members, including those not otherwise entitled to vote, having been intimated in writing and for which proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

It is a company whose securities are not listed or are not in the process of listing on any

stock exchange, whether in India or outside India; and

Its ultimate or any intermediate holding company files consolidated financial statements

with the Registrar which are in compliance with the applicable Accounting Standards.

Ind AS 110, 'Consolidated Financial Statements' and Division II of Schedule III to the Companies Act, 2013 (Refer Annexure II) should be applied in the preparation and presentation of consolidated financial statements which includes:

i Consolidated Balance Sheet;

ii Consolidated Statement of Profit and Loss;

iii Consolidated Statement of Changes in Equity;

iv Consolidated Cash Flow Statement;

v Consolidated Notes to the Financial Statements.

When a company is required to prepare Consolidated Financial Statements, the company shall mutatis mutandis follow the requirements of Schedule III to the Companies Act, 2013 as applicable to a company in the preparation of balance sheet, statement of changes in equity and statement of profit and loss in addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules 2015. In addition, the company shall disclose additional information as required by Ind AS 27 and Ind AS 112 (Refer Unit 8).

CONSOLIDATION PROCEDURES for CONSOLIDATED BALANCE SHEET

Process

1. Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
2. Consolidated financial statements:
   - Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
   - Offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Ind AS 103 Business Combination' explains how to account for any related goodwill).
   - Eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full).
3. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements.
4. Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Calculation of goodwill / capital reserve

1. It will be useful to refer the provisions of Ind AS 103, 'Business Combinations' when computing the goodwill / capital reserve in the case of acquisition of a subsidiary. As per Ind AS 103:
   - Business combination is a transaction or other event in which an acquirer obtains control of one or more businesses;
   - Non—controlling interest is the equity not attributable, directly or indirectly, to a parent.
2. As per para 32 of Ind AS 103, the acquirer shall recognize goodwill as of the acquisition date Measured as the excess of (a) over (b) below:

   (a) the aggregate of:

   (i) the consideration transferred is measured in accordance with Ind AS 103, which generally requires acquisition – date fair value; and

   (ii) the amount of any non – controlling interest in the subsidiary measured in accordance with Ind AS 103:

   (b) The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103.

3. As per para 19 of Ind AS 103, for each acquisition of a subsidiary, the investor shall measure at the acquisition date components of non-controlling interest in the subsidiary that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

   (a) Fair value; or

   (b) The present ownership instruments' proportionate share in the recognized amounts of the subsidiary's identifiable net assets.

   The computation of goodwill / bargain purchase price (capital reserve) involves following steps:

   Step 1: Determine the fair value of consideration transferred by the parent;

   Step 2: Determine the amount of non – controlling interest.

   As per method 1 : 'Fair Value method'

   As per method 2 : 'Proportionate Share Method'

   Step 3: The value of recognized amount of subsidiary's identifiable net assets, as determined in accordance with Ind AS 103:

   Step 4: Determine goodwill / bargain purchase price:

   Goodwill arises where aggregate of amount determined in step1 and step2 exceeds amount determined in step3.

QUESTION NO 23 (Q54 IN 103) (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 24 (Q55 IN 103) (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 25 (Q56 IN 103)

In the aforesaid example, if the consideration is ₹ 90

QUESTION NO 26 (Q57 IN 103)

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 27 (Q58 IN 103)

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 28 (Q59 IN 103)

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 29 (Q60 IN 103)

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 30(Q61 IN 103)

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 31 (Q62 IN 103)

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 value 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 32 (Q63 IN 103)

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 Purcahse gain in the process.

QUESTION 33 (Q64 IN 103)

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 l.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 34 (Q65 IN 103)

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.

Identifiable net assets	1,00,00,000
Less: Consideration transferred	(50,00,000)
NCI (10 million x 30%)	(30,00,000)
Gain on bargain purchase	20,00,000

QUESTION 35 (Q66 IN 103) 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 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. Asseses 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 optional 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 36 (Q67 IN 103):

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 37 (Q68 IN 103)

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)).

ADDITIONAL CONCEPTS TO BE CONSIDERED

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 38 (Q69 IN 103)

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 39 (Q70 IN 103)

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 ijn 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 comulative 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 40 (Q71 IN 103)

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:

	(₹ in crore)
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

The carrying amount of the investment in the associate on 31st March, 20X2 was therefore ₹ 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:

	(₹ in crore)
Fair value of the 30% interest already owned	9,000
Fair value of XYZ's identifiable net assets	30,000

How should such business combination be accounted for?

QUESTION NO 41 (Q72 IN 103)

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.?

CONCEPT 2:

CONTROL IN BUSINESS WITHOUT ACQUISITION OF SHARES

QUESTION NO 42 (Q73 IN 103)

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 consolidate 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.?

QUESTION 43 (Q84 IN 103)

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.

CONCEPT 3: ACCOUNTING FOR POST ACQUISITION PROFITS

QUESTION 44

From the following data, determine in each case:

1) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation
2) Goodwill or Gain on bargain purchase.
3) Amount of holding company's share of profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be ₹ 2,00,000 in each case

Case	Subsidiary Company	% of shares owned	Cost	Date of Acquisition 1.04.20X1		Consolidation date 31.03.20X2	
				Share Capital [A]	Retained earnings [B]	Share Capital [C]	Retained earnings [D]
Case 1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
Case 2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
Case 3	C	80%	56,000	50,000	20,000	50,000	20,000
Case 4	D	100%	1,00,000	50,000	40,000	50,000	56,000

The company has adopted an accounting policy to measure Non-controlling interest at NCI's proportionate share of the acquiree's identifiable net assets. It may be assumed that the fair value of acquiree's net identifiable assets is equal to their book values.

CONCEPT 4: NEGATIVE NON CONTROLLING INTEREST

QUESTION 45:

Attribution of profit / loss to non-controlling interest

A Ltd. Acquired 70% equity shares of B Ltd. On 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. Had an equity share capital of ₹ 10,00,000 and other equity of ₹ 80,000. In the four consecutive years B Ltd. Fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. Experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. Recorded annual profits of ₹ 1,00,000, and ₹ 1,50,000 respectively. Show the non- controlling interests and goodwill at the end of each year for the purpose of consolidation. Assume that the assets are at fair value.

CONCEPT 5: UNIFORM ACCOUNTING POLICIES

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

QUESTION 46

PQR Ltd. Is the subsidiary company of MNC Ltd. In the individual financial statements prepared in accordance with Ind AS, PQR Ltd. Has adopted Straight-line method (SLM) of depreciation and MNC Ltd. Has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per Ind AS 110, Consolidated Financial Statements, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd. Prepared as per Ind AS?

QUESTION 47

H Limited has a subsidiary, S Limited and an associate, A Limited. The three companies are engaged in different lines of business.

These companies are using the following cost formulas for their valuation in accordance with Ind AS 2 'Inventories'.

Name of the Company	Cost formula used
H Limited	FIFO
S Limited, A Limited	Weighted average cost

Whether H Limited is required to value inventories of S Limited and A Limited also using FIFO formula in preparing its consolidated financial statements?

CONCEPT 6: REPORTING PERIOD OF PARENT AND SUBSIDIARY

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date.

When the end of the reporting period of the parent is different from that of a subsidiary (e.g. parent's financial year ends on 31 March 20X1 but the subsidiary's financial year ends on 31 December 20X0), the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.

If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months.

The length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period. This means that if the financial statements of a subsidiary used for consolidation in previous periods were ending on different dates than that of the parent whereas the financial statements used for current period end on the same date as that of the parent then the comparatives for previous period should be restated to have comparison of equivalent periods.

QUESTION 48

How should assets and liabilities be classified into current or non-current in consolidated financial statements when parent and subsidiary have different reporting dates?

QUESTION 49

A Limited, an Indian Company has a foreign subsidiary, B Inc. Subsidiary B Inc. has taken a long term loan from a foreign bank, which is repayable after the year 20X9. However, during the year ended 31st March, 20X2, it breached one of the conditions of the loan, as a consequence of which the loan became repayable on demand on the reporting date. Subsequent to year end but before the approval of the financial statements, B Inc. rectified the breach and the bank agreed not to demand repayment and to let the loan run for its remaining period to maturity as per the original loan terms. While preparing its standalone financial statements as per IFRS, B Inc. has classified this loan as a current liability in accordance with IAS 1 'Presentation of Financial Statements'.

Whether A limited is required to classify such loan as current while preparing its consolidated financial statement under Ind AS?

CONCEPT 7
ACCOUNTING OF DIVIDEND FROM SUBSIDIARY AND ITS IMPACT ON NON- CONTROLLING INTEREST

As per para 5.7.1A of Ind AS 109, dividends are recognized in profit or loss by an investor entity only when:

- The entity's right to receive payment of the dividend is established,
- It is probable that the economic benefits associated with the dividend will flow to the entity, and
- The amount of the dividend can be measured reliably.

As per para 12 of Ind AS 27, an entity shall recognize a dividend from a subsidiary in its separate financial statements when its right to receive the dividend is established.

As per the Companies Act, 2013, the entity's right to receive the dividend is established when it is declared by the shareholders in the annual general meeting of the company.

An investor should recognise a dividend from a subsidiary, a joint venture or an associate as income in its separate financial statements. As per Ind AS 36, declaration of dividend by a subsidiary, associate or joint venture coupled with a few more evidences is an indication of impairment of investment.

QUESTION 50: DIVIDEND PROPOSED BY SUBSIDIARY

XYZ Ltd. Purchased 80% shares of ABC Ltd. On 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the Statement of Profit and Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. Has earned a profit of ₹ 20,000 and later on it declared and paid a dividend of ₹ 30,000.

Assume, the fair value of non-controlling interest is same as the fair value on a per-share basis of the purchased interest#. All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is ₹ 1,50,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. Whenever it is received after approval in the ensuing annual general meeting.

What is the amount of non-controlling interest as on 1st April, 20X1 (using Fair value Method) and 31st March, 20X2? Also pass a journal entry on the acquisition date.

(#This assumption is only for illustration purpose. However, in practical scenarios the fair value of NCI will be different than the fair value of the controlling interest.)

QUESTION 51: DIVIDEND PROPOSED BY SUBSIDIARY

From the facts given in the above illustration, calculate the amount of non-controlling interest as on 1st April, 20X1 (Using NCI's proportionate share method) and 31st March, 20X2.

Also pass a journal entry on the acquisition date.

QUESTION 52: DIVIDEND PROPOSED BY SUBSIDIARY

The facts are same as in the above illustration except that the fair value of net identifiable asset is ₹ 1,60,000. Calculate NCI and Pass Journal Entry on the acquisition date

Note: Use fair value method for 31st March 20X1.

QUESTION 53: DIVIDEND PROPOSED BY SUBSIDIARY

The facts are same as in the above illustration except that the fair value of net identifiable asset is ₹ 1,60,000. Calculate NCI and Pass Journal Entry on the acquisition date. Use NCI's proportionate share method for 31st March 20X1.

CONCEPT 8: ELIMINATION OF INTRA-GROUP TRANSACTIONS

In order to present financial statements for the group in a consolidated format, the effect of transactions between group entities should be eliminated. Intra – group balances and intra – group transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intra – group transactions should also be eliminated unless cost cannot be recovered.

Liabilities due to one group entity by another will be set off against the corresponding asset in the other group entity's financial statements; sales made by one group entity to another should be excluded from turnover and from purchase (or related head) or the appropriate expense heading in the consolidated statement of profit and loss.

To the extent that the buying entity has further sold the goods in question to a third party, the eliminations to sales and cost of sales are all that is required, and no adjustments to consolidated profit or loss for the period, or to net assets, are needed. However, to the extent that the goods in question are still on hand at year end, they may be carried at an amount that is in excess of cost to the group and the amount of the intra-group profit must be eliminated, and assets are reduced to cost to the group.

For transactions between group entities, unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and Property, Plant and Equipment, Intangible Assets and Investment Property, are eliminated in full. The requirement to eliminate such profits in full applies to the transactions of all subsidiaries that are consolidated – even those in which the group's interest is less than 100%.

Unrealised profit on inventories

Where a group entity sells goods to another, the selling entity, as a separate legal entity, records profits made on those sales. If these goods are still held in inventory by the buying entity at the year end, however, the profit recorded by the selling entity, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group. On consolidation, the unrealized profit on closing inventories will be eliminated from the group's profit, and the closing inventories of the group will be recorded at cost to the group.

Unrealised profit on transfer of non-current assets

Similar to the treatment described above for unrealized profits in inventories, unrealized inter- company profits arising from intra-group transfers of Property, Plant and Equipment, Intangible Assets and Investment Property are also eliminated from the consolidated financial statements.

Unrealised losses

Unrealised losses resulting from intra-group transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

QUESTION 54:

Elimination of intra-group profit on sale of assets by a subsidiary to its parent

A parent owns 60% of a subsidiary. The subsidiary sells some inventory to the parent for ₹ 35,000 and makes a profit of ₹ 15,000 on the sale. The inventory is in the parent's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.

QUESTION 55:

Elimination of intra-group profit on sale of assets by a parent to its subsidiary

In the above illustration, assume that it is the parent that makes the sale. The parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for ₹ 35,000 and makes a profit of ₹ 15,000. On the sale the inventory is in the subsidiary's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.

QUESTION 56:

Inventories of subsidiary out of purchases from the parent

A Ltd, a parent company sold goods costing ₹ '200 lakh to its 80% subsidiary B Ltd. At ₹ 240 lakh. 50% of these goods are lying at its stock. B Ltd. Has measured this inventory at cost i.e. at ₹ 120 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

QUESTION 57:

Inventories of parent out of purchases from the subsidiary

Ram Ltd., a parent company purchased goods costing ₹ 100 lakh from its 80% subsidiary Shyam Ltd. At ₹ 120 lakh. 50% of these goods are lying at the godown. Ram Ltd. Has measured this inventory at cost i.e. at ₹ 60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate.

QUESTION 58:

Property, plant and equipment (PPE) sold by parent to subsidiary

A Ltd. (which is involved in the business of selling capital equipment) a parent company sold a capital equipment costing ₹ 100 lakh to its 80% subsidiary B Ltd. At ₹ 120 lakh. The capital equipment is recorded as PPE by B Ltd. The useful life of the PPE on the date of transfer was 10 years. Show the necessary adjustment in the consolidated financial statements (CFS).

CONCEPT 9: CHANGE IN THE PROPORTION HELD BY CONTROLLING AND NON-CONTROLLING INTERESTS

A parent's ownership interest may change without a loss of control, for example, in following situations:

- Parent buys shares from non-controlling interest (say, increase in stake from 60% to 70%)
- Parent sells shares to non-controlling interest (say, decrease in stake from 70% to 60%)

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

Example

M Ltd. holds 70% stake in N Ltd. Now if M Ltd. purchases additional 10% stake in N Ltd. or sells 10% of its existing stake (i.e. without losing control) then it is an equity transaction.

When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Further, it must be noted that due to such changes in controlling and non-controlling interests, no changes are made to subsidiary's assets (including goodwill) and liabilities. It is again emphasized that no gain or loss is recognized in such transactions.

QUESTION 59:

Sale of 20% interest in a wholly- owned subsidiary

Entity P sells a 20% interest in a wholly owned subsidiary to outside investors for ₹ 100 lakh in cash. The carrying value of the subsidiary's net assets is ₹ 300 lakh, including goodwill of ₹ 65 lakh from the subsidiary's initial acquisition.

Pass journal entries to record the transaction.

QUESTION 60:

Acquisition of additional stake in a subsidiary

Entity A acquired 60% of entity B two years ago for ₹ 6,000. At that time, entity B's fair value was ₹ 10,000. Lt had net assets with a fair value of ₹ 6,000 (which is assumed same as book value). Goodwill of ₹ 2,400 was recorded (being ₹ 6,000 – (60% x ₹ 6,000). On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is ₹ 20,000 and entity A pays ₹ 4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is ₹ 12,000 and the carrying amount of the non- controlling interest is ₹ 4,000.

Pass journal entries to record the transaction.

QUESTION 61:

Acquisition of additional stake in a subsidiary

A Ltd. Acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance Sheet finalized as on 1.4.20X0:

	₹ in thousand
Separate financial statements	As on 31.3.20X0
Investment in subsidiary (70% interest) – at cost	14,000
Purchase price for additional 10% interest	2,600
Consolidated financial statements	
Non-controlling interests (30%)	6,600
Consolidated profit & loss account balance	2,000
Goodwill	600

The reporting date of the subsidiary and the parent is 31 March 20X0. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

QUESTION 62:

Acquisition of additional stake in a subsidiary

A Ltd. Acquired 70% shares of B Ltd. On 1.4.20X0 when the fair value of net assets of B Ltd. Was ₹ 200 lakh. During 20X0-20X1, B Ltd. Made profit of ₹ 100 lakh. Individual and consolidated balance sheets as on 31.3.20X1 are as follows:

₹ lakh

	A	B	Group
Assets			
Goodwill			10
PPE	627	200	827
Financial assets:			
Investments	150		
Cash	200	30	230
Other current assets	23	70	93
	1,000	**300**	**1160**
Equity and liability			
Share capital	200	100	200
Other equity	800	200	870
Non-controlling interest			90
	1,000	**300**	**1160**

A Ltd. Acquired another 10% stake in B Ltd. On 1.4.20X1 at ₹ 32 lakh. The proportionate carrying amount of the non-controlling interest is ₹ 30 lakh. Show the individual and consolidated balance sheet of the group immediately after the change in non-controlling interest.

QUESTION 63:

Reduction in interest in subsidiary

Amla Ltd. Purchased a 100% subsidiary for ₹ 10,00,000 at the end of 20X1 when the fair value of the subsidiary Lal Ltd.'s net asset was ₹ 8,00, 000.

The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for ₹ 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is ₹ 18,00,000 (including net assets of ₹ 16,00,000 & goodwill of ₹ 2,00,000).

Calculate gain / loss on sale of interest in subsidiary as on 31st March 20X4.

QUESTION 64:

Reduction in interest in subsidiary

Entity A sells 30% interest in its wholly-owned subsidiary to outside investors in an arm 's length transaction for ₹ 500 crore in cash and retains a 70% controlling interest in the subsidiary. At the time of the sale, the carrying value of the subsidiary's net assets in the consolidated financial statements of Entity A is ₹ 1,300 crore, additionally, there is a goodwill of ₹ 200 crore that arose on the subsidiary's acquisition. Entity A initially accounted for NCI representing present ownership interests in the subsidiary at fair value and it recognises subsequent changes in NCI in the subsidiary at NCI's proportionate share in aggregate of net identifiable assets and associated goodwill. How should Entity A account for the transaction?

CONCEPT 10: LOSS OF CONTROL

A parent can lose control over a subsidiary in a number of ways. These include:

- Loss of control due to outright sale – where the entire stake is sold off,
- Loss of control due to partial sale – where the parent retains interest as an associate, jointly controlled entity or a financial asset,
- Deemed loss of control where no consideration is received but the parent's interest is diluted in some other manner such as:

  Voting rights issued to a new investor,

  Control on relevant activities,

  Consolidation of voting rights of other shareholders;

  An investor acquiring substantial stake from the stock exchange.

In this section we will discuss following two things:

- Accounting treatment of loss of control of a subsidiary
- Loss of control of a subsidiary in two or more arrangements (transactions)

Accounting treatment on loss of control of a subsidiary

If a parent loses control of a subsidiary, it shall follow the accounting treatment mentioned below:

If a parent loses control of a subsidiary, it shall

Derecognise:	Recognise:	Reclassify:	Recognises gain / loss:
• the assets (including any goodwill) and liabilities of the subsidiary • the carrying amount of any non-controlling interests in the former subsidiary	• the fair value of the consideration received • if loss of control involves a distribution of shares of the subsidiary to owners, then that distribution; and • any investment retained in the former subsidiary at its fair value at the date when control is lost (refer note 1 below)	• to profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts • recognised in other comprehensive income in relation to the subsidiary (refer note 2 below)	• recognise any resultingdifference as a gain or loss in profit or loss attributable to the parent

QUESTION 65:

Subsidiary issues shares to a third party and parent loses control

In March 20X1 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is ₹ 20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at ₹ 12 per share, raising ₹ 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were ₹ 4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder.

QUESTION 66:

Calculation of gain on outright sale of subsidiary

A parent purchased 80% interest in a subsidiary for ₹ 1,60,000 on 1 April 20X1 when the fair value of the subsidiary's net assets was ₹ 1,75,000. Goodwill of ₹ 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of ₹ 8,000 was charged in the consolidated financial statements for year ended 31 March 20X3. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 20X4 for ₹ 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was ₹ 2,25,000 (not including goodwill of ₹ 12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write off was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary in its separate financial statements at cost, as permitted by Ind AS 27.

Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 20X4.

QUESTION 67:

Partial disposal when subsidiary becomes an associate

AT Ltd. Purchased a 100% subsidiary for ₹ 50,00,000 on 31st March 20X1 when the fair value of the net assets of BT Ltd. Was ₹ 40,00,000. Therefore, goodwill is ₹ 10,00,000. AT Ltd. Sold 60% of its investment in BT Ltd. On 31st March 20X3 for ₹ 67,50,000, leaving the AT Ltd. With 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd. Excluding goodwill is ₹ 80,00,000. Assume the fair value of the investment in associate BT Ltd. Retained is proportionate to the fair value of the 60% sold, that is ₹ 45,00 000.

Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

QUESTION 68:

Partial disposal when 10% investment in former subsidiary is retained

The facts of this illustration are same per the above Illustration, except the group AT Ltd. Disposes of a 90% interest for ₹ 85,50,000 leaving the AT Ltd. With a 10% investment. The fair value of the remaining interest is ₹ 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold)

Calculate gain or loss on sale of proportion of BT Ltd. In AT Ltd.'s separate and consolidated financial statements as on 31st March 20X3.

QUESTION 69:

Loss control of a subsidiary in two transactions

MN Ltd. was holding 80% stake in UV Ltd. Now, MN Ltd. has disposed of the entire stake in UV Ltd. in two different transactions as follows:

- Transaction 1: Sale of 25% stake for a cash consideration of ₹ 2,50,000
- Transaction 2: Sale of 55% stake for a cash consideration of ₹ 5,50,000

Both the transactions have happened within a period of one month. In accordance with the guidance given in Ind AS 110, both the transactions have to be accounted as a single transaction.

The net assets of UV Ltd. and non-controlling interest on the date of both the transactions was ₹ 9,00,000 and ₹ 1,80,000 respectively (assuming there were no earnings between the period of two transactions).

How MN Ltd. should account the transaction?

CONCEPT 11: CHAIN-HOLDING UNDER CONSOLIDATION

QUESTION 70: CHAIN HOLDING

Prepare the consolidated Balance Sheet as on 31st March, 20X2 of a group of companies comprising P Limited, S Limited and SS Limited. Their balance sheets on that date are given below:

₹ in lakhs

	P Ltd.	S Ltd.	SS Ltd.
Assets			
Non-Current Assets			
Property, Plant and Equipment	320	360	300
Investment:			
32 lakh shares in S Ltd.	340		
24 lakh shares in SS Ltd.		280	

Current Assets			
Inventories	220	70	50
Financial Assets			
Trade Receivables	260	100	220
Bills Receivables	72	-	30
Cash in hand and at Bank	228	40	40
	1440	850	640
Equity and Liabilities			
Shareholder's Equity			
Share Capital (₹ 10 per share)	600	400	320
Other Equity			
Reserves	180	100	80
Retained earnings	160	50	60
Current Liabilities			
Financial Liabilities			
Trade Payables	470	230	180
Bills Payable			
P Ltd.		70	
SS Ltd.	30	-	-
	1440	**850**	**640**

The following additional information is available:

(i) P Ltd. Holds 80% shares in S Ltd. And S Ltd. Holds 75% shares in SS Ltd. Their holdings were acquired on 30th September, 20X1.

(ii) The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

(iii) On 1st April, 20X1 the following balances stood in the books of S Ltd. And SS Ltd.

₹ in Lakhs

	S Limited	SS Limited
Reserves	80	60
Retained earnings	20	30

(iv) ₹ 10 lakhs included in the inventory figure of S ltd, is inventory which has been purchased from SS Ltd at cost plus 25%.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume market prices of S Ltd and SS Ltd are the same as respective face values.

QUESTION 71:

Treatment of goodwill and non-controlling interest where a parent holds an indirect interest in a subsidiary

A parent company (entity A) has an 80% owned subsidiary (entity B). Entity B makes an acquisition for cash of a third company (entity C), which it then wholly owns. Goodwill of

₹ 1,00,000 arises on the acquisition of entity C.

How should that goodwill be reflected in consolidated financial statement of entity A? Should it be reflected as

a) 100% of the goodwill with 20% then being allocated to the non- controlling interest, or

b) 80% of the goodwill that arises?

SOLUTION:

Assuming that entity B prepares consolidated financial statements, 100% of the goodwill would be recognized on the acquisition of entity C in those financial statements. Entity A should reflect 100% of goodwill and allocate 20% to the non- controlling interest in its consolidated financial statements. This is because the non-controlling interest is a party to the transaction and the goodwill forms part of the net assets of the sub group (in this case, the sub group being the group headed by entity B).

CONCEPT 12: CUMULATIVE PREFERENCE SHARES HELD BY NCI

If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

QUESTION 72

R Ltd. Hold 80% stake on Y Ltd. Y Ltd. Has also issued 10% cumulative preference shares worth ₹ 10,00,000 to the non-controlling interest. During the year, Y Ltd. Earned profit of ₹ 5,00,000. Y Ltd. Has not declared any dividend on cumulative preference share for current year. Calculate the profit attributable to holding company in post acquisition profits.

PREPARATION OF CONSOLIDATED PROFIT & LOSS

- The items of income and expenses are added on line by line basis.
- Intra-group transactions are eliminated in full (e.g. sales made by parent to a subsidiary which is recorded as purchase by subsidiary are eliminated from the consolidated profit & loss by reducing both sales of parent and purchase of subsidiary)

PREPARATION OF CONSOLIDATED CASH FLOWS

- Items of cash flow from various activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be eliminated.

QUESTION 73:

PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

Given below are the financial statements of P Ltd and Q Ltd as on 31.3.20X1:

Balance Sheet

(₹ in Lakhs)

	P Ltd.	Q Ltd.
Assets		
Non-current assets		
Property Plant Equipment	1,07,000	44,000
Financial Assets:		
Non-Current Investments	5,000	1,000
Loans	10,000	
Current Assets		
Inventories	20,000	10,000
Financial Assets:		
Trade Receivables	8,000	10,000
Cash and Cash Equivalents	38,000	1,000
Total Assets	1,88,000	66,000
Equity and Liabilities		
Shareholders Fund		
Share Capital	20,000	10,000

Other equity	1,20,000	40,000
Non-Current Liabilities		
Financial Liabilities		
Long term liabilities	30,000	10,000
Deferred tax liabilities	5,000	1,000
Long term provisions	5,000	1,000
Current Liabilities		
Financial Liabilities		
Trade Payables	6,000	2,000
Short term Provisions	2,000	2,000
Total Equity & Liabilities	**1,88,000**	**66,000**
Notes to Financial Statements	**P Ltd.**	**Q Ltd**
Reserve & Surplus		
General Reserve	1,00,000	30,000
Retained earnings	20,000	10,000
Inventories	**1,20,000**	**40,000**
Raw Material	10,000	5,000
Finished Goods	10,000	5,000
	20,000	10,000

(₹ in Lakhs)

Statement of Profit and Loss
For the year ended on 31st March, 20X2

	Notes	P Ltd.	Q Ltd.
i. Statement of Profit and Loss for the year ended on 31st March 20X2			
Sales	1	2,00,000	80,000
Other Income	2	3,000	
Total Revenue		**2,03,000**	**80,000**
Expenses			
Raw Material Consumed	3	1,10,000	48,000
Change in inventories finished stock	4	(5,000)	(3,000)

Employee benefit expenses		30,000	10,000
Finance Costs	5	2,700	1,000
Depreciation		7,000	4,000
Other Expenses	6	10,350	6,040
Total Expenses		**1,55,050**	**66,040**
Profit Before Tax		47,950	13,960
Tax Expense:			
Current Tax	11	15,000	4,000
Deferred Tax		2,000	1,000
		17,000	5,000
Profit after Tax		**30,950**	**8,960**
ii. Statement of Other Comprehensive Income			
Fair Value gain on investment in subsidiary	8	1,000	0
Fair Value gain on other non-current investments*	8	500	250
		1,500	**250**

* Note: Statement of Other Comprehensive Income shall present 'items that will not be reclassified to profit or loss' and 'items that will be reclassified to profit and loss'. However, such bifurcations had not been made above.

Statement of changes in Equity
For the year ended in 31 March 20X2

P Ltd.	Share Capital	General Reserve	Profit & Loss	Fair Value Reserve	Total
Balance as on 1.4.20X1	20,000	1,00,000	20,000		1,40,000
Dividend for the year 20X1- 20X2			(8,000)		(8,000)
Dividend distribution tax			(1,350)		(1,350)
Dividend received from subsidiary			1,680		1,680
Profit for the year 20X1- 20X2			30,950		30,950

Fair value gain on investment in subsidiary See Note 7				1,000	1,000
Fair value gain on other non- current investments in subsidiary See Note 7				500	500
Transfer to reserve	____	20,000	(20,000)	____	____
Balance as on 31.3.20X2	**20,000**	**1,20,000**	**23,280**	**1,500**	**1,64,780**
Q Ltd.					
Balance as on 1.4.20X1	10,000	30,000	10,000		50,000
Dividend for the year 20X1- 20X2			(2,400)		(2,400)
Dividend distribution tax			(400)		(400)
Profit for the year 20X1-20X2			8,960		8,960
Fair value gain on other non- current investments in subsidiary See Note 7				250	250
Transfer to reserve	____	5,000	(5,000)	____	____
Balance as on 31.3.20X2	**10,000**	**35,000**	**11,160**	**250**	**56,410**

Balance Sheet as on 31st March, 20X2

	Note	P Ltd	Q Ltd.
Assets			
Non-current assets			
Property Plant Equipment	7	1,17,000	45,000
Financial Assets:			
Non-Current Investments	8	42,500	1,250
Long Term Loans		10,000	
Current Assets			
Inventories		35,000	15,000

Financial Assets:			
Trade Receivables		10,000	8,000
Cash and Cash Equivalents			
(See Statement of Cash Flows)		930	4,200
Total Assets		**2,15,430**	**73,450**
Equity and Liabilities			
Share Capital		20,000	10,000
Other equity (See Statement of changes in Equity)		1,44,780	46,410
		1,64,780	56,410
Non-Current Liabilities			
Financial Liabilities			
Borrowings		30,000	10,000
Deferred tax liabilities		7,000	2,000
Long term provisions	9	4,600	930
Current Liabilities		41,600	12,930
Financial Liabilities			
Trade Payables		8,000	4,000
Short term Provisions	10	1,050	110
		9,050	4,110
Total Liabilities		**50,650**	**17,040**
Total Equity & Liabilities		**2,15,430**	**73,450**

Statement of Cash Flows

For the year ended on 31 March 20X2

	P. Ltd.	Q. Ltd
i. Cash Flows from operating activities		
Profit after Tax	30,950	8,960
Add Back:		
Current Tax	15,000	4,000
Deferred Tax	2,000	1,000
Depreciation	7,000	4,000
Finance Costs	2,700	1,000
Change In Provisions	(1,350)	(1,960)
Reversal of Interest Income	(1000)	0
Working Capital Adjustments		
Inventories	(15,000)	(5,000)
Trade Receivables	(2,000)	2,000
Trade Payables	2,000	2,000
	40,300	16,000
Less: Advance Tax	(15,000)	(4,000)
	25,300	12,000
ii. Cash flows from investment activities		
Purchase of Property Plant Equipment	(17,000)	(5,000)
Acquisition of subsidiary	(36,000)	0
Interest Income	1,000	
Dividend Income	1,680	
	(50,320)	(5,000)
iii. Cash Flow from financing activities		
Dividend Payment	(8,000)	(2,400)
Dividend distribution tax	(1,350)	(400)
Interest payment	(2,700)	(1,000)
	(12,050)	(3,800)

Net Changes in Cash Flows (i + ii + iii)	**(37,070)**	**3,200**
Balance of Cash and Cash Equivalents as on 1.4.20X1	38,000	1,000
Balance of Cash and Cash Equivalents as on 31.3.20X2	930	4,200

Notes	P Ltd.	Q Ltd.
Note 1 – Sales		
Sales to Q Ltd.	20,000	
Other Sales	1,80,000	80,000
	2,00,000	80,000
Note 2 – Other Income		
Interest from Q Ltd.	1,000	
Royalty from Q Ltd.	2,000	
	3,000	
Note 3 – Raw Material Consumed		
Opening Stock	10,000	5,000
Purchases from P Ltd.		20,000
Other Purchases	1,20,000	30,000
Closing Stock	20,000	7,000
	1,10,000	**48,000**
Note 4 – Change in inventories of finished stock		
Opening Stock	10,000	5,000
Closing Stock	15,000	8,000
	(5,000)	**(3,000)**
Note 5 – Finance Costs		
Interest	2,700	
Interest to P Ltd.	______	1,000
	2,700	**1,000**
Note 6 – Other Expenses		
Long term provisions	100	30
Short Term provisions	50	10
Royalty to P Ltd.		2,000

Others	10,000	4,000
Acquisition Expenses	200	______
	10,350	**6,040**
Note 7 – Property Plant Equipment		
New Purchases	17,000	5,000
Note 8 – Fair value of non-current investments		
Investments in subsidiary	37,000	
Other Investments	5,500	1,250
	42,500	**1,250**
Fair Value Gain		
Investments in subsidiary	1,000	0
Other investments	500	250
	1,500	**250**
Note 9 – Long term provisions		
Balance as on 1.4.20X1	5,000	1,000
Transfer to short term provisions	(500)	(100)
New Provision	100	30
Balance as on 31.3.20X2	**4,600**	**930**
Note 10 – Short term provisions		
Balance as on 1.4.20X1	2,000	2,000
Transfer from long term provisions	500	100
Payment	(1,500)	(2,000)
New	50	10
Balance as on 31.3.20X2	**1,050**	**110**
Note 11 – Provisions for Tax & Advance Tax		
Tax Provision	15,000	4,000
Less: Advance Tax	15,000	4,000
	0	0

On 1.4.20X1, P Ltd. Acquired 70% of equity shares (700 lakhs out of 1,000 lakhs shares) of Q Ltd. At ₹ 36,000 lakhs. The company has adopted an accounting policy to measure Non-controlling interest at fair value (quoted market price) applying Ind AS 103. Accordingly,

the company computed full goodwill on the date of acquisition. Shares of both the companies are of face value ₹ 10 each. Market price per share of Q Ltd. As on 1.4.20X1 is ₹ 55. Entire long-term borrowings of Q Ltd. Is from P Ltd. The fair value of net identifiable assets is at ₹ 50,000 lakhs.

P Ltd. Has decided to account for investment in subsidiary at fair value through other comprehensive income as per Ind AS 27. Other non-current investments are classified as financial assets at fair value other comprehensive income by irrevocable choice as per Ind AS 109. There is no tax capital gains.

The group has paid dividend for the year 20X0-20X1 and transferred to reserve out of profit for 20X1-20X2 as follows:

(₹ in lakhs)

	P Ltd.	**Q Ltd.**		
Dividend for the year 20X1-20X2		Share of P Ltd.	Non-controlling interest	Total
Dividend	8,000	1,680	720	2,400
Dividend distribution tax	1,350	280	120	400
	9,350	**1,960**	**840**	**2,800**
Transfer to reserve out of profit for the year 20X1-20X2	20,000			

Trade receivables of P Ltd, include ₹ 3,000 Lakhs due from Q Ltd.

Based on the above financial statements for the year ended on 31 March, 20X2 and information given, prepare Consolidated Financial Statements.

COMPREHENSIVE PROBLEMS ON CONSOLIDATION

QUESTION 1

DEF Ltd. acquired 100% ordinary share of ₹ 100 each XYZ Ltd. on 1st October 2011. On March 31, 2012 the summarized Balance Sheets of the two companies were as given below:

	DEF Ltd.	XYZ Ltd.
Assets		
Property Plant Equipment		
Land & Buildings	15,00,000	18,00,000
Plant & Machinery	24,00,000	13,50,000
Investment in XYZ Ltd.	34,00,000	
Inventory	12,00,000	3,64,000
Financial Assets		
Trade Receivable	5,98,000	4,00,000
Cash	1,45,000	80,000
Total	**92,43,000**	**39,94,000**
Equities & Liabilities		
Equity Capital (Shares of ₹ 100 each fully paid)	50,00,000	20,00,000
Other Equity		
Other reserves	24,00,000	10,00,000
Retained Earnings	5,72,000	8,20,000
Financial Liabilities		
Bank Overdraft	8,00,000	
Trade Payable	4,71,000	1,74,000
Total	**92,43,000**	**39,94,000**

The retained earnings of XYZ Ltd. showed a credit balance of ₹ 3,00,000 on 1st April 2011 out of which a dividend of 10% was paid on 1st November; DEF Ltd has credit the dividend received to retained earnings account; Fair value of P & M as on 1st October 2011 was ₹ 20,00,000. The rate of depreciation on plant & machinery is 10%

Following are the changes in fair value as per respective IND AS from Book value as on 1st October 2011 which is to be considered while consolidating the Balance Sheets.

Liabilities	Amount	Assets	Amount
Trade Payables	1,00,000	Land & Buildings	10,00,000
		Inventories	1,50,000

Prepare consolidated Balance Sheet as on March 31, 2012

QUESTION NO 2

Ram Ltd acquired 60% ordinary share of ₹ 100 each of Krishan Ltd. on 1st October 2011 on March 31, 2012 the summarized Balance Sheets of the two companies were as given below:

	Ram Ltd.	Krishan Ltd.
Assets		
Property, Plant Equipment		
Land & Buildings	3,00,000	3,60,000
Plant & Machinery	4,80,000	2,70,000
Investment in Krishan Ltd	8,00,000	-
Inventory	2,40,000	72,800
Financial Assets		
Trade Receivable	1,19,600	80,000
Cash	29,000	16,000
Total	**19,68,600**	**7,98,800**
Equity & Liabilities		
Equity Capital (Shares of ₹ 100 each fully paid)	10,00,000	4,00,000
Other Equity		
Other Reserves	6,00,000	2,00,000
Retained earnings	1,14,400	1,64,000
Financial Liabilities		
Bank Overdraft	1,60,000	
Trade Payable	94,200	34,800
Total	**19,68,600**	**7,98,800**

The Retained earnings of Krishan Ltd. showed a credit balance of ₹ 60,000 on 1st April 2011 out of which a dividend of 10% was paid on 1st November; Ram Ltd. has credited the dividend received to its Retained earnings ; Fair Value of P & M as on 1st October 2011 was ₹ 4,00,000; The rate of depreciation on plant & machinery is 10%.

Following are the changes in fair value as per respective IND As from book value as on 1st October 2011 which is to be considered while consolidating the Balance Sheets.

Liabilities	Amount	Assets	Amount
Trade Payables	20,000	Land & Buildings	2,00,000
		Inventories	30,000

Prepare consolidated Balance Sheet as on March 31, 2012

QUESTION 3

On 31st March 2012, Blue Heavens Ltd. acquired 100% ordinary shares caryring voting rights of Orange County Ltd. for ₹ 6,000 lakh in cash and it controlled Orange County Ltd. from that date. The acquisition – date statements of financial position of Blue Heavens Ltd. and Orange Country Ltd. and the fair values of the assets and liabilities recognized on Orange County Ltd. Statement of Financial position were:

	Blue Heavens Ltd. Carrying Amount	Orange Country Ltd. Carrying Amount	Fair Value
	₹ (Lakh)	₹ (Lakh)	₹ (lakh)
Assets			
Non-current assets			
Building and other PPE	7,000	3,000	3,300
Investment in Orange County Ltd.		6,000	
Current Assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	1500	700	700
Total Assets	**15,500**	**4,450**	

Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
Current Liabilities			
Trade payables	300	150	150
Total liabilities and equity	**15,500**	**4,450**	

Prepare the Consolidated Balance sheet as on March 31, 2012 of group of entities Blue Heavens Ltd. and Orange county Ltd.

QUESTION NO 4

The facts are the same as in Question 3 above. However, Blue Heavens Ltd. Acquires ony 75% of the ordinary shares, to which voting rights are attached of Orange County Ltd. Blue heavens Ltd. pays ₹ 4,500 lakhs for the shares. Prepare the consolidated Balance Sheet as on March 31, 2012 of group of entities Blue Heavens Ltd. and Orange Country Ltd.

QUESTION NO 5

Facts are same as in Question 3 & 4, Blue Heavens Ltd. acquires 75% of Orange country Ltd. Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. At 31 March 2013, i.e. one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd. Carrying Amount	Orange Country Ltd. Carrying Amount
	₹ (Lakh)	₹ (Lakh)
Assets		
Non-current assets		
Building and other PPE	6,500	2,750
Investment in Orange County Ltd.	4,500	_____
	11,000	**2,750**

Inventories	800	550
Trade receivables	380	300
Cash	4170	1420
	5350	2270
Total Assets	**16,350**	**5,020**
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current Liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	**16,350**	**5,020**

Statements of comprehensive income for the year ended 31st March 2013.

	Blue Heavens Ltd. Carrying Amount	**Orange Country Ltd. Carrying Amount**
	₹ (Lakh)	**₹ (Lakh)**
Revenue	3,000	1,900
Cost of Sales	(1,800)	(1,000)
Gross Profit	1,200	900
Administrative Expenses	(400)	(350)
Profit for the year	800	550

Note: Blue Heavens Ltd. is unable to make a reliable estimate of the useful life of goodwill and consequently, the useful life is presumed to be ten years. Blue Heavens Ltd. uses the straight-line amortisation method for goodwill. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 March 2012 and estimated residual values of zero. Blue Heavens Ltd.

Uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31 March 2012 was sold during 2013.

Prepare the Consolidated Balance Sheet as on March 31, 2012 of group of entities Blue Heavens Ltd. and Orange County Ltd.

QUESTION NO 6

P Pvt. Ltd. has a number of wholly-owned subsidiaries including S Pvt. Ltd. at 31st March 2012. P Pvt. Ltd. consolidated statement of financial position and the group carrying amount of S Pvt. Ltd. assets and liabilities (ie the amount included in that consolidated statement of financial position in respect of S Pvt. Ltd. assets and liabilities) at 31st March 2012 are as follows:

Particulars	Consolidated ₹ in millions	Group carrying amount of S Pvt. Ltd. Asset and Liabilities Ltd. (₹ in millions)
Assets		
Non-current Assets		
Goodwill	380	180
Buildings	3,240	1,340
Current Assets		
Inventories	140	40
Trade Receivables	1,700	900
Cash	3,100	1000
Total Assets	8560	3,460
Equities & Liabilities		
Equity		
Share Capital	1,600	
Other Equity		
Retained Earnings	4,260	
Current liabilities		
Trade Payables	2,700	900
Total Equity & Liabilities	8,560	900

Prepare consolidated Balance Sheet after disposal as on 31st March, 2012 when P Pvt. Ltd. group sold 100% shares of S Pvt. Ltd. to Independent party for ₹ 3,000 millions.

QUESTION NO 7

Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 2012

Reliance Ltd. consolidated statement of financial position and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (i.e. the amount included in that consolidated statement of financial position in respect of Reliance Jio Infocomm Ltd. assets and liabilities at 31st March 2012 are as follows:

Particulars	Consolidated (₹ In '000)	Group carrying amount of Reliance Jio Infocomm Ltd. asset and liabilities Ltd. (₹ in '000)
Assets		
Non-current Assets		
Goodwill	190	90
Buildings	1,620	670
Current Assets		
Inventories	70	20
Trade Receivables	850	450
Cash	1,550	500
Total Assets	4,280	1,730
Equity & Liabilities		
Equity		
Share Capital	800	
Other Equity		
Retained earnings	2,130	
	2930	
Current liabilities		
Trade Payables	1,350	450
Total Equity & Liabilities	4,280	450

Prepare consolidated Balance Sheet after disposal as on 31st March, 2012 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for ₹ 1000 (₹ 000).

QUESTION 8

Airtel Telecommunications Ltd. owns 100% share capital of Airtel Infrastructures Pvt. Ltd. On 1 April 20X1 Airtel Telecommunications Ltd. acquired a building from Airtel Infrastructures Pvt. Ltd., for ₹ 11,00,000 that the group plans to use as its new headquarters office.

Airtel Infrastructures Pvt. Ltd. had purchased the building from a third party on 1 April 20X0 for ₹ 10,25,000. At that time the building was assessed to have a useful life of 21 years and a residual value of ₹ 5,00,000. On 1 April 20X1 the carrying amount of the building was ₹ 10,00,000 in Airtel Infrastructures Pvt. Ltd.'s individual accounting records.

The estimated remaining useful life of the building measured from 1 April 20X1 is 20 years and the residual value of the building is now estimated at ₹ 3,50,000. The method of depreciation is straight-line.

Pass necessary accounting entries in individual and consolidation situations.

QUESTION 9

As at the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited. During the financial year, AB Limited sells 70% of its equity interest in BC Limited to PQR Limited for a total consideration of ₹ 56 crore and consequently loses control of BC Limited. At the date of disposal, fair value of the 20% interest retained by AB Limited is ₹ 16 crore and the net assets of BC Limited are fair valued at ₹ 60 crore.

These net assets include the following:

(a) Debt investments classified as fair value through other comprehensive income (FVOCI) of ₹ 12 crore and related FVOCI reserve of ₹ 6 crore.

(b) Net defined benefit liability of ₹ 6 crore that has resulted in a reserve relating to net measurement losses of ₹ 3 crore.

(c) Equity investments (considered not held for trading) of ₹ 10 crore for which irrevocable option of recognising the changes in fair value in FVOCI has been availed and related FVOCI reserve of ₹ 4 crore.

(d) Net assets of a foreign operation of ₹ 20 crore and related foreign currency translation reserve of ₹ 8 crore.

In consolidated financial statements of AB Limited, 90% of the above reserves were included in equivalent equity reserve balances, with the 10% attributable to the non-controlling interest included as part of the carrying amount of the non-controlling interest.

QUESTION 10

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 11 (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

	Amount (₹)
Revenue	3,80,000
Cost of sales	(2,20,000)
Gross profit	1,60,000
Depreciation	(30,000)
Other operating expenses	(56,000)
Interest cost	(4,000)
Profit before taxation	**70,000**
Taxation	(15,000)
Profit after taxation	**55,000**

Consolidated balance sheet

	20X2	20X1
Assets	**Amount (₹)**	**Amount (₹)**
Cash and cash equivalents	8,000	5,000
Trade receivables	54,000	50,000
Inventories	30,000	35,000
Property, plant and equipment	1,60,000	80,000
Goodwill	18,000	—
Total assets	**2,70,000**	**1,70,000**
Liabilities		
Trade payables	68,000	60,000
Income tax payable	12,000	11,000
Long term debt	1,00,000	64,000
Total Liabilities	**1,80,000**	**1,35,000**
Shareholders' equity	**90,000**	**35,000**
Total liabilities and shareholders'	**2,70,000**	**1,70,000**

Other information

All of the shares of entity B were acquired for ₹ 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

	Amount (₹)
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)
Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**

Prepare the Consolidated Statement of Cash Flows for the year 20X2, as per Ind AS 7.

INVESTMENT ENTITIES

Determining whether an entity is an investment entity

A parent shall determine whether it is an investment entity. An entity is an investment entity if it fulfils all the following conditions:

Obtains funds from one or more investors for providing those investor(s) with **investment management** services	Commits to its investor(s) that its business purpose is to invest funds solely for **returns from capital appreciation, investment income**, or both	**Measures and evaluates** the performance of substantially all of its **investments on a fair value basis**

In assessing whether an entity meets the definition of investment entity as above, the entity shall consider whether it has the following typical characteristics of an investment entity:

Typical characteristics of an investment entity

More than one investment	More than one investor
Investors are not related parties of the entity	Entity has ownership interests in the form of equity or similar interests

The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity but indicates that additional judgement is required in determining whether the entity is an investment entity.

If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity or the typical characteristics of an investment entity, a parent shall reassess whether it is an investment entity.

Following is the detailed discussion on two of the three elements of the definition of an investment entity (business purpose and fair value measurement) and the typical characteristics of an investment entity. As regards the first element, i.e. provision of investment management services, that essentially differentiates an investment entity from other entities.

Business Purpose

The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both.

Documents or other evidence that indicate the entity's investment objectives are include:

offering memorandum of the entity

publications distributed by the entity and other corporate

partnership documents of the entity

manner in which the entity presents itself to other parties (such as potential investors or potential investees)

For example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments.

Apart from the business purpose of investing for capital appreciation and investment income, an investment entity may provide investment-related services (e.g. investment advisory services, investment management, investment support and administrative services), to third parties as well as to its investors, even if those activities are substantial to the entity, subject to the entity continuing to meet the definition of an investment entity.

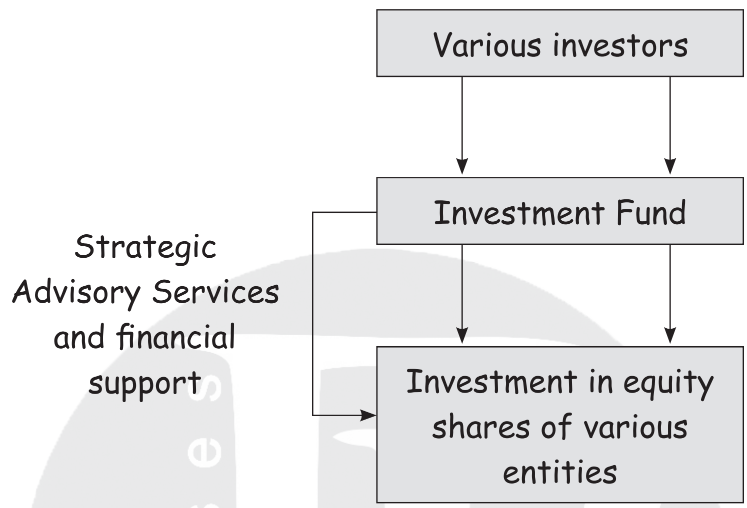
An investment entity may also participate in the following investment-related activities if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

a) providing management services and strategic advice to an investee; and

b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

QUESTION 1: BUSINESS PURPOSE OF AN INVESTMENT ENTITY

An asset manager has set up and investment fund for the purpose of acquiring capital contributions from various investors (by issuing them units in the fund) and investing those contributions in the equity share capital of various entities for the purpose of earning capital appreciation on those investments. Following is the existing structure of the fund.



Apart from the investments in various entities, the investment fund also provides its investee the strategic advisory services so that it can result in increase in the capital appreciation from investments in those investees. It also provides its investees financial support in the form of loan to provide them with funds for acquiring capital assets. The investment fund does not hold such investments for a period longer than 5 years. The investment fund measures and evaluate the performance of the investments on fair value basis.

Whether the investment fund can be treated as an investment entity?

Exit strategies

One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments.

An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.

Exit strategies can vary by type of investment.

- **For investments in private equity securities**, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee).
- **For equity investments that are traded in a public market**, examples of exit strategies include selling the investment in a private placement or in a public market.
- **For real estate investments**, an example of an exit strategy includes the sale of the real estate through specialized property dealers or the open market.

An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

QUESTION 2:

EXIT STRATEGIES OF AN INVESTMENT ENTITY

ABC Ltd. Is established with primary objective of investing in the equity shares of various entities across various industries based on the detailed research about each industry and entities within that industry being done by the investment manager of the company.

The investment manager decides the timing as to when the investments should be made considering the current market situation. Sometimes, the investment manager decides to invest the idle funds into short-term to medium-term debt instruments with fixed maturity. The exit strategies are in place for the investments done in equity shares but the same is not there for investments done in debt instruments.

Determine whether the entity fulfils the exit strategy condition of being classified as investment entity?

SOLUTION:

The exit strategies are in place for investments done in equity shares. But not in place for investments done in debt instruments. However, it should be noted that the debt instruments have fixed maturity period and they cannot be held for indefinite period. Hence, there is no need for having exit strategies for such instruments. Accordingly, the exit strategy condition is fulfilled for being classified as investment entity.

Earnings from investments

To be an investment entity, an entity must commit to its investors that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both.

An entity is not an investment entity if the entity, or another member of the group containing the entity obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties unrelated to the investee.

Such other benefits include following:

Acquisition, use, exchange or exploitation of the **processes, assets or technology of an investee**. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, etc. of any investee

Joint arrangements or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services;

Financial guarantees or assets provided by an investee for borrowing arrangements of the entity or another group member (however, an investment entity would still be able to use an investment in an investee as collateral for any of its borrowings)

An **option held by a related party** of the entity **to purchase,** from that entity or another group member, an **ownership interest** in an investee of the entity;

Transactions (except as mentioned in next paragraph) between the entity or another group member and an investee that are

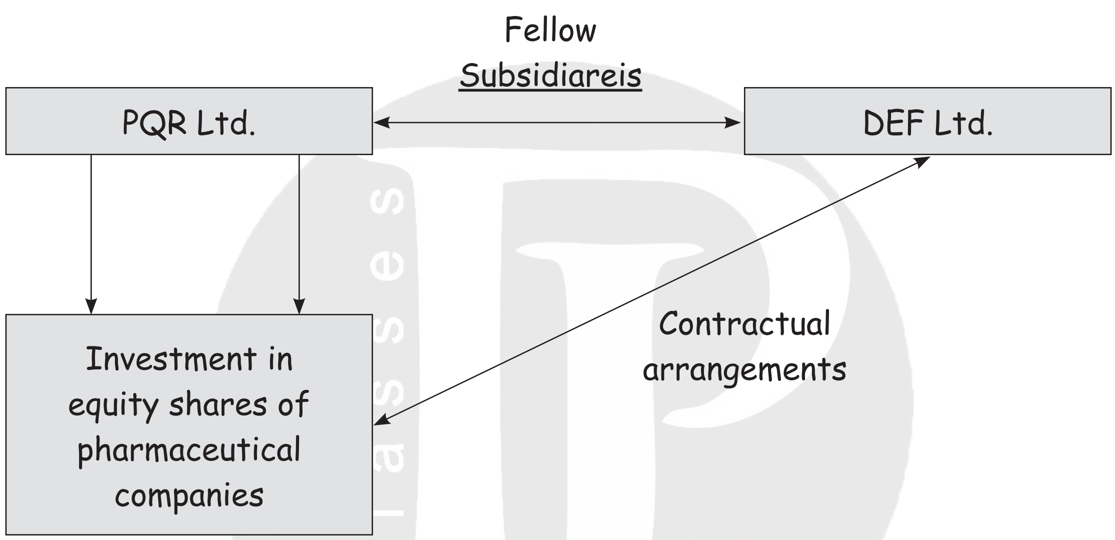
- on terms that are unavailable to unrelated parties; or
- not at fair value; or
- represent a substantial portion of the investee's or the entity's or other group entities' business

An investment entity may have a strategy to invest in more than one investee in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation and investment income from those investees. An entity is not disqualified from being classified as an investment entity merely because such investees trade with each other.

QUESTION 3:

Earnings from investments of an investment entity

PQR Ltd. Is established with primary objective of investing in the equity shares of various pharmaceutical companies which are involved in the research and development of medicine for a critical illness. DEF Ltd. Is a follow subsidiary of PQR Ltd. And DEF Ltd. Has entered into contractual arrangements with all the investees of PQR Ltd. That in case they are successful in developing the medicine then they will transfer the patent and distribution rights for that medicine to DEF Ltd. At less then market price. This arrangement is explained in following diagram:



Determine whether PQR Ltd. Can be classified as investment entity?

SOLUTION:

PQR Ltd. And DEF Ltd. Are part of same group. Further, DEF Ltd. Have exclusive right to acquire the patent and distributions rights from the investees of PQR Ltd. And that too at less then the market price. Hence, the related party of PQR Ltd. Is in position to obtain benefits other than capital appreciation and investment income from the investees that are not available to other parties unrelated to the investee. Accordingly, PQR Ltd. Cannot be classified as investment entity.

Exemptions to investment entities

An investment entity shall not consolidate its subsidiaries or apply Ind AS 103 'Business Combinations' when it obtains control of another entity; and measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

If an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services related to the investment entity's investment activities, it shall consolidate that subsidiary and apply the requirements of Ind AS 103 to the acquisition of any such subsidiary. If the subsidiary that provides the investment-related services or activities is itself an investment entity then the investment entity parent shall measure that subsidiary at fair value through profit or loss.

A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity. This is explained in following diagram form:

QUESTION 4

HTF Ltd. Was formed by T Ltd. To invest in technology start-up companies for capital appreciation. T Ltd. Holds a 70 percent interest in HTF Ltd. And controls HTF Ltd. The other 30 percent ownership interest in HTF Ltd. Is owned by 10 unrelated investors. T Ltd. Holds options to acquire investments held by HTF Ltd., at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of T Ltd. No plans for exiting the investments have been identified by HTF Ltd. HTF Ltd. Is managed by an investment adviser that acts as agent for the investors in HTF Ltd.

Determine whether HTF Ltd. Is an investment entity or not.

SOLUTION:

Even though HTF Ltd.'s business purpose is investing for capital appreciation and it provides investment management services to its investors, HTF Ltd. Is not an investment entity because of the following arrangements and circumstances:

(a) T Ltd., the parent of HTF Ltd. Holds options to acquire investments in investees held by HTF Ltd. If the assets developed by the investees would benefit the operations of T Ltd. This provides a benefit in addition to capital appreciation or investment income; and

(b) the investment plans of HTF Ltd. Do not include exit strategies for its investments, which are equity investments. The options held by T Ltd. Are not controlled by HTF Ltd. And do not constitute an exit strategy.

Accounting when an entity becomes an investment entity

When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status (except for any subsidiary that itself is not an investment entity but provide services related to the investment entity's investment activities. Such subsidiaries shall be continued to be consolidated). The investment entity shall apply the requirements of loss of control explained earlier in this unit to those subsidiaries that it ceases to consolidate as if the investment entity had lost control of those subsidiaries at that date.

QUESTION 5:

AN ENTITY BECOMES AN INVESTMENT ENTITY

CD Ltd. purchased a 100% subsidiary for ₹ 20,00,000 on 31st March 20X1 when the fair value of the net assets of KL Ltd. was ₹ 16,00,000. Therefore, goodwill was ₹ 4,00,000. CD Ltd. becomes an investment entity on 31st March 20X3 when the carrying value of its investment in KL Ltd. (measured at fair value through profit or loss) was ₹ 25,00,000. At the date of change in status, the carrying value of net assets of KL Ltd. excluding goodwill was ₹ 19,00,000.

Calculate gain or loss with respect to investment in KL Ltd. on the date of change in investment entity status of CD Ltd.

SOLUTION:

The gain on the disposal will be calculated as follows:

	₹
Fair value of retained interest (100%)	25,00,000
Less: Net assets disposed, including goodwill (19,00,000 + 4,00,000)	(23,00,000)
Gain on the date of change in investment entity status of CD Ltd.	2,00,000

NOTES

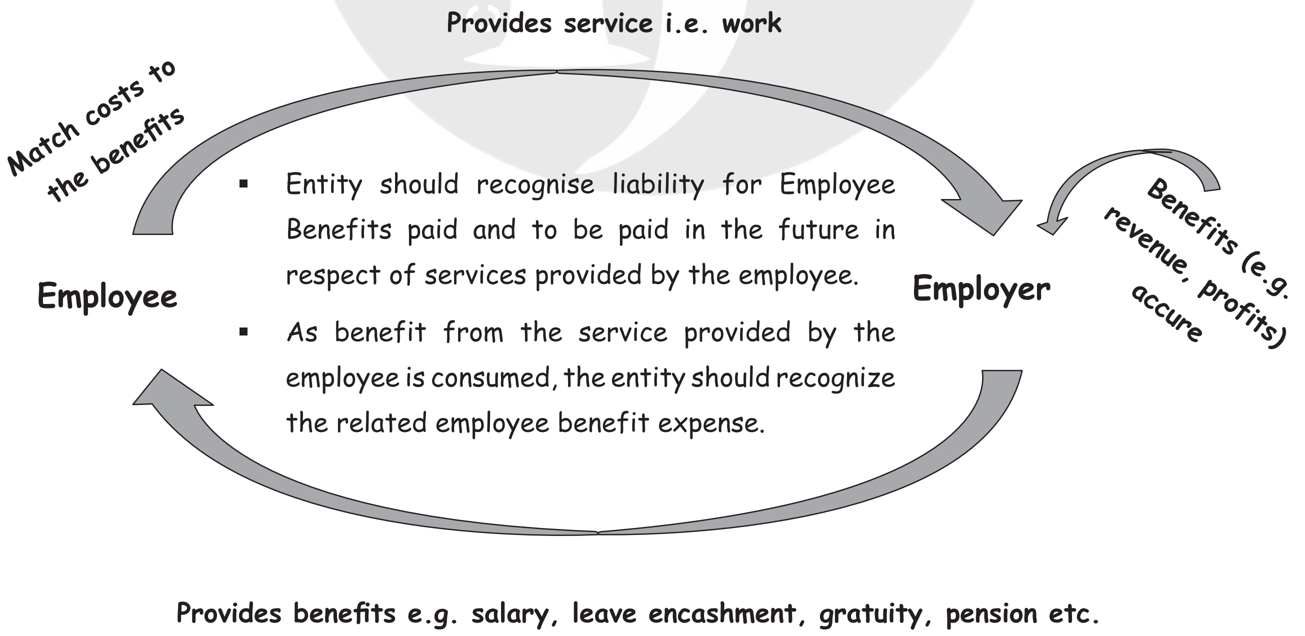
IND AS 19: EMPLOYEES BENEFITS

CONCEPT 1: OBJECTIVE OF IND AS 19

- The objective of this standard is to prescribe the accounting and disclosure for employee benefits.
- Ind AS 19 requires an entity to recognise:
  - (a) a liability for advance services received from an employee; and
  - (b) an expense for consumption of economic benefits raised from the service provided by an employee in exchange for employee benefits.

Financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not when cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

When employees provide services to their employer during a period, their services lead to generation of benefits (revenues or profits or increased efficiency), directly or indirectly, for their employers for that period. The underlying assumption of accrual requires that for the benefit earned in a particular period, the costs incurred in earning that benefit need to be recognised entirely.



CONCEPT 2: SCOPE

The concept of 'Employee Benefits' has evolved over the years to encompass more than just the salaries, wages and social welfare contributions. The companies of today – established or start-ups – provide a host of benefits to its employees including, but not limited to, Employees' Stock Option Plans, jubilee bonuses, long-term disability benefits etc. In fact, companies like Google even provide unusual benefits such as 'death benefits', which involve paying the deceased's spouse or domestic partner 50% of their salary for 10 years after death of the employee.

- This Standard shall be applied by an employer in accounting for all employee benefits other than benefits to which Ind AS 102, Share-based Payment, is applicable (e.g. Employees Stock Option Plans).
- This Standard does not deal with reporting by employee benefit plans.
- Employee benefits to which this Standard applies include those provided
  - under formal plans/agreements between an entity and its individual employees/ group of employees/their representatives,
  - as required by law or as required by any type of industry arrangements whereby an entity is required to contribute to any nation/state/industry or other multi-employer plans; or
  - by those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits.

Example of a constructive obligation - Where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

CONCEPT 3: EMPLOYEE BENEFITS

Employee benefits include:

(i) Short employee benefits,

(ii) Post-employment benefits,

(iii) Other long term employee benefits and

(iv) Termination benefits.

All these categories have different characteristics and hence the Standard has specified separate accounting requirements for each such category.

Employee Benefits
- **Short Term Benefits**
- **Post Employee Benefits**
- **Other Long Term Benefits**
- **Termination Benefits**

- Employee benefits include benefits provided either to
  - Employees; or
  - Their dependants; or
  - Their beneficiaries.
- Employee benefits may be settled by payments (or the provision of goods or services) made either
  - directly to the employees; or
  - their spouses; or
  - their children; or
  - their other dependants; or
  - Others, such as insurance companies.
- An employee may provide services to an entity on a
  - full-time; or
  - part-time; or
  - permanent; or
  - casual; or
  - Temporary basis.

Note: For the purpose of this Standard, employees include directors and other management personnel.

Employee benefits include	
Payments in cash or equivalents	Payments by provision of goods or services

↓

Employee benefits are paid to			
Employees	Dependants of employees	Beneficiaries of employees	Others such as insurance companies

↓

Employees include					
Full-time Employees	Part Time Employees	Permanent Employees	Casual Employees	Temporary Employees	Directors and Other Management Personnel

SECTION A: SHORT-TERM EMPLOYEE BENEFITS

- Short-term employee benefits include items expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services.
- It includes
  - (a) Wages, salaries and social security contributions;
  - (b) Paid annual leave and paid sick leave;
  - (c) Profit-sharing and bonuses; and
  - (d) Non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Short-term employee benefits include			
Wages, salaries and social security contributions	Paid annual leave and paid sick leave	Profit-sharing and bonuses	Non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees

- Reclassification of a short-term employee benefit is not required if the entity's expectations of the timing of settlement of such benefits changes temporarily.
- Reclassification may be considered-

  If the characteristics of the benefit change (such as a change from a non-accumulating benefit to an accumulating benefit) or

  If a change in expectations of the timing of settlement is not temporary.

A. RECOGNITION AND MEASUREMENT OF SHORT-TERM BENEFITS

Accounting for short term benefits has two characteristics:

(a) short-term benefits are measured on an undiscounted basis; and

(b) they don't involve any actuarial valuation for their measurement.

The undiscounted amount of short-term employee benefits expected to be paid in exchange for that service shall be recognised:

(a) as a liability (accrued expense), after deducting any amount already paid.

If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) As an expense, if it doesn't form part of the cost of an asset as per any other Ind AS (e.g. Ind AS 2, Inventories or Ind AS 16 Property, Plant and Equipment).

Note: Recognition of short-term employee benefit is in the form of either paid expenses or profit sharing or bonus plans.

B. SHORT-TERM PAID ABSENCES

An employer may compensate an employee for absence for various reasons including holidays, sickness and short-term disability, maternity or paternity, jury service and military service. Entitlement to paid absences (i.e. compensated balances) fall into two categories and are recognized as follows:

(a) **Accumulating** paid absences - recognized when the employees render service that increases their entitlement to future paid absences; and

(b) **Non-accumulating** paid absences - recognized when the absences occur.

ACCUMULATING PAID ABSENCES

- These are the absences that are carried forward and can be used in future periods if the employee is not able to use them in current reporting period of the employer. They can be either:
    - (i) **Vesting:** In this case, employees are entitled to a cash-payment for the unutilised entitlement at the time of leaving the entity; and
    - (ii) **Non-vesting:** In this case, employees are not entitled to a cash payment for unused entitlement on leaving.
- This obligation exists and is recognized, even if the compensated absences are non-vesting. However, in case an employee leaves the entity before they use an accumulated non-vesting entitlement, it will affect the measurement of this obligation.
- An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period.

QUESTION 1: VESTED ACCUMULATING BENEFITS

Mr. Rajan is working for Infotech Ltd. Consider the following particulars: Annual salary of Mr. Rajan = ₹ 30,00,000

Total working days in 20X0-X1 = 300 days

Leaves allowed in 20X0-X1 as per company policy = 10 days

Leaves utilized by Mr. Rajan in 20X0-X1 = 8 days

The unutilized leaves are settled by way of payment and accordingly, carry forward of such leaves to the subsequent period is not allowed.

Compute the total employee benefit expense for Infotech Ltd. in respect of 20X0-X1.

QUESTION 2: NON-VESTED ACCUMULATING BENEFITS

Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual Salary	₹ 30,00,000	₹ 30,00,000
No. of working days during the year	300 days	300 days
Leaves Allowed	10 days	10 days

Leaves Taken	7 days	13 days
Leave utilized carried forward to next year	3 days	NIL

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2.

Infotech Ltd. contends that it will record ₹ 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2.

Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years.

QUESTION 3: NON-VESTED ACCUMULATING BENEFITS

Assume same information as in Illustration 2.

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 2 days of 20X0-20X1 subsequently.

However, in 20X1-20X2, Mr. Niranjan availed in actual all 3 days of brought forward leave.

Compute the expense to be recognised in 20X0-20X1 and 20X1-20X2. Also pass journal entries for both the years.

QUESTION 4

Sunderam Pvt. Ltd. has a headcount of 100 employees in 20X0-20X1. As per the employee policy, the employees are entitled to:

- 30 casual leaves out of which 10 casual leaves may be carried forward to the next year; and
- 10 sick leaves out of which 2 sick leaves may be carried forward as paid leave.

At 31st March, 20X1, the average unused entitlement is 5 days per employee for casual leaves and 1 day per employee for sick leave. On an average, it is found that the number of such employees who would be claiming casual leaves would be 30 and 10 employees who would claim sick leaves.

Compute the liability to be recognised in respect of sick leaves and casual leaves by the entity at the end of the financial year 20X0-20X1.

QUESTION 5

An entity has 100 employees, who are each entitled to ten working days of paid sick leave for each year. Unused sick leave may be carried forward for one financial year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis).

At 31 March 20X1, the average unused entitlement is two days per employee. Based on past experience, the management expects that only 20% of the employees will use 1 day from their carried forward leave. Salary per day is ₹ 2,500.

Compute the expenses in respect of the short-term compensated absences, if they are assumed to be (a) vested short-term compensated absences, and (b) non-vested short-term compensated absences.

QUESTION 6

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates observed during past 10 years represents 6% per annum. Acer Ltd. provides the following benefits to all its employees:

Paid vacation - 10 days per year regardless of date of hiring. Compensation for paid vacation is 100% of employee's salary and unused vacation can be carried forward for 1 year. As of 31st March, 20X1, unused vacation carried forward was 3 days per employee, average salary was ₹ 15,000 per day and accrued expense for unused vacation in 20X0-20X1 was ₹ 65,00,000. During 20X1-20X2, employees took 9 days of vacation in average. Salary increase in 20X1-20X2 was 10%.

How would Acer Ltd. recognize liabilities and expenses for these benefits as of 31st March, 20X2?. Pass the journal entry to show the accounting treatment.

QUESTION 7

An entity has 100 employees, who are each entitled to five working days of paid sick leaves for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (LIFO basis).

At 31st March, 20X1, the average unused entitlement is two days per employee. The entity expects, on the basis of experience that is expected to continue, that 92 employees will take no more than five days of paid sick leaves in 20X1-20X2 and that the remaining eight employees will take an average of six and a half days each.

The entity expects that it will pay an additional twelve days of sick pay as a result of the unused entitlement that has accumulated at 31st March, 20X1 (one and a half days each, for eight employees). Would the entity require to recognize any liability in respect of leaves?

QUESTION 8

Cisca Pvt. Ltd. has a headcount of around 1,000 employees in the organisation in 20X0-20X1. As per the company's policy, the employees are given 35 days of privilege leaves (PL), 15 days of sick leaves (SL) and 10 days of casual leaves. Out of the total PL and sick leaves, 10 PL leaves and 5 sick leaves can be carried forward to next year. On the basis of past trends, it has been noted that 200 employees will take 5 days of PL and 2 days of SL and 800 employees will avail 10 days of PL and 5 days of SL.

Also the company has been incurring profits since 20XX. It has decided in 20X0-20X1 to distribute profits to its employees @ 4% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Cisca Pvt. Ltd. is expected to be around 3.5%. The profits earned during 20X0-20X1 is ₹ 2,000 crores.

Cisca Pvt. Ltd. has a post-employment benefit plan also available which is in the nature of defined contribution plan where contribution to the fund amounts to ₹ 100 crores which will fall due within 12 months from the end of accounting period.

The company has paid ₹ 20 crores to its employees in 20X0-20X1.

What would be the treatment of the short-term compensating absences, profit-sharing plan and the defined contribution plan in the books of Cisca Pvt. Ltd?

NON-ACCUMULATING PAID ABSENCES

- These are the absences that do not carry forward and they will lapse if the current period's entitlement is not used in full by the employee.
- They do not entitle employees to a cash payment for unused entitlement on leaving the entity.

  Example: Sick pay (to the extent that unused past entitlement does not increase future entitlement).
- An entity shall recognise no liability or expense until the time of the absence because the employee service does not increase the amount of the benefit.

C.PROFIT-SHARING AND BONUS PLANS

- Expected costs of profit-sharing and bonus plans shall be recognised when and only when:
  - (a) the entity has a present legal or constructive obligation to make such payments as a result of past events; and
  - (b) a reliable estimate of the obligation can be made by the entity.
- Under some profit-sharing plans, employees receive a share of the profit only if they remain with the entity for a specified period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments.
- An entity may have no legal obligation to pay a bonus. Nevertheless, in some cases, an entity has a practice of paying bonuses. In such cases, the entity has a constructive obligation because the entity has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.
- An entity can make a reliable estimate of its legal or constructive obligation under a profit- sharing or bonus plan when, and only when:
  - (a) the formal terms of the plan contain a formula for determining the amount of the benefit;
  - (b) the entity determines the amounts to be paid before the financial statements are approved for issue; or
  - (c) past practice gives clear evidence of the amount of the entity's constructive obligation.
- An obligation under profit-sharing and bonus plans results from employee service and not from a transaction with the entity's owners.
- **Therefore, an entity recognises the cost of profit-sharing and bonus plans not as a distribution of profit but as an expense.**

QUESTION 9

Laxmi Mills is a profit-making entity and has reported profit of ₹ 200 crore in the financial year 20X1-20X2. According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation.

Under this plan, an entity is under an obligation to pay if the employees complete a specified period with the organisation. Laxmi Mills has estimated that due to staff turnover in the organisation, the estimated pay-out would be around 4.5%.

Compute the liability and expense of the company under this plan.

QUESTION 10

Acer Ltd. has 350 employees (same as a year ago). The average staff attrition rates as observed during past 10 years represents 6% per annum. Acer provides the following benefits to all its employees:

Annual bonus - during past 10 years.

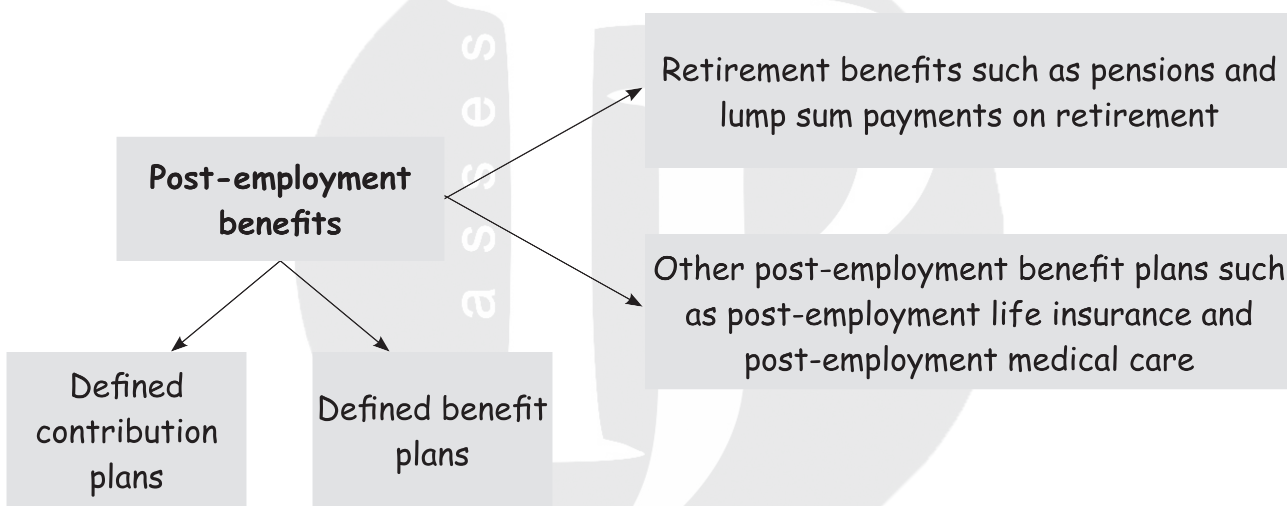
Acer paid bonus to all employees who were in service during the entire financial year. Bonus was paid in June following the financial year-end. Amount of bonus for 20X1-20X2 paid in June 20X2 represented ₹ 1,25,000 per employee. Acer Ltd. used to increase amount of bonus based on official inflation rate which is 8.5% for 20X2-20X3, although there was no legal obligation to increase the bonus by such inflation rate.

How would Acer Ltd. recognize liabilities and expenses for these employee benefits as on 31st March, 20X3? Pass the journal entry to show the accounting treatment.

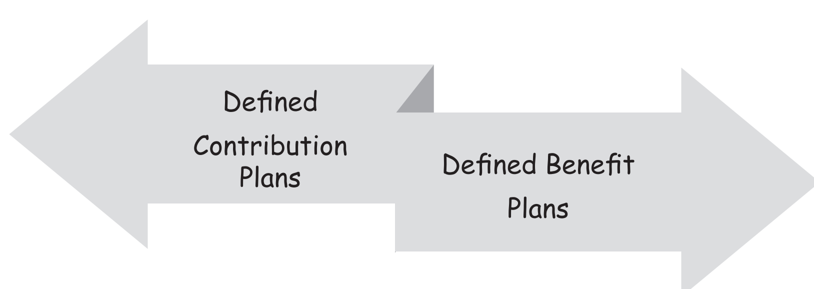
SECTION B: POST EMPLOYMENT BENEFITS

POST-EMPLOYMENT BENEFITS

- Post-employment benefits include:
  - (a) Retirement benefits such as pensions and lump sum payments on retirement; and
  - (b) Other post-employment benefit such as post-employment life insurance and post-employment medical care.
- Depending upon the economic substance of the plan which is derived from its principal terms and conditions, post-employment benefit plans are classified as
  - (i) Either defined contribution plans
  - (ii) Or defined benefit plans



Classification of Post-employment Benefit Plans into Defined Contribution Plan vs Defined Benefit Plans



DEFINED CONTRIBUTION PLANS

(a) The entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund.

(b) Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post- employment benefit plan or to an insurance company, together with investment returns arising from the contributions.

(c) As a result of this, actuarial risk (which means that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall, in substance on the employee (and not on the entity like in defined benefit plan).

DEFINED BENEFIT PLANS

(a) The entity's obligation is to provide the agreed benefits to current and former employees; and

(b) Actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity (and not on the employee like in the case of defined contribution plan).

(c) Thus, if actuarial or investment experience are worse than expected, the entity's obligation may be increased.

The above differences can be summarized as follows:

S. No.	Particulars	Defined Contribution Plans	Defined Benefit Plans
1.	Entity's obligation	The entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund.	The entity's obligation is to provide the agreed benefits to current and former employees.
2.	Risk bearer	Actuarial risk and investment risk fall on the employee and not on the entity.	Actuarial risk and investment risk fall on the entity and not on the employee.

3.	Change in the obligation	Generally, no change in the contribution of an entity is made except in certain cases.	If actuarial or investment experience are worse than expected, the entity's obligation may be increased for providing to the employees.
4.	Determination of the amount of post-employment benefit	The amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity and employee as well.	Pre-determined / Agreed post- employment benefits are received by the employee.

QUESTION 11

A company pays each employee a lump-sum one-time benefit upon retirement. This benefit is computed based on the employee's years in service in the company and the final salary prior to retirement. To cover its liabilities from this remuneration, the company contributes 3% of annual gross salaries to the fund. Would this obligation represent a defined contribution plan or a defined benefit plan and why?

SOLUTION:

Defined benefit plan.

Reason: Although the Company pays contributions to the fund to cover its liabilities, amount of remuneration is determined in advance and Company will have to carry the risk in case the fund's assets are not sufficient to cover remuneration in full.

QUESTION 12

In accordance with applicable legislation, company contributes 12% and employees 12% of annual gross salaries to the provident and pension fund. Upon retirement, the employees will get the accumulated balance that is calculated based on employee's years of service and his average salary for past 15 years before retirement. The pension will be paid out of the state fund assets and the company has no further obligation except to make contributions. Would this obligation represent a defined contribution plan or a defined benefit plan?

SOLUTION:

Defined contribution plan.

Reason: Although employee's pension is determined in advance by the formula (and thus employees neither carry actuarial nor investment risks), Company's liability is limited to contributions to the fund. In this case, as pension will be paid out of the state fund, it is a state fund which carries all the risks.

MULTI-EMPLOYER PLANS

- An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms).
- In the case of a multi-employer defined benefit plan, normally
  - ➢ The amount of contributions is decided keeping in mind the amount of benefits that an entity is required to pay in the same period and
  - ➢ The future benefits that an entity gets during the current period will be paid out of future contributions.
  - ➢ Employers have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned.
  - ➢ Employees' benefits are determined by the length of their service in the entity as a future amount which is required to be paid to them. Such a plan would create actuarial risk to the entity (i.e. if the ultimate cost of benefits already earned at the end of the reporting period is more than expected, the entity will have to either increase its contributions or to persuade employees to accept a reduction in benefits).
- In case the multi-employer plan is a defined benefit plan, an entity shall:

  (a) account for its proportionate share of the

    (i) defined benefit obligation,

    (ii) plan assets and

    (iii) cost associated with the plan

    in the same way as for any other defined benefit plan; and

  (b) disclose the information required.
- When sufficient information is not available to use defined benefit accounting for a multi- employer plan that is a defined benefit plan, an entity shall:

  (a) account for the plan as if it were a defined contribution plan;

(b) disclose:

(i) the fact that the plan is a defined benefit plan;

(ii) the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and

(iii) the expected contributions to the plan for the next annual reporting period; and

DEFINED BENEFIT PLANS THAT SHARE RISKS BETWEEN ENTITIES UNDER COMMON CONTROL

- Defined benefit plans that share risks between entities under common control, for example, a parent and its subsidiaries, are not multi-employer plans.
- An entity who is participating in such a plan shall obtain information about the plan as a whole on the basis of assumptions that apply to whole plan as a whole.
- The entity shall, in its separate or individual financial statements, recognise the net defined benefit cost it charged, if there is a contractual agreement or stated policy for charging the net defined benefit cost for the whole plan to individual group entities.
- In case there is no such agreement or policy, the net defined benefit cost shall be recognised in the separate or individual financial statements of the group entity that is legally the sponsoring employer for the plan.
- The other group entities shall, in their separate or individual financial statements, recognise a cost equal to their contribution payable for the period.

STATE PLANS

- A state plan is accounted for in the same way as a multi-employer plan.
- State plans are normally established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national or local government or by another body (for example, an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.
- Some plans established by an entity provide both compulsory benefits, as a substitute for benefits that would otherwise be covered under a state plan, and additional voluntary benefits. Such plans are not state plans.
- State plans are characterised as defined benefit or defined contribution, depending on the entity's obligation under the plan.

- Many state plans are funded on a pay-as-you- go basis which implies that contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period. In such kind of a case, future benefits earned during the current period will be paid out of future contributions.
- In most of the state plans, the entity has no legal or constructive obligation to pay those future benefits as its only obligation as an entity is to pay the contributions as they fall due and in case the entity does not employ members of the state plan, it will have no obligation to pay the benefits earned by its own employees in previous years. For this reason, state plans are normally defined contribution plans.

INSURED BENEFITS

- An entity normally pays insurance premiums for funding a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan.
- The entity shall treat the plan as a defined benefit plan in case an entity has (either directly, or indirectly through the plan) a legal or constructive obligation, either to pay:
  - (a) the employee benefits directly when they fall due; or
  - (b) further amounts if the insurer does not pay all future employee benefits which are relating to employee service in the current and prior periods.
- Where an entity is funding a post-employment benefit obligation and contributes to an insurance policy under which the entity retains a legal or constructive obligation, in this case the payment of the premiums does not amount to a defined contribution arrangement. This can be either directly or indirectly through the plan, through the mechanism for setting future premiums or through a related party relationship with the insurer. Hence the entity shall:
  - (a) account for a qualifying insurance policy as a plan asset; and
  - (b) recognise other insurance policies as reimbursement rights.
- The entity has no obligation to pay benefits to the employees and the insurer has sole responsibility for paying the benefits where an insurance policy is in the name of a specified plan participant or a group of plan participants and the entity does not have any legal or constructive obligation to cover any loss on the policy.
- The payment of fixed premiums under such kind of arrangement is a settlement of the employee benefit obligation rather than an investment to meet the obligation. Therefore, an entity treats such payments as contributions to a defined contribution plan.

ACCOUNTING FOR DEFINED CONTRIBUTION PLANS

- The reporting entity's obligation for each period is determined by the amounts to be contributed for that period.
- No actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss.
- The obligations are measured on an undiscounted basis.

RECOGNITION AND MEASUREMENT

When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

As a liability (accrued expense), after deducting any contribution already paid.

In case the amount of contribution already paid under a defined contribution plan exceeds the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, a reduction in future payments or a cash refund;

Where contributions to a defined contribution plan do not fall due wholly before twelve months after the end of the annual reporting period in which the employees render the related service, the contributions shall be discounted using the discount rate as specified in this Standard.

QUESTION 13

Acer Ltd. provides lump-sum remuneration upon retirement to its employees. Remuneration is paid out of the fund to which Acer Ltd. contributes 12% of annual gross salaries. Contributions are made twice a year ie in November of the related financial year and in June after the financial year-end. Total annual gross salaries for 20X0-X1 amounted to ₹ 50 crores. Contribution made by Acer Ltd. in November 20X0 was ₹ 2.8 crores. Remuneration depends on the number of employee's service and amount of cash in the fund at retirement date (Acer Ltd. has no further obligations except for contributions).

How should this transaction appear in the financial statements of Acer Ltd. as of 31 March 20X1?

ACCOUNTING FOR DEFINED BENEFIT PLANS

Accounting for defined benefit plans is complex because -

- Actuarial assumptions are required to measure the obligation and the expense;
- There is a possibility of actuarial gains and losses;
- The obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

QUESTION 14

Dinkar Ltd., a large IT company, accounts for gratuity on payment basis, and supports such accounting policy by making the following disclosure in the Financial Statements:

"Due to high labour turnover, a large degree of uncertainty is involved in estimating the liability of gratuity. Accordingly, the management opines that as the estimates of the uncertainty would confuse the readers by complicating the financial statements, such liability would be recorded on payment basis."

The management opines that by making the above disclosures, the company is complying with the requirements of all the Ind AS, as a disclosure to the effect of the above is given. The management is also willing to specifically highlight the above aspect by making it conspicuous in the financial statements.

Is the contention of management correct as per the provisions of Ind AS?

SOLUTION:

In the given case, compliance with Ind AS would not be a conflict, as the compliance with Ind AS 19 would ensure that the accrual assumption laid down in the Framework is complied with. Further, a disclosure cannot be a remedy for non-compliance. Therefore, the company have to state that the Ind AS have not been complied with by the company in the preparation and presentation of its Financial Statements.

Hence, the company will have to suitably modify the financial statements considering the materiality and pervasiveness of the non-compliance.

RECOGNITION AND MEASUREMENT

- Defined benefit plans can be:
  - Unfunded or
  - Funded.

  They may be funded wholly or partly by contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid.
- The payment of funded benefits when they fall due depends on
  - The financial position and the investment performance of the fund; and
  - An entity's ability (and willingness) to make good any shortfall in the fund's assets.
- Therefore, the entity, in substance, underwrites the actuarial and investment risks associated with the plan.
- Hence the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period.

STEPS INVOLVED IN ACCOUNTING BY AN ENTITY FOR DEFINED BENEFIT PLANS

Determine the deficit or surplus	• PUCM (Projected Unit Credit Method) • Discounting • Fair value of plan assets
Determine the amount of the net defined benefit liability (asset)	• As the amount of the deficit or surplus
Determine the amounts to be recognised in Profit or Loss	• Current service cost • Past service cost • Net interest
Determine the remeasurements of the net defined benefit liability (asset)	• Acturial Gain or Loss • Return on Plan Assets • Any Change in effect of Asset Ceiling

Step I: Determining the Deficit or Surplus

This involves:

(a) using actuarial techniques, the projected unit credit method, to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods.

This requires an entity to -

(i) determine how much benefit is attributable to the current and prior periods and

(ii) make estimates (actuarial assumptions) about

- demographic variables (such as employee turnover and mortality); and
- financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit;

(b) discounting that benefit in order to determine the present value of the defined benefit obligation; and the current service cost

(c) deducting the fair value of any plan assets from the present value of the defined benefit obligation.

Step II: Determining the amount of the net defined benefit liability (asset)

Determining the amount of the net defined benefit liability (asset) as the amount of the deficit or surplus determined in step I above, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

Step III: Determining amounts to be recognised in profit or loss:

(i) current service cost.

(ii) any past service cost and gain or loss on settlement.

(iii) net interest on the net defined benefit liability (asset).

Step IV: Determining the remeasurements of the net defined benefit liability (asset), to be recognised in other comprehensive income, comprising:

(i) actuarial gains and losses;

(ii) return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and

(iii) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

In case an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately.

An entity shall determine the net defined benefit liability (asset) with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period

CONCEPT 1: PRESENT VALUE OF DEFINED BENEFIT OBLIGATIONS AND CURRENT SERVICE COST

In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) Apply an actuarial valuation method;

(b) Attribute benefit to periods of service; and

(c) Make actuarial assumptions.

ACTUARIAL VALUATION METHOD: PROJECTED UNIT CREDIT METHOD

- Projected Unit Credit Method (PUCM) is used by an entity to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.
- The Projected Unit Credit Method (which is also sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) perceives each period of service as which gives rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation.

QUESTION 15

AJ Ltd is engaged in the business of trading of chemicals having a net worth of ₹ 150 crores. The company's profitability is good and hence the company has introduced various benefits for its employees to keep them motivated and to ensure that they stay with the organization. The company is an associate of RJ Ltd which is listed on Bombay Stock Exchange in India.

The company initially did not have any HR function but over the last 2 years, the management set up that function and now HR department takes care of all the benefits related to the employees and how they can be structured in a manner beneficial to both the employees and the objectives of the company.

One of the employee benefits involves a lump sum payment to employee on termination of service and that is equal to 1 per cent of final salary for each year of service. Consider the salary in year 1 is ₹ 10,000 and is assumed to increase at 7 per cent (compound) each year.

Taking a discount rate at 10 per cent per year, you are required to show

(a) benefits attributed (year on year) and

(b) the obligation in respect of this benefit (year on year)

For and employee who is expected to leave at the end of year 5

Following assumptions may be taken to solve this:

- There are no changes in actuarial assumptions.
- No additional adjustments are needed to reflect the probability that the employee may leave the entity at an earlier or later date.

ATTRIBUTING BENEFIT TO PERIODS OF SERVICE

- An entity shall attribute benefit to periods of service under the plan's benefit formula, in determining the present value of its defined benefit obligations and the related current service cost
- However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:
  - (a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service) until
  - (b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.
- The Projected Unit Credit Method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations).
- Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested).
- Employee service given the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. An entity considers the probability that some employees may not satisfy any vesting requirements in measuring its defined benefit obligation.

QUESTION 16

A plan pays a benefit of ₹ 150 for each year of service. The benefits vest after ten years of service. Compute the benefit to be attributed each year?

SOLUTION:

1. A benefit of ₹ 150 is attributed to each year.
2. In each of the first ten years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service. This is because the benefits vest at a future date (i.e. after ten years of service).

QUESTION 17

A plan pays a benefit of ₹ 150 for each year of service, excluding service before the age of 25. The benefits vest immediately. Compute the benefit to be attributed each year?

SOLUTION:

1. No benefit is attributed to the service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional).
2. A benefit of ₹ 150 is attributed to each subsequent year. There is no requirement to reflect any probability of completion as the benefits vest immediately.

QUESTION 18

A plan pays a lump-sum retirement benefit of ₹ 4,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service.

Category of Employee	Description	Benefit attributed per year
Employees who join before the age of 35	• These employees will be in service for 20 years at the age of 55. Accordingly, the service leads to benefits at the age of 35 and are conditional of further service.	• For these employees, the entity attributes benefit of ₹ 200 (₹ 4,000 divided by 20 years) each year from the age of 35 to the age of 55.

	• However, service beyond the age of 55 leads to no material amount of further benefits (i.e. benefit will still be the same).	• The current service cost and the present value of the obligation should reflect the probability of an employee not completing the necessary service period.
Employees who join after the age of 35	• These employees will not be in service for 20 years at the age of 55 and must wait till the age of 65, regardless of the years of service. • The service leads to benefits at the beginning of employment and service beyond age 65 leads to no material amount of further benefits.	• For these employees, the entity attributes benefit of ₹ 4,000 ÷ (65 years – whatever age when employment started may be 40, 45, 50…) to each year of service from the start until the age of 65. • The current service cost and the present value of the obligation should reflect the probability of an employee not completing the necessary service period.

QUESTION 19

Amra Pvt. Ltd. has a plan for its employees where it has decided to pay a lump-sum benefit of ₹ 2,000 that will vest after ten years of service. However, that plan will provide no further benefit for subsequent service.

Compute the benefit attributed for 10 years of service and for the period of service after 10 years?

SOLUTION:

1. In this case, as per the company's plan, a benefit of ₹ 200 (₹ 2,000 ÷ 10 years) is attributed to each of the first 10 years.
2. The current service cost in each of the first ten years reflects the probability that the employee may not complete ten years of service. This is because the benefits vest at a future date (i.e. after ten years of service).

No benefit is attributed to subsequent years.

QUESTION 20

Sanat Pvt. Ltd. has a plan for the employees where employees are entitled to a benefit of 5% of final salary for each year of service before the age of 55. Compute the benefit attributed up to 55 years and after 55?

SOLUTION:

Benefit of 5% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

QUESTION 21

A post-employment medical plan reimburses 40 percent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service. How will the benefit be attributed to the years of service?

SOLUTION:

1. Under the Plan's Benefit Formula, the entity should attribute 4% of the present value of the expected medical costs (40% ÷ 10 years) to each of the first ten years, and 1% (10% ÷ 10 years) to each of the second ten years.
2. For employees expected to leave within 10 years, no benefit is attributed.
3. The Current Service Cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits.

QUESTION 22

A post-employment medical plan reimburses 10 percent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service.

How will the benefit be attributed to the years of service?

QUESTION 23

AKJ Ltd is a listed company engaged in the business of manufacturing of electronic equipment. The company has various branch offices spread out across India and has 1,000 employees.

As per the statutory requirements, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years -

(a) On his superannuation, or

(b) On his retirement or resignation, or

(c) On his death or disablement due to accident or disease.

The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.

The amount payable is determined by a formula linked to number of years of service and last drawn salary. The amount payable to an employee shall not exceed ₹ 10,00,000.

Compute the amount of employee benefit, if any, attributed to each year of service.

SOLUTION:

For those employees for whom the amount payable as per the formula does not exceed ₹ 10,00,000, over the expected period of service, the amount payable will be divided by the expected period of service and the resulting amount will be attributed to each year of the expected period of service, including the period before the stipulated period of 5 years.

QUESTION 24

A plan provides a monthly pension of 0.3% of final salary for each year of service. The pension is payable from the age of 65. What is the current service cost?

SOLUTION:

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.3% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit.

QUESTION 25

A plan pays a benefit of ₹ 140 for each year of service, excluding service before the age of 25. The benefits vest immediately. Compute the benefit to be attributed before the age of 25 and after 25?

SOLUTION:

No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of ₹ 140 is attributed to each subsequent year.

QUESTION 26

B Pvt. Ltd. has a post-employment medical plan which will reimburse 20% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service. How would you measure the benefit to be attributed for the employee service for the Iast 20 years, 10 and 20 years and within 10 years?

SOLUTION:

As per Ind AS 19, the benefit will be attributed till the period the employee service will lead to no material amount of benefits. And service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after twenty or more years, the entity would attribute benefit on a straight-line basis. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2.5% (i.e. 50% divided by 20) of the present value of the expected medical costs.

For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 2% (20 % divided by 10) of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

For employees expected to leave within ten years, no benefit is attributed.

ACTUARIAL ASSUMPTIONS

- Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits.
- Actuarial assumptions shall be unbiased and mutually compatible.
- Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.
- Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, salary increment rate and discount rates.

ACTUARIAL ASSUMPTIONS COMPRISE:

(a) **DEMOGRAPHIC ASSUMPTIONS** about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

   (i) mortality, both during and after employment;

   (ii) rates of employee turnover, disability and early retirement;

(b) **FINANCIAL ASSUMPTIONS,** dealing with items such as:

(i) the discount rate;

(ii) future salary and benefit levels;

(iii) in the case of medical benefits, future medical costs, including claim handling costs (i.e. the costs that will be incurred in processing and resolving claims, including legal and adjuster's fees); and

Actuarial Assumptions: Mortality and Discount Rate

1. Mortality Assumptions

Entity is required to determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment.

In order to estimate the ultimate cost of the benefit an entity shall takes into consideration the expected changes in mortality, for example by modifying standard mortality tables with estimates of mortality improvements.

2. Discount Rate Assumptions

- The rate which is used to discount post-employment benefit obligations (both funded and unfunded) is determined by reference to market yields on government bonds at the end of the reporting period.
- Subsidiaries, associates, joint ventures and branches domiciled outside India shall discount post-employment benefit obligations arising on account of post-employment benefit plans using the rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds.
- In case, such subsidiaries, associates, joint ventures and branches are domiciled in countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds of that country shall be used.
- Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period and taking account of any material changes in the obligation.

PAST SERVICE COST AND GAINS AND LOSSES ON SETTLEMENT

- When determining past service cost, or a gain or loss on settlement, an entity shall remeasure the net defined benefit liability (asset) using the current fair value of plan assets and current actuarial assumptions (including current market interest rates and other current market prices) reflecting:

- the benefits offered under the plan and the plan assets before the plan amendment, curtailment or settlement; and
- the benefits offered under the plan and the plan assets after the plan amendment, curtailment or settlement.

- An entity need not distinguish between past service cost resulting from a plan amendment, past service cost resulting from a curtailment and a gain or loss on settlement if these transactions occur together. In some cases, a plan amendment occurs before a settlement, such as when an entity changes the benefits under the plan and settles the amended benefits later. In those cases, an entity recognises past service cost before any gain or loss on settlement.

PAST SERVICE COST

- Change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment is known as past service cost.
- An entity shall recognise past service cost as an expense at the earlier of the following dates:
  (a) when the plan amendment or curtailment occurs; and
  (b) when the entity recognises related restructuring costs (refer Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets) or termination benefits.
- Plan amendment happens when an entity introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan.
- Curtailment arises when an entity significantly reduces the number of employees covered by a plan. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan.
- Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases).

GAINS AND LOSSES ON SETTLEMENT

- A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan (other than a payment of benefits to, or on behalf of, employees in accordance with the terms of the plan and included in the actuarial assumptions).

For example, a one-off transfer of significant employer obligations under the plan to an insurance company through the purchase of an insurance policy is a settlement; a lump sum cash payment, under the terms of the plan, to plan participants in exchange for their rights to receive specified post-employment benefits is not.

- The gain or loss on a settlement is the difference between:
  - (a) the present value of the defined benefit obligation being settled, as determined on the date of settlement; and
  - (b) the settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement.
- Gain or loss on the settlement of a defined benefit plan is recognised by the entity when the settlement occurs.

FAIR VALUE OF PLAN ASSETS

- The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus.
- Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, 1.10.2

COMPONENTS OF DEFINED BENEFIT COST

- An entity is required to recognise the components of defined benefit cost, except to the extent that another Ind AS (refer Ind AS 2 and Ind AS 16) requires or permits their inclusion in the cost of an asset, as follows:
  - (a) service cost in profit or loss;
  - (b) net interest on the net defined benefit liability (asset) in profit or loss; and
  - (c) remeasurements of the net defined benefit liability (asset) in other comprehensive income.
- Remeasurements of the net defined benefit liability (asset) recognised in other comprehensive income shall not be reclassified to profit or loss in a subsequent period. However, the entity may transfer those amounts recognised in other comprehensive income within equity.

REMEASUREMENTS OF THE NET DEFINED BENEFIT LIABILITY (ASSET)

- Remeasurements of the net defined benefit liability (asset) comprise:
  - (a) actuarial gains and losses;
  - (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
  - (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).
- Actuarial gains and losses occur from increases or decreases in the present value of the defined benefit obligation because of changes in actuarial assumptions and experience adjustments. Following are the few causes of actuarial gains and losses:
  - (a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;
  - (b) the effect of changes to assumptions concerning benefit payment options;
  - (c) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs; and
  - (d) the effect of changes in the discount rate.
- Actuarial gains and losses does not include changes in the present value of the defined benefit obligation because of the introduction, amendment, curtailment or settlement of the defined benefit plan, or changes to the benefits payable under the defined benefit plan. Rather such changes shall result in past service cost or gains or losses on settlement.
- In measuring the return on plan assets, an entity deducts the costs of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the defined benefit obligation. Other administration costs are not deducted from the return on plan assets.

QUESTION 27

Pratap Ltd. belongs to the ship-building industry. The company reviewed an Actuarial Valuation for the first time for its pension scheme which revealed a surplus of ₹ 60 lakhs. It wants to spread the same over the next 2 years by reducing the annual contribution to ₹ 20 lakhs instead of ₹ 50 lakhs.

The average remaining life of the employees is estimated to be 6 years. Advise the Company in line with Ind AS 19.

SOLUTION:

1. **Recognition:** As per Ind AS 19, any Actuarial Gains and Losses should be recognized as a re- measurement of the Net Defined Benefit Liability / (Asset) in "Other Comprehensive Income".
2. **Measurement and Presentation:** In the given case, the amount of surplus from Pension Scheme of ₹ 60 lakhs is an Actuarial Gain and should be recognized as a "re-measurement" in "Other Comprehensive Income", and not to be adjusted from the amount of annual contribution in future years.
3. **Disclosure:** The change relating to Actuarial Valuation for the Pension Scheme requires disclosure under Ind AS 8. Disclosures required by Ind AS 19 should also be made in the financial statements.

QUESTION 28

RKA Private Ltd is an old company established in 19XX. The company started with a very small capital base and today it is one of the leading companies in India in its industry. The company has an annual turnover of ₹ 11,000 crores and planning to get listed in the next year.

The company has a large employee base. The company provided a defined benefit plan to its employees. Following is the information relating to the balances of the fund's assets and liabilities as at 1st April, 20X1 and 31st March, 20X2.

₹ in lacs

Particulars	1st April, 20X1	31st March, 20X2
Present value of benefit obligation	1,400	1,580
Fair value of plan assets	1,140	1,275

For the financial year ended 31st March, 20X2, service cost was ₹ 55 lacs. The company made a contribution of an amount of ₹ 111 lacs to the plan. No benefits were paid during the year.

Consider a discount rate of 8%. You are required to -

(a) Compute the balance(s) of the company to be included its balance sheet as on 31st March, 20X2 and amounts to be recognized in the statement of profit and loss and other comprehensive income for the year ended 31st March, 20X2.

(b) Give the journal entries in respect of amount(s) to be recognized.

QUESTION 29

OPQ Ltd is a listed company having its corporate office at Nagpur. The company has a branch office at Chennai. The company has been operating in Indian market for the last 10 years.

The company operates a pension plan that provides a pension of 2.5% of the final salary for each year of service. The benefits become vested after seven years of service.

On 1st April, 20X8, the company increased the pension to 3% of the final salary for each year of service starting from 1st April, 20X1. On the date of the improvement, the present value of the additional benefits for service from 1st April, 20X1 to 1 April 20X8 was as follows:

- Employees with more than seven years' service on 1 January 20X8 – ₹ 2,75,000
- Employees with less than 7 years of service – ₹ 2,21,000 (average 4 years to go). What would be the accounting treatment in this case?

QUESTION 30

SA Pvt Ltd is engaged in the business of retail having 100 retail outlets across Northern and Southern India. The company's head office is located at Chennai.

SA Pvt Ltd is a subsidiary of SAG Ltd. SAG Ltd is listed on the National Stock Exchange in India.

Following information is available for SA Pvt Ltd:

Plan Assets

At 1st April, 20X1, the fair value of plan assets was ₹ 10,000.

Contribution to the plan assets done on 31st March, 20X2 – ₹ 3,000

Amount paid on 31st March, 20X2 – ₹ 300

At 31st March, 20X2, the fair value of plan assets was ₹ 14,700

Actual return on plan assets – ₹ 2,000

Defined Benefit Obligation

At 1st April, 20X1, present value of the defined benefit obligation was ₹ 12,000.

At 31st March, 20X2, present value of the defined benefit obligation was ₹ 15,500. Actuarial losses on the obligation for the year ended 31st March, 20X2 were ₹ 100.

Current Service Cost – ₹ 2,500

Benefit paid – ₹ 300

Discount rate used to calculate defined benefit liability - 10%.

As per Ind AS 19, please suggest if there is any amount based on the above-mentioned information that would be taken to other comprehensive income (with workings). Also compute net interest on the net defined benefit liability (asset).

QUESTION 31

A Ltd. prepares its financial statements to 31st March each year. It operates a defined benefit retirement benefits plan on behalf of current and former employees. A Ltd. receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April, 20X1, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was ₹ 5,20,00,000. On 1st April, 20X1, the annual market yield on government bonds was 5%. During the year ended 31st March, 20X2, A Ltd. made contributions of ₹ 70,00,000 into the plan and the plan paid out benefits of ₹ 42,00,000 to retired members. Both these payments were made on 31st March, 20X2.

The actuaries advised that the current service cost for the year ended 31st March, 20X2 was ₹ 62,00,000. On 28th February, 20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by ₹ 15,00,000 from that date.

During the year ended 31st March, 20X2, A Ltd. was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by ₹ 80,00,000. Before 31st March, 20X2, A Ltd. made payments of ₹ 75,00,000 to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 31st March, 20X2, the actuaries advised that the present value of the defined benefit obligation was ₹ 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were ₹ 5,60,00,000.

Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 20X2 as per Ind AS.

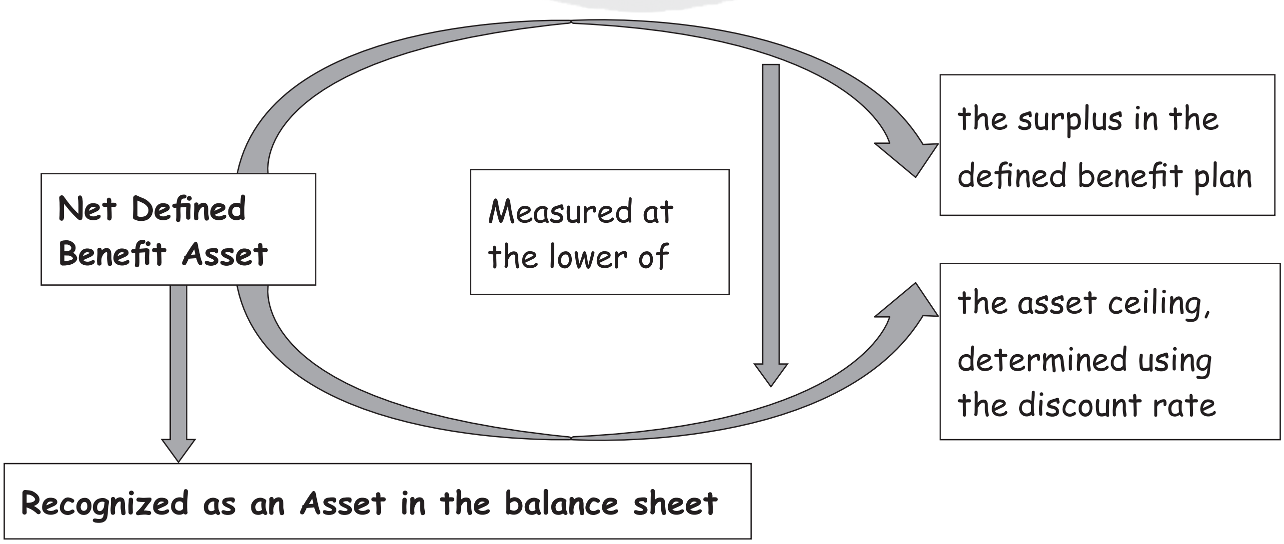
QUESTION 32

On 1 April 20X1, the fair value of the assets of XYZ Ltd's defined benefit plan were valued at ₹ 20,40,000 and the present value of the defined obligation was ₹ 21,25,000. On 31st March,20X2 the plan received contributions from XYZ Ltd amounting to ₹ 4,25,000 and paid out benefits of ₹ 2,55,000. The current service cost for the financial year ending 31

March 20X2 is ₹ 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 20X2 was ₹ 23,80,000, and the present value of the defined benefit obligation was ₹ 27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehensive income and balance sheet?

BALANCE SHEET

- An entity shall recognise the net defined benefit liability (asset) in the balance sheet.
- When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:
  - (a) the surplus in the defined benefit plan; and
  - (b) the asset ceiling, determined using the discount rate.
- A net defined benefit asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are arisen. An entity recognises a net defined benefit asset in such cases because:
  - (a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;
  - (b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and
  - (c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.



QUESTION 33

How will the following information be presented in the Balance Sheet of Udyog Ltd.?

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	3,500
Fair Value of Plan Assets	3,332

SOLUTION:

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	3,500
Less : Fair Value of Plan Assets	(3,332)
Deficit to be treated as Net Defined Benefit Liability under Non-current Liabilities as Provisions in the Balance Sheet	168

QUESTION 34

How will the following information be presented in the Balance Sheet of Udyog Ltd.?

Particulars	**₹ in lakhs**
PV of Defined Benefit Obligations	2,750
Fair Value of Plan Assets	2,975
Asset Ceiling	175

SOLUTION:

Particulars	₹ in lakhs
PV of Defined Benefit Obligations	2,750
Less: Fair Value of Plan Assets	(2,975)
Surplus, to be treated as Net Defined Benefit Asset,	225
Asset Ceiling as per Ind AS 19	175
Least of above is Surplus to be treated as Net Defined Benefit Asset under Balance Sheet	175

PRESENTATION

- An asset relating to one plan will be offset against a liability relating to another plan when, and only when, the entity:
  - (a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and
  - (b) there is an intention either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.
- The offsetting criteria are similar to those established for financial instruments in Ind AS 32, Financial Instruments: Presentation.

Current/Non-current Distinction

This Standard does not specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

IND AS 19 — THE LIMIT ON A DEFINED BENEFIT ASSET, MINIMUM FUNDING REQUIREMENTS AND THEIR INTERACTION

(1) Ind AS 19 limits the measurement of a defined benefit asset to the lower of the surplus in the defined benefit plant and asset ceiling (i.e. the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan). Questions have arisen about when refunds or reductions in future contributions should be regarded as available, particularly when a minimum funding requirement exists.

(2) Minimum funding requirements normally stipulate a minimum amount or level of contributions that must be made to a plan over a given period. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions that must be made to a plan over a given period. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions.

(3) Further, the limit on the measurement of a defined benefit asset may cause a minimum funding requirement to be onerous. Normally, a requirement to make contributions to a plan would not affect the measurement of the defined benefit asset or liability. This is because the contributions, once paid, will become plan assets and so the additional net liability is nil. However, a minimum funding requirement may give rise to a liability if the required contributions will not be available to the entity once they have been paid.

Scope

This Appendix applies to all post-employment defined benefits and other long-term employee defined benefits. For the purpose of this Appendix, minimum funding requirements are any requirements to fund a post-employment or other long-term defined benefit plan.

Issues

The issues addressed in this Appendix are:

(1) when refunds or reductions in future contributions should be regarded as available in accordance with the definition of the asset ceiling.

(2) how a minimum funding requirement might affect the availability of reductions in future contributions.

(3) when a minimum funding requirement might give rise to a liability.

Availability of a refund or reduction in future contributions

(4) Availability of a refund or a reduction in future contributions shall be determined in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan.

(5) An economic benefit is available in the form of a refund or a reduction in future contributions if the entity can realise it at some point during the life of the plan or when the plan liabilities are settled.

(6) The economic benefit available does not depend on how the entity intends to use the surplus. An entity shall determine the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. An entity shall not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

(7) In accordance with Ind AS 1, the entity shall disclose information about the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amount of the net asset or liability recognised in the balance sheet. This might include disclosure of any restrictions on the current realisability of the surplus or disclosure of the basis used to determine the amount of the economic benefit available.

The economic benefit available as a refund

1. The right to a refund

- A refund is available to an entity only if the entity has an unconditional right to a refund:
  - (a) during the life of the plan, without assuming that the plan liabilities must be settled in order to obtain the refund (e.g., in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or
  - (b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or
  - (c) assuming the full settlement of the plan liabilities in a single event (i.e., as a plan wind-up).
- An unconditional right to a refund can exist whatever the funding level of a plan at the end of the reporting period.
- If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset.

2. Measurement of the economic benefit

- An entity shall measure the economic benefit available as a refund as the amount of the surplus at the end of the reporting period (being the fair value of the plan assets less the present value of the defined benefit obligation) that the entity has a right to receive as a refund, less any associated costs.

  For instance, if a refund would be subject to a tax other than income tax, an entity shall measure the amount of the refund net of the tax.

- In measuring the amount of a refund available when the plan is wound up, an entity shall include the costs to the plan of settling the plan liabilities and making the refund.

  For example, an entity shall deduct professional fees if these are paid by the plan rather than the entity, and the costs of any insurance premiums that may be required to secure the liability on wind-up.

- If the amount of a refund is determined as the full amount or a proportion of the surplus, rather than a fixed amount, an entity shall make no adjustment for the time value of money, even if the refund is realisable only at a future date.

The economic benefit available as a contribution reduction

(8) The economic benefit available as a reduction in future contributions is the future service cost to the entity for each period over the shorter of the expected life of the plan and the expected life of the entity, if there is no minimum funding requirement for contributions relating to future service. The future service cost to the entity excludes amounts that will be borne by employees.

(9) An entity shall determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future can be assumed by the entity until the plan is amended and shall assume a stable workforce in the future unless the entity makes a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction.

The effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions

(10) An entity shall analyse any minimum funding requirement at a given date into contributions that are required to cover

(a) any existing shortfall for past service on the minimum funding basis; and

(b) future service.

Contributions to cover any existing shortfall on the minimum funding basis in respect of services already received do not affect future contributions for future service.

They may give rise to a liability.

(11) If there is a minimum funding requirement for contributions relating to the future service, the economic benefit available as a reduction in future contributions is the sum of:

(a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (i.e., paid the amount before being required to do so); and

(b) the estimated future service cost in each period less the estimated minimum funding requirement contributions that would be required for future service in those periods if there were no prepayment as described in (a).

(12) An entity shall estimate the future minimum funding requirement contributions for future service taking into account the effect of any existing surplus determined using the minimum funding basis but excluding the prepayment. An entity shall use assumptions consistent with the minimum funding basis and, for any factors not specified by that basis, assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period. The estimate shall include any changes expected as a result of the entity paying the minimum contributions when they are due. However, the estimate shall not include the effect of expected changes in the terms and conditions of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period.

(13) When an entity determines the amount, if the future minimum funding requirement contributions for future service exceed the future service cost in any given period, that excess reduces the amount of the economic benefit available as a reduction in future contributions.

When a minimum funding requirement may give rise to a liability

(14) If an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.

(15) To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the defined benefit asset or increase the defined benefit liability so that no gain or loss is expected.

SECTION C: LONG-TERM EMPLOYEE BENEFITS

- Long-term employee benefits (other than post-employment benefits) are those employee benefits which are not expected to be settled wholly before twelve months after the end of the annual reporting period.
- Other long-term employee benefits include, for example:
  - (a) long-term paid absences such as long-service or sabbatical leave;
  - (b) jubilee or other long-service benefits;
  - (c) long-term disability benefits;
  - (d) profit-sharing and bonuses; and
  - (e) deferred remuneration.
- The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits.

A.RECOGNITION AND MEASUREMENT

- For other long-term employee benefits, an entity shall recognise the net total of the following amounts in profit or loss, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:
  - (a) service cost;
  - (b) net interest on the net defined benefit liability (asset); and
  - (c) remeasurements of the net defined benefit liability (asset).
- One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered.

  Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

Disclosure

Though this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures.

For example:

a. Where the expense resulting from such benefits is material and so would require disclosure in accordance with Ind AS 1.

b. When required by Ind AS 24, an entity discloses information about other long-term employee benefits for key management personnel.

SECTION D: TERMINATION BENEFITS

- This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination of employment rather than employee service.
- Termination benefits results from either:
  - (a) an entity's decision to terminate the employment or
  - (b) an employee's decision to accept an entity's offer of benefits in exchange for termination of employment.
- Termination benefits do not include employee benefits resulting from termination of employment at the request of the employee without an entity's offer, or as a result of mandatory retirement requirements, because those benefits are post-employment benefits.
- Some entities provide a lower level of benefit for termination of employment at the request of the employee (in substance, a post-employment benefit) than for termination of employment at the request of the entity. The difference between the benefit provided for termination of employment at the request of the employee and a higher benefit provided at the request of the entity is a termination benefit.

A. RECOGNITION

- An entity is required to recognise a liability and expense for termination benefits at the earlier of the following dates:
  - (a) when the entity can no longer withdraw the offer of those benefits; and
  - (b) when the entity recognises costs for a restructuring which is within the scope of Ind AS 37 and involves the payment of termination benefits.

  For termination benefits payable as a result of an employee's decision to accept an offer of benefits in exchange for the termination of employment, the time when an entity can no longer withdraw the offer of termination benefits is the earlier of:
  - (a) when the employee accepts the offer; and
  - (b) when a restriction (e.g. a legal, regulatory or contractual requirement or other restriction) on the entity's ability to withdraw the offer takes effect.

  For termination benefits payable as a result of an entity's decision to terminate an employee's employment, the entity can no longer withdraw the offer when the entity has communicated to the affected employees a plan of termination meeting all of the following criteria:

(a) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.

(b) The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date.

B. MEASUREMENT

An entity shall measure termination benefits on initial recognition, and shall measure and recognise subsequent changes, in accordance with the nature of the employee benefit, provided that if the termination benefits are an enhancement to post-employment benefits, the entity shall apply the requirements for post-employment benefits. Otherwise:

(a) If the termination benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the termination benefit is recognised, the entity shall apply the requirements for short-term employee benefits.

(b) If the termination benefits are not expected to be settled wholly before twelve months after the end of the annual reporting period, the entity shall apply the requirements for other long-term employee benefits.

Because termination benefits are not provided in exchange for service, the concepts relating to the attribution of the benefit to periods of service as discussed for defined benefit plans are not relevant.

QUESTION 35: TERMINATION BENEFITS

As a result of a recent acquisition, an entity plans to close a factory in ten months and, at that time, terminate the employment of all of the remaining employees at the factory. Because the entity needs the expertise of the employees at the factory to complete some contracts, it announces a plan of termination as follows.

Each employee who stays and renders service until the closure of the factory will receive on the termination date a cash payment of ₹ 30,000. Employees leaving before closure of the factory will receive ₹ 10,000.

There are 120 employees at the factory. At the time of announcing the plan, the entity expects 20 of them to leave before closure.

IMPORTANT DEFINITIONS UNDER IND AS 19

DEFINITIONS OF EMPLOYEE BENEFITS

1. **Employee Benefits :** All forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.

2. **Short-term Employee Benefits :** Employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.

   Example : Wages, salaries, paid annual leave.

3. Post-employment Benefits: Employee benefits (other than termination benefits and short- term employee benefits) that are payable after the completion of employment.

   Example : Pensions, lumpsum payments on retirement.

4. **Other long-term employee benefits** are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.

   Example : Long-term paid absences such as long-service leave or sabbatical leave, jubilee or other long-service benefits.

5. **Termination benefits** are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

   (a) an entity's decision to terminate an employee's employment before the normal retirement date; or

   (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment

   Example : VRS Compensation or Retrenchment Compensation

Types of Employee Benefits		
	Short Term Benefits	Expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service
	Post Employee Benefits	Payable after the completion of employment (other than termination benefits and short-term benefits
	Other Long Term Benefits	Other than short-term, post-employment and termination benefits
	Termination Benefits	Provided in exchange for the termination of an employee's employment

DEFINITIONS RELATING TO CLASSIFICATION OF PLANS

1. **Post-employment Benefit Plans:** These plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

   Under these plans, the benefits are given to the employees after employment, like gratuity, pension, provident fund etc.

   Note: Defined contribution plans and defined benefit plans are two categories of post-employment benefits plans.

2. **Defined Contribution Plans:** They are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

   In these plans, the contribution is defined i.e. contribution is fixed and known to the entity.

   Example : Provident Fund contribution by the employer to the Employees' Provident Fund Organisation, Ministry of Labour & Employment, Government of India.

3. **Defined Benefit Plans:** Post-employment benefit plans other than defined contribution plans.

   Example: Gratuity.

4. **Multi-employer Plans:** Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

   (a) pool the assets contributed by various entities that are not under common control; and

   (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees.

DEFINITIONS RELATING TO THE NET DEFINED BENEFIT LIABILITY (ASSET)

1. **Net defined benefit liability (asset):** The deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

2. **Deficit or surplus:**

   (a) the present value of the defined benefit obligation less

   (b) the fair value of plan assets (if any).

3. **Asset ceiling:** The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

4. **Present Value of a Defined Benefit Obligation:** Present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

5. **Plan assets** comprise:

   (a) assets held by a long-term employee benefit fund; and

   (b) qualifying insurance policies.

6. **Assets held by a long-term employee benefit fund:** Assets (other than non-transferable financial instruments issued by the reporting entity) that:

   (a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

   (b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

      (i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

      (ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

7. **Qualifying Insurance Policy:** Insurance policy issued by an insurer that is not a related party (as defined in Ind AS 24, Related Party Disclosures) of the reporting entity, if the proceeds of the policy:

   (a) can be used only to pay or fund employee benefits under a defined benefit plan; and

   (b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

      (i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

      (ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

7. **Fair Value:** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Ind AS 113, Fair Value Measurement.)

DEFINITIONS RELATING TO DEFINED BENEFIT COST

1. **Service** cost comprises:
   (a) Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
   (b) Past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and
   (c) any gain or loss on settlement.
2. **Net interest on the net defined benefit liability (asset):** The change during the period in the net defined benefit liability (asset) that arises from the passage of time.
3. **Remeasurements of the net defined benefit liability (asset) comprise:**
   (a) actuarial gains and losses;
   (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
   (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).
4. **Actuarial gains and losses** are changes in the present value of the defined benefit obligation resulting from:
   (a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
   (b) the effects of changes in actuarial assumptions.
5. **Return on plan assets:** Interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:
   (a) any costs of managing plan assets; and
   (b) any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.
6. **Settlement:** A transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

NOTES

IND AS 28:
INVESTMENT IN ACCOCIATES & JOINT VENUTRUES

CONCEPT 1: INTRODUCTION

Ind AS 28, Investments in Associates and Joint Ventures,

(a) Prescribes the accounting for investments in associates and

(b) Sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

It is important to note here that Ind AS 111, describes joint arrangements including joint ventures and prescribes equity method for joint ventures. But here, in Ind AS 28, the equity method is described for both Associate and Joint Ventures.

CONCEPT 2 : SCOPE

The Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.

CONCEPT 3 : SIGNIFICANT INFLUENCE

The concept of 'Significant influence' signifies the close relationship between two entities where one has the power to influence the decision making in the other entity. In today's business world, many companies do not have actual control over other companies but hold significant ownership to influence the decision making in such companies. Many such investments are in the form of joint ventures in which two or more companies form a new entity to carry out a specified operating purpose.

For Example, Microsoft and NBC formed MSNBC, a cable channel and online site to go with NBC's broadcast network. Each partner owns 50 percent of the joint venture. For each of these investments, the investors do not possess absolute control because they hold less than a majority of the voting stock. Thus, the preparation of consolidated financial statements is inappropriate. However, the large percentage of ownership indicates that each investor possesses some ability to affect the investee's decision-making process.

Definition

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Analysis

Holding 20% or More of the Voting Rights: If an entity holds, directly or indirectly (e.g., through subsidiaries) 20 per cent or more of the voting power of the investee, it is presumed

That the entity has significant influence, unless it can be clearly demonstrated that this is not the case.

Holding Less than 20% of Voting rights: Also, in cases where the entity holds, directly or indirectly (e.g., through subsidiaries) less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.

QUESTION NO 1

X Ltd. owns 20% of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consist of five members. The remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.

A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meeting at the short notice and make decisions in the absence of X Ltd.'s representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd's representative has attended board meetings, but suggestion for items to be included on the agenda have been ignored and the other directors oppose any suggestions made by X Ltd. Is Y Ltd an associate of X Ltd.?

SOLUTION:

Despite the fact that the X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent X Ltd. from exerting significant influence. Whilst it appears that X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent X Ltd.'s efforts and stop X Ltd from actually having any influence.

Since, significant influence requires participation in decision making process which X Ltd. has. Therefore, X Ltd. has significant influence over Y Ltd. Hence, Y Ltd would be an associate of X Ltd. Y Ltd is jointly controlled by the other two entities.

Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee. Existence of significant influence may be judged by the following factors.

a) **Representation on the board of directors or equivalent governing body of the investee;**

QUESTION 2

Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd's board comprise of eight members and two of these members are appointed by Kuku Ltd. Each board member has one vote at meeting. Is Boho Ltd. an associate of Kuku Ltd.?

SOLUTION:

Boho Ltd is an associate of Kuku Ltd as significant influence is demonstrated by the presence of directors on the board and the relative voting rights at meetings.

It is presumed that entity has significant influence where it holds 20% or more of the voting power of the investee, but it is not necessary to have 20% representation on the board to demonstrate significant influence, as this will depend on all the facts and circumstances. One board member may represent significant influence even if that board member has less than 20% of the voting power. But for significant influence to exist it would be necessary to show based on specific facts and circumstances that this is the case, as significant influence would not be presumed.

b) **Participation in policy – making processes, including participation in decisions about dividends or other distributions;**

Example:

X Ltd creates a separate legal entity in which it holds less than 20% of the voting interests but however controls that entity through contracts that ensures that decisions-making power and the distribution of profits and losses lies with X Ltd. In such cases the investor is able to exercise significant influence over its investee.

Example:

Info Ltd owns 9% equity in Sync Ltd. However, it has the approval or veto rights over critical decisions of compensation, hiring, termination, and other operating and capital spending decisions of Sync Ltd. The non-controlling rights are so restrictive that it is appropriate to infer that control rests with the Info Ltd for all major decisions.

c) **Material transactions between the entity and its investee;**

QUESTION 3

Q Ltd manufactures shoes for a leading retailer P Ltd. P Ltd provides all designs for the shoes and participates in scheduling, timing and quantity of the production. The majority (i.e. 90%) of Q Ltd.'s sales are made to the retailer, P Ltd. P Ltd. has 10% shareholding in the Q Ltd. It acquired this interest many years ago at the start of their relationship. Does significant influence exist?

SOLUTION:

Q Ltd is highly dependent on the retailer for the continued existence of the business. Despite having only a 10% interest in Q Ltd, P Ltd has significant influence.

QUESTION 4

X Ltd owns 15% of the voting rights of Y Ltd, and the remainder are widely dispersed among the public.

X Ltd also is the only supplier of crucial raw materials to Y Ltd, further it provides certain expertise guidance regarding the maintenance of Y Ltd's factory.

Discuss the relationship between X Ltd and Y Ltd.

SOLUTION:

Y Ltd is effectively functioning because of the participation of X Ltd in the Y Ltd's factory despite having 15% interest in Y Ltd. X Ltd has significant influence.

d) **Interchange of managerial personnel; or**

QUESTION 5

Entity X and entity Y, operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provides for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board as well as to entity X's. Analyse.

SOLUTION:

The secondment of the board member and a senior manager from entity X to entity Y gives entity X, a range of power over a new production process and may evidence that entity X has significant influence over entity Y. This assessment take into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

e) **Provision of essential technical information.**

QUESTION 6

Soul Ltd has 18% interest in God Ltd. Soul Ltd manufacture mobile telephone handsets using technology developed by God Ltd. God Ltd licenses the technology to Soul Ltd and updates the licence agreement for new technology on a regular basis. The handsets are sold by Soul Ltd and represent substantially Soul Ltd's entire sale. Analyse.

SOLUTION:

Soul Ltd is dependent on the technology that God Ltd supplies since a high proportion of Soul Ltd's sales are based on that technology. Therefore, Soul Ltd is likely to be an associate of God Ltd because of the provision of essential technical informational.

CONCEPT 4: POTENTIAL VOTING RIGHTS

An investor may hold any instrument (such as share warrants, share call options, debt or equity instruments) issued by an associate and terms of the instrument is that a holder will get an equity rights on the expiry of the term i.e they are convertible into ordinary shares, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e. potential voting rights). Only an existing right will be considered for determining the Significant influence. Any potential voting rights that will arise in future will not be considered while determining significant influence.

It is worth nothing that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

CONCEPT 5: EQUITY METHOD

a) On the date of acquisition:

Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost.

Investment in Associate A/c Dr.

To Cash A/c

b) Recognising the share in Profit or loss:

Since the investor has the significant influence over the investee, the investor has an interest in the performance of the investee. It can influence the dividend to be distributed irrespective of the actuals profits made by the investee. Here the recognition of income based on profit distributed may not be a true measure of the income earned by an investor on an investment in an associate or a joint venture. The distributions made may bear little relation to the actual performance of the associate or joint venture. Hence recognising actual profit or loss (irrespective of the amount of dividend distributed) is more reflective of the actual value of the investment.

(i) If Associate or joint ventures makes profit

Investment in Associate A/c Dr.

To share in Profit from Associate A/c

(ii) If Associate or joint venture makes losses.

Share in Losses from Associate A/c Dr.

To Investment in Associate A/c

(iii) Cash dividend received: Any distribution of dividend in the form of cash received from the associate reduces the carrying amount of the investment.

Application of equity method

Investee Event	**Books of Investor**
Income is earned	Proportionate share of income is recognised by investor
Dividends distributed	Investor's share in dividends reduces the investment account.

QUESTION 7

Amar Ltd. acquires 40% share of Ram Ltd. On 1 April, 2011, the price paid is ₹10,00,000. Ram Ltd has reported a profit of ₹ 2,00,000 and paid dividend of ₹ 1,00,000. Make necessary journal entries in the books of Amar Ltd.

CONCEPT 6: APPLICATION OF EQUITY METHOD

The investor needs to apply equity method of accounting when it has joint control or significant influence over the investee.

The rationale behind the application of the equity method is that in case of an associate or a joint venture, an investor commences to gain the ability to influence the decision-making process of an investee as the level of ownership rises. The investor, hence, has the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50 percent or less of the voting rights. Clearly, this is a subject of judgments and interpretations in practice. Also, it is important to note that 'significant influence' is required to be present but there is no requirement that any actual influence must have ever been applied.

However, the investor is exempt from the application of Equity Method under certain circumstances.

Exemptions from applying the equity method

An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of Ind AS 110 or if all the following apply:

(a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.

(b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

(c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.

(d) The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with Ind AS.

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109.

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment- linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 regardless of whether the venture capital organisation has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation.

CONCEPT 7: DISCONTINUING OF EQUITY METHOD

The investor should discontinue the use of Equity Method from the date the significant influence or joint control ceases.

CONCEPT 8: EQUITY METHOD PROCEDURES

While preparing the consolidated financial statements, an investor applies equity method of accounting for investments in associates and joint ventures. It includes the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries taken together. The holdings of the group's other associates or joint ventures are ignored for this purpose.

When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies.

In accounting, transactions between related companies are identified as either downstream or upstream. Downstream transfers include investor's sale of an item to investee. Conversely, a downstream transfer means sales made by investee to investor. These two types of intra entity transactions are examined separately.

Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated.

QUESTION 8

Assume that Babu Ltd owns a 40% share of Sahu Ltd and accounts for this investment through the equity method. In 2011, Babu Ltd sells inventory to Sahu Ltd at a price of 50,000. This figure includes a gross profit of 30%.

By the end of 2011, Sahu Ltd has sold 40,000 of these goods to outside parties while retaining 10,000 in inventory for sale during the subsequent year.

QUESTION 9 EQUITY METHOD ACCOUNTING

B Ltd acquired a 30% interest in D Ltd and achieved significant influence. The cost of the investment was ₹ 2,50,000. The associate has net assets of ₹ 5,00,000 at the date of acquisition. The fair value of those net assets is ₹ 6,00,000 as a fair value of property, plant

& equipment is ₹ 1,00,000 higher than its book value. This property, plant & equipment has a remaining useful life of 10 years.

After acquisition D Ltd recognize profit after tax of ₹1,00,000 and paid a dividend out of these profits of ₹9,000. D Ltd has also recognised exchange losses of ₹20,000 directly in other comprehensive income.

CONCEPT 9: IMPAIRMENT LOSSES

After application of the equity method, it is necessary to recognise any additional impairment loss with respect to Investor's net investment in the associate or joint venture. There has to be substantial objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. There may be combined multiple events that may result in impairment. It is important to note that any losses expected from future events, no matter how likely, are not recognized. Objective evidences may include

(a) significant financial difficulty of the associate or joint venture;

(b) a breach of contract, such as a default or delinquency in payments by the associate or joint venture;

(c) the entity, for economic or legal reasons relating to its associate's or joint venture's financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;

(d) it becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation; or

(e) the disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

Example:

X Ltd, an associate of Y Ltd, disappears from the active market as its financial instruments are no longer publicly traded. However, this is not evidence of impairment. It has to supported by other evidences.

Example:

There is a downgrade of an associate's or joint venture's credit rating. This, however, is not an evidence of impairment, although it may be evidence of impairment when considered with other available information.

Example:

There are significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Goodwill that forms part of the carrying amount of the net investment in an associate or a joint venture is not separately recognised. Therefore, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in Ind AS 36, Impairment of Assets. Instead, the entire carrying amount of the investment is tested for impairment in accordance with Ind AS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Accordingly, any reversal of that impairment loss is recognised in accordance with Ind AS 36 to the extent that the recoverable amount of the net investment subsequently increases.

In determining the value in use of the net investment, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment;

or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

QUESTION NO 10

X Ltd. purchases 20% shares of Associates Ltd. for ₹ 200 lakhs as on 1.4.2015. On the date of purchase, shareholders' funds of Associate Ltd. was ₹ 900 lakhs.

	31.3.2016	31.3.2017
Net profits of the Associates	₹ 100 lakhs	(₹ 40 lakhs)
Other Comprehensive Income		
(Net of deferred tax liability)	₹ 10 lakhs	₹ 10 lakhs
Dividend paid (2014-15 and 2015-16)	₹ 100 lakhs	₹ 100 lakhs

Show equity method accounting for the investment in associates and corresponding credits to profit or loss and other comprehensive income of the investor.

QUESTION NO 11

[Adjustment difference in depreciation charge]

On 1.4.2015, X Ltd. acquired 20% equity interest in B Ltd. for ₹ 210 lakhs. Carrying amount of net assets of B Ltd. is ₹ 800 lakhs and fair value ₹ 1000 lakhs. The difference arises out of fair value of depreciable assets. The carrying amount of depreciable assets of B Ltd. ₹ 400 lakhs, the fair value of which are determined at ₹ 600 lakhs for purpose of acquisition of 20% stake by X Ltd.

During the year 2015-16, profit after tax of B Ltd. is ₹ 80 lakhs (which is arrived at after charging depreciation of ₹ 35 lakhs based on the carrying amount).

Show equity method accounting of the associate.

QUESTION NO 12

[Downstream transaction with impairment loss]

As on 1.4.2015 and 31.3.2016, investment in associates of X Ltd. are-

(1) 20% of equity shares of A Ltd.

(2) 30% of equity shares of B Ltd.

Based on the following information, show equity method accounting for the purpose of consolidated financial statements of X Ltd.:

	₹ in lakhs	
	A Ltd.	B Ltd.
As on 1.4.2015		
Cost of investments	200	650
Shareholders' funds:		
Share capital	100	100
General Reserve	800	2000
	900	2100
Proportionate share in equity	180	630
Goodwill	20	20
Profit for the year	80	120
Unsold inventories purchased from X Ltd.	200	
Total purchases	500	
Cost of goods sold as per X Ltd.	400	
Unsold inventories in the books of X Ltd. Purchased from B Ltd.		100
Total purchases from B Ltd.		300
Cost of goods sold as per B Ltd.		270

QUESTION NO 13 [NON-MONETARY CONTRIBUTION]

On 1.4.2015, X Ltd. contributed non-monetary assets (Plant and equipment: carrying amount ₹ 100 lakhs, fair value ₹ 150 lakhs) to B Ltd. in exchange of 20% equity interest in B Ltd. Proportionate share of equity interest as on the date of acquisition is ₹ 130 lakhs.

During the year 2015 -16, profit after tax of B Ltd. is ₹ 100 lakhs (which is arrived at after charging depreciation of ₹ 20 lakhs on the **PPE** contributed by X Ltd.)

Show equity method accounting of the associate.

NEW QUESTIONS ADDED IN STUDY MATERIAL

QUESTION 1: NO PARTICIPATION

E Ltd. holds 25% of the voting power of an investee. The balance 75% of the voting power is held by three other investors each holding 25%.

The decisions about the financing and operating policies of the investee are taken by investors holding majority of the voting power. Since, the other three investors together hold majority voting power, they generally take the decisions without presence of E limited. Even if E Ltd. proposes any changes to the financing and operating policies of the investee, the other three investors do not vote in favour of those changes. So, in effect the suggestions of E Ltd. are not considered while taking decisions related to financing and operating policies.

Determine whether E Ltd. has significant influence over the investee?

SOLUTION:

Since E Ltd. is holding more than 20% of the voting power of the investee, it indicates that E Ltd. might have significant over the investee. However, the other investors in the investee prevent E Ltd. from participating in the financing and operating policy decisions of the investee. Hence, in this case, E Ltd. is not in a position to have significant influence over the investee.

QUESTION 2: PARTICIPATION IN POLICY-MAKING PROCESSES

M Ltd. holds 10% of the voting power an investee. The balance 90% voting power is held by nine other investors each holding 10%.

The decisions about the relevant activities (except decision about taking borrowings) of the investee are taken by the members holding majority of the voting power. The decisions about taking borrowings are required to be taken by unanimous consent of all the investors. Further, decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee.

Determine whether M Ltd. has significant influence over the investee?

SOLUTION:

In this case, though M Ltd. is holding less than 20% of the voting power of the investee, M Ltd.'s consent is required to take decisions about taking borrowings which is one of the relevant activities. Further, since the decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee, it cannot be said that all the investors have joint control over the investee.

Hence, it can be said that M Ltd. has significant influence over the investee due to power to participate in decisions even if investment level is 10%.

QUESTION 3:

MATERIAL TRANSACTIONS BETWEEN THE ENTITY AND ITS INVESTEE

RS Ltd. is an entity engaged in the business of pharmaceuticals. It has invested in the share capital of an investee XY Ltd. and is holding 15% of XY Ltd.'s total voting power.

XY Ltd. is engaged in the business of producing packing materials for pharmaceutical entities. One of the incentives for RS Ltd. to invest in XY Ltd. was the fact that XY Ltd. is engaged in the business of producing packing materials which is also useful for RS Ltd. Since last many years, XY Ltd.'s almost 90% of the output is procured by RS Ltd.

Determine whether RS Ltd. has significant influence over XY Ltd.?

SOLUTION:

Since 90% of the output of XY Ltd. is procured by RS Ltd., XY Ltd. would be dependent on RS Ltd. for the continuation of its business. Hence, even though RS Ltd. is holding only 15% of the voting power of XY Ltd. it has significant influence over XY Ltd.

QUESTION 4:

PROVISION OF ESSENTIAL TECHNICAL INFORMATION

R Ltd. is a tyre manufacturing entity. The entity has entered into a technology transfer agreement with another entity Y Ltd. which is also involved in the business of tyre manufacturing. R Ltd. is an established entity in this business whereas Y Ltd. is a relatively new entity.

As per the agreement, R Ltd. has granted to Y Ltd. a license to use its the technical information and know-how which are related to the processes for the manufacture of tyres. Y Ltd. is dependent on the technical information and know-how supplied by R Ltd. because of its lack of expertise and experience in this business. Further, R Ltd. has also invested in 10% of the equity share capital of Y Ltd.

Determine whether R Ltd. has significant influence over Y Ltd.?

SOLUTION:

Y Ltd. obtains essential technical information for the running of its business from R Ltd. Hence R Ltd. has significant influence over Y Ltd. despite of holding only 10% of the equity share capital of Y Ltd.

QUESTION 5: POTENTIAL VOTING RIGHTS

An entity which is currently holding 10% of the voting power of an entity has an option of purchase additional 15% voting power of the investee from other investors. However, the entity currently does not have financial ability to purchase additional 15% voting power of the investee. Determine whether the entity has significant influence over the investee?

SOLUTION:

Considering the potential voting rights, the entity can have more than 20% of the voting power of the investee and hence it is presumed that the entity has significant influence over the investee. The fact that the entity does not have financial ability to purchase such additional voting power is not considered in such assessment (It should be noted that under Ind AS 110, potential voting rights which an entity cannot exercise because of its financial ability are not considered as substantive and hence not factored in the assessment. However, under Ind AS 28, there is no such requirement given. Hence the potential voting rights, even if they are not substantive as per Ind AS 110, are included in the assessment of significant influence.)

QUESTION 6:

ACCOUNTING ENTRIES RELATED INVESTMENT IN ASSOCIATE

On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of ₹ 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of ₹ 10,000 and other comprehensive income of ₹ 2,000. In that year, B Ltd. also declared dividend to the extent of ₹ 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate.

QUESTION 7: EXEMPTION FROM APPLYING EQUITY METHOD

MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15% held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

SOLUTION:

The 15% interest which is held directly by MNO Ltd. should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd. can avail the exemption from applying the equity method to that 10% interest and instead measure that investment at fair value through profit or loss. To summarise, the total interest of 25% in DEF Ltd. should be measured as follows:

- 15% interest held directly by MNO Ltd.: Measure as per equity method of accounting
- 10% interest held indirectly through a mutual fund: Measure as per equity method of accounting or at fair value thorough profit or loss as per Ind AS 109

QUESTION 8: ACQUISITION OF INTEREST IN AN ASSOCIATE

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for ₹ 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was ₹ 3,00,000 and the fair value was ₹ 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of ₹ 40,000 and other comprehensive income of ₹ 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

QUESTION 9:

Cumulative preference shares issued by associate

KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares to other investors worth ₹ 10,00,000. During the year, MN Ltd. earned profit of ₹ 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

QUESTION 10:

Share in the consolidated financial statements of associate

Entity A holds a 20% equity interest in Entity B (as associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of ₹ 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for ₹ 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of ₹ 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	₹	Liabilities	₹
Investment in B	200	Equity	200
Total	200	Total	200

B's consolidated financial statements

Assets	₹	Liabilities	₹
Assets (from C)	1,000	Equity	1,000
Total	1,000	Total	1,000

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements

Assets	₹	Liabilities	₹	₹
Assets (from C)	1,000	Equity	1,000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1,100
		Non-controlling interest		200
Total	1,300	Total		1,300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now ₹ 220 (20% of ₹ 1,100) i.e. ₹ 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

QUESTION 11:

Upstream and downstream transaction between an entity and its associate

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of ₹ 10,00,000. This included profit of 10% on the transaction price i.e. profit of ₹ 1,00,000. Out the above inventory, M Ltd. sold inventory of ₹ 6,00,000 to outside customers. Hence, the inventory of ₹ 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

QUESTION 12:

Impairment loss on downstream and upstream transaction between an entity and its joint venture

Scenario A

X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of ₹ 8,00,000. The asset's carrying value in X Ltd.'s books was ₹ 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Scenario B

Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

QUESTION 13:

Loss making associate and long-term interests

An entity has following three type interests in an associate:

- **Equity shares:** 25% of the equity shares to which equity method of accounting is applied
- **Preference shares:** Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.
- **Long-term loan:** The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.

At the start of year 1, the carrying value of each of the above interests is as follows:

- Equity shares – ₹ 10,00,000
- Preference shares – ₹ 5,00,000
- Long-term loan – ₹ 3,00,000

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5.

End of Year	Increase / (Decrease) in fair value of preference shares as per Ind AS 109	Impairment loss / (reversal) on long-term loan as per Ind AS 109	Entity's share in profit / (loss) of associate
1	(50,000)	(50,000)	(16,00,000)
2	(50,000)	-	(2,00,000)
3	1,00,000	50,000	-
4	50,000	-	10,00,000
5	30,000	-	10,00,000

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

QUESTION 14:

Recording in profit or loss of the gain / loss on discontinuation of equity method

CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is ₹ 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of ₹ 80,000. The fair value of the retained 30% interest is ₹ 1,20,000. Determine how much gain / loss should be recorded in profit or loss of CD Ltd.

QUESTION 15:

Investment in joint venture held for sale

Ram Ltd. holds 50% of the equity share capital of Shyam Ltd. The balance 50% equity share capital is held by another investor. Ram Ltd. has joint control over Shyam Ltd. and it is a joint venture of Ram Ltd., accounted using equity method. Now Ram Ltd. is planning to sell 10% of the equity share capital of Shyam Ltd. to a third party. Such 10% investment meets the criteria of an asset held for sale and has been measured and disclosed accordingly. Now determine how should Ram Ltd. account 40% interest retained in Shyam Ltd.

IND AS 111: JOINT ARRANGEMENTS

QUESTION 1: JOINT CONTROL

ABC Ltd. and DEF Ltd. have entered into a contractual arrangement to manufacture a product and sell that in retail market. As per the terms of the arrangement, decisions about the relevant activities require consent of both the parties. The parties share the returns of the arrangement equally amongst them. Whether the arrangement can be treated as joint arrangement?

SOLUTION:

The arrangement is a joint arrangement since both the parties are bound by the contractual arrangement and the decisions about relevant activities require unanimous consent of both the parties.

QUESTION 2: IMPLICIT JOINT CONTROL

PQR Ltd. and XYZ Ltd. established an arrangement in which each has 50% of the voting rights and the contractual arrangement between them specifies that at least 51% of the voting rights are required to make decisions about the relevant activities. Whether the arrangement can be treated as joint arrangement?

SOLUTION:

In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

QUESTION 3: IMPLICIT JOINT CONTROL

A Ltd., B Ltd. and C Ltd. established an arrangement whereby A Ltd. has 50% of the voting rights in the arrangement, B Ltd. has 30% and C has 20%. The contractual arrangement between A Ltd., B Ltd. and C Ltd. specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

SOLUTION:

In this case, even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75% of the voting rights to make decisions about the relevant activities imply that A Ltd. and B Ltd. have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A Ltd. and B Ltd. agreeing.

QUESTION 4: EXPLICIT JOINT CONTROL

An arrangement has three parties: X Ltd. has 50% of the voting rights in the arrangement and Y Ltd. and Z Ltd. each have 25%. The contractual arrangement between them specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

SOLUTION:

In this case, even though X Ltd. can block any decision, it does not control the arrangement because it needs the agreement of either Y Ltd. or Z Ltd. In this question, X Ltd., Y Ltd. and Z Ltd. collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75% of the voting rights (i.e. either X Ltd. and Y Ltd. or X Ltd. and Z Ltd.). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

QUESTION 5: EXPLICIT JOINT CONTROL

An arrangement has A Ltd. and B Ltd. each having 35% of the voting rights in the arrangement with the remaining 30% being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. Whether the arrangement can be treated as joint arrangement?

SOLUTION:

A Ltd. and B Ltd. have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A Ltd. and B Ltd. agreeing.

The above case also highlight that it is not necessary that all the parties in an arrangement should have joint control to form a joint arrangement. Some party or parties may be participating in the joint arrangement but may not be having joint control of that joint arrangement. That is the reason the word "or" has been used between the words "all" and "group of parties" in the flowchart given earlier.

QUESTION 6: JOINT CONTROL THROUGH BOARD REPRESENTATION

Electronics Ltd. is established by two investors R Ltd. and S Ltd. The investors are holding 60% and 40% of the voting power of the investee respectively.

As per the articles of association of Electronics Ltd., both the investors have right to appoint 2 directors each on the board of Electronics Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether Electronics Ltd. is controlled by a single investor or is jointly controlled by both the investors.

SOLUTION:

The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. Hence, Electronics Ltd. is jointly controlled by both the investors. R Ltd. holding majority of the voting rights is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

QUESTION 7: CHAIRMAN WITH CASTING VOTE

MN Software Ltd. is established by two investors M Ltd. and N Ltd. Both the investors are holding 50% of the voting power each of the investee.

As per the articles of association of MN Software Ltd., both the investors have right to appoint 2 directors each on the board of the company. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. The decision about relevant activities of the entity will be taken by board of directors through simple majority. Articles of association also provides that M Ltd. has right to appoint the chairman of the board who will have right of a casting vote in case of a deadlock situation.

Determine whether MN Software Ltd. is jointly controlled by both the investors.

SOLUTION:

The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor.

However, the chairman of the board has right for a casting vote in case of a deadlock in the board. Hence, M Ltd. has the ability to take decisions related to relevant activities through 2 votes by directors and 1 casting vote by chairman of the board. Therefore, M Ltd. individually has power over MN Software Ltd. and there is no joint control.

QUESTION 8: EQUAL VOTING RIGHTS BUT NO JOINT CONTROL

ABC Ltd. is established by two investors AB Ltd. and BC Ltd. Each investor is holding 50% of the voting power of the investee.

As per the articles of association of ABC Ltd., AB Ltd. and BC Ltd. have right to appoint 3 directors and 2 directors respectively on the board of ABC Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether ABC Ltd. is jointly controlled by both the investors.

SOLUTION:

The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 5 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by AB Ltd. can take the decisions independently without the consent of any of the directors appointed by BC Ltd. Hence, ABC Ltd. is not jointly controlled by both the investors. Equal voting rights held by both the investors is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

QUESTION 9: JOINT CONTROL OVER SPECIFIC ASSET

X Ltd. and Y Ltd. entered into a contractual arrangement to buy a piece of land to construct residential units on the said land and sell to customers.

As per the arrangement, the land will be further divided into three equal parts. Out of the three parts, both the parties will be responsible to construct residential units on one part each by taking decision about relevant activities independently and they will entitled for the returns generated from their own part of land. The third part of the land will be jointing managed by both the parties requiring unanimous consent of both the parties for all the decision making.

Determine whether the arrangement is a joint arrangement or not.

SOLUTION:

The two parts of the land which are required to be managed by both the parties independently on their own would not fall within the definition of a joint arrangement. However, the third part of the land which is required to be managed by both the parties with unanimous decision making would meet the definition of a joint arrangement.

QUESTION 10:

Multiple relevant activities directed by different investors

Entity R and entity S established a new entity RS Ltd. to construct a national highway and operate the same for a period of 30 years as per the contract given by government authorities.

As per the articles of association of RS Ltd, the construction of the highway will be done by entity R and all the decisions related to construction will be taken by entity R independently. After the construction is over, entity S will operate the highway for the period of 30 years and all the decisions related to operating of highway will be taken by entity S independently. However, decisions related to funding and capital structure of RS Ltd. will be taken by both the parties with unanimous consent.

Determine whether RS Ltd. is a joint arrangement between entity R and entity S?

SOLUTION:

In this case, the investors should evaluate which of the decisions about relevant activities can most significantly affect the returns of RS Ltd. If the decisions related to construction of highway or operating the highway can affect the returns of the RS Ltd. most significantly then the investor directing those decision has power over RS Ltd. and there is no joint arrangement. However, if the decisions related to funding and capital structure can affect the returns of the RS Ltd. most significantly then RS Ltd. is a joint arrangement between entity R and entity S.

QUESTION 11: INFORMAL AGREEMENT FOR SHARING OF CONTROL

An entity has four investors A, B, C and D holding 10%, 20%, 30% and 40% voting power respectively. The articles of association requires decisions about relevant activities to be taken by majority voting rights. However, investor A, B and C have informally agreed to vote together. This informal agreement has been effective in recent meetings of the investors to take decisions about relevant activities. Whether A, B and C have joint control over the entity?

SOLUTION:

In this case, three investors have informally agreed to make unanimous decisions. These three investors together also have majority voting rights in the entity. Hence, investor A, B and C have joint control over the entity. The agreement between investor A, B and C need not be formally documented as long as there is evidence of its existence in recent meetings of the investors.

QUESTION 12: PARTY WITH PROTECTIVE RIGHTS

D Ltd., E Ltd. and F Ltd. have established a new entity DEF Ltd. As per the arrangement, unanimous consent of all three parties is required only with respect to decisions related to change of name of the entity, amendment to constitutional documents of the entity to enter into a new business, change in the registered office of the entity, etc. Decisions about other relevant activities require consent of only D Ltd. and E Ltd. Whether F Ltd. is a party with joint control of the arrangement?

SOLUTION:

Consent of F Ltd. is required only with respect to the fundamental changes in DEF Ltd. Hence these are protective rights. The decisions about relevant activities are taken by D Ltd. and E Ltd. Hence, F Ltd. is not a party with joint control of the arrangement.

QUESTION 13:

Resolution of disputes without unanimous consent

Entity A and Entity B established a contractual arrangement whereby the decision related to relevant activities are required to be taken by unanimous consent of both the parties. However, in case of any dispute with any vendor or customer of the arrangement, entity A has right to take necessary decisions for the resolution of disputes including decisions of going for the arbitration or filing a suit in court of law. Whether the arrangement is a joint arrangement?

SOLUTION:

The arrangement is a joint arrangement since the contractual arrangement requires decisions about relevant activities to be taken by unanimous consent of both the parties. The right available with entity A to take decisions for resolution of disputes will not prevent the arrangement from being a joint arrangement.

QUESTION 14: JOINT OPERATION

P Ltd. and Q Ltd. are two construction entities and they have entered into a contractual arrangement to jointly construct a metro rail project.

The construction of metro rail project involves various activities such as construction of infrastructure (like metro station, control room, pillars at the centre of the road, etc.) for the metro, laying of the tracks, acquiring of the coaches of the metro, etc. The total length of the metro line to be constructed is 50 kms. As per the arrangement, both the parties are responsible to construct 25 kms each. Each party is required to incur its own cost, use its own assets, incur the liability and has right to the revenue from their own part of the work.

Determine whether the arrangement is a joint operation or not?

SOLUTION:

The arrangement is a joint operation since the arrangement is not structured through a separate vehicle and each party has rights to the assets, and obligations for the liabilities relating to their own part of work in the joint arrangement.

QUESTION 15:

Joint operation by sharing an asset

RS Ltd. and MN Ltd. entered into a contractual arrangement to run a business of providing cars of hire. The cars will be owned by both the parties jointly. The expenses to run the car (like driver salary, petrol, maintenance, insurance, etc.) and revenues from the business will be shared between both the parties as agreed in the contractual arrangement. Determine whether the arrangement is a joint operation or not?

SOLUTION:

The arrangement is a joint operation since the arrangement is not structured through a separate vehicle.

QUESTION 16:

Legal form indicates the arrangement to be a joint venture

Entity X and Entity Y are engaged in the business of Engineering, Procurement and Construction (EPC) for its customers. Both the parties have jointly won a contract from a customer for executing an EPC contract and for that the parties have established a new entity XY Ltd. The contract will be executed through XY Ltd.

All the assets required for the execution of the contract will be acquired and liabilities relating to the execution will be incurred by XY Ltd. in its own name. Entity X and entity Y will have share in the net profits of XY Ltd. in the ratio of their shareholding i.e. 50% each. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

SOLUTION:

The legal form of the separate vehicle is a company. The legal form of the separate vehicle causes the separate vehicle to be considered in its own right. Hence, it indicates that the arrangement is a joint venture. In this case, the parties should further evaluate the terms of contractual arrangements and other relevant facts and circumstance to conclude whether the arrangement is a joint venture or a joint operation.

QUESTION 17:

Legal form indicates the arrangement to be a joint operation

Two entities have established a partnership firm with each party having 50% share in the net profits of the firm. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

SOLUTION:

In this case, the parties to the arrangement should evaluate whether the legal form creates separation between the partners and the partnership firm. If the parties conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. If the assessment of legal form of the partnership firm indicates that the firm is a joint operation then there is no need to evaluate any other factors and it is concluded that the partnership firm is a joint operation.

QUESTION 18:

Assessing the terms of the contractual arrangement

Continuing with the QUESTION 16 above, assume that Entity X and Entity Y have entered into a separate agreement whereby they have agreed that each party has an interest in the assets of the XY Ltd. and each party is liable for the liabilities of XY Ltd. in a specified proportion. Determine whether the joint arrangement is a joint operation or a joint venture?

QUESTION 19:

Assessing other facts and circumstances

Two parties structure a joint arrangement in an incorporated entity i.e. Entity A in which each party has a 50% ownership interest. The purpose of the arrangement is to manufacture materials required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of Entity A (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in Entity A are the assets and liabilities of Entity A. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of Entity A. There are following other relevant facts and circumstances applicable in this case:

- The parties agreed to purchase all the output produced by Entity A in a ratio of 50:50. Entity A cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by Entity A. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

Based on the above fact pattern, determine whether the arrangement is a joint operation or a joint venture?

QUESTION 20:

Multiple joint arrangements under single framework agreement

AB Ltd. and CD Ltd. have entered into a framework agreement to manufacture and distribute a new product i.e. Product X. The two activities to be performed as per the framework agreement are i) Manufacture of Product X and ii) Distribution of Product X. The manufacturing of the product will not be done through a separate vehicle. The parties will purchase the necessary machinery in their joint name. For the distribution of the product, the parties have established a new entity ABCD Ltd. All the goods manufactured will be sold to ABCD Ltd. as per price mutually agreed by the parties. Then ABCD Ltd. will do the marketing and distribution of the product. Both the parties will have joint control over ABCD Ltd.

The legal form of ABCD Ltd. causes it to be considered in its own right (ie the assets and liabilities held in ACD Ltd. are the assets and liabilities of ABC Ltd. and not the assets and liabilities of the parties). Further, the contractual arrangement and other relevant facts and circumstances also do not indicate otherwise.

Determine whether various arrangements under the framework agreement are joint operation or joint venture?

SOLUTION:

The manufacturing of Product X is not done through a separate vehicle and the assets used to manufacture the product are jointly owned by both the parties. Hence, the manufacturing activity is a joint operation.

The distribution of Product X is done through a separate vehicle i.e. ABCD Ltd. Further, AB Ltd. and CD Ltd. do not have rights to the assets, and obligations for the liabilities, relating to ABCD Ltd. Hence ABCD Ltd. is a joint venture.

QUESTION 21:

Accounting of interest in joint operation

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the capital of PQ. However, the contractual terms of the joint arrangement states that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ and obligations for all other liabilities in PQ in proportion to their share of capital (i.e. 50% each).

PQ's balance sheet is as follows:

Balance sheet

Liabilities	₹	Assets	₹
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		**3,00,000**

How should P record in its financial statements its rights and obligations in PQ?

QUESTION 22:

Accounting of interest in joint operation

AB Ltd. and BC Ltd. have established a joint arrangement through a separate vehicle PQR. The legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Ltd. has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owned by PQR to a lender XYZ. AB Ltd. and BC Ltd. have rights to all other assets of PQR and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each)

PQR's balance sheet is as follows:

Balance sheet

Liabilities	₹	**Assets**	₹
Debt owed to XYZ	240	Cash	40
Employee benefit plan obligation	100	Building 1	240
Equity	140	Building 2	200
	480		**480**

How should AB Ltd. record in its financial statements its rights and obligations in PQR?

QUESTION 23:

Accounting for sales or contributions of assets to a joint operation

A Ltd. is one of the parties to a joint operation holding 60% interest in a joint operation and the balance 40% interest is held by another joint operator. A Ltd. has contributed an asset held by it to the joint operation for the activities to be conducted in joint operation. The carrying value of the asset sold was ₹ 100 and the asset was actually sold for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the sale of asset to joint operation in its books?

QUESTION 24:

Accounting for purchases of assets from a joint operation

A Ltd. is one of the parties to a joint operation holding 60% interest in the joint operation and the balance 40% interest is held by another joint operator. A Ltd. has purchased an asset from the joint operation. The carrying value of the asset in the books of joint operation was ₹ 100 and the asset was actually purchased for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the purchase of asset from joint operation in its books?

IND AS 27:
SEPARATE FINANCIAL STATEMENTS

1. It is necessary to distinguish between a consolidated financial statements, a separate financial statements and an individual financial statements.
   a. An individual financial statement is prepared by an entity that does not have a subsidiary, an associate or a joint venture's interest in a joint venture.
   b. Separate financial statements are statements of an investor where investments in the subsidiary, joint venture and associate are accounted for at cost or in accordance with Ind AS 109, Financial Instruments.
   C. Consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income and cash flows of the parent and its subsidiaries are presented as those of a single entity.

   Note: Financial statements in which equity method is applied for investments in joint ventures and associates, technically referred to as economic entity financial statements, are also termed as consolidated financial statements.
2. Separate financial statements are presented in addition to:
   a. Consolidated Financial Statements (prepared in case of a subsidiary or subsidiaries);

   or

   b. Financial Statements in which invesments in associates and joint ventures are accounted for using equity method.

   Note: These financial statements are not separate financial statements.
3. Entity may present separate financial statements as its only financial statements if it is:
   a. Exempt from consolidation; or
   b. Exempt from applying equity method; or
   c. An investment entity and apply exception to consolidation for all of its subsidiaries.

Example:

Entity A Limited has a subsidiary, a joint venture and an associate. It is required to prepare consolidated financial statements. In the consolidated financial statements, it will consolidate:

- The subsidiary as per full consolidation method.
- The associate as per equity method.
- Joint ventures are consolidated as per equity method in CFS whereas joint operations are consolidated as per proportionate consolidation method in IFS

PREPARATION OF SEPARATE FINANCIAL STATEMENTS

1. Separate financial statements shall be prepared in accordance with all applicable Ind AS except that it shall account for investments in subsidiaries, joint ventures and associates either:

    a. **At cost:** Account for in accordance with Ind AS 105. `Non-current Assets Held for Sale and Discontinued Operations' (if investment is classified as held for sale then cost will be accounted for as per Ind AS; or

    b. In accordance with Ind AS 109 ' Financial Instruments'.

2. The entity shall apply the same accounting for each category of investments.

    " **For Example,** an entity that has investments in subsidiaries, associates & joint ventures can account for its investments in subsidiaries & associates at cost and investments in joint ventures in accordance with Ind AS 109. However, if that entity has investments in two associates, it cannot account investment in one associate as cost & investment in other associate in accordance with Ind AS 109. It has to choose either of the method for both the investments in associates.

3. An entity may be required to classify its investments in subsidiaries, joint ventures and associates as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105. In such a situation, when these investments are accounted for at cost, they will henceforth be accounted for and measured as per Ind AS 105. However the measurement of investments accounted as per Ind AS 109, is not changed in such circumstances.

4. **Exceptions:**

    a. Investments in associates and joint ventures could also be held by a venture capital organization, mutual fund, unit trust, investment linked insurance funds or similar entities. In accordance with paragraph 18 of Ind AS 28 ' Investments in Associates and Joint Ventures', these entities may elect to measure investments in associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109 in its consolidated financial statement. In these circumstances, the entity shall also measure those investments in associates or joint ventures at fair value through profit or loss in accordance with Ind AS 109 in its separate financial statements also.

b. An investment entity is not required to consolidate its subsidiaries or apply Ind AS 103, Business Combinations, when it obtains control of another entity. Instead it measures its investment in subsidiaries at fair value through profit or loss in accordance with Ind AS 109 in its consolidated financial statements. It is required to account for its investment in that 'unconsolidated' subsidiary in its separate financial statements also at fair value through profit or loss in accordance with Ind AS 109. It should be noted that an investment entity is required to consolidate a subsidiary or apply Ind AS 103 when that subsidiary provides services that relates to the investment activities of the investment entity. In such a situation, the aforesaid requirement does not apply.

5. **Measurement where parent reorganized the group:**

a. A parent may reorganize the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

(i) New parent obtains control by issuing equity instruments in exchange of existing equity instruments.

(ii) Assets & liabilities of new & original group are same immediately before and after reorganization.

(iii) Owners have same absolute & relative interest in net assets of original group and the new group, immediately before and after reorganization.

(iv) The new parent accounts for its investment in the original parent in its separate financial statements,

b. In these circumstances, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganization.

c. Similarly, an entity that is not a parent might establish a new entity as its parent in a manner that satisfies the criteria above. The above requirements apply equally to such reorganizations.

NOTES

IND AS 112: DISCLOSURES

IN SEPARATE FINANCIAL STATEMENTS

i. **Disclosures will be as per all applicable Ind AS**

ii. **When parent elects not to prepare consolidated financial statements and prepares separate financial statements:**

   a. Fact that financial statement is a separate financial statement

   b. Exemption from consolidation used: entity have to disclose about exemption from consolidation

   c. Name & place of business (country of incorporation, if different) of entity those CFS is produced for public use & where those CFS are obtainable: If entity produce any CFS to pubic use those CFS are prepare as per Ind AS

   d. List of significant investment in subsidiaries, JV & associates containing details regarding investee

      i. Name

      ii. Principal place of business (country of incorporation, if different)

      iii. Proportion of ownership interest held

   e. Method used for accounting

iii. **Parent (i.e. an investment entity) prepare separate financial statement as its only financial statement:**

   a. Fact that financial statement is its only financial statement

   b. Disclosures as per Ind AS 112

iv. **Entity other than above:**

   a. Fact that financial statement is a separate financial statement

   b. List of significant investment in subsidiaries, JV & associates containing details regarding investee

      i. Name

      ii. Principal place of business (country of incorporation, if different)

      iii. Proportion of ownership interest held

   c. Method used for accounting

i. The significant judgments and assumptions entity has made in determining:

a. Nature of its interest in another entity or arrangement;

b. Type of joint arrangement in which it has an invested;

c. That it meets the definition of an investment entity

ii. Information about its interests in:

a. subsidiaries

b. arrangements and associates

c. structured entities that are not controlled by the entity

iii. Investment entity status:

a. Change of status

b. Reason

c. Effect of change on financial statement:

   i. Total fair value of subsidiaries ceases to be consolidated

   ii. Total gain or loss

   iii. Line item in Profit or loss

iv. Interest in subsidiaries:

a. Information that enable users to understand:

   i. Composition of group

   ii. Interest that non controlling Interests have in group activities & cash flows that are material including:

      1. Name of subsidiary

      2. Principal place of business (country of Incorporation if different)

      3. Proportion of ownership Interest (voting rights proportion, if different)

      4. Profit & Loss allocated

      5. Accumulated Non controlling interest

      6. Summarized financial information about the subsidiary

b. **Information to enable user to evaluate:**

   i. Nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group including:

      1. To transfer cash or other assets
      2. guarantees or other requirements or loans and advances being made or repaid
      3. the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity right
      4. Carrying amount of assets & liabilities in CFS on which restriction applies

   ii. Nature of and changes in, the risks associated with its interests in consolidated structured entities including:

      1. Terms of contractual arrangement-that require to provide financial support
      2. Events & circumstances that could expose to risk
      3. Provided any financial support:
         a. Type & amount of support
         b. Reason of support
      4. Provided any support to previously unconsolidated structured entity, result in controlling:
         a. Reason of support
      5. Intention of support or assist

   iii. the consequences of changes in its ownership interest (no loss of control):

      1. Schedule to show the effect of equity attributable

   iv. the consequences of losing control of a subsidiary:

      1. Gain or loss & line item in profit or loss
      2. Gain or loss attributable to FV of investment in Subsidiary

c. **Financial statement of subsidiary is of a different date:**

   i. End of reporting period date of the subsidiary
   ii. Reason for using different date

v. **Interest In unconsolidated Subsidiaries (by investment entities):** For each unconsolidated subsidiaries

a. Subsidiary name

b. Principal place of business (country of incorporation, if different)

c. Proportion of ownership interest

d. Financial statement of subsidiary & its parent

e. Significant restriction on the ability of an unconsolidated subsidiary:

   i. Transfer fund (in form of cash dividends)

   ii. Repay loans & advances

f. Current commitments or intention to provide support or assistance

g. Provided any financial support:

   i. Type & amount of support

   ii. Reason of support

h. Provided any support to previously unconsolidated structured entity, result in controlling:

i. Reason of support

i. Terms of contractual arrangement-that require to provide financial support

j. Events & circumstances that could expose to risk

vi. **Interest in joint arrangements & associates:**

a. **For nature, extent & financial effect: (for material joint arrangement & associates)**

   i. Name of joint arrangement or associate

   ii. Nature of relationship

   iii. Principal place of business (country of incorporation, if different)

   iv. Proportion of ownership interest

   v. Investment measured using Equity method or FV

   vi. Summarized Financial information

   vii. Investment valued using equity method-Then FV

   viii. Financial information in aggregate for all individually immaterial:

      i. Joint ventures

      ii. Associates

ix. Significant restriction on the ability of joint ventures or associates:
   i. Transfer fund (in form of cash dividends)
   ii. Repay loans & advances

x. Financial statement used in applying equity method are of different a
   i. Reporting period end date
   ii. Reason of different date

xi. Unrecognized share of losses of JV or associate (stop recognizing loss when applying equity method)

b. Risk associated:

i. Commitments

ii. Contingent liabilities incurred relating to interest in Joint ventures or associates

vii. Interest in Unconsolidated structured entities:

a. Nature, extent: exposure of risk

b. Information to enable user to evaluate the nature of and changes in the risk

c. Qualitative & quantitative Information about unconsolidated structured entities

d. Information about sponsored entities:
   i. How it has determined-which entity to sponsored
   ii. Income from that entities
   iii. Carrying amount of all assets transfer to those entities

e. Information in tabular format

f. Carrying amount of asset & liabilities of those entities, recongnised in financial & line item in BS statement

g. Amount represent maximum loss & how it determined & if not determined then reason

h. Comparison of above loss with carrying amount of assets & liabilities recongnised

i. Current intention to provide support or assistance

j. Provide any financial support:
   i. Type & amount of support
   ii. Reason of support

viii. Summarized financial Information for subsidiaries, Joint ventures & associates:

a. Subsidiary that has non-controlling interest that are material:

   i. Dividends paid

   ii. Financial information about asset, liability, profit or loss, cash flow (before intercompany elimination)

b. Joint ventures and associate that are material:

   i. Dividend received

   ii. Financial information about asset, liability, profit or loss, cash flow

c. Joint Venture that are material:-

   i. Cash & cash equivalent

   ii. Current financial liability (excluding trade, trade payables, provisions)

   iii. Non Current financial liabilities (excluding trade, trade payables, provisions)

   iv. Depreciation & amortization

   v. Interest income & expenses

   vi. Income tax expenses

d. If entity uses equity method to account for Jv or associates interest:-

   i. Ind AS financial statement of JV or associates should be adjusted (FV adjustment)

   ii. Reconciliation of adjustment

   iii. But above disclosures are not required if:-

      i. FV measured as per Ind AS 28;

      ii. JV or associate does not prepare Ind AS financial statement

IND AS 101: FIRST –TIME ADOPTION OF IND AS

QUESTION 1

E Ltd. is required to first time adopt Indian Accounting Standards (Ind AS) from April 1, 2016 The management of E Ltd. has prepared its financial statements in accordance with Ind AS and an explicit and unreserved statement of compliance with Ind AS has been given. However, there is a disagreement on application of one Ind AS. Can such financial statements of E Ltd. be treated as first Ind AS financial statements?

SOLUTION:

Ind AS 101 defines first Ind AS financial statements as "The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS." In accordance with the above definition, if an explicit and unreserved statement of compliance with Ind AS has been given in the financial statements, even if the auditor's report contains a qualification because of disagreement on application of Indian Accounting standard (s), it would be considered that E Ltd. has done the first time adoption of Ind AS. In such a case, exemptions given under Ind AS 101 cannot be availed again. If, however, the unreserved statement of compliance with Ind AS is not given in the financial statements, such financial statements would not be considered to first Ind AS financial statements.

QUESTION NO 2

X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for 20X0-20X1. What will be its date of transition?

SOLUTION:

The date of transition for X Ltd. will be April 1, 20X0 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to adopt an Ind AS from April 1, 20X1, and it will give comparatives as per Ind AS for 20X0-20X1. Accordingly, the beginning of the comparative period will be April, 20X0 which will be considered as date of transition.

QUESTION NO 3

X Ltd. was using cost model for its property, plant and equipment (tangible fixed assets) till March 31, 20X1 under previous GAAP. On April 1, 20X0, i.e., the date of its transition to Ind AS, it used fair values as the deemed cost in respect of its fixed assets. Whether it will amount to a change in accounting policy?

SOLUTION:

Use of fair values on the date of transition will not tantamount to a change in accounting policy. The fair values of the property, plant and equipment on the date on transition will be considered as deemed cost without this being considered as a changes in accounting policy.

QUESTION NO 4

Ind AS requires allocation of losses to the non-controlling interest, which may ultimately lead to a debit balance in non-controlling interests, even if there is no contract with the non-controlling interest holders to contribute assets to the Company to fund the losses. Whether this adjustment is required or permitted to be made retrospectively?

QUESTION NO 5

A Ltd. had made certain investments in B Ltd's convertible debt instruments. The conversion rights are substantive rights and would provide A Ltd. with a controlling stake over B Ltd. A Ltd. has evaluated that B Ltd. would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS consolidated financial statements. B Ltd. was not considered as subsidiary, associate or a joint venture under previous GAAP. How should B Ltd. be consolidated on transition to Ind AS assuming that A Ltd. has opted to avail the exemption from retrospective restatement of past business combinations?

QUESTION NO 6

A Ltd. has a subsidiary B Ltd. On first time adoption of Ind AS by B Ltd., it availed the optional exemption of not restating its past business combinations. However, A Ltd. in its consolidated financial statements has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of A Ltd. considering that A Ltd. does not avail the business combination exemption? Will the answer be different if the A Ltd. adopts Ind AS after the B Ltd?

QUESTION NO 7

X Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. It has given 200 stock options to its employees. Out of these, 75 options have vested on November 30, 20X0 and the remaining 125 will vest on November 30, 20X1. What are the options available to X Ltd. at the date of transition?

SOLUTION:

Ind AS 101 provides that a first –time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments that vested before the date of transition to Ind-AS. However, if a first time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclose publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.

Having regard to the above, X Ltd. has the following options:

- For 75 options that vested before the date of transition:
  - (a) To apply Ind AS 102 and account for the same accordingly, provided it has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.
  - (b) Not to apply Ind AS102.

    However, for all grants of equity instruments to which Ind AS 102 has not been applied, i.e., equity instruments vested but not settled before date of transition to Ind AS. X Ltd. would still need to disclose the information.
- For 125 options that will vest after the date of transition: X Ltd. will need to account for the same as per Ind AS 102.

QUESTION NO 8

X Ltd. is the holding company of Y Ltd. X Ltd. is required to Ind AS from April 1, 2016. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of is property, plant and equipment whereas Y Ltd. wants to use fair value of its property, plant and equipment as its deemed cost on the date of transition. Examine whether X Ltd. can do so for its consolidated financial statement. Also, examine, whether different entities in group can use different basis for arriving at deemed cost for property, plant and equipment in their respective standalone financial statements

QUESTION NO 9

For the purpose of deemed cost on the date of transition, an entity has the option of using the carrying value as the deemed cost. In this context, suggest which carrying value is to be considered as deemed cost: original cost or net book value? Also examine whether this would have any impact on future depreciation charge?

SOLUTION:

For the purpose of deemed cost on the date of transition, if an entity uses the carrying value as the deemed cost, then it should consider the net book value on the date of transition as the deemed cost and not the original cost because carrying value here means net book value. The future depreciation charge will be based on the net book value and the remaining useful life on the date of transition. Further, as per the requirements of Ind AS 16, the depreciation method, residual value and useful life need to be reviewed atleast annually. As a result of this, the depreciation charge may or may not be the same as the depreciation charge under the previous GAAP.

QUESTION NO 10

Revaluation under previous GAAP can be considered as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to fair value or cost or depreciated cost of assets in accordance with Ind AS, adjusted to reflect, e.g., changes in general or specific price index. What is the acceptable time gap of such revaluation form the date of transition? Can adjustments be made to take effects of events subsequent to revaluation?

SOLUTION:

There are no specific guidelines in Ind AS 101 to indicate the acceptable time gap of such revaluation form the date of transition. The management of an entity needs to exercise judgement in this regard. However, generally, a period of 2-3 Years may be treated as an acceptable time gap of such revaluation from the date of transition. In any case, adjustments should be made to reflect the effect of material events subsequent to revaluation.

QUESTION NO 11

Y Ltd. is first time adopter of Ind AS. The date of transition is April 1, 2015. On the date of transition, there is a long- term foreign currency monetary liability of ₹ 60 crores (US $ 10 million converted at an exchange rate of US $ 1 = ₹ 60). The accumulated exchange difference on the date of transition is nil since Y Ltd. was following AS 11 notified under the Companies (Accounting Standards) Rules, 2006 and has not exercised the option provided in paragraph 46/46A Of AS 11. The Company wants to avail the option under paragraph 46A of AS 11 prospectively or retrospectively on the date of transition to Ind AS. How should it account for the translation differences in respect of this item under Ind AS 101?

SOLUTION:

Ind AS 101 provides that a first –time adopter may continue the policy adopted for accounting for exchange difference arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

QUESTION NO 12

Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1, 2010, it obtained a 7 year US$ 1,00,000 loan. it has been exercising the option provided in paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company wants to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so?

SOLUTION:

Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. In view of the above, the Company can continue to follow the existing accounting policy of amortising the exchange differences in respect of this loan over the balance period of such long term liability.

QUESTION NO 13

A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investments as its deemed cost on first –time adoption. In that case, does the carrying amount of investment require to be adjusted for this transaction?

SOLUTION:

In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associates and joint ventures as its deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

QUESTION NO 14

On April 1, 2014, Sigma Ltd. issued 30,000 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on March 31, 2018 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10% The date of transition to Ind AS is April 1,2016. Suggest haw should Sigma Ltd. account for this compounds financial instrument on the date of transition. The present value of ₹ 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of year	6%	10%
1	0.94	0.91
2	0.89	0.83
3	0.84	0.75
4	0.79	0.68

SOLUTION:

Ind AS 32, Financial Instruments: Presentation, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, in accordance with this Ind AS, a first time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS. In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6x3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110x 0.68 (Note 2)	74.80
Total liability component	93.82
Total equity component (Balancing figure)	6.18
Face value of debentures	100.00
Equity component per debenture	6.18
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of transition, the amount of ₹ 30,00,000 being the amount of debentures will be split as under:

Debt	₹ 28,14,600
Equity	₹ 1,85,400

Note:

1. 3.17 is PV of Annuity Factor of ₹ 1 at a discount rate of 10% for 4 years.
2. On maturity, ₹ 110 will be paid (₹ 100 as principal payment + ₹ 10 as premium)

QUESTION NO 15

H Ltd. has following assets and liabilities as March 31, 2016 prepared in accordance with previous GAAP.

Particulars	Notes	Amounts (₹)
Fixed assets	1	1,34,50,000
Investments in S. Ltd.	2	48,00,000
Debtors		2,00,000
Advances for purchase of inventory		50,00,000
Inventory		8,00,000

Cash		49,000
Total assets		2,42,99,000
VAT deferral loan	3	60,00,000
Creditors		30,00,000
Short term borrowing		8,00,000
Provisions		12,00,000
Total liabilities		1,10,00,000
Share capital		1,30,00,000
Reserves:		2,99,000
Cumulative translation difference	4	1,00,000
ESOP reserve	4	20,000
Retained earnings		1,79,000
Total equity		1,32,99,000
Total equity and liabilities		2,42,99,000

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 2016:

1. In relation to tangible fixed assets (property, plant and equipment), the following adjustments were identified:
   - Fixed assets comprise land held for capital appreciation purposes costing ₹ 4,50,000 and was classified as investment property as per Ind AS 40.
   - Exchange differences of ₹ 1,00,000 were capitalised to depreciable fixed assets on which accumulated depreciation of ₹ 40,000 was recognised.
   - There were no asset retirement obligations.
   - The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.
2. The Company had an investment in S Ltd. (subsidiary of H Ltd.) for ₹ 48,00,000 that carried a fair value of ₹ 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. **Financial instruments:**

- **VAT deferral loan ₹ 60,00,000:**

  The VAT deferral loan of ₹ 60,00,000 was obtained on March 31,2016, for setting up a business in a backward region with a condition to created defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10% being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 2016, is ₹ 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan

  The retained earnings of the Company contained the following

- **ESOP reserve of ₹ 20,000:**

  The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised ₹ 12,000 towards the vested options and ₹ 8,000 over a period of time as ₹ ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been ₹ 15,000 and ₹ 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

- **Cumulative translation difference:**

  ₹ 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind 101 exemption of resetting the cumulative translation difference to zero.

SOLUTION:

Adjustments for opening balance sheet as per Ind AS 101

1. **Fixed assets:** As the land for capital appreciation purposes qualifies as investment property, such investment property should be reclassified from property, plant and equipment (PPE) to investment property and presented separately; As the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property should be carried at its previous GAAP carrying values. As such, the past capitalised exchange differences require no adjustment in this case.

2. **Investment in subsidiary:** On first time adoption of Ind AS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the Company can recognise such investment at a value of ₹ 68,00,000.

3. **Financial instruments:** As the VAT deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discount at an appropriate discounting factor. Consequently, the VAT deferral loan should be recognised at ₹ 37,25,528 and the remaining ₹ 22,74,472 would be recognised as deferred government grant.

4. **ESOPs:** Ind AS 101 provides an exemption of not restating the accounting as per the .previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-time adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date need to be restated in accordance with Ind AS 102. As such, the additional impact of ₹ 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.

5. **Cumulative translation difference:** As per paragraph D 12 of Ind AS 101, the first-time adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of ₹ 1,00,000 should be transferred to retained earnings

6. **Retained earnings should be increased by ₹ 20,99,000 on account of the following:**

	₹
Increase in fair value of investment in subsidiary (note 2)	20,00,000
Additional ESOP charge on unvested options (note 4)	(1,000)
Transfer of cumulative translation difference balance to retained (note 5)	1,00,000

After the above adjustments, the carrying values of assets and liabilities for the purpose of opening Ind AS balance sheet of Company H should be as under:

Particular	Notes	Previous	Adjustments	Ind AS GAAP
Non- Current Assets				
Fixed assets	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Advances for purchase of inventory		50,00,000		50,00,000
Current Assets				
Debtors		2,00,000		2,00,000
Inventory		8,00,000		8,00,000
Cash		49,000		49,000
Total assets		**2,42,99,000**	**20,00,000**	**2,62,99,000**
Non-current Liabilities				
Sales tax deferral loan	3	60,00,000	(22,74,472)	37,25,528
Deferred government grant	3	0	22,74,472	22,74,472
Current Liabilities				
Creditors		30,00,000		30,00,000
Short term borrowing		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		**1,10,00,000**		**1,10,00,000**
Share capital		1,30,00,000		1,30,00,000
Reserves:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Other reserves	6	1,79,000	20,99,000	22,78,000
Total equity		**1,32,99,000**	**20,00,000**	**1,52,99,000**
Total equity and liabilities		**2,42,99,000**	**20,00,000**	**2,62,99,000**

TEST YOUR KNOWLEDGE

QUESTIONS

1. Company A intends to restate its past business combinations with effect with from 30 June 2010 (being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for property, plant and equipment (PPE), can be adopted?

2. X Ltd. was using cost model for its property, plant and equipment till March 31, 2016 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 2016. On April 1, 2015, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS financial statements would amount to a change in accounting policy?

3. Y Ltd is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1, 2010, it obtained a 7 Year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange difference in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21, The Effects of Changes in Foreign Exchange Rates with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so?

4. A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101. However, it does not wish to continue with is existing policy of capitalizing exchange fluctuation on loan term foreign currency monetary items to fixed assets i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of property, plant and equipment under previous GAAP?

NEWLY ADDED QUESTIONS IN SM IN IND AS 101

QUESTION 1

Government of India provides loans to MSMEs at a below-market rate of interest to fund the set-up of a new manufacturing facility.

Company A's date of transition to Ind AS is 1 April 20X5.

In 20X2, Company A had received a loan of ₹ 1 crore at a below-market rate of interest from the government. Under Indian GAAP, Company A accounted for the loan as equity and the carrying amount was ₹ 1 crore at the date of transition. The amount repayable at 31 March 20X9 will be ₹ 1.25 crore.

The loan meets the definition of a financial liability in accordance with Ind AS 32. Company A therefore reclassifies it from equity to liability. It also uses the previous GAAP carrying amount of the loan at the date of transition as the carrying amount of the loan in the opening Ind AS balance sheet. It calculates the annual effective interest rate (EIR) starting 1 April 20X5 as below:

EIR = Amount / Principal(1/t) i.e. 1.25/1(1/4) i.e. 5.74%. approx.

Show the table of interest at IRR and carrying amount at the end of each year.

SOLUTION:

During the next 4 years, the interest expense charged to statement of profit and loss shall be:

Year ended	Opening amortised cost (₹)	Interest expense for the year (₹) @ 5.74% P.a. approx.	Closing amortised cost (₹)
31 March 20X6	1,00,00,000	5,73,713	1,05,73,713
31 March 20X7	1,05,73,713	6,06,627	1,11,80,340
31 March 20X8	1,11,80,340	6,41,430	1,18,21,770
31 March 20X9	1,18,21,770	6,78,230	1,25,00,000

QUESTION 2

(MTP OCT 2020…Q.4….ALREDAY DISCUSSED IN MTP VIDEO)

Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of Shaurya Limited's shares are held by the Government of India and rest by other investors.

This is the first time that Shaurya limited would be applying Ind AS for the preparation of its financials for the current financial year 2019-2020. Following balance sheet is prepared as per earlier GAAP as at the beginning of the preceding period along with the additional information:

Balance Sheet as at 31 March 2018

(All figures are in '000, unless otherwise specified)

Particulars	Amount
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	10,00,000
(b) Reserves & Surplus	25,00,000
(2) Non-Current Liabilities	
(a) Long Term Borrowings	4,50,000
(b) Long Term Provisions	3,50,000
(c) Deferred tax liabilities	3,50,000
(3) Current Liabilities	
(a) Trade Payables	22,00,000
(b) Other Current Liabilities	4,50,000
(c) Short Term Provisions	12,00,000
TOTAL	**85,00,000**
ASSETS	
(1) Non-Current Assets	
(a) Property, Plant & Equipment (net)	20,00,000
(b) Intangible assets	2,00,000
(c) Goodwill	1,00,000
(d) Non-current Investments	5,00,000

(e)	Long Term Loans and Advances	1,50,000
(f)	Other Non-Current Assets	2,00,000
(2)	Current Assets	
(a)	Current Investments	18,00,000
(b)	Inventories	12,50,000
(c)	Trade Receivables	9,00,000
(d)	Cash and Bank Balances	10,00,000
(e)	Other Current Assets	4,00,000
TOTAL		**85,00,000**

Additional Information (All figures are in '000) :

1. Other current liabilities include ₹ 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and ₹ 60,000 are statutory government dues.
2. Long term loans and advances include ₹ 40,000 loan and the remaining amount consists Advance to staff of ₹ 1,10,000.
3. Other non-current assets of ₹ 2,00,000 consists Capital advances to suppliers.
4. Other current assets include ₹ 3,50,000 current assets receivable in cash and Prepaid expenses of ₹ 50,000.
5. Short term provisions include Dividend payable of ₹ 2,00,000. The dividend payable had been as a result of board meeting wherein the declaration of dividend for financial year 2017-2018 was made. However, it is subject to approval of shareholders in the annual general meeting.

Chief financial officer of Shaurya Limited has also presented the following information against corresponding relevant items in the balance sheet:

a) Property, Plant & Equipment consists a class of assets as office buildings whose carrying amount is ₹ 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be ₹ 15,00,000. Company wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements.

b) The fair value of Intangible assets as on the date of transition is estimated to be ₹ 2,50,000. However, the management is reluctant to incorporate the fair value changes in books of account.

c) Shaurya Ltd. had acquired 80% shares in a company, Excel private limited few years ago thereby acquiring the control upon it at that time. Shaurya Ltd. recognised goodwill as per erstwhile accounting standards by accounting the excess of consideration paid over the net assets acquired at the date of acquisition. Fair value exercise was not done at the time of acquisition.

d) Trade receivables include an amount of ₹ 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates using hindsights, the provision needs to be revised to ₹ 25,000.

e) Company had given a loan of ₹ 1,00,000 to an entity for the term of 10 years six years ago. Transaction costs were incurred separately for this loan. The loan carries an interest rate of 7%. The principal amount is to be repaid in equal installments over the period of ten years at the year end. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 50,000 as against the carrying amount of loan which at present amounts to ₹ 40,000. However, Ind AS 109 mandates to recognise the interest income as per effective interest method after the adjustment of transaction costs. Management says it is tedious task in the given case to apply the effective interest rate changes with retrospective effect and hence is reluctant to apply the same retrospectively in its first time adoption.

f) In the long-term borrowings, ₹ 4,50,000 of component is due towards the State Government. Interest is payable on the government loan at 4%, however the prevailing rate in the market at present is 8%. The fair market value of loan stands at ₹ 4,20,000 as on the relevant date.

g) Under Previous GAAP, the mutual funds were measured at cost or market value, whichever is lower. Under Ind AS, the Company has designated these investments at fair value through profit or loss. The value of mutual funds as per previous GAAP is ₹ 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is ₹ 2,30,000.

h) Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be ₹ 50,000 on account of Ind AS transition adjustments.

Requirements:

- Prepare transition date balance sheet of Shaurya Limited as per Indian Accounting Standards
- Show necessary explanation for each of the items presented by chief financial officer in the form of notes, which may or may not require the adjustment as on the date of transition.

QUESTION 3

(RTP MAY 2019…Q11…ALREADY DISCUSSED IN RTP VIDEO)

XYZ Pvt. Ltd. is a company registered under the Companies Act, 2013 following Accounting Standards notified under Companies (Accounting Standards) Rules, 2006. The Company has decided to voluntarily adopt Ind AS w.e.f 1st April, 20X2 with a transition date of 1st April, 20X1.

The Company has one Wholly Owned Subsidiary and one Joint Venture which are into manufacturing of automobile spare parts.

The consolidated financial statements of the Company under Indian GAAP are as under:

Consolidated Financial Statements

(₹ in Lakhs)

Particulars	31.03.20X2	31.03.20X1
Shareholder's Funds		
Share Capital	7,953	7,953
Reserves & Surplus	16,547	16.597
Non-Current Liabilities		
Long Term Borrowings	1,000	1.000
Long Term Provisions	1,101	691
Other Long-Term Liabilities	5,202	5,904
Current Liabilities		
Trade Payables	9,905	8.455
Short Term Provisions	500	475
Total	**42,208**	**41,075**
Non-Current Assets		
Property Plant & Equipment	21,488	22,288
Goodwill on Consolidation of subsidiary and JV	1,507	1,507
Investment Property	5,245	5,245
Long Term Loans & Advances	6,350	6,350
Current Assets		
Trade Receivables	4,801	1,818
Investments	1,263	3,763
Other Current Assets	1,554	104
Total	**42,208**	**41,075**

Additional Information:

The Company has entered into a joint arrangement by acquiring 50% of the equity shares of ABC Pvt. Ltd. Presently, the same has been accounted as per the proportionate consolidated method. The proportionate share of assets and liabilities of ABC Pvt. Ltd. included in the consolidated financial statement of XYZ Pvt. Ltd. is as under:

Particulars	₹ in Lakhs
Property, Plant & Equipment	1,200
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Trade Payables	75
Short Term Provisions	35

The Investment is in the nature of Joint Venture as per Ind AS 111.

The Company has approached you to advice and suggest the accounting adjustments which are required to be made in the opening Balance Sheet as on 1st April, 20 X1.

QUESTION 4 (RTP NOV 2019….Q.14)

Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31st March, 20X3. The transition date is 1st April, 20X1.

The following adjustments were made upon transition to Ind AS:

(a) The Company opted to fair value its land as on the date on transition.

The fair value of the land as on 1st April, 20X1 was ₹ 10 crores. The carrying amount as on 1st April, 20X1 under the existing GAAP was ₹ 4.5 crores.

(b) The Company has recognised a provision for proposed dividend of ₹ 60 lacs and related dividend distribution tax of ₹ 18 lacs during the year ended 31st March, 20X1. It was written back as on opening balance sheet date.

(c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is ₹ 75 lacs.

(d) The Company has an Equity Share Capital of ₹ 80 crores and Redeemable Preference Share Capital of ₹ 25 crores.

(e) The reserves and surplus as on 1st April, 20X1 before transition to Ind AS was ₹ 95 crores representing ₹ 40 crores of general reserve and ₹ 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.

(f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards) and as per Ind AS to be presented in the opening balance sheet as on 1st April, 20X1.

Ignore deferred tax impact.

QUESTION 5

ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS.

QUESTION 6

A Ltd acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first time adoption. Ind that case, does the carrying amount of investment required to be adjusted for this transaction?

SOLUTION:

In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associated and joint ventures as its deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

QUESTION 7

Company B is a foreign subsidiary of Company A and has adopted IFRS as issued by IASB as its primary GAAP for its local financial reporting purposes. Company B prepares its financial statements as per Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 for the purpose of consolidation with Company A. On transition of Company A to Ind-AS, what would be the previous GAAP of the foreign subsidiary Company B for its financial statements prepared for consolidation with Company A?

INDIAN ACCOUNTING STANDARD 12
INCOME TAXES

There was a time in India, few decades back when the concept of zero income tax entities was prevalent. Due to various income tax benefits, these companies had no current tax liability for any income tax that was payable based on that year's accounting profit. Thus, No provision of income tax was created. Profit after tax used to be equal to profit before tax. But from accounting perspective, this was not a correct reflection of results quite a few of these tax benefits were primarily accelerated benefits.

For example, depreciation was deductible in taxation on written down value method (WDV) whereas in the books of accounts, entities could claim depreciation on straight line method (SLM) AS everybody knows that under WDV method, in initial years depreciation charge is greater than depreciation under SLM. This resulted into accounting profits but no taxable profits. But over the useful life of the asset, depreciation under both methods is equal. In later years, depreciation charge under SLM would be higher than in depreciation under WDV. Therefore, in later years, in such a situation, the taxable profits will be higher than the book profits. This will require a higher tax provision in books when compared to the accounting profits of that year. Basically, this differential will due to non-provision of tax liability in an earlier year.

EXAMPLE 1:

An entity has acquired an asset for ₹ 10,000. The depreciation rate as per income tax is 40% on WDV basis. In books of account, entity claims depreciation on equivalent SLM basis of 16.21% the entity has accounting and taxable profits of ₹ 20,000 from year 1 to year 4, inclusive, before any allowance of depreciation in either case.

The tax rate is 30%. Assuming no concept of deferred tax, the provision for current tax would be computed as under:

Year	1	2	3	4
Cost of the asset	10,000	10,000	10,000	10,000
Depreciation rate –WDV	40%	40%	40%	40%
Depreciation amount – WDV	4,000	2,400	1,440	864
Taxable profits before depreciation	20,000	20,000	20,000	20,000
Less: Depreciation	(4,000)	(2,400)	(1,440)	(864)

Taxable profits after depreciation	16,000	17,600	18,560	19,136
Tax rate	30%	30%	30%	30%
Tax amount	4,800	5,280	5,568	5,741

However, in the books of accounts, the situation will be as under ;

Year	1	2	3	4
(a) Cost of the asset	10,000	10,000	10,000	10,000
(b) Depreciation rate –SLM	16.21%	16.21%	16.21%	16.21%
(c) Depreciation amount -SLM	1.621	1,621	1,621	1,621
(d) Accounting profit before depreciation	20,000	20,000	20,000	20,000
(e) Less: Depreciation	(1,621)	(1,621)	(1,621)	(1,621)
(f) Accounting profits after depreciation	18,379	18,379	18,379	18,379
(g) Tax amount –as above	4,800	5,280	5,568	5,741
(h) Effective tax rate = (g)/(f)	26.12%	28.73%	30.30%	31.24%
(i) Tax provision @ 30% tax rate {30%*(f)}	5,514	5,514	5,514	5,514

Thus, from the above two tables, for an accountant the tax should be ₹ 5,514 in all cases as per the accounting profit. The results are distorted. You will observe that in year 3, in books, the amount of tax provision is higher by ₹ 54 (5,568- 5,514) and in year 4, it is higher by ₹ 227 (5,741-5,514). This is so because in year 1 & 2, these figures are lower by ₹ 714 (5,514 - 4,800) ₹ 234 (5,514 -5,280). Thus, the liability that was incurred in year 1 & 2 is paid year 3 onwards However, no provision of the differential (₹ 714 in year 1& 2 ₹ 234 in year2) is made.

The provision of differential should have been made by the entity following there major accounting concepts and convention of periodicity, matching and accrual. The entity has merely deferred the payment of tax to subsequent year. This Understanding and appreciation of situation gave rise to the concept of deferred tax liabilities or deferred tax assets.

In earlier years, deferred tax was recognised based on concepts of timing differences and permanent differences based on differences in accounting profits and taxable profits known as income tax liability method. This concept stands revised with this Accounting Standard which recognised deferred tax based on temporary differences that arises due to difference in the carrying value of an item of asset or liability as per books of accounts with the carrying value of that item as per income tax provisions, known as tax based. This method is known as balance sheet approach.

This Accounting standard though titled as 'income taxes' primarily deals with deferred tax though guidance is provided on current tax.

Differences

- Temporary Differences
  - Taxable Temporary Difference (Results in DTL)
  - Deductible Temporary Deference (Results in DTA)
- Other than Temporary differences
  - Cannot be reversed

- Items of current tax or defer tax recognized in profit and loss are subject to two exceptions:
  1. An item of current tax or defer tax pertaining to other comprehensive income should be recognized in other comprehensive income
  2. An item of current tax or defer tax pertaining to direct equity should be recognized in direct equity

Tax Accounting

- Transactions and Events recognised Outside Profit and Loss
  - Related Tax effects recognised in other comprehensive Income
  - Related Tax Effect recognised in Statement of Changes in Equity
- Transactions and Events recognised in profit in Loss
  - Related tax effects also recognised in profit or Loss

DEFINITIONS

Having understood, the basic concepts of current tax and deferred tax, the following definitions needs to be appreciated:

(a) **Accounting profit** is profit or loss for a period before deducting tax expense.

(b) **Taxable profit (tax loss)** is profit (loss) for a period, computed as per the income tax act, upon which income taxes are payable (recoverable).

(c) **Tax expense (tax income)** is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

(d) **Current tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

(e) **Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

(f) **Deferred tax assets** are the amount of income taxes recoverable in future periods in respect of:

- Deductible temporary differences;
- The carry forward of unused tax losses; and
- The carry forward of unused tax credits.

(g) **Temporary differences** are differences between the carrying amounts of an assets or liability in the balance sheet and its tax base.

(h) **Temporary differences** may be either:

- **Taxable temporary differences,** which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
- **Deductible temporary differences,** which are temporary differences that will result in amount that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

(i) The **tax base** of an asset or liability is the carrying amount to that asset or liability for tax purposes.

To facilitate, easy understanding, this chapter has been divided as under:

(a) Part A: Tax Expense

(b) Part B: Current Tax, its recognition Measurement and Presentation

(c) Part C: Deferred tax, its Recognition, Measurement and presentation

(d) Part D: practical Application

(e) Part E: Disclosures

PART A: TAX EXPENSE (TAX INCOME)

- Tax expense or tax income is the aggregate amount include in the determination of profit or loss for the period in respect of current of tax and deferred tax.
- The following needs to be appreciated:
  - (a) Tax expense could be positive or negative. Thus, there could be a tax income.
  - (b) Tax expense is the aggregate of:
    - **Current tax; and**
    - **Deferred** tax.

PART B: CURRENT TAX

Current tax

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

Recognition

(a) **Current tax liability**

- Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability.
- The exact liability of current tax crystallizes only on preparation and finalization of financial statements at the end of the reporting period.
- Any excess of this liability over the prepaid taxes (advance tax) and withhold taxes (TDS) is to be treated as current liability. This liability may be for the current reporting period or may relate to earlier reporting periods.

(b) **Current tax assets**

- If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognised as an asset.
- Further, wherever tax loss of a reporting period could be carried backwards, the entity is eligible as per tax laws to a benefit. The entity recognises this benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

Example

An entity has An entity has paid a tax in the previous year on a profit of ₹ 5, 00,000 and suffered a loss in the current year of ₹ 6, 00,000. Such loss ₹ 6, 00,000 can be adjusted against the loss to the extent of ₹ 5, 00,000 and the entity will create tax asset to that extent. It is called carry backward of losses.

- Thus, the benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset.

PART C: DEFERRED TAX, ITS RECOGNITION, MEASUREMENT AND PRESENTAITON

The following steps should be followed in the recognition, measurement and presentation of deferred tax liabilities or assets:

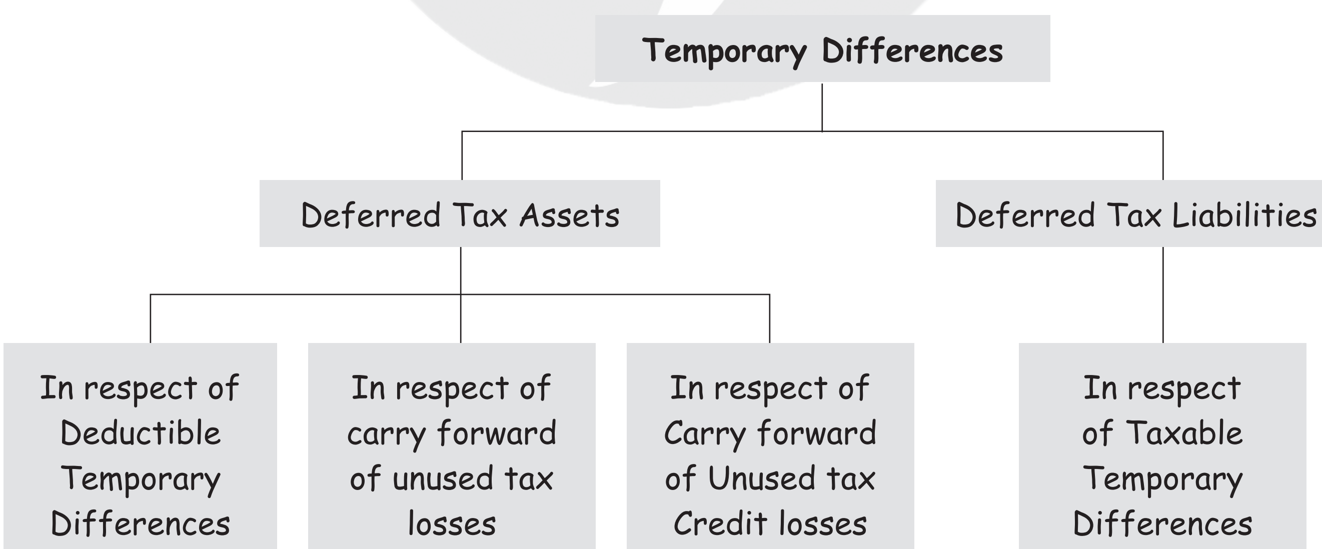
Step 1: Compute carrying amounts of assets and liabilities

Step 2: Compute tax base

Step 3: Compute temporary differences

Step 4: Classify temporary differences into either:

- Taxable temporary difference
- Deductible temporary difference



Hitherto, In India entities have been determining deferred tax based on Accounting standard (AS) 22, accounting for Taxes on Income, as notified in companies (Accounting Standards) Rules, 2006. The concept there is of timing difference; and permanent difference'. Based upon the nature of difference, deferred tax liabilities or assets are recognised. The Ind AS 12 is based on the concept of temporary difference. As per Ind AS 12, there are only temporary differences, no permanent differences and timing differences are a component of temporary differences. The concept of temporary differences' is core of this Ind AS

The term temporary difference is defined as the difference between the carrying amount of an asset or liability in the balance sheet and its tax base.

Example

An entity has an item of plant and machinery acquired on the first day of the reporting period for ₹ 1, 00,000. It depreciates it @ 20% p. a on SLM basis. The carrying amount in balance sheet is ₹ 80,000. the taxation laws require depreciation @ 30% on WDV basis, The tax base at the end of the reporting period is ₹ 70,000. the temporary difference is ₹ 10, 000 (₹ 80,000 - ₹ 70,000)

The contention in favor of temporary difference is that at the end of the day, all differences between the carrying amount and tax base of an asset or liability will reverse. At most the entity may be able to delay the timing of reversal but the difference will ultimately reversed, therefore the term 'temporary difference 'is used. The cumulative impact is zero'.

Example

An entity acquires an asset on the first day of reporting period for ₹ 120 with a useful life of 6 years and no residual value .it depreciate the asset on SLM basis. The tax rate is 30%. The tax depreciation is as assumed in the computation below.

The following computations are perfromed.

Financial Statements

Year	1	2	3	4	5	6
Gross Block	120	120	120	120	120	120
Cumulative Depreciation	20	40	60	80	100	120
Carrying Amount	100	80	60	40	20	0

Tax Computation

Year	1	2	3	4	5	6
Tax base brought forward	120	30	20	13	8	3
Depreciation charge (assumed)	90	10	7	5	5	3
Tax base carried forward	30	20	13	8	3	0

Temporary Difference

Year	1	2	3	4	5	6
Carrying Amount	100	80	60	40	20	0
Tax base carried forward	30	20	13	8	3	0
Temporary difference	70	60	47	32	17	0
Cumulative impact	+70	-10	-13	-15	-15	-17
	+70	-70				

Movement in Balance Sheet

Year	1	2	3	4	5	6
Temporary difference @ 30%	70	60	47	32	17	0
Deferred tax liability	21	18	14	10	5	0
Movement in provision	+21	-3	-4	-4	-5	-5
cumulative	+21	-21				

Based on the above discussions, a matrix as under may be drawn:

	For Assets	For Liabilities
If carrying amount > tax base	TaxableTemporary Difference Deferred Tax Liability	Deductible Temporary Difference Deferred Tax Asset
If carrying amount < tax base	Deductible Temporary Difference Deferred Tax Asset	Taxable Temporary Difference Deferred Tax Liability
If carrying amount = tax base	No temporary difference	No temporary difference

Further examples of Taxable temporary differences:

- **Transactions that affect profit or loss**

Example

Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis

Example

Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected.

In this case, there is also a deductible temporary difference associated with any related inventory.

Example

Depreciation of an asset is accelerated for tax purpose.

Example

Development costs have been capitalised and will be amortised to the statement of profit and loss but were deducted in determining taxable profit in the period in which they were incurred.

Example

Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

- **Transactions that affect the balance sheet**

Example

Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold of scrapped.

Example

A borrower records a loan at the proceeds received (Which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortisation of the transaction costs to accounting profit. The transaction costs were deducted for tax purposes in the period when the loan was first recognised

Example

A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs, The transaction costs are amortised to accounting profit over the life of the loan,. Those transaction costs are not deductible in determining the taxable profit of future, current of prior periods.

Example

The liability component of a compound financial instrument (for example a convertible bond) is measured at discount to the amount repayable on maturity (see Ind AS 32, Financial instruments: presentation). The discount is not deductible in determining taxable profit (tax loss).

- **Fair value adjustments and revaluation**

Example

Financial assets are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

Example

An entity revalues property, plant and equipment (Under the revaluation model treatment in Ind AS 16, property, plant and Equipment) but no equivalent adjustment is made for tax purposes.

- **Business combinations and consolidation**

Example

The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes.

Example

Reductions in the carrying amount of goodwill are not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business.

Example

Unrealized losses resulting from intragroup transactions are eliminated by inclusion in the carrying amount of inventory of property, plant and equipment.

Example

Retained earnings of subsidiaries, branches, associates and joint ventures are included in consolidated retained earnings, but income taxes will be payable if the profits are distributed to the reporting parent.

Example

Investment in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rate.

Example

The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in different currency.

Further examples of deductible temporary differences:

Transactions that affect profit of loss

Example

Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the entity pays either retirement benefits or contributions to a fund. (note: similar deductible temporary differences arise where other expenses. Such as gratuity and leave encashment or interest, are deductible on a cash basis in determining taxable profit.)

Example

Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the end of the reporting period for tax purposes.

Example

The cost of inventories sold before the end of the reporting period is deducted in determining accounting profit when goods or services are delivered but is deducted in determining taxable profit when cash is collected. (it may be noted. There is also a taxable temporary difference associated with the related trade receivable.)

Example

The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

Example

Preliminary expenses (or organization or other start up costs) are recognised as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.

Example

Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.

Example

A government grants which is included in the balance sheet as deferred income will not be taxable in future periods.

- **Fair value adjustments and revaluation**

Example

Financial assets are carried at fair which is less than cost, but no equivalent adjustment is made for tax purposes.

- **Business combinations and consolidation**

Example

A liability is recognised at its fair value in a business combination, but none of the related expense is deducted in determining taxable profit until a later period.

Example

Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

Example

Investments in foreign subsidiaries branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates.

Example

The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in a different currency.

Deferred tax arising from a business Combination

(a) As discussed above, temporary differences may arise in a business combination. In accordance with Ind AS 103, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with this Ind AS, in certain circumstances, an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

(b) As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination for example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it might no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the business combination but does not include it as part of the accounting for the business combination. Therefore, the acquirer does not take it into account in measuring the goodwill or bargain purchase gain it recognises in the business combination.

(c) The potential benefit of the acquiree's income tax loss carry forward or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently. An entity shall recognise acquired deferred tax benefits that it realises after the business combination as follows:

- Acquired deferred tax benefits recognised within the measurement period that result from new information about facts and circumstances that existed at the acquisition date shall be applied to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill is Zero, any remaining deferred tax benefits shall be recognised in other comprehensive income and accumulated in equity as capital reserve or recognises directly in capital reserve, depending on whether paragraph 34 or paragraph 36A of Ind AS 103 would have applied had the measurement period adjustments been known on the date of acquisition itself.
- All other acquired deferred tax benefits realised shall be recognised in profit or loss (or, if this Standard so requires, outside profit or loss).

QUESTION 1

An entity has a deductible temporary difference of ₹ 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profit up to ₹ 60,000. The cost of implementing this tax planning strategy is ₹ 12,000. The tax rate is 30%. compute the deferred tax asset that should be recognised.

QUESTION NO 2

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of ₹ 10,000 and the tax rate was 25% On February 28, 20X1, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 20X2. Discuss the treatment of deferred tax in case tax reporting date of A Limited's financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2.

QUESTION NO 3

An asset which cost ₹ 150 has a carrying amount of ₹ 100. Cumulative depreciation for tax purposes is ₹ 90 and the tax rate is 25% Calculate the tax base.

QUESTION NO 4

A company had purchased an asset at ₹ 1, 00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20%. (Depreciation rate for tax purposes is 25%. The operating profit is ₹ 1,00,000 for all the 5 years. Tax rate is 30% for the next 5 years. Calculate the book value as per financial and tax purposes and then DTL.

QUESTION NO 5

A Ltd. Acquired B Ltd. the following assets and liabilities are acquired in a business combination.

₹ 000's

	Fair value	Carrying amount	Temporary
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)
	570	595	(25)
9% Debentures	(100)	(100)	
	470	495	
Consideration paid	500	500	__

Calculate Deferred Tax Asset.

QUESTION NO 6

XYZ Ltd. proposes to issue 1000 shares to its 200 employees under ESOP. (Vesting condition: continuous employment for 3 years). 10% labour turnover is observed and value of option is ₹ 40. Calculate Deferred Tax Asset. What is if the entity gets a deduction of ₹ 19,00,000 (say as per tax law share based payment is measured differently) instead of ₹ 17,49,600 ?

QUESTION NO 7

B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of ₹ 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of ₹ 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30% Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 20X1.

QUESTION NO 8

A company ABC Limited prepares its accounts annually on 31st March. On 1ST April 2001 it purchases a machine at a cost of Rs. 1,50,000. The machine has a useful life of three years and an expected scrap value of Zero. Although it is eligible for a 100% first year depreciation allowance for the tax purposes, the straight line method is considered appropriate for accounting purposes. ABC Limited has profits before depreciation and taxes of Rs. 2,00,000 each year and the corporate tax rate is 40per cent each year.

QUESTION NO 9

In above illustration, the corporate tax rate has been assumed to be same in each of the three years. If the rate of tax is assumed 40%, 35% and 38% respectively, compute the amount of deferred tax liability?

QUESTION NO 10

A company ABC Limited prepares its accounts annually on 31st March. The company has incurred a loss of Rs.1,00,000 in the year 2001 and made profits of Rs.50,000 and 60,000 in year 2002 and 2003 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 2001. It was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set off. It is also assumed that there is no difference between taxable income and accounting income except that set off of loss is allowed in years 2002 and 2003 for tax purpose.

QUESTION NO 11

Liverpool Limited has three financial statement elements for year ended 31.03.2001, the book value and tax basis value is given below:-

	Book value	tax value
Equipment	2,00,000	1,20,000
Prepaid insurance	75,000	Nil
Warranty liability	50,000	Nil

Calculate the deferred tax asset/liability. Tax rate is 40%.

EXTRA QUESTIONS ON IND AS 12

QUESTION 12

The directors of H wish to recognise a material deferred tax asset in relation to ₹ 250 Cr of unused trading losses which have accumulated as at 31st March 20X1. H has budgeted profits for ₹ 80 Cr for the year ended 31st March 20X2. The directors have forecast that profits will grow by 20% each year thereafter. However, the improvement in trading results may occur after the next couple of years to come at the position of breakeven. The market is currently depressed and sales orders are at a lower level for the first quarter of 20X2 than they were for the same period in any of the previous five years. H operates under a tax jurisdiction which allows for trading losses to be only carried forward for a maximum of two years.

Analyse whether a deferred tax asset can be recognized in the financial statements of H for the year ended 31st March 20X1?

QUESTION 13

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is ₹ 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease rentals are ₹ 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent.

Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2.

QUESTION 14

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of ₹ 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of a B Ltd. share was ₹ 2.00

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at ₹ 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1.

The following matters emerged:

- Property having a carrying value of ₹ 15 Cr at 1 April 20X1 had an estimated market value of ₹ 18 Cr at that date.
- Plant and equipment having a carrying value of ₹ 1 Cr at 1 April 20X1 had an estimated market value of ₹ 13 Cr at that date.
- Inventory in the books of B Ltd. is shown at a cost of ₹ 2.50 Cr. The fair value of the inventory on the acquisition date is ₹ 3 Cr.

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.

QUESTION 15

On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ₹ 4 Cr subject to a two-year vesting period. The income tax law permits a tax deduction at the exercise date of the intrinsic value of the options. The intrinsic value of the options at 31st March 20X2 was ₹ 1.60 Cr and at 31st March 20X3 was ₹ 4.60 Cr. The increase in the fair value of the options on 31st March 20X3 was not foreseeable at 31st March 20X2. The options were exercised at 31st March 20X3.

Give the accounting for the above transaction for deferred tax for period ending 31st March, 20X2 and 31st March, 20X3. Assume that there are sufficient taxable profits available in future against any deferred tax assets. Tax rate of 30% is applicable to P Ltd.

QUESTION 16

A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is ₹ 100 thousand and taxable profit for year 20X1-20X2 is ₹ 104 thousand. The difference between these amounts arose as follows:

1. On 1st February, 20X2, it acquired a machine for ₹ 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.
2. In the year 20X1-20X2, expenses of ₹ 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

Prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation.

QUESTION 17

A Ltd prepares financial statements to 31 March each year. The rate of income tax applicable to A Ltd is 20%. The following information relates to transactions, assets and liabilities of A Ltd during the year ended 31 March 20X2:

(i) A Ltd has a 40% shareholding in L Ltd. A Ltd purchased this shareholding for ₹ 45 Cr. The shareholding gives A Ltd significant influence over L Ltd but not control and therefore A Ltd. accounts for its interest in L Ltd using the equity method. The equity method carrying value of A Ltd's investment in L Ltd was ₹ 70 Cr on 31 March 20X1 and ₹ 75 Cr on 31 March 20X2. In the tax jurisdiction in which A Ltd operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.

(ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31 March. On 31 March 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31 March 20X2, A Ltd charged depreciation in its statement of profit or loss of ₹ 2 Cr and claimed a tax deduction for tax depreciation of ₹ 1.25 Cr. On 31 March 20X2, the building was revalued to ₹ 45 Cr. In the tax jurisdiction in which A Ltd operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Basis the above information, you are required to compute:

(a) The deferred tax liability of A Ltd at 31 March 20X2

(b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X2

QUESTION 18

K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March 20X2, K Ltd entered into the following transactions:

(a) On 1st April 20X1, K Ltd purchased an equity investment for ₹ 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March 20X2, the fair value of the investment was ₹ 2,40,000. In the tax jurisdiction in which

K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.

(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ₹ 80,000. The goods had cost to K Ltd for ₹ 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.

(c) On 31st October 20X1, K Ltd received ₹ 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November 20X1 to 31st July 20X2. K Ltd recognised revenue of ₹ 1,20,000 in respect of this transaction in the year ended 31st March 20X2 and will recognise the remainder in the year ended 31st March 20X3. Under the tax jurisdiction in which K Ltd operates, ₹ 2,00,000 received on 31st October 20X1 was included in the taxable profits of K Ltd for the year ended 31st March 20X2.

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March 20X2. Assume tax rate to be 25%.

QUESTION 19

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for ₹ 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of ₹ 5 crore, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

QUESTION 20

ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January, 20X1 for ₹ 1000 crore. By 31st March, 20X5 PQR Ltd. had made profits of ₹ 50 crore (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Assume the dividend distribution tax rate applicable is 15%. Show deferred tax treatment.

QUESTION 21

X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, the following events affected the tax position of the group:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of ₹ 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of ₹ 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 2019, X Ltd. expects to make taxable profits which are well in excess of ₹ 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than ₹ 20,00,000.

(iii) During the year ended 31st March, 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was ₹ 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

(iv) On 1st April, 2017, X Ltd. borrowed ₹ 1,00,00,000. The cost to X Ltd. of arranging the borrowing was ₹ 2,00,000 and this cost qualified for a tax deduction on 1st April, 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March, 2020 will be ₹ 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of ₹ 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

QUESTION 22

(RTP MAY 2019…..Q2….ALREADY DISCUSSED IN RTP VIDEO)

PQR Ltd., a manufacturing company, prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 2018, the following events affected the tax position of the group:

- QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of ₹ 30,00,000. QPR Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.
- During the year ended 31st March, 2018, PQR Ltd. capitalised development costs which satisfied the criteria as per Ind AS 38 'Intangible Assets'. The total amount capitalised was ₹ 16,00,000. The development project began to generate economic benefits for PQR Ltd. from 1st January, 2018. The directors of PQR Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.
- On 1st April, 2017, PQR Ltd. borrowed ₹ 1,00,00,000. The cost to PQR Ltd. of arranging the borrowing was ₹ 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be ₹ 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of ₹ 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%.

QUESTION 23

(RTP NOV 2019….Q19….ALREADY DISCUSSED IN RTP VIDEO)

An entity is finalising its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30th June, 20X2.

The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

Deferred tax asset	₹ 80,000
Deferred tax liability	₹ 60,000

Of the deferred tax asset balance, ₹ 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.

Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries.

QUESTION 24

(TAX BENEFITS ON INDEXATION OF ASSETS TO BE SOLD IN NEAR FUTURE)

(1) Cost of acquired land 1,00,000

(2) Index rate per annum 10% p.a.

(3) Land will be held for 2 years

(4) Tax rate 30%

Calculate deferred tax due to indexation of asset. What will be your answer if the given Asset will be held for long term purpose and sale is not expected in near future.

QUESTION 25

(DTL ON GOODWILL IN BUSINESS COMBINATION IF TAX BASE IS NIL)

A limited acquired B limited for 1,00,000. The net assets of B limited are to be assumed 65,000. Assume Tax base of goodwill is zero. Tax rate 30%. Show the entry at the time of business combination including deferred tax on goodwill.

QUESTION 26

(RECONCILIATION STATEMENT)

An entity has made an accounting profit of ₹ 1,00,000. The tax rate is 30%. In computing the accounting profit, a penalty of ₹ 10,000 has been considered which is not tax deductible. There are no other tax impacts. In this case, the taxable profits are ₹ 1,10,000 (₹ 1,00,000 + ₹ 10,000) and tax expense @ 30% is ₹ 33,000. Show reconciliation statement.

QUESTION 271

(RECONCILIATION IN DIFFERENT TAX JURISDICTION)

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of ₹ 1,500 (20X1: ₹ 2,000) and in country B of ₹ 1,500 (20X1: ₹ 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of ₹ 100 (20X1: ₹ 200) are not deductible for tax purposes.

SELF READING EXAMPLES GIVEN IN STUDY MATERIAL

EXAMPLE 1

Entity X acquired an intangible asset (a license) for ₹ 10 Cr that has a life of five years. The asset will be solely recovered through use. No tax deductions can be claimed, as the license is amortised or as when the license expires. No tax deductions are available on disposal. Trading profits from using the license will be taxed at 30%.

The tax base of the asset is nil, because the cost of the intangible asset is not deductible for tax purposes (either in use or on disposal). A temporary difference of ₹ 10 Cr arises; prima facie a deferred tax liability of ₹ 3 Cr should be recognized on this amount. However, no deferred tax is recognised on the asset's initial recognition. This is because the temporary difference did not arise from a business combination and did not affect accounting or taxable profit at the time of the recognition.

The asset will have a carrying amount of ₹ 8 Cr at the end of year 1. The entity will pay tax of ₹ 2.40 Cr through recovery of the asset by earning taxable amounts of ₹ 8 Cr. The deferred tax liability is not recognised, because it arises from initial recognition of an asset. Similarly, no deferred tax is recognised in later periods.

EXAMPLE 2

As at 31st March, 20X1, an entity has both taxable temporary differences and deductible temporary difference with the following reversal pattern. Deductible temporary differences cannot be carried forward.

Particulars	Year (₹)		
	1	2	3
Taxable temporary difference			
Opening balance	10,000	5,000	2,000
Recognized in taxable income	5,000	3,000	2,000
Closing balance	5,000	2,000	-
Deductible temporary difference			
Opening balance	8,000	4,000	-
Recognized in taxable income	4,000	4,000	-
Closing balance	4,000	-	-

Statement of taxable income			
Taxable temporary difference	5,000	3,000	2,000
Deductible temporary difference	4,000	4,000	-

The entity can recognize deferred tax assets for the deductible temporary differences up to ₹ 7,000 (₹ 4,000 for year 1 & ₹ 3,000 for year 2) as a taxable temporary difference of that amount is available.

INDIAN ACCOUNTING STANDARD 113
FAIR VALUE MEASUREMENT

WHAT IS FAIR VALUE?

Normally assets and liabilities are being exchanged between parties at their agreed terms and conditions based on the prices which might be related to the entity or event based or in other words which is not at arm's length prices. To define Fair Values one has to ensure that the values reflect all assumptions/adjustments to change from transaction specific/ entity specific to normal transaction which is common for all interested parties.

In other word, it is a market based value rather than an specific prices and this price should be received to sell an asset or paid to transfer a liability in a normal transaction (e.g. other than any stressed sale etc). Fair Value in an exit price and not a price at which an Asset/ liability sells/ purchases otherwise.

OBJECTIVE

• Defines fair value
• Sets out in a single Ind AS a framework for measuring fair value; and
• Requires disclosures about fair value measurements

Fair value is a market-based measurement, not an entity-specific measurement.

The objective of a fair value measurement is-

- To estimate the price
- At which an orderly transaction to sell the asset or to transfer the liability would take place
- Between market participants
- At the measurement date
- Under current market conditions

(i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that:

- Maximises the use of relevant observable inputs and
- Minimises the use of unobservable inputs.

Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Ind AS shall be applied to an entity's own equity instruments measured at fair value.

<u>What is not covered?</u>

Standard specifically describes the below exceptions which are not covered by the Accounting Standard and hence one has to look at the respective standard itself to identify the process to calculate Fair Values of the items of the standard. The scope exclusion will be applied on below-

<u>Measurement and Disclosure exclusion</u>

(a) share-based payment transaction within the scope of Ind AS 102, Share based payment;

(b) leasing transaction within the scope of Ind AS 17, Leases; and

(c) measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2, Inventories, or value in use in Ind AS 36, Impairment of Assets.

<u>Disclosure exclusion</u>

(a) plan assets measured at fair value in accordance with Ind AS 19, Employee Benefits;

(b) assets for which recoverable amount is fair value less costs of disposal in accordance with Ind AS 36.

<u>DEFINITION</u>

This Ind AS defines fair value as **<u>the price</u>** that would be received to sell an asset or paid to transfer a liability in **<u>an orderly transaction</u>** between **<u>market participants</u>** at the measurement date.

Fair value			
The price that would be to sell an asset or paid to transfer a liability	In an orderly transaction	Between market participants	At the measurement date

Let us understand some of the major that terms that have been used in the definition of Fair Value in order to arrive at Fair Values of an Asset or Liability-

The restrictions could be entity specific an asset/ liability specific hence all such restrictions which are asset/liability specific & being Transfer to the buyer as it is, then will be considered while calculating fair value. In contract, if the restrictions are entity specific then it will not be considered.

To consider in Fair Value

Entity specific restrictions	NO
Asset/liability specific restrictions	YES

Example: Entity Specific restrictions

An entity is having a land which has a restriction to develop into a commercial house because of restricted business objective in which currently it operates. The entity wants to sell the land and there would not be any restriction for a buyer of the land to develop a commercial house. Since this restriction is entity specific, hence it will not be considered while calculating fair value of the land.

Example

A manufacturing company is having certain securities which have been pledged with a bank and restricted to sell it for next 2 years. The restriction is entity specific and hence will not considered while calculating fair value of the security as other market participant will not consider this restriction which is purely an entity specific,

Example: Asset/Liability specific restrictions

A car has been bought for private use and there is a restriction of not to use the car for any commercial purposes. Commercial vehicle is having more fair value than private vehicle. since the restriction to use the vehicle is asset specific and market participant will also consider the asset specific restrictions while calculating fair values for such asset and hence this condition will be considered while evaluating fair value of the car.

UNIT OF ACCOUNT

- **Unit of Account**
  - An Asset or Liability is aggregated or disaggregated → For recognition
  - An Asset or a Liability is aggregated or disaggregated → For Measurement

Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities of recognition or disclosure purposes depends on its unit of account.

The unit of account for the asset or liability shall be determine in accordance with the Ind AS that requires or permits the fair value measurement, except as provided in this Ind. AS.

This essentially defines the level of aggregation or disaggregation while calculating Fair Values of the Assets/Liabilities.

Example

An Entity having certain securities which are quoted at market and these are recognised at fair value in the Balance Sheet. Quoted prices **at individual level** will be used in order to find Fair Values of these Investments. Example In order to evaluate fair values of assets to identify impairment as per Ind-As 36- Impairment of Assets which requires to measure such Fair Value at Cash generating units, hence group of assets will used in order to find values for the requirement of such Standard.

THE TRANSACTION

A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market/ participants to sell the asset or transfer the liability at the measurement date under current market conditions.

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(a) in the principal market for the asset or liability; or

(b) in the absence of a principal market, in the most advantageous market for the asset or liability.

There could be different principal markets of different reporting entities even belongs to the same group. The principal market/most advantageous market would separately be evaluated for different assets/ liabilities under the fair valuation requirements.

Principal market

Market which is normally the place in which the assets/ liabilities are being transacted with highest volume with high level of activities comparing with any other market available for similar transactions.

Example

Share of a company which is listed at BSE and NYSE has different closing prices at the year and. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Sicne BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

Most advantageous market

- This is the market which either maximises the amount that would be received when an entity sells an asset or minimise the amount that is to be paid while transferring the liability.
- In the absence of principal market, this market is used for Fair Valuation of the Assets/ Liabilities. In many cases Principal market & most advantageous market will be same.
- The market will be assessed based on net proceeds from the sale which will deduct expenses associated with such sale in most advantageous market.

Example

Diamond (a commodity) has got a domestic market where the prices are lesser comparing to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done at domestic market only i.e., 90% and balance 10% only can be sold via export. The highest level of activities with highest volume is being done at domestic market. Hence, principal market for diamond would be domestic market. Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. However, if principal market is available, then its prices would be used for fair valuation of assets/liabilities.

MARKET PARTICIPNRTS

An entity shall measure the fair value of an asset of a liability using the assumptions the market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

What are market participants?

The parties which eventually transact the asset/liabilities either in principal market or most advantageous market in their vest economic interest i.e.,

- They should be independent and not a related party. However, if related parties have done similar transaction on arm's length price, then it can be between related parties as well.
- The parties should not be under any stress or force to enter into these transactions
- All parties should have reasonable and sufficient information about the same.

Example

A land has legal restriction to use it for commercial purposes in nest 10 years irrespective of its holder. The fair value of the land will include this restriction about its usage because it is an asset related restriction and any buyer will need to take over with similar restriction to use the land for next 10 years. Now to evaluate its fair value, one has to consider the restriction based on the assumptions which normally would be taking into account by its market participants, mentioned as below

a) Whether the restriction is commonly imposed on each type of land?

b) How useful it will be after the end of 10 Years?

c) Whether there is any alternative use which may be considered normally by participant for similar kind of deals?

d) How liquid the sale of land will be with such restrictions?

e) comparing the Price with similar kind of land without restrictions to arrive at its fair values.

THE PRICE

Fair value is the price would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that piece is directly observable or estimated using another valuation technique.

A fair value is being assessed based or principal and if principal market is not available then based on the most advantageous market.

Transaction cost

Principal (or most advantageous) market is where significant level of transactions and activities takes place and it eventually covers/considers all such transaction costs. Hence, it would not be appropriate to consider any transaction cost further while assessing fair vales from such principal markets.

Note: Transaction costs do not include transport costs.

Transport cost

If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

It would be considered, if in case it is an inherent part of the Assets/Liability so transacted e.g. commodity.

	Principal market	Most advantageous market
Transaction Cost	NO	YES
Transport cost	YES	YES

Example

An entity sells certain commodity which are available actively at location A and which is considered to be its principal market (being significant value of transactions and activities takes place). However, fair value of the commodity is required to be assessed for location B which is far from location A and requires a transport cost of INR 100. Since the transport cost is not a transaction cost and it is not specific to any transaction but is inherent cost which requires to be incurred while bringing such commodity from location B, it will be considered while evaluating fair value from the principal market.

VALUATION TECHNIQUES

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

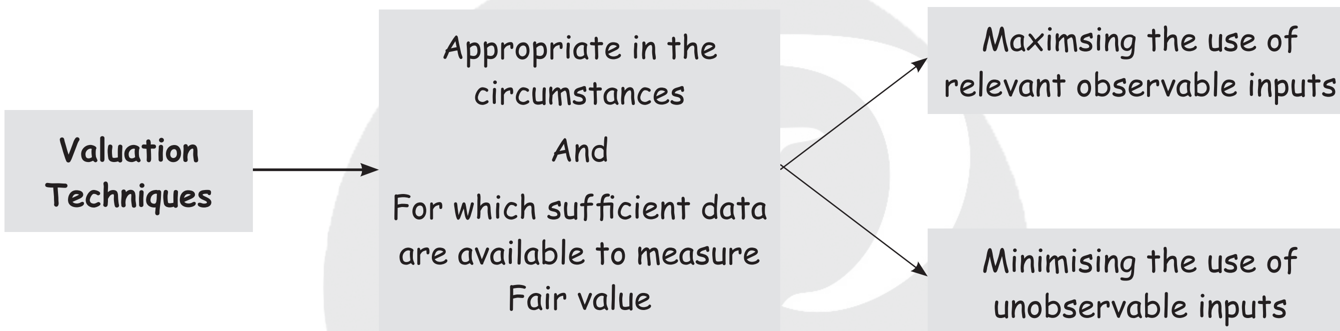
It is pertinent to note that the overall objective to use any valuation approach or technique is in accordance with all relevant date available related to the Asset/liability which could untilise all directly observable inputs.

Note: It is worth to be noted that in case of availability of **Quoted prices** which are being used in an active market, there is no need to consider any valuation approach further.

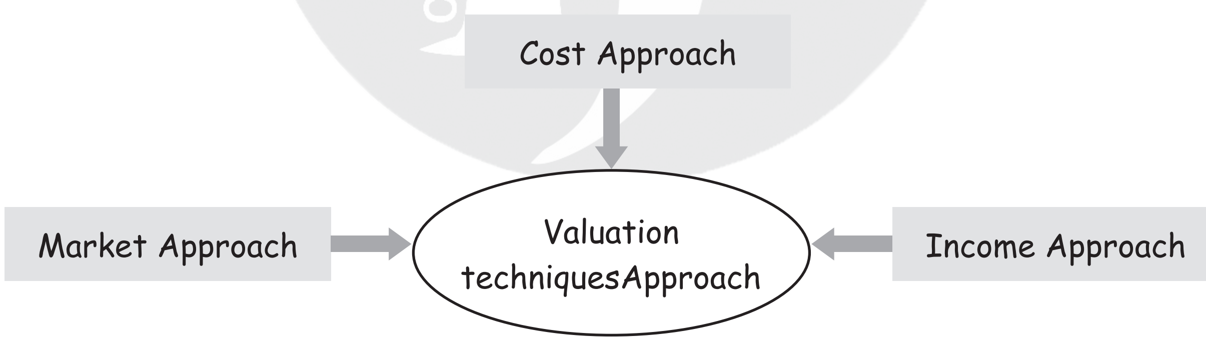
The standard requires and allows using one or combination of more-than one approach to measure any fair value which corroborates all inputs available related to such asset/liability. Selecting an appropriate approach is matter of judgment and based on the available inputs related to the asset/liability.

Example

An unquoted investment would require being Fair Valued which can be done either taking similar entity quoted prices with appropriate adjustments or a valuation of business using DCF of some other techniques. This would purely be dependent upon the available inputs and approach relevant for the Asset/liability.



Ind AS 113 specifies following three approaches to measure fair values:



1. **MARKET APPROACH:** The market approach uses prices and other relevant information generated by market transaction involving identical or comparable (i.e similar) assets, liabilities or a group of assets and liabilities, such as a business.

   For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

Quoted prices are indicative values of any business if it exchanges in an active market. However, in the absence of such quoted prices, it is relevant to value the business based on market values and do some adjustment relevant to the assets/liabilities. Standard specifies a valuation technique called "Matrix pricing" which is normally used to value debt securities. This technique relates the securities with some similar benchmarked securities. including coupons, Credit ratings etc, to derive at fair value of the debt.

Example

An entity does not have any security which is quoted in an active market, however its price to earnings ratio is being used to corroborate its enterprise value with certain adjustment relevant to the business e.g., there are some specific restrictions to use certain assets for some specific period being in a specialised industry.

2. **INCOME APPROACH:** The income approach converts future amounts (e.g., cash flow or income and expenses) to a single current (i.e., discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

It is a present value of all future earnings from an entity whose fair values are being evaluated or in other words all future cash flows to be discounted at current date to get fair value of the asset/liability.

Assumption to the future cash flows and an appropriate discount rate would be based on the other market participant's views. Related risks and uncertainty would reaure to be considered and would be taken into either in cash flow or discount rate.

Standard defines the below techniques which may be considered while using income approach

a) Present value techniques

b) Option pricing models e.g., Black-Scholes Merton models or binomial models,

c) The multi period excess earing method.

Example

An Entity has estimated its next year earing (cash flow) based on certain probability which can be mentioned below

year	Possible Cash flow (INR)	Probability	Probability weighted cash flows
1	700	20%	140%
2	800	40%	320
3	900	40%	<u>360</u>

		Total expected Cash F Low	820
		Risk free rate	6%
		Present value of Cash flow (1 year)	820/(1.06)= INR 773.58

3. **COST APPROACH:** This method describes how much cost is required to replace existing asset/liability in order to make it in a working condition. All related costs will be its fair value. It actually considers replacement cost of the asset/liability for which we need to find fair value.

INPUTS TO VALUATION TECHNIQUES

(NOT COVERED IN CLASS: PLS DO SELF READING HERE)

Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

It has widely been mentioned that observable inputs should be used to evaluate fair value of an asset/liability and we should minimise using any unobservable inputs.

Standard describes the below instances where observable inputs are being used in case of certain Financial instruments:

Markets (by nature)	Prices observable	Rationale	Ind AS 113 compliant
Exchange markets	Closing prices	Readily available	Yes
Dealer Market	Bid & Ask Prices	Readily available than Closing prices	Yes
Brokered Marked	Buy & Sell order Matching, commercial And residential markets	Broker knows better Prices from both buy & Sell side	Yes
Principal to Principal Markets	Negotiated prices with no intermediary	Little information available in market	Yes

FAIR VALUE HIERARHY

In order to establish comparability and consistency in fair value measurement, Ind AS 113 has made some hierarchy to define the level of inputs for fair value. The hierarchy is purely based on the level of inputs available for the specific Asset /liability for which the fair value is to be measured.

Some significant notes about the fair value hierarchy

- The hierarchy has been categorised in 3 levels which are based on the level of inputs that are being used to find out such fair values. There could be a situation where more than one level of fair value is being used, hence standard provide a guidance which states that in case of using more than one level of input, the entire class of asset/liability will be defined by its level which has significance on overall basis,

  Note: significance has not been defined anywhere and could be a matter of judgement.
- Standard defines the valuation techniques that could be used to evaluate fair values of Assets/liabilities and its level of hierarchy will be depending upon the level of inputs that have been used while using such valuation techniques.
- If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorised within Level 3 of the fair value hierarchy.

Example

If a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted piece to reflect the effect of that restriction. If that quoted price is a Level 2 input and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorised within Level 3 of the fair value hierarchy.

Level 1 Inputs

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available.

A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (e.g., on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability

Whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date

Example

An entity is holding investment which is quoted in BSE, India and NYSE, USA. However, significant activities are being done at BSE only. The fair value of the investment would be referenced to the quoted price at BSE India (which is Level 1 fair value- Direct quoted price with no adjustments).

Level 2 Inputs

Level 2 inputs are inputs other than quoted price included within Level 1 that are observable for the asset or liability, either directly or indirectly.

If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 Inputs include the following:

(a) quoted prices for similar asset or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability for example

- (i) interest rates and yield curves observable at commonly quoted intervals;
- (ii) implied volatilities; and
- (iii) credit spreads.
- (iv) market-corroborated inputs.

Example

Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency. It requires rate of swap which is of 11 years. However, normally the rates are available only for the maximum period of 10 years. The rate for 11 years' can be established using extrapolation or some other technique which is based on 10 years available rates of swap. The fair value of 11 years so derived would be level w fair value.

Example

An entity has an investment in another entity which has no active market. However, some similar investment is being traded in an active market. Now, the fair valuation can be done based on either the price based on the market which is not active or similar traded investment in an active market. This would be considered as level 2 inputs.

Level 3 inputs

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability, Therefore, unobservable inputs shall reflect the assumptions that market participant would use when pricing the asset or liability, including assumptions about risk.

Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability.

For example- It might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g., when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value).

Example: interest rate swap

An adjustment to a mid-market consensus (non-binding) price for the swap is being developed using data that are not directly observable and cannot otherwise be corroborated by observable market date. This would be level 3 Fair value input.

Example: Cash-generating unit

A Level 3 input would be a financial forecast (e.g., of cash flows or profit or loss) development using the entity's own data, if there is no reasonably available information that indicates usage of different assumptions by participants.

QUESTION 1

An asset is sold 2 different active markets (a market in which transaction for the asset or liability takes palace with sufficient frequency and volume to provide pricing information on an ongoing basis) at different prices.

An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The price that would be received is 26, transaction costs in that market are 3 and the costs to transport the asset to that market are 2 (i.e., the net amount that would be received is 21.)

In Market B:

The price that would be received is 25, transaction costs in that market are 1 and the costs to transport the asset to that market are 2 (i.e., the net amount that would be received in Market B is 22).

QUESTION 2

Company J acquires and land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high –rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.

QUESTION 3

ABC Ltd. acquired 5% equity shares of XYZ Ltd. for ₹ 10 crore in the year 20X1-X2 The company is in process of preparing the financial statements for the year 20X2-X3 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, the ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for ₹ 60 crore. The price of such transaction was determined on the basis of Comparable Companies Method (CCM)-Enterprise Value (EV) / EBITDA which was 8. For the current year, the EBITDA of XYZ Ltd.

is ₹ 40 crore. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.'s investment in XYZ Ltd. as on the balance sheet date?

SOLUTION:

Determination of Enterprise Value of XYZ Ltd.

Particulars	₹ In crore
EBITDA as on the measurement date	40
EV/EBITDA multiple as on the date of valuation	8
Enterprise value of XYZ Ltd.	320

Determination of subsequent Measurement of XYZ Ltd.

Particulars	₹ In crore
Enterprise Value of XYZ Ltd.	320
ABC Ltd. S share based on percentage of holding (5% of 320)	16
Less: Liquidity discount & non-controlling stake discount (5%5% =10%)	(1.6)
Fair value of ABC Ltd.' s investment in XYZ Ltd.	14.4

QUESTION 4

UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flow of PT Ltd. for the next 5 years are as follows:

(₹ In crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965

The weightage average cost of capital of PT Ltd. is 11% the total debt as on measurement date is ₹ 1,465 crore and the surplus cash & cash equivalent is ₹ 106.14 crore.

The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd.as per Income Approach.

SOLUTION:

Determination of equity value of PT Ltd.

(₹ In crore)

Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965
Discount rate	0.9009	0.8116	0.7312	0.6587	0.5935
Free Cash Flow available to the firm	168.56	152.26	89.06	177.19	2,518.69
Total of all years					3,105.76
Less: Debt					(1,465)
Add: Cash & Cash equivalent					106.14
Equity Value of PT Ltd.					1,746.90
No. of Shares					85,284,223.0
Per Share Value					204.83

QUESTION 5

You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. the details of the KK Ltd. are as follow:

Particulars	₹ In crore
Valuation as per Market Approach	5268.2
Valuation as per Income Approach	3235.2
Debt obligation as on Measurement date	1465.9
Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	312.4

Determine the Equity value of KK Ltd. as on the Measurement date on the Basis of above details.

SOLUTION:

Equity Valuation of KK Ltd.

Particulars	**Weights**	**(₹ In crore)**
As per Market Approach	50	5268.2
As per Income Approach	50	3235.2
Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%)		4,251.7
Less: Debt obligation as on measurement date		(1465.9)
Add: surplus cash & cash equivalent		106.14
Add: Fair value of surplus assets and liabilities		312.40
Enterprise value of KK Ltd.		3204.33
No. of shares		85,284,223
Value per share		375.72

EXTRA QUESTIONS ON IND AS 113: FAIR VALUE MEASUREMENT

QUESTION 1

Discount Rate assessment to measure present value:

Investment 1 is a contractual right to receive ₹ 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets :

(a) Investment 2 is a contractual right to receive ₹ 1,200 in 1 year and has a market price of ₹ 1,083.

(b) Investment 3 is a contractual right to receive ₹ 700 in 2 years and has a market price of ₹ 566.

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information.

QUESTION 2

Comment on the following by quoting references from appropriate Ind AS.

(i) DS Limited holds some vacant land for which the use is not yet determined. The land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment properly. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

On what basis will the land be fair valued under Ind AS ?

(ii) DS Limited holds equity shares of a private company. In order to determine the fair value of the shares, the company used discounted cash flow method as there were no similar shares available in the market.

Under which level of fair value hierarchy will the above inputs be classified ?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares?

ANALYSIS OF FINANCIAL STATEMENTS
CASE STUDIES BASED ON IND AS

CASE STUDY 1

On April 1, 20X1, Pluto Ltd. has advance a loan for ₹ 10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. ₹ 10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. ₹ 40,000 (₹ 10 lakhs x 4%).

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

SOLUTION:

Paragraph 8 of Ind AS 19 states that:

"Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment".

The Accountant of Pluto Ltd. has recognised the staff loan in the balance sheet at ₹ 10 lakhs being the amount disbursed and ₹ 40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

(a) Calculation of Fair Value of the Loan

Year	Cash Inflow	Discounting Factor (10%)	Present Value
1	2,40,000	0.909	2,18,160
2	2,32,000	0.826	1,91,632
3	2,24,000	0.751	1,68,224
4	2,16,000	0.683	1,47,528
5	2,08,000	0.621	1,29,168
Total			**8,54,712**

Staff loan should be initially recorded at ₹ 8,54,712.

(b) Employee Benefit Expense

Loan Amount – Fair Value of the loan = ₹ 10,00,000 – ₹ 8,54,712 = ₹ 1,45,288

₹ 1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss on SLM basis over the period.

Amortisation table:

Year	Opening balance of Staff Advance	Interest (10%)	Repayment	Closing balance of Staff Advance
	(a)	(b)= (ax10%)	(c)	(d)= a+b-c
1	8,54,712	85,471	2,40,000	7,00,183
2	7,00,183	70,018	2,32,000	5,38,201
3	5,38201	53,820	2,24,000	3,68,021
4	3,68,021	36,802	2,16,000	1,88,823
5	1,88,823	19,177 (b.f)	2,08,000	Nil

Balance Sheet extracts showing the presentation of staff loan as at 31st March 20X2

Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

Assets	
Non-current Assets	
Financial Assets	
I Loan	5,38,201
Current Assets	
Financial Assets	
I Loans (7,00,183 - 5,38,201)	1,61,982

CASE STUDY 2

Pluto Ltd. has purchased a manufacturing plant for ₹ 6 lakhs on 1 April 20X1. The useful life of the plant is 10 years. On 30th September 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.

Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September 20X3 and 31 March 20X4 was ₹ 4 lakhs and ₹ 3.5 lakhs respectively.

The accountant has performed the following working:

	INR
Carrying amount on initial classification as held for sale	6,00,000
Less: Accumulated dep (6,00,000/ 10 Years)* 2.5 years	(1,50,000)
Fair Value less cost to sell as on 31 March 20X3	4,00,000
The value will be lower of the above two	4,00,000

Balance Sheet extracts as on 31 March 20X4

Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	3,50,000

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

SOLUTION:

Paragraph 13 of Ind AS 105 states that:

"An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use."

Paragraph 55 of Ind AS 16 states that:

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

Going by the guidance given above,

The Accountant of Pluto Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should be treated as abandoned asset rather as held for sale because its carrying amount will be principally recovered through continuous use. Pluto Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet is given as below:

Calculation of carrying amount as on 31 March 20X4	
Purchase Price of Plant Less: Accumulated depreciation (6,00,000/ 10 Years)* 3 Years	6,00,000 (1,80,000)
	4,20,000

Balance Sheet extracts as on 31 March 20X4

Assets Non-Current Assets Property, Plant and Equipment	 4,20,000

CASE STUDY 3

On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re- packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

The accountant of Jupiter Ltd treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

	INR lakhs
Cost	8.00
Net realisable value (9.6 -2)	7.60
Inventories (lower of cost and net realisable value)	7.60

Required:

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

CASE STUDY 4

On April 1, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for ₹ 30 lakhs. Sun Ltd. has 3 cash-generating units A, B and C with fair value of Rs 12 lakhs, 8 lakhs and 4 lakhs respectively. The company recognizes goodwill of Rs 6 lakhs that relates to CGU 'C' only.

During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment.

Required:

Analyse whether the view adopted by the CFO of Sun Ltd is in compliance of the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS

SOLUTION:

The above treatment needs to be examined in the light of the provisions given in Ind AS 36: Impairment of Assets.

Para 9 of Ind AS 36

Impairment of Assets' states that "An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Further, paragraph 10(b) of Ind AS 36 states that:

"Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually".

Sun Ltd has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence the treatment made by the Company is not in accordance with Ind AS 36.

Accordingly, impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

CASE STUDY 5

Venus Ltd. is a multinational entity that owns three properties. All three properties were purchased on April 1, 20X1. The details of purchase price and market values of the properties are given as follows:

Particulars	Property 1	Property 2	Property 3
	Factory	Factory	Let-Out
Purchase Price	15,000	10,000	12,000
Market value 31.03.20X2	16,000	11,000	13,500
Life	10 Years	10 Years	10 Years
Subsequent Measurement	Cost Model	Revaluation Model	Revaluation Model

Property 1 and 2 are used by Venus Ltd. as factory building whilst property 3 is let-out to a non-related party at a market rent. The management presents all three properties in balance sheet as 'property, plant and equipment'.

The Company does not depreciate any of the properties on the basis that the fair values are exceeding their carrying amount and recognise the difference between purchase price and fair value in Statement of Profit and Loss.

Required:

Analyse whether the accounting policies adopted by the Venus Ltd. in relation to these properties is in accordance of Indian Accounting Standards (Ind AS). If not, advise the correct treatment alongwith working for the same.

SOLUTION:

The above issue needs to be examined in the umbrella of the provisions given in Ind AS 1 'Presentation of Financial Statements', Ind AS 16 'Property, Plant and Equipment' in relation to property '1' and '2' and Ind AS 40 'Investment Property' in relation to property '3'.

As per the facts given in the question, Venus Ltd. has

(a) presented all three properties in balance sheet as 'property, plant and equipment';

(b) applied different accounting policies to Property '1' and '2';

(c) revaluation is charged in statement of profit and loss as profit; and

(d) applied revaluation model to Property '3' being classified as Investment Property.

These accounting treatment is neither correct nor in accordance with provision of Ind AS 1, Ind AS 16 and Ind AS 40.

Accordingly, Venus Ltd. shall apply the same accounting policy (i.e. either revaluation or cost model) to entire class of property being property '1' and '2". It also required to depreciate these properties irrespective of that, their fair value exceeds the carrying amount. The revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

There is no alternative of revaluation model in respect to property '3' being classified as Investment Property and only cost model is permitted for subsequent measurement. However, Venus ltd. is required to disclose the fair value of the property in the Notes to Accounts. Also the property '3' shall be presented as separate line item as Investment Property.

Therefore, as per the provisions of Ind AS 1, Ind AS 16 and Ind AS 40, the presentation of these three properties in the balance sheet is as follows:

Case 1:

Venus Ltd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance sheet extracts as at 31st March 20X2

		INR
Assets		
Non-current Assets		
Property, Plant and Equipment		
Property '1'	13,500	
Property '2'	9,000	22,500
Investment properties		
Property '3'		10,800

Case 2:

Venus Ltd. has applied the Revaluation Model to an entire class of property, plant and equipment.

Balance sheet extracts as at 31st March 20X2

		INR
Assets		
Non-current Assets		
Property, Plant and Equipment		
Property '1'	16,000	
Property '2'	11,000	27,000
Investment Properties		
Property '3'		10,800
Equity and Liabilities		
Other Equity		
Revaluation Reserve		
Property '1'	2,500	
Property '2'	2,000	4,500

The revaluation reserve should be routed through Other Comprehensive Income (subsequently not reclassified to Profit and Loss) in Statement of Profit and Loss and Shown as a separate column in Statement of Changes in Equity.

CASE STUDY 6

On 1st January 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March 20X2, that there was a 75% probability they would have to pay damages of ₹ 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ₹ ₹ 12 lakhs to the customer on 15th May 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May 20X2.

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

SOLUTION:

The above treatment needs to be examined in the light of the provisions given in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' and Ind AS 10 'Events After the Reporting Period'.

As per given facts, the potential payment of damages to the customer is an obligation arising out of a past event which can be reliably estimated. Therefore, following the provision of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' – a provision is required. The provision should be for the best estimate of the expenditure required to settle the obligation at 31 March 20X2 which comes to ₹ 7.5 lakhs (₹ 10 lakhs * 75%).

Further, following the principles of Ind AS 10 'Events After the Reporting Period' evidence of the settlement amount is an adjusting event. Therefore, the amount of provision created shall be increased to ₹ 12 lakhs and accordingly be recognised as a current liability.

CASE STUDY 7

Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April 20X1, the company has received a government grant for ₹ 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Required:

Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

SOLUTION:

As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.

"If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met".

Understanding of the given facts, The Company has recognised the proportionate grant for Rs 2 lakhs in Statement of Profit and Loss before the conditions attaching to government grant are met which is not correct and nor in accordance with provision of Ind AS 41 'Agriculture'.

Accordingly, the accounting treatment of government grant received by the Mercury Ltd. is governed by the provision of Ind AS 41 'Agriculture' rather Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance'.

Government grant for ₹ 10 lakhs shall be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e. after the expiry of specified period of five years of continuing engagement in the plantation of eucalyptus tree.

Balance Sheet extracts showing the presentation of Government Grant as on 31st March 20X2

	INR
Liabilities	
Non-current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

CASE STUDY 8

Mercury Ltd. has sold goods to Mars Ltd. at a consideration of ₹ 10 lakhs, the receipt of which receivable in three equal installments of ₹ 3,33,333 over a two year period (receipts on 1st April 20X1, 31st March 20X2 and 31st March 20X3).

The company is offering a discount of 5 % (i.e. ₹ 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at ₹ 10 Lakhs and hence, the management has recognised the revenue from sale of goods for ₹ 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

CASE STUDY 9

(RTP NOV 2020: Q1…………ALREADY DISCUSSED THERE)

Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ₹ 30,000 for the incorporation of company and to do other necessary statuary registrations. ₹ 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 20X1.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. ltd. for the year ending 31st March, 20X2 as follows :

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	**11,00,000**
Expenses :	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	**7,45,000**
Profit before tax (c) = (a) – (b)	**3,55,000**
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	**1,12,500**
Profit for the year (e) = (c) = (d)	**2,42,500**

Balance Sheet

Particulars	Amount (₹)
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000

(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
Total	**5,21,000**
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
Total	**5,21,000**

Additional information of Softbharti Pvt. Ltd. :

(i) Deferred tax liability of ₹ 6,000 is created due to following temporary difference :

Difference in depreciation amount as per Income tax and Accounting profit

(ii) There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 20X2 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	₹ 1,00,000	₹ 80,000

Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.

(iii) Current tax is calculated at 30% on PBT - ₹ 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to ₹ 1,25,700.

(iv) After the reporting period, the directors have recommended dividend of ₹ 15,000 for the year ending 31st March, 20X2 which has been deducted from reserves and surplus. Dividend payable of ₹ 15,000 has been grouped under other current liabilities' alongwith other financial liabilities.

(v) There are 'Government statuary dues' amounting to ₹ 15,000 which are grouped under 'other current liabilities'.

(vi) The capital advances amounting to ₹ 50,000 are grouped under 'Other non-current assets'.

(vii) Other current assets of ₹ 51,000 comprise Interest receivable from trade receivables.

(viii) Current investment of ₹ 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ₹ 50,000 as at 31st March, 20X2.

(ix) Actuarial gain on employee benefit measurements of ₹ 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31st March, 20X2.

The financial statements for financial year 20X1-20X2 have not been yet approved.

You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information.

CASE STUDY 10

Mumbai Challengers Ltd., a listed entity, is a sports organization owning several cricket and hockey teams. The issues below pertain to the reporting period ending 31st March 20X2.

(a) Owning to the proposed schedules of Indian Hockey League as well as Cricket Premier Tournament, Mumbai Challengers Ltd. needs a new stadium to host the sporting events. This stadium will form a part of the Property, Plant and Equipment of the company. Mumbai Challengers Ltd. began the construction of the stadium on 1 December, 20X1. The construction of the stadium was completed in 20X2-20X3. Costs directly related to the construction amounted to ₹ 140 crores in December 20X1. Thereafter, ₹ 350 crores have been incurred per month until the end of the financial year. The company has not taken any specific borrowings to finance the construction of the stadium, although it has incurred finance costs on its regular overdraft during the period, which were avoidable had the stadium not been constructed. Mumbai Challengers Ltd. has calculated that the weighted average cost of the borrowings for the period 1 December 20X1 to 31st March 20X2 amounted to 15% per annum on an annualized basis.

The company seeks advice on the treatment of borrowing costs in its financial statements for the year ending 31st March 20X2.

(b) Mumbai Challengers Ltd. acquires and sells players' registrations on a regular basis. For a player to play for its team, Mumbai Challengers Ltd. must purchase registrations for that player. These player registrations are contractual obligations between the player and the company. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club.

At the end of each season, which happens to also be the reporting period end for Mumbai Challengers Ltd., the club reviews its contracts with the players and makes decisions as to whether they wish to sell/transfer any players' registrations. The company actively markets these registrations by circulating with other clubs a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. In some cases, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for any other reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of ₹ 175 crores. These registrations had a net book value of ₹ 49 crores.

Mumbai Challengers Ltd. seeks your advice on the treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above.

(c) Mumbai Challengers Ltd. measures its stadiums in accordance with the revaluation model. An airline company has approached the directors offering ₹ 700 crores for the property naming rights of all the stadiums for five years. Three directors are on the management boards of both Mumbai Challengers Ltd. and the airline. Additionally, statutory legislations regulate the financing of both the cricket and hockey clubs. These regulations prevent contributions to the capital from a related party which 'increases equity without repayment in return'. Failure to adhere to these legislations could lead to imposition of fines and withholding of prize money.

Mumbai challengers Ltd. wants to know to take account of the naming rights in the valuations of the stadium and the potential implications of the financial regulations imposed by the legislations.

CASE STUDY 11

(a) Neelanchal Gas Refinery Ltd. (hereinafter referred to as Neelanchal), a listed company, is involved in the production and trading of natural gas and oil. Neelanchal jointly owns an underground storage facility with another entity, Seemanchal Refineries Ltd. (hereinafter referred to as Seemanchal). Both the companies are engaged in extraction of gas from offshore gas fields, which they own and operate independently of each other. Neelanchal owns 60% of the underground facility and Seemanchal owns 40%. Both the companies have agreed to share services and costs accordingly, with decisions relating to the storage facility requiring unanimous agreement of the parties. The underground facility is pressurised so that the gas is pushed out when extracted. When the gas pressure is reduced to a certain level, the remaining gas is irrecoverable and remains in the underground storage facility until it is decommissioned. As per the laws inforce, the storage facility should be decommissioned at the end of its useful life.

Neelanchal seeks your advice on the treatment of the agreement with Seemanchal as well as the accounting for the irrecoverable gas.

(b) Neelanchal has entered into a ten-year contract with Uttaranchal Refineries Pvt. Ltd. (hereinafter referred to as Uttaranchal) for purchase of natural gas. Neelanchal has paid an advance to Uttaranchal equivalent to the total quantity of gas contracted for ten years based on the forecasted price of gas. This advanced amount carries interest at the rate of 12.5% per annum, which is settled by Uttaranchal way of supply of extra gas. The contract requires fixed quantities of gas to be supplied each month. Additionally, there is a price adjustment mechanism in the contract whereby the difference between the forecasted price of gas and the prevailing market price is settled in cash on a quarterly basis. If Uttaranchal does not deliver the gas as agreed, Neelanchal has the right to claim compensation computed at the current market price of the gas.

Neelanchal wants to account for the contract with Uttaranchal in accordance with Ind AS 109 Financial Instruments and seeks your inputs in this regard.