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CA FINAL

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CA Chiranjeev Jain

ABOUT THE AUTHOR

CA Chiranjeev Jain has qualified Chartered Accountancy Course in 2005 and has completed all the levels of this course in his very first attempt. He is among the top rank holders Delhi University having done his graduation from Sri Ram College of Commerce. He scored more than 90% in accounts at all levels of CA and university examinations. He has done Diploma in Information System Audit conducted by the ICAI. He has also done Masters in Business Administration (MBA) with specialization in Finance.

After completing Academic & Professional Education, he has worked with Deloitte Haskin & Sells as a chartered accountant and developed immense skills in the practical application of various accounting standards. Finally he exposed himself to the practice as chartered accountant and adapted to teaching accounts (the subject he loves the most) as his career.

He possesses a vast experience in teaching accountancy to students of CA CPT, IPCC & Final. He is also into Corporate Training in the industry and has addressed a number of courses and seminars organized by Professional Institutions. He has served as an examiner of accounts at CA IPCC and Final level. He is an expert in both Indian Accounting Standards and IFRS.

He has conducted face to face classes at Hyderabad, Bangalore, Kolkata and Ahmadabad apart from VSAT classes in the Southern region with ETEN CA. His easy way of teaching Accountancy from the very basic and his motivational lectures are very famous among CA students' fraternity.

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Thanks
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POSITIVE FEEDBACK ABOUT SIR'S CLASSES

Shalaka Tiwari - Shastri, Hyderabad

I have taken the classes for CA Final FR from Chiranjeev Jain sir and I believe he is an great teacher and a amazing mentor.
His methodology of teaching is unique, while in class there's no concept untaught. He teaches whole heartedly and makes sure that you get your basics right.
I have no other words to express this better.
I will say, just join him and u will see the results !!
CJ sir ROCKS !!!!!

Amit Jain, Kolkata

Hi Students, I am CA Amit Kumar Jain, practicing in Gurgaon. I am one of the old students of CA Chiranjeev Sir, and belong to his first CA final batch in kolkata. Today, on Teacher's Day, I would love to convey my gratitude to him for his wonderful coaching classes. The learnings shared by him both related to course and related to practical life after CA, has been very useful in my journey. He is one of the best CA Final teacher in India and I recommend all students to join him.

Navneet Singh, Hyderabad

When I started my journey to become a Chartered accountant, the only fear I had was will I be able to have that conceptual knowledge which is needed the most in a profession like ours.!!
Now after completing my CA I can tell you that starting from Accounts in CPT then with Accounts in IPCC and to end with Financial reporting in CA Final, the conceptual understanding of the subject which I gained from you helped me become what I am now..
Thank you Sir once again to be available whenever asked for and help me achieve my dream of becoming a CA.

Obaid Khan, Hyderabad

To begin with a quote "It takes a big heart to help shape little minds."
Thank You Sir, for being an Amazing faculty throughout CA journey. Now that I completed my journey, I feel immensely honoured for being your student and learning the concepts precisely in a manner that helps in application too.
Words might fall short to express the gratitude, for you have been an Amazing teacher, mentor and a friend.
Just a small appreciation post from a student, moreover from a Fan of your ideas and teaching.

Isan Singh, Kolkata

i have taken FR classes from CA Chiranjeev Jain Sir….He is best in this subject…. It's because of Sir I get to know so much about accounts especially IND AS,
I have also taken accounts from him in CA IPCC and I scored very good marks in IPCC even though I was average in accounts subject. He teach from base which makes easy for average students to score high in exams. He gives through conceptual knowledge do that students will able to write worst paper in exams with ease.
Thanks sir for ur valuable teaching.

Arihant Kothari, Hyderabad

Thanks to the man with great caps,a perfect guide who has really helped us at every point and gave his helpful hands without any complaints .. You be the best sir ☺☺☺
It is to thankyou for those priceless teachings ☺I m really thankfull for all you good words that kept me motivated and focussed towards my goal . I feel lucky to get a place under your umbrella .. Whatever be the results your imprints will always be there sir .Thanks a lot sir !☺

Ashutosh Lahoti, Hyderabad

Thank you sir for providing us the best lectures with an ease. It was an amazing time spending with you. I'm very lucky to learn the subject of Accountancy that too of IPCC level under your guidance. You made this subject very easy with your experience and teaching quality. Actually your friendly nature towards the students made it more easier to understand the subject. Even your scoldings were like roses without thornes.
Thank you so much sir for helping us get through our targets. Will be missing those class fun but hope to see you soon in CA final classes.
😇Proud to be CHIRANJEEVIAN 😇

Niharika Phalod, Hyderabad

"A good teacher can inspire hope, ignite the imagination and instill a love of learning"
I would truly like to appreciate the great effort you have put into tutoring and enlightening my way. Because of your guidance and patience, I've come this far in my CA journey. Thankyou for always being there in all my confusions and helping me deal with all the stress during ipcc days!
Accounts couldn't be more easier and all the credit goes to your easy techniques.
Thankyou for being my mentor. I'm truly blessed to be your student! Wish you a very happy teachers day Sir. ☺

Nikita Simran, Hyderabad

I'm so grateful to be your student. Thank you for instilling in me the passion for learning. You've put in selfless efforts in shaping our career! We're truly blessed to have a mentor like you ☺ Lastly I would like to say-Now I see the world in a different light
I can discriminate between wrong and right, I perceive things in a different style, I have learnt to go the extra mile, I have a deeper understanding of things Dear teacher you have truly given me wings 🙏
Thank you for everything sir 🙏

Shalaka Tiwari - Shastri, Hyderabad

I have taken the classes for CA Final FR from Chiranjeev Jain sir and I believe he is an great teacher and a amazing mentor.
His methodology of teaching is unique, while in class there's no concept untaught. He teaches whole heartedly and makes sure that you get your basics right.
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I will say,just join him and u will see the results !!
CJ sir ROCKS !!!!!

Chinna Poojari , Bangalore

Venkata Sumanth, Vijaywada

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Sir,. It's very glad to have these words to you..u r d person who stands with me not only as my guru but as a family member during my tough times.. The way you teach us makes ourself to Mold towards subject conceptually...Coz of u only I have got AIR's in IPCC and CMA.... Being ur student makes me proud...gives me confidence that I can achieve all thru success.....finally thank you is not enough for ur services...Just will show thanks in the form of results in our exams....
Not only the subject your personality as a Chartered Accountant tis the Perfect Example for all Budding CA's.
One word about my guru ."CA Chiranjeevi sir is the BAADSHAH OF IND AS " in india.

Teachers usually make us study... Chiranjeev Jain sir made us enjoy the subject...We stepped out of the class with tonnes of confidence and belief .....
Thank you very much sir....
We never found in your class, a teacher- student relationship...We always felt that we are being taught by a best friend and well-wisher...
We will be grateful forever sir....
With tonnes of love...
One word about Chiranjeevi Jain sir ....
You taught us from your Heart...not from book...

Afsar Shaik, Hyderabad
Sir...trust me...before starting of this batch....I wondered how ur gonna complete this in 70 days...wr as other faculies r taking for 3 or 4 mnths....but finally I got my answer....u gave us the main thing what we want actually i.e, conceptual clarity....thank u soo much sir

Ashish Soni, Hyderabad
Sir you can inspire hope, ignite the imagination, and instill a love of learning..motivating...Thank You Sir ## CJ Sir the Best#

Ankitha Baldwa, Hyderabad
Thank you so much sir u be the best lecturer of my life😍Apka padane ka style baat karne ka style Apki shyaris Kya baat sir, missing all my memorable moments of ur class

Chaitanya, Hyderabad
Your way of teaching is something different that we will be in a thought that you are teaching slow but we'll get to know your fast once we missed your class and seeing the notes the next day. Really loved the class very much sir. Thankuuuuu so much sir.
The real life stories you teaches in class are inspired. Sir, we will go through many teachers in life sir. But only few we can remember lifelong. You're one among them and one you got the position with 70 days time while with everyone I spent not less than 2 years. Once again Thank you sir.
Sir, I may not score 90+ in exam, But I'm sure I'll give my 200% for getting 90+. Because we have only two options. Either 90+ or 90+.

Sakshi Sharma, Hyderabad
I have been taught by so many teachers but amongst them all you made the greatest impact by not only teaching by guiding us too. The loving ways of teachers like you is difference between teaching and educating thanks for teaching us, educating us, and empowering us thanks a lot sir

Khushi Srivastava, Hyderabad
I pursued 61 in accounting just because of Chiranjeev Jain Sir. His notes are not less than a face to face teaching...he covers each and every minute stuff...lucky to be his student.

Soujanya V M, Bangalore
I have attended his classes and he is very knowledgeable..He teaches the complex things in a very simple manner...He is a good guide for a student ...Because of him I got exemption in IPCC accounts...Students who are interested in conceptual learning can join his classes without any second thought...!
The chart prepared by him is simple and easily understandable...Very much useful for the students for last minute revision...
Thank you sir for all the teaching and guidance...!!

Rakhi Jha, Hyderabad
#SIR Ji # THANK YOU, I joined Yeshas just because you were teaching us ACCOUNTS #Your the most coolest & friendly faculty #You always motivated us #You always guided us on right path #Yet I can't believe that today was our last IPCC class # I personally never ever saw a great faculty like YOU # We all gonna miss you so much😣 #You always helped us SIR JI # You were just like our friend's #A BIG BIG THANK YOU SIR JI # See you soon in CA-FINAL #WILL MISS YOU SIR JI #LOVE YOU TONS & TONS ❤️

Shams Afaq, Hyderabad
I have done my schooling from science stream,so at the start of CPT only I was nervous, if I will be able to do accounts. But my whole nervousness was transformed into interest of learning by Chiranjeev Sir. He created a strong foundation for me with conceptual clarity. It was his easy going approach even when the concepts were challenging, I scored 44/60 in CPT and then 76/100 in IPCC. I will always be grateful to you. You are phenomenal. Keep up the good work!

Nithin Mundada, Hyderabad
The way you teach.. The knowledge you share.. The care you take..The love you shower..Makes you.. The world's best sir....It's my pleasure to have such a nice sir with charming smile..and I have never seen such a sir like.....

Jaya Chandra, Visakhapatnam
Sir's notes is very helpful during revision and he teaches from basics on which we generally don't pay much attention. The way he links each topic is good and he has much clarity in how to teach complex topics.

Naveen Pspk , Hyderabad
Scored 75 in Accounts..its just because of Mr.CA chiranjeevjain sir...initially I was bothered about DAT subject as I was from science background... But then I met with sir classes it changed whole scenario ....&d result is dis....tq sir tq so much....

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Provisions, Contingent Liabilities and Contingent Assets (IND AS 37)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 X Shipping Ltd. is required by law to overhaul its shipping fleet once in every 3 years. The company's finance team was of the view that recognising the costs only when paid would prevent matching of revenue earned all the time with certain costs of large amounts which are incurred occasional. Thereby, it has formulated an accounting policy of providing in its books of account for the future cost of maintenance (overhauls, annual inspection etc.) by calculating a rate per hours sailed on sea and accumulating a provision over time. The provision is adjusted when the expenditure is actually incurred. Is the accounting policy of X Shipping Ltd. correct?

Ans: A provision is made for a present obligation arising out of a past event. Overhauling does not arise out of past event. Even a legal requirement to overhaul does not make the cost of overhaul a liability, because no obligation exists to overhaul the ships independently of the company's future actions - the company could avoid the future expenditure by its future actions for example by selling the ships. So there is no present obligation.

As per the standard, financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the end of the reporting period.

Therefore, the accounting policy of X Shipping Ltd. is not correct. The company should adopt the component approach in Ind AS 16, Property, Plant and Equipment, for accounting for the refurbishment cost.

Q 2 X Chemical Ltd. is operating in the vicinity of a river since 20 years. A community living near X Chemical Ltd. claims that its operations has caused contamination of drinking water. X Chemical Ltd. has received notice from the governmental environmental agency that official investigations will be made into claims of pollution caused by the entity. If it is found that X Chemical Ltd. has caused contamination, then penalties and fine would be levied on it.

X Chemical Ltd. believes that it has implemented all environmental safety measures to an extent that it is unlikely to cause pollution. Management is not sure whether it has all the information about the entire 20 years. Therefore, neither management nor external experts are able to assess X Chemical Ltd.'s responsibility until the investigation has completed.

In such situation, how should management of X Chemical Ltd. account for a liability?

Ans: As per the standard, in the present case, the available evidence does not support a conclusion that a present obligation exists. However, there is a possible obligation which exists and will be confirmed upon completion of investigations. Therefore, management should disclose the contingent liability for potential penalties and fines that may be imposed if contamination is proved.

Q 3 X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is

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to be paid if the export incentives are received. As per the accounting policy of X Ltd., it recognises export incentives when actually realised, on account of the uncertainty in realising such incentives. Export incentives have not been received for the year 20X1-20X2, however X Ltd. is hopeful of receiving the export incentives in the year 20X2-20X3. In the financial statements for 20X1-20X2, should X Ltd. provide for both base commission and additional commission?

Ans: So far as the base percentage of sales commission is concerned, it is a present obligation arising out of past events. The obligating event takes place when the sales are made and also since commission is based on percentage of sale, reliable estimation can also be made. Therefore, the base percentage of sales commission should be provided.

However, in respect of additional commission, it is to be paid when the export incentives are recognised and export incentives are recognised only when it is received. Therefore, the obligating event will arise only when export incentives are received. Hence, no provision for additional commission is to be made in financial year 20X1-20X2. The expectation of X Ltd. to receive the export incentives in next year would not make any difference as on 31 March 20X2.

Q 4 X Sugars Ltd. has entered into a sale contract of Rs. 3,00,00,000 with Y Choclates Ltd. for the supply of sugar during 20X1-20X2. As per the contract the delivery is to be made within 2 months from the date of contract. In case of failure to deliver within the schedule, X Sugars Ltd. has to pay a compensation of Rs. 30,00,000 to Y Chocolates Ltd.

During the transit, the vehicle carrying the sugar met accident and X Sugar Ltd. lost the entire consignment. It is, however covered by an insurance policy. According to the report of the surveyor, the amount is collectible, subject to the deductible clause [i.e., 15% of the claim] in the insurance policy. The cost of goods lost was Rs. 2,50,00,000.

Before the financial year end, X Sugars Ltd. received informal information from the insurance company that their claim had been processed and the payment had been dispatched for 85% of the claim amount. Meanwhile Y Chocolates Ltd. has made demand of Rs. 30,00,000 since the goods were not delivered on time.

What provision or disclosure would X Ltd. need to make at year end?

Ans: As per the standard, where an inflow of economic benefits is probable, an entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out in Ind AS 37.

So X Sugars Ltd. would need to disclose the contingent asset of Rs. 2,12,50,000 (Rs. 2,50,00,000 x 85%) at the end of the financial year 20X1-20X2.

It would also need to make a provision of Rs. 30,00,000 towards the clam of Y Chocolates Ltd.

Q 5 An entity sells 1,000 units of a product with warranties under which the entity will repair any manufacturing defects that become apparent within the first six months after purchase. If a minor defect is detected in a product, estimated repair costs of Rs. 100 will result. If a major defect is detected in a product, estimated repair costs of Rs. 400 will result. The entity's experience together with its future expectations indicate that 75 per cent of the goods sold

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have no defects, 20 per cent of the goods sold have minor defects and 5 per cent of the goods sold have major defects.

Ans: When the provision involves a large population of items, the best estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities.

The expected value of the cost of repairs is

(75% × 1,000 units sold × nil) + (20% × 1,000 units × Rs. 100) + (5% × 1,000 units × Rs. 400) = Rs. 40,000.

Therefore a provision of Rs. 40,000 would be appropriate.

Q 6 X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at Rs. 50,00,000, the present value of which is Rs. 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation?

Ans: The obligation should be measured at the present value of outflows i.e., Rs. 30,00,000. Further a risk adjustment of 5% i.e., Rs. 1,50,000 (Rs. 30,00,000 x 5%) would be made.

So, the liability will be recognised at = Rs. 30,00,000 + Rs.1,50,000 = Rs. 31,50,000.

Q 7: X Chemicals Ltd. engaged in the chemical industry causes environmental damage by dumping waste in the river near its factory. It does not clean up because there is no environmental legislation requiring cleaning up and X Chemicals Ltd. is causing damage for last 40 years. As at March 31, 20X2, the State Legislature has passed a path breaking legislation requiring all polluting factories to clean-up the river water already contaminated. The formal Gazette notification of the law is pending. How should X Chemicals Ltd. deal with this situation?

Ans: The obligating event is the contamination of water and because of the virtually certainty of legislation requiring cleaning up, an outflow of resources is certain. It is possible to arrive at best estimated cost for the cleanup activity. So, a provision should be recognised in the books of X Chemicals Ltd. for 20X1-20X2.

Q 8 X Beauty Solutions Ltd. is selling cosmetic products under its brand name 'B', but it is getting its product manufactured from Y Ltd. It has an understanding with Y Ltd. that if the company becomes liable for any damage claims, due to any injury or harm to the customer of the cosmetic products, 30% will be reimbursed to it by Y Ltd. During the financial year 20X1-20X2, a claim of Rs. 30,00,000 demanded by customers from X Beauty Solutions Ltd. How should X Beauty Solutions Ltd. account for the claim that becomes payable?

Ans: X Beauty Solutions Ltd. will get reimbursement of Rs. 9,00,000 (Rs. 30,00,000 x 30%) from Y Ltd. So, X Beauty Solutions Ltd. should make a provision of Rs. 21,00,000 (Rs. 30,00,000 - Rs. 9,00,000) in financial year 20X1-20X2 and disclose a contingent liability of Rs. 9,00,000. The contingent liability is recognised keeping in view the fact that in case Y Ltd. does not pay, then X Beauty Solutions Ltd. will be liable for the whole claim.

Q 9: X Telecom Ltd. has income tax litigation pending before appellate authorities. Legal advisor's opinion is that X Telecom Ltd. will lose the case and estimated that liability of Rs. 1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at

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which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years. How should X Telecom Ltd. calculate the amount of borrowing cost?

Ans: The discount factor of 10% for 2 years is 0.827. X Telecom Ltd. will initially recognise provision for Rs. 82,70,000 (Rs. 1,00,00,000 x 0.827).

The discount factor of 10% at the end of year 1 is 0.909. At the end of year 1, provision amount would be Rs. 90,90,000 (Rs. 1,00,00,000 x 0.909).

As per the standard, the difference between the two present values i.e., Rs. 8,20,000 is recognised as a borrowing cost in year 1.

At the end of the Year 2, the liability would be Rs. 1,00,00,000.

The difference between the two present values i.e., Rs. 9,10,000 (Rs. 1,00,00,000 - Rs. 90,90,000) is recognised as borrowing cost in year 2.

Q 10: X Packaging Ltd. has two segments, packaging division and paper division. In March 20X1, the board of directors approved and announced a formal plan to sell the paper division in June 20X1. Operating losses of the paper division are estimated to be approximately Rs. 50,00,000 during the period from April 1, 20X1 to the expected date of disposal. Management of X Packaging Ltd. wants to include the future operating loss of Rs. 50,00,000 in a provision for restructuring in the financial statements for the period ended March 31, 20X1. Can X Packaging Ltd. include these operating losses in a provision for restructuring?

Ans: Standard states that provision should not be made for future operating losses. Since Ind AS 37 prohibits the recognition of future operating losses, so X Packaging Ltd. should not include these future operating losses in a provision for restructuring even though these losses relate to the disposal group.

Q 11 X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at Rs. 50 per unit at a contract price of Rs. 5,00,000. As per the terms of contract, X Metals Ltd. would have to pay Rs. 60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at Rs. 45 per unit.

How should X Metals Ltd. account for this transaction in its books of account in respect of the above contract?

Ans: These circumstances do indicate an onerous contract. The only benefit to be derived from the purchase contract costing Rs. 5,00,000 are the proceeds from the sale contact, which are Rs. 4,50,000. Therefore, a provision should be made for the onerous element of Rs. 50,000, being the lower of cost of fulfilling the contract and the penal cost of cancellation of Rs. 60,000.

Q 12: X Cements Ltd. has three manufacturing units situated in three different states of India. The board of directors of X Cements Ltd., in their meeting held on January 10, 20X1, decided to close down its operations in one particular state on account of environmental reasons. A detailed formal plan for shutting down the above unit was also formalised and agreed by the board of directors in that meeting, which specifies the approximate number of employees who will be compensated and expenditure expected to be incurred. Date of implementation of plan has also been mentioned. Meetings were also held with customers, suppliers, and

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workers to communicate the features of the formal plan to close down the operations in the said state, and representatives of all interested parties were present in those meetings. Do the actions of the board of directors create a constructive obligation that needs a provision for restructuring? [ICAI SM]

Ans: As per Ind AS 37, the conditions prescribed are:

(a) there should be detailed formal plan of restructuring;

(b) which should have raised valid expectations in the minds of those affected that the entity would carry out the restructuring by announcing the main features of its plans to restructure.

The board of directors did discuss and formalise a formal plan of winding up the operation in the above said state. This plan was communicated to the parties affected and created a valid expectation in their minds that X Cements Ltd. would go ahead with its plans to close down operations in that state. Thus, there is a constructive obligation that needs to be provided at year-end.

Q 13 In 2017, an entity involved in nuclear activities recognises a provision for decommissioning costs of Rs. 300 million. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced. Draft the note.

Ans: A provision of Rs. 300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2077 and 2087; however, there is a possibility that decommissioning will not take place until 2117–2127. If the costs were measured based upon the expectation that they would not be incurred until 2117–2127 the provision would be reduced to Rs. 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.

Q 14 An entity is involved in a dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of Rs. 100 million. The entity recognises a provision for its best estimate of the obligation, but discloses none of the information required by the standard. Draft the note.

Ans: Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of Rs. 100 million. The information usually required by Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The directors are of the opinion that the claim can be successfully resisted by the company.

Q 15 X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of Rs. 1,00,00,000

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against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had more than 50% chance of winning the appeal. Please advise how the company should account for these transactions in the financial year 20X1-20X2.

Ans: Ind AS 37 provides that in rare cases it not clear whether there is a present obligation, for example, in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity should determine whether a present obligation exits at the end of the reporting period by taking account of all available evidence, for example, the opinion of experts.

In the present case, the company is not confident that whether it would win the appeal. By taking into account the opinion of the legal counsel, it is not sure that whether the company would win the appeal. On the basis of such evidence, it is more likely than not that a present obligation exists at the end of the reporting period. Therefore, the entity should recognise a provision. The company should provide for a liability of Rs. 1,00,00,000.

Q 16 An entity is a telecom operator. Laying of cables across the world is a requirement to enable the entity to run its business. Cables are also laid under the sea and contracts are entered into for the same. By virtue of laws of the countries through which the cable passes, the entity is required to restore the sea bed at the end of the contract period. What is the nature of obligation that the entity has in such a case?

Ans: Paragraph 14 of Ind AS 37 states "A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

Further, with regard to past event paragraph 17 of Ind AS 37 states "A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

On the basis of the above, provision should be recognised as soon as the obligating event takes place because the entity is under legal obligation to restore the sea bed, provided the other recognition criteria stated in paragraph 14 reproduced above are met. Moreover, the amount of the provision would depend on the extent of the obligation arising from the obligating event. In the instant case, an obligating event is the laying of cables under the sea.

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To the extent the cables have been laid down under the sea, a legal obligation has arisen and to that extent provision for restoration of sea bed should be recognised.

Q 17 Entity A is a dealer in washing machines. Entity A offers to its customers a scheme whereby it states that after a period of 3 years, the entity offers to buy back the washing machine at a fixed price which is expected to be less than the fair value of the machine at the end of three years. The credit emanating the refrom will be required to be used by the customer for buying a new washing machine, i.e., new washing machine will be sold at a discounted price.

Past experience indicates that customers generally opt for this scheme. At the time of sale of the first washing machine should entity A recognise any provision in this regard?**[ICAI SM]**

Ans: In the instant case, assuming that the entity recognises the entire revenue on the sale of first washing machine, a provision for expected cost of meeting the obligation of selling the second machine at discounted price should be recognised because sale of first washing machine is the past event.

Moreover, past experience indicates that customers generally opt for this scheme, therefore, probability of outflow of resources is more likely than not. Since it is a normal practice which the entity follows, reliable estimate of the amount of meeting the obligation can also be made.

QUESTIONS FROM RTP/MTP/EXAMS

Q 18. U Ltd. is a large conglomerate with a number of subsidiaries. It is preparing consolidated financial statements as on 31st March 2018 as per the notified Ind AS. The financial statements are due to be authorised for issue on 15th May 2018. It is seeking your assistance for some transactions that have taken place in some of its subsidiaries during the year.

G Ltd. is a wholly owned subsidiary of U Ltd. engaged in management consultancy services. On 31st January 2018, the board of directors of U Ltd. decided to discontinue the business of G Ltd. from 30th April 2018. They made a public announcement of their decision on 15th February 2018

G Ltd. does not have many assets or liabilities and it is estimated that the outstanding trade receivables and payables would be settled by 31st May 2018. U Ltd. would collect any amounts still owed by G Ltd's customers after 31st May 2018. They have offered the employees of G Ltd. termination payments or alternative employment opportunities.

Following are some of the details relating to G Ltd.

- On the date of public announcement, it is estimated by G Ltd. that it would have to pay 540 lakhs as termination payments to employees and the costs for relocation of employees who would remain with the Group would be Rs. 60 lakhs. The actual termination payments totalling to Rs. 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the total relocation cost is Rs. 63 lakhs.
- G Ltd. had taken a property on operating lease, which was expiring on 31st March 2022. The present value of the future lease rentals (using an appropriate discount rate) is Rs. 430 lakhs. On 15th May 2018, G Ltd. made a payment to the lessor of Rs. 410 lakhs in return for early termination of the lease.

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The loss after tax of G Ltd. for the year ended 31st March 2018 was Rs. 400 lakhs. G Ltd. made further operating losses totalling Rs. 60 lakhs till 30th April 2018.

How should U Ltd. present the decision to discontinue the business of G Ltd. in its consolidated statement of comprehensive income as per Ind AS?

What are the provisions that the Company is required to make as per lnd AS 37?

Ans: A discontinued operation is one that is discontinued in the period or classified as held for sale at the year end. The operations of G Ltd were discontinued on 30th April 2018 and therefore, would be treated as discontinued operation for the year ending 31st March 2019. It does not meet the criteria for held for sale since the company is terminating its business and does not hold these for sale.

Accordingly, the results of G Ltd will be included on a line-by-line basis in the consolidated statement of comprehensive income as part of the profit from continuing operations of U Ltd for the year ending 31st March 2018.

As per para 72 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', restructuring includes sale or termination of a line of business. A constructive obligation to restructure arises when:

(a) an entity has a detailed formal plan for the restructuring

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

The Board of directors of U Ltd have decided to terminate the operations of G Ltd. from 30th April 2018. They have made a formal announcement on 15th February 2018, thus creating a valid expectation that the termination will be implemented. This creates a constructive obligation on the company and requires provisions for restructuring.

A restructuring provision includes only the direct expenditures arising from the restructuring that are necessarily entailed by the restructuring and are not associated with the ongoing activities of the entity.

The termination payments fulfil the above condition. As per Ind AS 10 'Events after Reporting Date', events that provide additional evidence of conditions existing at the reporting date should be reflected in the financial statements. Therefore, the company should make a provision for Rs. 520 lakhs in this respect.

The relocation costs relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Hence, these would be recognised on the same basis as if they arose independently of a restructuring.

The operating lease would be regarded as an onerous contract. A provision would be made at the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. Hence, a provision shall be made for Rs. 410 lakhs.

Further operating losses relate to future events and do not form a part of the closure provision.

Therefore, the total provision required = Rs. 520 lakhs + Rs. 410 lakhs = Rs. 930 lakhs

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Q 19. During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2016 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2016, the Company commenced legal action against F claiming damages in respect of the supply of defec tive raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2016, QA Ltd. has estimated that the damages it would have to pay K would be Rs. 5 crores. This estimate was revised to Rs. 5.2 crores as on 31st March, 2017 and Rs. 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of Rs. 5.3 crores to K.

On 1st December, 2016, QA Ltd. had estimated that it would receive damages of Rs. 3.5 crores from F. This estimate was revised to Rs. 3.6 crores as at 31st March, 2017 and Rs. 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid Rs. 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31 st March, 2017, provided Rs. 3.6 crores as the financial statements were approved by the Board of Directors on 26th April, 2017.

(i) Whether the Company is required to make provision for the claim from customer K as per applicable Ind AS? If yes, please give the rationale for the same.

(ii) If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2017? Give brief reasoning for your choice.

(A)	Statement of Profit and Loss A/c	Dr. Rs. 5.2 crores	
	To Current Liability A/c		Rs. 5.2 crores
(B)	Statement of Profit and Loss A/c	Dr. Rs. 5.3 crores	
	To Non-Current Liability A/c		Rs. 5.3 crores
(C)	Statement of Profit and Loss A/c	Dr.Rs. 5.25 crores	
	To Current Liability A/c		Rs. 5.25 crores

(iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS?

Ans (i) Yes, QA Ltd. is required to make provision for the claim from customer K as per Ind AS 37 since the claim is a present obligation as a result of delivery of faulty goods manufactured. Also, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations. Further, a reliable estimate of Rs. 5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31st March, 2017.

(ii) Option (A) : Statement of Profit and Loss A/c Dr. Rs. 5.2 crore

To Current Liability A/c Rs. 5.2 crore

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(iii) As per para 31 of Ind AS 37, QA Ltd. shall not recognise a contingent asset. Here the probability of success of legal action is very high but there is no concrete evidence which makes the inflow virtually certain. Hence, it will be considered as contingent asset only and shall not be recognized.

Q 20. Sun Limited has entered into a binding agreement with Moon Limited to buy a custom-made machine for Rs. 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry. **[Nov 2018]**

Ans: As per Ind AS 37, Executory contracts are contracts under which

- neither party has performed any of its obligations; or
- both parties have partially performed their obligations to an equal extent.

The contract entered by Sun Ltd. is an executory contract, since the delivery has not yet taken place.

Ind AS 37 is applied to executory contracts only if they are onerous.

Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

As per the facts given in the question, Sun Ltd. will not require the machine ordered. However, since it is a binding agreement, the entity cannot exit / cancel the agreement. Further, Sun Ltd. has to scrap the machine after delivery at nil scrap value.

These circumstances do indicate that the agreement/contract is an onerous contract. Therefore, a provision should be made for the onerous element of Rs. 4,00,000 ie the full cost of the machine.

Onerous Contract Provision Expense A/c	Dr.	4,00,000	
To Provision for Onerous Contract Liability A/c			4,00,000
(Being asset to be received due to binding agreement recognized)			
Profit and Loss Account (Loss due to onerous contract)	Dr.	4,00,000	
To Onerous Contract Provision Expense A/c			4,00,000
(Being loss due to onerous contract recognized and asset derecognsied)			

QUESTIONS FROM OTHER SOURCE

Q 21 At the end of the financial year ending on 31st December, 2007, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (Rs)

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In respect of five cases		
- Win	100%	---
Next ten cases		
- Win	60%	---
- Lose (Low damages)	30%	1,20,000
- Lose (High damages)	10%	2,00,000
Remaining five cases		
- Win	50%	---
- Lose (Low damages)	30%	1,00,000
- Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof. **[May 2010]**

Ans: In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per IND AS 37, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

Expected loss in next ten cases = 30% of Rs 1,20,000 + 10% of Rs 2,00,000

= Rs 36,000 + Rs 20,000 = Rs 56,000

Expected loss in remaining five cases = 30% of Rs 1,00,000 + 20% of Rs 2,10,000

= Rs 30,000 + Rs 42,000 = Rs 72,000

To disclose contingent liability on the basis of maximum loss will be highly unrealistic.

Therefore, the better approach will be to disclose the overall expected loss of Rs 9,20,000 (Rs 56,000 X 10 + Rs 72,000 X 5) as contingent liability.

Q 22 An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year :	2% provision
More than 1 year :	3% provision

The company has raised invoices as under:

Invoice Date	Amount Rs.
19th January, 2011	40,000
29th January, 2012	25,000

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15th October, 2012 90,000

Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31stMarch, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013. **[May 2013]**

Ans: Provision to be made for warranty under IND AS 37 'Provisions, Contingent Liabilities and Contingent Assets'

As at 31st March, 2012 = Rs. 40,000 x .02 + Rs. 25,000 x .03 = Rs. 800 + Rs. 750 =	Rs. 1,550
As at 31st March, 2013 = Rs. 25,000 x .02 + Rs. 90,000 x .03 = Rs. 500 + Rs. 2,700 =	Rs. 3,200
Amount debited to Profit and Loss Account for year ended 31st March, 2013	Rs.
Balance of provision required as on 31.03.2013	3,200
Less: Opening Balance as on 1.4.2012	(1,550)
Amount debited to profit and loss account	1,650

Q 23 Sun Ltd. has entered into a sale contract of Rs. 5 crores with X Ltd. during 2009-10 financial year. The profit on this transaction is Rs 1 crore. The delivery of goods to take place during the first month of 2010-11 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2009-10 financial years. As on balance sheet date (31.3.2010), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation. Should Sun Ltd. provide for contingency as per IND AS 37?

Ans: IND AS 37 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs 1.5 crores as per IND AS 37.

Q 24: Mini Ltd. took a factory premises on lease on 1.4.07 for Rs. 2,00,000 per month. The lease is operating lease. During March, 2008, Mini Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2010. The lease cannot be cancelled and cannot be sub–let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2010 should be provided in the accounts for the year ending 31.3.2008. Mini Ltd. seeks your advice.

Ans: In accordance with IND AS 37 'Provisions, Contingent Liabilities and Contingent Assets', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous as the economic benefit of lease contract for next 33 months up to 31.12.2010 will be nil. However, the lessee, Mini Ltd., has to pay lease rent of Rs 66,00,000 (i.e.2,00,000 p.m. for next 33 months). Therefore, provision on account of Rs.66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right

Q 25 A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of Rs. 900 lakhs. The directors are of the

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opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?

Ans: A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits is remote in the given situation, since the directors of WZW Ltd. are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability.

Q 26 M/s. Shishir Ltd., a public Sector Company, provides consultancy and engineering services to its clients. In the year 2014-15, the Government set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 1250 lakhs for pay revision in the financial year 2014-15 on the estimated basis as the report of the commission is yet to come. As per the contracts with client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

"Salaries and benefits include the provision of Rs. 1250 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made."

The Accountant feels that the company should also book/recognize the income by Rs. 1250 lakhs in Profit & Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant Accounting Standards.

Ans: As per IND AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists.

In this case, the provision of salary to employees of Rs. 1,250 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 1,250 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 1,250 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of Rs. 1,250 lakhs is not as per IND AS 37 and also the concept of prudence will not be followed if Rs. 1,250 lakhs is simultaneously recognized as income. Rs. 1,250 lakhs is not the revenue at present but only

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reimbursement of claim for which an asset is created. However the accountant incorrect to the extent as that non- recognition of Rs. 1,250 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Q 27 Quick Ltd. is a company engaged in the trading of spare parts used in the repair of automobiles. The company has been regular in depositing the tax, as such there is no liability of Income Tax etc. for the Financial Year 2012-13.

The figures for the year are as under:

Income chargeable to tax	Rs. 211.64 lakhs
Total income after adjustments	Rs. 228.48 lakhs
Tax thereon	Rs. 74.13 lakhs
TDS deducted during the year	Rs. 30.45 lakhs
Tax paid for the year	Rs. 43.68 lakhs

The company has prepared its Balance Sheet as per above figures. However, during the assessment proceeding held before the finalization of the Balance Sheet the Income Tax Officer has issued demand of Rs. 7.52 lakhs, insisting that this amount of TDS has not been uploaded online and thus is not acceptable as deduction.

The company has in reply to the same filed a rectification with the Assessing Officer. The company is trying to collect the TDS certificates, but Rs. 2.39 lakhs deducted by XY LTD., is not traceable. The rectification is lying pending with the Assessing Officer.

Please suggest the treatment of Rs. 2.39 lakhs and Rs. 7.52 lakhs in Balance Sheet.

Ans: As per IND AS 37 'Provisions, Contingent Liabilities and Contingent Assets', a contingent liability is: (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) a reliable estimate of the amount of the obligation cannot be made. An obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

In the given case, TDS shall be allowed by the IT department on submission of duplicate TDS certificates. Since the company is making efforts and is hopeful for its ultimate collection, contingent liability will be made for Rs. 2.39 lakhs in the books of account.

Further as per the standard, where it is more likely that no present obligation exists at the balance sheet date and the possibility of an outflow of resources embodying economic benefits is remote, no contingent liability is disclosed.

TDS certificates for Rs. 5.13 lakhs (Rs. 7.52 lakhs less Rs. 2.39 lakhs) have been submitted and the company has filed a rectification with the Assessing Officer. Therefore, the possibility of an outflow of resources embodying economic benefits is remote; the company shall not

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disclose it as contingent liability. This amount should be disclosed by way of a note to the accounts.

Q 28: A company, incorporated under Section 8 of the Companies Act, 2013, have main objective to promote the trade by organizing trade fairs / exhibitions. When company was organizing the trade fair and exhibitions it decided to charge 5%contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies,5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visit the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
2. A suitable disclosure to this effect is also made in the notes forming part of accounts.

Required:

(i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with IND AS 37.

(ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet. **[RTP]**

Ans:

(i) IND AS 37 "Provisions, Contingent Liabilities and Contingent Assets “states that a provision should be recognised when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

From the above, it is clear that in the contingencies considered by the company, neither a present obligation exists as a result of past event, nor are liable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognised for such contingencies under the facts and circumstances of the case.

(ii) "Provision" is the amount retained by the way of providing for any known liability. Since the contingencies stipulated by the company are not known at the balance sheet date, the provision in this regard cannot be created. Therefore, the provision so created by the company shall be treated as a ‘Reserve’.

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Q 29: Lucky P Limited has been assessed to Income-tax, in which a demand of Rs. 10 lacs has-been made. The company has gone in appeal. The company has deposited Rs. 6.00 lacs against the demand, on being pursued by the department. The company has been advised by its counsel that there is 80% chance of losing in respect of one of the grounds which may end up confirming the demand of Rs. 4.00 lacs, while on other grounds, there is fair chance of winning the appeal. How the company should treat the same while preparing the final accounts for the year ending 31st March, 2015?

Ans: In the given case, there is a present obligation of demand of Rs.10 lacs raised by the Income-tax department. As per the advise by the counsel, the outflow of resources up to Rs. 4 lacs is more likely to happen to settle the obligation since there is 80% probability of losing on one ground. Therefore, a provision of Rs. 4 lacs shall be made in the books of account for the year ended 31st March, 2015.

However, in respect of other grounds, there are fair chances of winning the appeal. Thus, no provision is required to be made for the remaining amount of Rs. 6,00,000 and it should be shown as contingent liability in the books of the company while preparing the final accounts for the year ended 31st March, 2015.

The company paid Rs. 6 lacs against demand on being pursued by the department but created a provision of Rs. 4 lacs only. Hence it is expecting to get a refund in due course. Till the final settlement of the case, Rs. 6 lacs paid against income tax demand will appear under the heading 'Non-current/Current Loans and Advances' and 'Provision for taxation' under the heading Long/Short term Provisions', based on the expected date of settlement.

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Events after the Reporting Period (IND AS10)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1

A case is going on between ABC Ltd., and GST department on claiming some exemption for the year 20X1-20X2. The court has issued the order on 15th April, 20X2 and rejected the claim of the company. Accordingly, the company is liable to pay the additional tax. The financial statements of the company for the year 20X1-20X2 have been approved on 15th May, 20X2. Should the company account for such tax in the year 20X1-20X2 or should it account for the same in the year 20X2-20X3?

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

Question 2:

A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of Rs. 4,00,000 each. On 30th April, 20X2, as per the new government rules, higher road tax and penalties are to be paid by the buyers for such cars (which were already expected to come) and hence the selling price of a car has come down and the demand for such cars has dropped drastically. The selling price has come down to Rs. 3,00,000 each. The financial statements of the company for the year 20X1-20X2 are not yet approved. Should the company value its stock at Rs. 4,00,000 each or should it value at Rs. 3,00,000 each? Ignore estimated costs necessary to make the sale. **[ICAI SM]**

Solution: Events after the reporting period provide the evidence about the net realisable value of the cars at the end of the reporting period and, therefore, the amount of Rs. 3,00,000 should be considered for the valuation of stock.

Question 3:

ABC Ltd., has purchased a new machinery during the year 20X1-20X2. The asset was finally installed and made ready for use on 15th March, 20X2. However, the company involved in installation and training, which was also the supplier, has not yet submitted the final bills for the same.

The supplier company sent the bills on 10th April, 20X2, when the financial statements were not yet approved. Should the company adjust the amount of capitalisation in the year 20X1-20X2 or in the year 20X2-20X3?

Answer: As per the provisions of the contract, the cost of installation and training of new machine is an integral part of the cost of asset purchased. Therefore, even if the details are available after reporting period, they provide proof about the circumstances that existed at the end of reporting period. Therefore, the cost of installation and training will be considered for capitalisation in the year 20X1-20X2.

Question 4:

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ABC Ltd., declares the dividend on 15th July, 20X2 as the results of year 20X1-20X2 as well as Q1 ending 30th June, 20X2 are better than expected. The financial statements of the company are approved on 20th July, 20X2 for the financial year ending 31st March, 20X2. Will the dividend be accounted for in the financial year 20X2-20X3 or will it be accounted for in the year 20X1-20X2?

Answer: The dividend is declared in the year 20X2-20X3. Therefore, the obligation towards dividend did not exist at the end date of reporting period i.e., on 31st March, 20X2. Therefore, it will be accounted for in the year 20X2-20X3 and not in 20X1-20X2, even if financial statements for 20X1-20X2 were approved after the declaration of dividend. It will, however, be disclosed in the notes in the financial statements for the year 20X1-20X2 in accordance with Ind AS 1

Question 5:

ABC Ltd. has announced its Interim results for Quarter 1, ending 30th June 20X2 on 5th July 20X2. However, till that time the AGM for the year 20X1-20X2 was not held. The accounts for 20X1-20X2 were approved by the board of directors on 15th July 20X2. What will be the period after the reporting date as per the definition of Ind AS 10?

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

Question 6:

ABC Ltd. is in the legal suit with the excise department. Company gets a court order in its favour, on 15th April 20X2, which resulted into reducing the excise liability as on 31st March 20X2. The management has not considered the effect of the transaction as the event is favourable to the company. Company's view is favourable events after the reporting date should not be considered as it would hamper the realization concept of accounting. Comment in the light of Ind AS 10? **[ICAI SM]**

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

Question 7:

ABC Ltd. is trading company in Laptops. On 31st March 20X2 company has 50 laptops which were purchased at Rs. 45,000 each. Company has considered the same price for calculation of closing inventory. On 15th April 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to Rs. 35,000 each. Company does not want to value the stock as Rs. 35,000 as the event of reduction took place after the 31st March 20X2 and the reduced prices were not applicable as on 31st March 20X2. Comment

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

Question 8:

JCB manufactures and sales earth moving machines. The machines are dispatched on 25th March 20X2 for exports. The machines reached the customer on 15th April 20X2. The details of the price of sale, foreign exchange rate etc. are available on 4th April 20X2. The accounts were approved by the

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management on 15th May 20X2. Shall company consider it as the sale of 20X1-20X2 and adjust the accounts for the information received on 4th April or not?

Answer: As per Ind AS 10, any information received after the reporting period for determining purchase of cost or sale of asset, related to earlier financial year, should be considered as an adjusting event.

QUESTIONS FROM RTP/MTP/EXAMS

Question 9:

XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 2013-2014, 2014-2015, 2015-2016 and 2016-2017. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 2017, the company failed to bag any of these. Its only activity till date is publication of Pune directory. The contract for publication of directories for Pune will expire on 31st December 2017. The financial statements for the F.Y. 2016-17 have been approved by the Board of Directors on July 10, 2017. Whether it is appropriate to prepare financial statements on going concern basis? **[RTP May 2019]**

Answer:

With regard to going concern basis to be followed for preparation of financial statements, Ind AS 10 provides as follows:

"An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting."

In accordance with the above, an entity needs to change the basis of accounting if the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

In the instant case, since contract is expiring on 31st December 2017 and it is confirmed on 23rd April, 2017, i.e., after the end of the reporting period and before the approval of the financial statements, that no further contact is secured, implies that the entity's operations are expected to come to an end. Accordingly, if entity's operations are expected to come to an end, the entity needs to make a judgement as to whether it has any realistic possibility to continue or not. In case, the entity determines that it has no realistic alternative of continuing the business, preparation of financial statements for 2016-17 and thereafter on going concern basis may not be appropriate.

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Valuation of Inventories (IND AS 2)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1: Cost of Inventory

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:

1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.

Ans: Items number 1, 2, 6, 7, 8, 9, 10 are allowed by Ind AS 2 for the calculation of cost of inventories. Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

Q 2 Night Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:

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

(ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per IND AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

Ans: Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Night Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

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As per IND AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Stock of empty bottles existing on the Balance Sheet date is the inventory and Night Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence stock of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with IND AS 2.

Q 3. In a manufacturing process of Vijoy Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount (Rs.)	Output (unit)	Closing stock as on 31-03-2012
Raw material	15,000	1,60,000	MP1-6,250	800
Wages	-	82,000	MP2- 5,000	200
Fixed overhead	-	58,000	BP-1,600	-
Variable overhead	-	40,000		-

Average market price of MP1 and MP2 is Rs. 80 per unit and Rs. 50 per unit respectively, by product is sold @ Rs. 25 per unit. There is a profit of Rs. 5,000 on sale of by-product after incurring separate processing charges of Rs. 4,000 and packing charges of Rs. 6,000, Rs. 6,000 was realised from sale of scrap.

Calculate the value of closing stock of MP1 and MP2 as on 31-03-2012. **[ICAI SM]**

Ans: As per IND AS 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1.	**Calculation of net realizable value of by-product, BP**		**Rs**
	Selling price of by-product BP (1,600 units x RRs. 25 per unit)		40,000
	Less: Separate processing charges of by- product BP		(4,000)
	Packing charges		(6,000)
	Net realizable value of by-product BP		30,000
2.	**Calculation of cost of conversion for allocation between joint products MP1 and MP2**		
		Rs.	Rs.
	Raw material		1,60,000
	Wages		82,000
	Fixed overhead		58,000
	Variable overhead		40,000
		3,40,000	
	Less: NRV of by-product BP (See calculation 1)	(30,000)	
	Sale value of scrap	(6,000)	(36,000)
	Joint cost to be allocated between MP1 and MP2		3,04,000
3.	**Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2**		
		MP1	MP2
	Output in units (a)	6,250 units	5,000 units

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	Sales price per unit (b)	Rs. 80	Rs. 50
	Sales value (a x b)	Rs. 5,00,000	Rs.2,50,000
	Ratio of allocation	2	1
	Joint cost of Rs. 3,04,000 allocated in the ratio of 2:1 (c)	Rs. 2,02,667	Rs. 1,01,333
	Cost per unit [c/a]	Rs. 32.43	Rs. 20.27
4.	**Determination of value of closing stock of MP1 and MP2**		
		MP1	MP2
	Closing stock in units	800 units	200 units
	Cost per unit	Rs. 32.43	Rs. 20.27
	Value of closing stock	Rs. 25,944	Rs.4,054

Q 4 Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

(a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department. The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

(b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the head office factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Ans:

(a) The retail method can be used for measuring inventories of the beauty products. The cost of the inventory is determined by taking the selling price of the cosmetics and reducing it by the gross margin of 65% to arrive at the cost.

(b) The handbags can be measured using standard cost especially if the results approximate cost. Given that The company has the information reliably on hand in relation to direct materials, direct labour, direct expenses and overheads, it would be the best method to use to arrive at the cost of inventories.

Q 5: UA Ltd. purchased raw material @ Rs. 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having

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10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is Rs. 300 per kg. How will you value the inventory of raw material?

Ans: As per Ind AS 2 "Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, UA Ltd. will value the inventory of raw material at Rs. 30,00,000 (10,000 kg. @ Rs. 300 per kg.).

Q 6: Sun Ltd. has fabricated special equipment (solar power panel) during 2014-15 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-2016 are as follows:

Solar power panel (WIP) Rs. 85 lakhs

Solar power panel (finished products) Rs. 55 lakhs

Sundry Debtor (solar power panel) Rs. 65 lakhs

The petition for winding up against the customer has been filed during 2015-16 by Sun Ltd.

Comment with explanation on provision to be made of Rs. 205 lakh included in Sundry Debtors, Finished Goods and Work-in-progress in the financial statements of 2015-16.

Ans: From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per IND AS 2 'Valuation of Inventories', inventories are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in IND AS 2i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per IND AS 2for Rs. 140 lakhs [i.e solar power panel (WIP) Rs. 85 lakhs + solar power panel (finished products) Rs. 55 lakhs].

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Note: Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 2015-16, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for Rs. 65 lakhs shall be made in the books against the debtors amount.

Q 7: Mercury Ltd. uses a periodic inventory system. The following information relates to 20X1-20X2.

Date	Particular	Unit	Cost p.u.	Total Cost
April	Inventory	200	10	2,000
May	Purchases	50	11	550
September	Purchases	400	12	4,800
February	Purchases	350	14	4,900
Total		1,000		12,250

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

(a) FIFO

(b) Weighted Average

Ans: FIFO inventory 31.03.20X2

Cost of Sales

350 @14 =	4,900
50 @ 12 =	600
	5,500
12,250-5,500 =	6,750

Weighted average cost per item

Weighted average inventory at 31.03.20X2

Cost of sales 20X1-20X2

12,250/1000 =	12.25
400 x 12.25 =	4,900
12,250-4,900 =	7,350

QUESTIONS FROM RTP/MTP/EXAMS

Q 8 On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was Rs. 10 million

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and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is Rs. 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to Rs. 8 million. The estimated selling expense required to make the sales would Rs. 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1.

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

What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2 **[RTP May 2018]**

Ans: As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as 'adjusting events'.

(a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be Rs. 10 million and net realisable value would be Rs. 7.5 million (i.e. Expected selling price Rs. 8 million- estimated selling expenses Rs. 0.5 million). Accordingly, inventory shall be measured at Rs. 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of Rs. 2.5 million would be recorded in income statement of that year.

(b) As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is Rs. 1 million and net realisable value would be Rs. 10. 5 million (i.e. expected selling price Rs. 11 million – estimated selling expense Rs. 0.5 million). Accordingly, inventory would be recorded at Rs. 10 million and inventory write down carried out in previous year for Rs. 2.5 million shall be reversed.

Q 9 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 Rs. 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs. 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs. 2 lakhs on repairing and re- packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of Rs. 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: Rs. lakhs

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Cost	8.00
Net realisable value (9.6 -2)	7.60
Inventories (lower of cost and net realisable value)	7.60

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 alongwith working for the same.

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

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

Further, paragraph 6 of Ind AS 2 defines:

"Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that:

"Inventories shall be measured at the lower of cost and net realisable value".

Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.

Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of Rs. 8 lakhs calculated below:

	Rs.' lakhs
Cost	8.00

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Net realisable value 9.60

Q 10 Inventories (lower of cost and net realisable value)8.00XYZ Limited has a plant with the normal capacity to produce 10,00,000 units of a product per annum and the expected fixed overhead is Rs. 30,00,000, Fixed overhead, therefore based on normal capacity is Rs. 3 per unit.

Determine Fixed overhead as per Ind AS 2 'Inventories' if

(i) Actual production is 7,50,000 units.

(ii) Actual production is 15,00,000 units. **[May 2018]**

Ans: **Actual production is 7,50,000 units:** Fixed overhead is not going to change with the change in output and will remain constant at Rs. 30,00,000, therefore, overheads on actual basis is Rs. 4 per unit (30,00,000 / 7,50,000).

Hence, by valuing inventory at Rs. 4 each for fixed overhead purpose, it will be overvalued and the losses of Rs. 7,50,000 will also be included in closing inventory leading to a higher gross profit then actually earned.

Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) Rs. 22,50,000 and balance Rs. 7,50,000 shall be transferred to Profit & Loss Account.

Actual production is 15,00,000 units: Fixed overhead is not going to change with the change in output and will remain constant at Rs. 30,00,000, therefore, overheads on actual basis is Rs. 2 (30,00,000 / 15,00,000).

Hence by valuing inventory at Rs. 3 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At Rs. 3 per unit, total fixed overhead comes to Rs. 45,00,000 whereas, actual fixed overhead expense is only Rs. 30,00,000. Therefore, it is advisable to include fixed overhead on actual basis (15,00,000 x 2) Rs. 30,00,000.

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Property, Plant and Equipment (IND AS 16)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of Rs. 5,00,000 to install machinery in the new location.
2. Rent of Rs. 15,00,000
3. Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building?

Ans: Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company do not meet the requirement of IND AS 16 and therefore, cannot be capitalised.

Q 2 Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed.

Management has prepared the budget for this period including expenditure related to construction and remodelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

Ans: Management should capitalise the costs of construction and remodelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the remodelling expenditure, and thus the expenditure should be considered part of the asset.

However, the cost of salaries, utilities and storage of goods are operating expenditures that would be incurred if the supermarket was open. These costs are not necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management and should be expensed.

Q 3 An amusement park has a 'soft' opening to the public, to trial run its attractions. Tickets are sold at a 50% discount during this period and the operating capacity is 80%. The official opening day of the amusement park is three months later. Management claim that the soft opening is a trial run necessary for the amusement park to be in the condition capable of operating in the intended manner. Accordingly, the net operating costs incurred should be capitalised. Comment.

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Ans: The net operating costs should not be capitalised, but should be recognised in the Statement of Profit and Loss.

Even though it is running at less than full operating capacity (in this case 80% of operating capacity), there is sufficient evidence that the amusement park is capable of operating in the manner intended by management. Therefore, these costs are specific to the start-up and, therefore, should be expensed as incurred.

Q 4. MS Ltd. has acquired a heavy machinery at a cost of Rs. 1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is Rs. 45,00,000.

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

Ans: The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset. The original invoice for the machine did not specify the cost of the turbine; however, the cost of the replacement — Rs. 45,00,000 — can be used as an indication (usually by discounting) of the likely cost, six years previously.

If an appropriate discount rate is 5% per annum, Rs. 45,00,000 discounted back six years amounts to Rs. 33,57,900 [Rs. 45,00,000/(1.05)6], i.e., the approximate cost of turbine before 6 years.

The current carrying amount of the turbine which is required to be replaced of Rs. 13,43,160 would be derecognised from the books of account, (i.e., Original Cost Rs. 33,57,900 as reduced by accumulated depreciation for past 6 years Rs. 20,14,740, assuming depreciation is charged on straight-line basis.)

The cost of the new turbine, Rs. 45,00,000 would be added to the cost of machine, resulting in a revision of carrying amount of machine to Rs. 71,56,840. (i.e., Rs. 40,00,000* – Rs. 13,43,160 + Rs. 45,00,000).

*Original cost of machine Rs. 1,00,00,000 reduced by accumulated depreciation (till the end of 6 years) Rs. 60,00,000.

Q 5 On 1st April 20X1, an item of property is offered for sale at Rs. 10 million, with payment terms being three equal installments of Rs. 33,33,333 over a two years period (payments are made on 1st April 20X1, 31st March 20X2 and 31st March 20X3).

The property developer is offering a discount of 5 percent (i.e. Rs0.5 million) if payment is made in full at the time of completion of sale. Implicit interest rate of 5.36 percent p.a.

Show how the property will be recorded in accordance of Ind AS 16.

Ans: Ind AS 16 requires that the cost of an item of PPE is the cash price equivalent at the recognition date. Hence, the purchaser that takes up the deferred payment terms will recognise the acquisition of the asset as follows:

On 1st April 20X1	(INR)	(INR)
Property, Plant and Equipment Dr.	95,00,000	
To Cash		33,33,333

To Accounts Payable (Initial recognition of property)		61,66,667
On 31st March 20X2 Interest Expense Dr. Accounts payable Dr. To Cash (Recognition of interest expense and payment of second installment)	 3,30,533 30,02,800	 33,33,333
On 31st March 20X3 Interest Expense Dr. Accounts payable Dr. To Cash (Recognition of interest expense and payment of final installment)	 1,69,467 31,63,867	 33,33,334

Q 6 Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of Rs. 10 million. The fair value of such asset is Rs. 15 million. It exchanges the land and building for a private jet, which has a fair value of Rs. 18 million, and pays additional Rs. 3 million in cash.

Show the necessary treatment as per Ind AS 16.

Ans: Provided that the transaction has commercial substance, the entity should recognised the private jet at a cost of Rs. 18 million (its fair value) and should recognise a profit on disposal of the land and building of Rs. 5 million, calculated as follow:

	(Rs. 000)
Fair value of Asset acquired	18,000
Less: Carrying amount of land and building disposed	(10,000)
Cash Paid	(3,000)
Profit on exchange of assets	5,000

The required journal entry is therefore as follow:

Property, Plant and Equipment (Private Jet)	Dr.	18,000
To Property, Plant and Equipment (Land and Building)		10,000
To Cash		3,000
To Profit on exchange of assets		5,000

Q 7 Jupiter Ltd. has an item of plant with an initial cost of Rs. 100,000. At the date of revaluation accumulated depreciation amounted to Rs. 55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be Rs. 65,000. Find out the entries to be passed?

Ans: Method – I:

Accumulated depreciation	Dr.	55,000	
To Asset Cost			55,000

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Asset Cost	Dr.	20,000	
To Revaluation reserve			20,000

The net result is that the asset has a carrying amount of Rs. 65,000 (100,000 – 55,000 + 20,000).

Method – II:

Carrying amount (100,000 – 55,000) =	45,000
Fair value (revalued amount)	65,000
Surplus	20,000

% of surplus (20,000/ 45,000) 44.44%

Entries to be Made:

Asset (1,00,000 x 44.44%)	Dr.	44,444	
To Accumulated Depreciation (55,000 x 44.44%)			24,444
To Surplus on Revaluation			20,000

Q 8: Venus Ltd. is a large manufacturing group. It owns a considerable number of industrial buildings, such as factories and warehouses, and office buildings in several capital cities. The industrial buildings are located in industrial zones whereas the office buildings are in central business districts of the cities. Venus's Ltd. management want to apply the Ind AS 16 revaluation model to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. Is this acceptable under Ind AS 16, Property, Plant and Equipment?

Ans: Venus's Ltd. management can apply the revaluation model to just the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location.

Ind AS 16 permits assets to be revalued on a class-by-class basis (Ind AS 16). The different characteristics of the buildings enable them to be classified as different PPE classes. The different measurement models can therefore be applied to these classes for subsequent measurement. All properties within the class of office buildings must therefore be carried at revalued amount. Separate disclosure of the two classes must be given in accordance with Ind AS 16.

Q 9: An item of PPE was purchased for Rs. 9,00,000 on 1 April 20X1. It is estimated to have a useful life of 10 years and is depreciated on a straight line basis. On 1 April 20X3, the asset is revalued to Rs. 9,60,000. The useful life remains unchanged at ten years.

Show the necessary treatment as per Ind AS 16.

Ans: Calculation of Additional Depreciation:

Actual depreciation for 20X3-20X4 based on revalued amount (9,60,000/8)	1,20,000
Depreciation for 20X4-20X5 based on historical cost (9,00,000/10)	(90,000)
Additional Depreciation	30,000

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In the profit or loss for 20X3-20X4, a depreciation expense of Rs. 1,20,000 will be charged. A reserve transfer, which will be shown in the statement of changes in equity, may be undertaken as follows:

Revaluation surplus	Dr.	30,000
To Retained earnings		30,000

The closing balance on the revaluation surplus on 31 March 20X4 will therefore be as follows:

Balance arising on revaluation (9,60,000 – 7,20,000)	2,40,000
Transfer to retained earnings	(30,000)
	2,10,000

Q 10: An asset which cost Rs. 10,000 was estimated to have a useful life of 10 years and residual value Rs. 2000. After two years, useful life was revised to 4 remaining years.

Calculate the depreciation charge.

Ans: INR

	Year-1	Year-2	Year-3
Cost	10,000	10,000	10,000
Less: Accumulated Depreciation	(800)	(1,600)	(3,200)
Carrying Amount	9,200	8,400	6,800
Charges for year	(10,000-2000)/10	(10,000-2000)/10	(8,400-2,000)/4
	800	800	1,600

Q 11: An entity acquired an asset 3 years ago at a cost of Rs. 5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.

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

Show the necessary treatment in accordance of Ind AS 16.

Ans: Change in Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of Ind AS 8 and hence will have a prospective effect.

Depreciation Charges for year 1 to 11 will be as follows:

Year 1	Rs. 500,000
Year 2	Rs. 450,000
Year 3	Rs. 405,000
Year 4 to Year 11	Rs. 456,000 p.a.

Q 12 On April 1, 20X1, XYZ Ltd. acquired a machine under the following terms:

Rs.

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

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on April 20, 20X1. At what cost the asset will be recognised?

Ans: In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the asset should be:

	Rs.
List price	80,00,000
Less: trade discount (10%)	(8,00,000)
	72,00,000
Import duty	5,00,000
Delivery fees	1,00,000
Electrical installation costs	10,00,000
Pre-production testing	4,00,000
Total amount to be capitalised at April 1, 20X1	**92,00,000**

Maintenance contract is a separate contract to get service, therefore, the maintenance contract cost of Rs. 7,00,000 should be taken as a prepaid expense and charged to the profit or loss over a period of 5 years.

In addition the settlement discount received of Rs. 3,60,000 (Rs. 72,00,000 x 5%) is to be shown as other income in the profit or loss.

Q 13 The term of an operating lease allows a tenant, XYZ Ltd. to tailor the property to meet its specific needs by building an additional internal wall, but on condition that the tenant returns the property at the end of the lease in its original state. This will entail dismantling the internal wall. XYZ Ltd. incurs a cost of Rs. 25,00,000 on building the wall and present value of estimated cost to dismantle the wall is Rs. 10,00,000. At what value should the leasehold improvements be capitalised in the books of XYZ Ltd.

Ans: The leasehold improvement is not only the cost of building the wall, but also the cost of restoring the property at the end of the lease. As such both costs i.e., Rs. 35,00,000 are capitalised when the internal wall is built and will be recognised in profit and loss over the useful life of the asset (generally the lease term) as a part of depreciation charge).

Q 14 X Limited started construction on a building for its own use on April 1, 20X0. The following costs are incurred:

	Rs.

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Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000
General overheads	1,00,000

Other relevant information: Material costing Rs. 1,00,000 had been spoiled and therefore wasted and a further Rs. 1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November 20X0 and it is estimated that Rs. 22,000 of the labour cost relate to that period. The building was completed on January 1, 20X1 and brought in use April 1, 20X1. X Limited had taken a loan of Rs. 40,00,000 on April 1, 20X0 for construction of the building (which meets the definition of qualifying asset as per Ind AS 23). The loan carried an interest rate of 8% per annum and is repayable on April 1, 20X2.

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

Ans: Only those costs which are directly attributable to bringing the asset into working condition for its intended use should be included. Administration and general costs cannot be included. Abnormal cost also should be excluded. The cost of spoilt materials and faulty designs are abnormal costs. The labour cost incurred during the stoppage is an abnormal cost and should not to be included. The interest on loan should be capitalised from April 1, 20X0, and capitalisation of interest on loan must cease when the asset is ready to use i.e., January 1, 20X1.

Amount to be included in Property, Plant and Equipment (PPE) :

Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Material (10,00,000 – 2,50,000)	7,50,000
Direct labour cost (4,00,000 – 22,000)	3,78,000
General overheads	Nil
Interest (40,00,000 x 8%) x 9/12	2,40,000
Total to be capitalized	48,18,000

Q 15 XYZ Ltd. purchased an asset on January 1, 20X0, for Rs. 1,00,000 and the asset had an estimated useful life of ten years and a residual value of Rs. nil. The company has charged depreciation using the straight-line method at Rs. 10,000 per annum. On January 1, 20X4, the management of XYZ Ltd. Reviews the estimated life and decides that the asset will probably be useful for a further four years and, therefore, the total life is revised to eight years. How should the asset be accounted for remaining years?

Ans: Change in useful economic life of an asset is change in accounting estimate, which is to be applied prospectively, i.e., the depreciation charge will need to be recalculated. On January

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1, 20X4, when the asset's net book value is Rs. 60,000. The company should amend the annual provision for depreciation to charge the unamortised cost (namely, Rs. 60,000) over the revised remaining life of four years. Consequently, it should charge depreciation for the next four years at Rs. 15,000 per annum.

Q 16 On 1 April 20X1, Sun ltd purchased some land for Rs. 10 million (including legal costs of Rs. 1 million) in order to construct a new factory. Construction work commenced on 1 May 20X1. Sun ltd incurred the following costs in relation with its construction:

– Preparation and levelling of the land – Rs. 3,00,000.

– Purchase of materials for the construction – Rs. 6·08 million in total.

– Employment costs of the construction workers – Rs. 2,00,000 per month.

– Overhead costs incurred directly on the construction of the factory – Rs. 1,00,000 per month.

– Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – Rs. 50,000 per month.

– Income received during the temporary use of the factory premises as a car park during the construction period – Rs. 50,000.

– Costs of relocating employees to work at the new factory – Rs. 300,000.

– Costs of the opening ceremony on 31 January 20X1 – Rs. 150,000.

The factory was completed on 30 November 20X1 and production began on 1 February 20X2. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be Rs. 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Rs. 1 payable in 40 years' time at an annual discount rate of 8% is 4·6 cents.

The construction of the factory was partly financed by a loan of Rs. 17·5 million taken out on 1 April 20X1. The loan was at an annual rate of interest of 6%. During the period 1 April 20X1 to 31 August 20X1 (when the loan proceeds had been fully utilised to finance the construction), Sun Ltd received investment income of Rs. 100,000 on the temporary investment of the proceeds.

Required:

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

[Nov 2018]

Ans: Computation of the cost of the factory

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Description	Included in P.P.E. Rs.'000	Explanation
Purchase of land	10,000	Both the purchase of the land and the associated legal costs are direct costs of constructing the factory.
Preparation and levelling	300	A direct cost of constructing the factory
Materials	6,080	A direct cost of constructing the factory
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a seven-month period
Direct overhead costs	700	A direct cost of constructing the factory for a seven-month period
Allocated overhead costs	Nil	Not a direct cost of construction
Income from use as a car park	Nil	Not essential to the construction so recognised directly in profit or loss
Relocation costs	Nil	Not a direct cost of construction
Opening ceremony	Nil	Not a direct cost of construction
Finance costs	700	Capitalise the interest cost incurred in an eight-month period (purchase of land would trigger off capitalisation)
Investment income on temporary investment of the loan proceeds	(100)	offset against the amount capitalised
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost
Total	20,000	
Computation of accumulated depreciation		
Total depreciable amount	10,000	All of the net finance cost of 600 (700 – 100) has been allocated to the depreciable amount. Also acceptable to reduce by allocating a portion to the non-depreciable land element principle
Depreciation must be in two parts: Depreciation of roof component Depreciation of remainder	50 58	10,000 x 30% x 1/20 x 4/12 10,000 x 70% x 1/40 x 4/12
Total depreciation	108	
Computation of carrying amount	19,892	20,000 – 108

Q 17. ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

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

Ans: According to Ind AS 16, these costs can be capitalized:

1.	Cost of the plant	Rs. 25,00,000

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2.	Initial delivery and handling costs	Rs. 2,00,000
3.	Cost of site preparation	Rs. 6,00,000
4.	Consultants' fees	Rs. 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	Rs. 3,00,000
		Rs. 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of Rs. 2,00,000 and operating losses before commercial production amounting to Rs. 4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Q 18. B Ltd. owns an asset with an original cost of Rs. 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be Rs. 20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to Rs. 10,000.

How would the above changes in estimates be made by B Ltd.?

Ans: The above changes in estimates would be effected in the following manner:

The asset has a carrying amount of Rs. 56,000 at the end of year 8 [Rs. 2,00,000 – Rs. 1,44,000] i.e. Accumulated Depreciation.

Accumulated depreciation is calculated as

Depreciable amount {Cost less residual value} = Rs. 2,00,000 – Rs. 20,000 = Rs. 1,80,000.

Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = Rs. 18,000.

Accumulated depreciation = 18,000 × No. of years (8) = Rs. 1,44,000.

Revision of the useful life to 12 years results in a remaining useful life of 4 years (12 – 8).

The revised depreciable amount is Rs. 46,000. (56,000 – 10,000)

Thus, depreciation should be charged in future at Rs. 11,500 per annum (Rs. 46,000/4 years).

Q 19. X Ltd. has a machine which got damaged due to fire as on January 31, 20X1. The carrying amount of machine was Rs. 1,00,000 on that date. X Ltd. sold the damaged asset as scrap for Rs. 10,000. X Ltd. has insured the same asset against damage. As on March 31, 20X1, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of Rs. 50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?

Ans: Impairment or losses of items of property, plant and equipment and related claims for or payments of compensation from third parties are separate economic events and should be accounted for separately.

X Ltd. should account for the above transaction as given below:

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At the time of sale of scrap machine, X Ltd. should write off the carrying amount of asset from books of account and provide a loss of Rs. 90,000. (i.e., carrying amount of Rs. 1,00,000 – realised amount of Rs. 10,000)

As on March 31, 20X1, X Ltd. should recognise income of Rs. 50,000 against the compensation receivable in its profit or loss.

Q 20. An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on April 1, 2017. The plant has a useful life of 40 years. Its initial cost was Rs. 1,20,000 which included an amount for decommissioning costs of Rs. 10,000, which represented Rs. 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on March 31. On March, value of the decommissioning liability has decreased by Rs. 8,000. The discount rate has not yet changed.

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

Ans: On March 31, 2027, the plant is 10 years old. Accumulated depreciation is Rs. 30,000 (Rs. 120,000 × 10/years). Because of the unwinding of discount (5 per cent) over the 10 years, the decommissioning liability has increased from Rs. 10,000 to Rs. 16,300.

On March 31, 2027, the discount rate has not changed. However, the entity estimates that, as a result of technological advances, the net present value of the decommissioning liability has decreased by Rs. 8,000. Accordingly, the entity adjusts the decommissioning liability from Rs. 16,300 to Rs. 8,300. On this date, the entity makes the following journal entry to reflect the change:

		Rs.	Rs.
Decommissioning liability	Dr.	8,000	
To Cost of asset			8,000

Following this adjustment, the carrying amount of the asset is Rs. 82,000 (Rs. 1,20,000 – Rs. 8,000 – Rs. 30,000), which will be depreciated over the remaining 30 years of the asset's life giving a depreciation expense for the next year of Rs. 2,733 (Rs. 82,000 ÷ 30). The next year's finance cost for the unwinding of the discount will be Rs. 415 (Rs. 8,300 × 5 per cent).

If the change in the liability had resulted from a change in the discount rate, instead of a change in the estimated cash flows, the accounting for the change would have been the same but the next year's finance cost would have reflected the new discount rate.

Q 21. An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on April 1, 20X1. The plant has a useful life of 40 years. Its initial cost was Rs. 1,20,000.; This included an amount for decommissioning costs of Rs. 10,000, which represented Rs. 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on March 31. Assume that a market-based discounted cash flow valuation of Rs. 1,15,000 is obtained at March 31, 20X4. It includes an allowance of Rs. 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On March 31, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by Rs. 5,000. The entity decides that a full valuation

of the asset is needed at March 31, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at Rs. 1,07,000, which is net of an allowance for the reduced decommissioning obligation.

How the entity will account for the above changes in decommissioning liability if it adopts revaluation model? **[MTP May 2019]**

Ans: At March 31, 20X4: Rs.

Asset at valuation (1)	1,26,600
Accumulated depreciation	Nil
Decommissioning liability	(11,600)
Net assets	1,15,000
Retained earnings (2)	(10,600)
Revaluation surplus (3)	15,600

Notes:

(1) Valuation obtained of Rs. 1,15,000 plus decommissioning costs of Rs. 11,600, allowed for in the valuation but recognised as a separate liability = Rs. 1,26,600.

(2) Three years' depreciation on original cost Rs. 1,20,000 × 3/40 = Rs. 9,000 plus cumulative discount on Rs. 10,000 at 5 per cent compound = Rs. 1,600; total Rs. 10,600.

(3) Revalued amount Rs. 1,26,600 less previous net book value of Rs. 1,11,000 (cost Rs. 120,000 less accumulated depreciation Rs. 9,000).

The depreciation expense for 20X4-20X5 is therefore Rs. 3,420 (Rs. 1,26,600 × 1/37) and the discount expense for 20X5 is Rs. 600. On March 31, 20X5, the decommissioning liability (before any adjustment) is Rs. 12,200. However, as per estimate of the entity, the present value of the decommissioning liability has decreased by Rs. 5,000. Accordingly, the entity adjusts the decommissioning liability from Rs. 12,200 to Rs. 7,200.

The whole of this adjustment is taken to revaluation surplus, because it does not exceed the carrying amount that would have been recognised had the asset been carried under the cost model. If it had done, the excess would have been taken to profit or loss. The entity makes the following journal entry to reflect the change:

		Rs.	Rs.
Decommissioning liability	Dr.	5,000	
To Revaluation surplus			5,000

As at March 31, 20X5, the entity revalued its asset at Rs. 1,07,000, which is net of an allowance of Rs. 7,200 for the reduced decommissioning obligation that should be recognised as a separate liability. The valuation of the asset for financial reporting purposes, before deducting this allowance, is therefore Rs. 1,14,200. The following additional journal entry is needed:

Notes:

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		Rs.	Rs.
Accumulated depreciation (1)	Dr.	3,420	
To Asset at valuation			3,420
Revaluation surplus (2)	Dr.	8,980	
To Asset at valuation (3)			8,980

Note:

(1) Eliminating accumulated depreciation of Rs. 3,420 in accordance with the entity's accounting policy.

(2) The debit is to revaluation surplus because the deficit arising on the revaluation does not exceed the credit balance existing in the revaluation surplus in respect of the asset.

(3) Previous valuation (before allowance for decommissioning costs) Rs. 1,26,600, less cumulative depreciation Rs. 3,420, less new valuation (before allowance for decommissioning costs) Rs. 1,14,200.

Following this valuation, the amounts included in the balance sheet are:

Asset at valuation	1,14,200
Accumulated depreciation	Nil
Decommissioning liability	(7,200)
Net assets	1,07,000
Retained earnings (1)	(14,620)
Revaluation surplus (2)	11,620

Notes:

(1) Rs. 10,600 at March 31, 20X4, plus depreciation expense of Rs. 3,420 and discount expense of Rs. 600 = Rs. 14,620.

(2) Rs. 15,600 at March 31, 20X4, plus Rs. 5,000 arising on the decrease in the liability, less Rs. 8,980 deficit on revaluation = Rs. 11,620.

Q 22. A Ltd. has amounted to Rs. 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be Rs. 65,000. an item of plant with an initial cost of Rs. 1,00,000. At the date of revaluation, accumulated depreciation

Pass Journal Entries with regard to Revaluation?

Ans: The entries to be passed would be:

		Rs.	Rs.
Accumulated depreciation	Dr.	55,000	
To Asset A/c			55,000

(Being elimination of accumulated depreciation against the cost of the asset)

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Asset A/c	Dr	20,000	
To Revaluation Surplus			20,000

(Being increase of net asset value to Fair value)

Note: The net result is that the asset has a carrying amount of Rs. 65,000 [1,00,000 – 55,000 + 20,000.]

QUESTIONS FROM RTP/MTP/EXAMS

Q 23 A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	Rs. 15,000,000	15 years
Plant and machinery	Rs. 10,000,000	10 years
Furniture and fixtures	Rs. 3,500,000	7 years

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

Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

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

Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 20X4. **[RTP May 2018]**

Ans: The annual depreciation charges prior to the change in useful life were

Buildings	Rs. 1,50,00,000/15 =	Rs. 10,00,000
Plant and machinery	Rs. 1,00,00,000/10 =	Rs. 10,00,000
Furniture and fixtures	Rs. 35,00,000/7 =	Rs. 5,00,000
Total =		Rs. 25,00,000 (A)

The revised annual depreciation for the year ending 31st March, 20X4, would be

Buildings	[Rs.1,50,00,000 – (Rs. 10,00,000 × 3)] / 10	Rs. 12,00,000
Plant and machinery	[Rs. 1,00,00,000 – (Rs. 10,00,000 × 3)] / 7	Rs. 10,00,000
Furniture and fixtures	[Rs. 35,00,000 – (Rs. 5,00,000 × 3)] / 5	Rs. 4,00,000
Total		Rs. 26,00,000 (B)

The impact on Statement of Profit and Loss for the year ending 31st March, 20X4

= Rs. 26,00,000 – Rs. 25,00,000 = Rs. 1,00,000

This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected.

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Accordingly, from 20X4-20X5 onward, excess of Rs. 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

Q 24 On 1st October, 2017, A Ltd. completed the construction of a power generating facility. The total construction cost was Rs. 2,00,00,000. The facility was capable of being used from 1st October, 2017 but A Ltd. did not bring the facility into use until 1st January, 2018. The estimated useful life of the facility at 1st October, 2017 was 40 years. Under legal regulations in the jurisdiction in which A Ltd. operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, A Ltd. has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of A Ltd. estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be Rs. 1,00,00,000. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of Rs. 1 receivable in 40 years' time is approximately 0.142.

Analyse and present how the above events would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Ans: All figures are Rs. in '000.

The power generating facility should be depreciated from the date it is ready for use, rather than when it would actually start being used. In this case, then, the facility should be depreciated from 1st October, 2017.

Although A Ltd. has no legal obligation to restore the piece of land, it does have a constructive obligation, based on its past practice and policies.

The amount of the obligation will be 1,420, being the present value of the anticipated future restoration expenditure (10,000 x 0.142).

This will be recognised as a provision under non-current liabilities in the Balance Sheet of A Ltd. at 31st March, 2018.

As time passes the discounted amount unwinds. The unwinding of the discount for the year ended 31st March, 2018 will be 35.5 (1,420 x 5% x 6/12).

The unwinding of the discount will be shown as a finance cost in the statement of profit or loss and the closing provision will be 1,455.50 (1,420 + 35.5).

The initial amount of the provision is included in the carrying amount of the non-current asset, which becomes 21,420 (20,000 + 1,420).

The depreciation charge in profit or loss for the year ended 31st March, 2018 is 267.75 (21,420 x 1/40 x 6/12).

The closing balance included in non-current assets will be 21,152.25 (21,420 – 267.75).

Q 25 ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large.

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Whether ABC Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)?

If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd. as per Ind AS? **[RTP Nov 2018]**

Ans: Paragraph 7 of Ind AS 16 states that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably.

Further, paragraph 9 provides that the standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances.

Paragraph 16, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In view of this, even though ABC Ltd. may not be able to recognize expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

Depreciation

As per paragraph 43 and 47 of Ind AS 16, if these assets have a useful life which is different from the useful life of the item of property, plant and equipment to which they relate, it should be depreciated separately. However, if these assets have a useful life and the depreciation method that are the same as the useful life and the depreciation method of the item of property, plant and equipment to which they relate, these assets may be grouped in determining the depreciation charge. Nevertheless, if it has been included in the cost of property, plant and equipment as a directly attributable cost, it will be depreciated over the useful lives of the said property, plant and equipment.

The useful lives of these assets should not exceed that of the asset to which it relates.

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Presentation

These assets should be presented within the class of asset to which they relate.

Q 26. Company X performed a revaluation of all of its plant and machinery at the beginning of 2018-2019. The following information relates to one of the machinery:

Amount	('000)
Gross carrying amount	Rs. 200
Accumulated depreciation (straight-line method)	Rs. 80
Net carrying amount	Rs. 120
Fair value	Rs. 150

The useful life of the machinery is 10 years and the company uses Straight line method of depreciation. The revaluation was performed at the end of the 4th year.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? **[RTP May 2019]**

Ans According to paragraph 35 of Ind AS 16, when an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

(a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with the paragraphs 39 and 40 of Ind AS 16.

If the Company opts for the treatment as per option (a), then the revised carrying amount of the machinery will be:

Gross carrying amount	Rs. 250	[(200/120) x 150]
Net carrying amount	Rs.150	
Accumulated depreciation	Rs. 100	(Rs. 250 – Rs. 150)

Journal entry

Plant and Machinery A/c (Gross Block)	Dr.	Rs. 50	
To Accumulated Depreciation			Rs. 20
To Revaluation Reserve			Rs. 30

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If the balance of accumulated depreciation is eliminated as per option (b), then the revised carrying amount of the machinery will be as follows:

Gross carrying amount is restated to Rs.150 to reflect the fair value and Accumulated depreciation is set at zero.

Journal entry

Accumulated Depreciation	Dr.	Rs. 80	
To Plant and Machinery A/c (Gross Block)			Rs. 80
Plant and Machinery A/c (Gross Block)	Dr.	Rs.30	
To Revaluation Reserve			Rs. 30

Depreciation

Option (a) –Since the Gross Block has been restated, the depreciation charge will be Rs. 25 per annum (Rs. 250 / 10 years).

Option (b) – Since the Revalued amount is the revised Gross Block, the useful life to be considered is the remaining useful life of the asset which results in the same depreciation charge of Rs. 25 per annum as per Option A (Rs. 150 / 6 years).

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Intangible Assets (IND AS 38)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1: Company XYZ ltd has provided training to its staff on various new topics like GST, Ind AS etc to ensure the compliance as per the required law. Can the company recognise such cost of staff training as intangible asset?

Ans: It is clear that the company will obtain the economic benefits from the work performed by the staff as it increases their efficiency. But it does not have control over them because staff could choose to resign the company at any time.

Hence the company lacks the ability to restrict the access of others to those benefits. Therefore, the staff training cost does not meet the definition of an intangible asset.

Q 2: Pluto Ltd. intends to open a new retail store in a new location in the next few weeks. Pluto Ltd has spent a substantial sum on a series of television advertisements to promote this new store. The Company has paid an amount of Rs. 800,000 for advertisements before 31 March 20X1. Rs. 700,000 of this sum relates to advertisements shown before 31 March 20X1 and Rs. 100,000 to advertisements shown in April 20X1. Since 31 March 20X1, The Company has paid for further advertisements costing Rs. 400,000.

Pluto Ltd is of view that such costs can be carried forward as intangible assets. Since market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of the above costs in the financial statements for the year ended 31 March 20X1.

Ans: Under Ind AS 38 – Intangible Assets – intangible assets can only be recognised if they are identifiable and have a cost which can be reliably measured. These criteria are very difficult to satisfy for internally developed intangibles. For these reasons, Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. The issue of how successful the store is likely to be does not affect this prohibition. Therefore such costs should be recognised as expenses. However, the costs would be recognised on an accruals basis. Therefore, of the advertisements paid for before 31 March 20X1, Rs.700,000 would be recognised as an expense and Rs. 100,000 as a pre-payment in the year ended 31 March 20X1. The Rs. 400,000 cost of advertisements paid for since 31 March 20X1 would be charged as expenses in the year ended 31 March 20X2.

Q 3: Mercury Ltd is preparing its accounts for the year ended 31 March 20X2 and is unsure about how to treat the following items.

1. The company completed a grand marketing and advertising campaign costing Rs. 4.8 Lakh. The finance director had authorised this campaign on the basis that it would create Rs. 8 lakh of additional profits over the next three years.

2. A new product was developed during the year. The expenditure totalled Rs. 3 lakh of which Rs. 1.5 lakh was incurred prior to 30 September 20X1, the date on which it became clear that the product was technically viable. The new product will be launched in the next four months and its recoverable amount is estimated at Rs. 1.4 lakh.

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3. Staff participated in a training programme which cost the company Rs. 5 lakh. The training organisation had made a presentation to the directors of the company outlining that incremental profits to the business over the next twelve months would be Rs. 7 lakh.

What amounts should appear as intangible assets in accordance with Ind AS 38 in Mercury's balance sheet as on 31 March 20X2?

Ans: The treatment in Mercury's financials as at 31 March 20X2 will be as follows:

1. Marketing and advertising campaign: no intangible asset will be recognised, because it is not possible to identify future economic benefits that are attributable only due to this campaign. All of the expenditure should be expensed in the statement of profit and loss.
2. New product: development expenditure appearing in the balance sheet will be valued at Rs. 1.5 lakh. The expenditure prior to the date on which the product becomes technically feasible is recognised in the statement of profit and loss.
3. Training programme: no asset will be recognised, because there is no control of the company over the staff and when staff leaves the benefits of the training, whatever they may be, also departs.

Q 4: Venus India Private Ltd acquired a software for its internal use costing Rs. 10,00,000. The amount payable for the software was Rs. 600,000 immediately and Rs. 400,000 in one year time. The other expenditure incurred were:-

Purchase tax : Rs. 1,00,000

Entry Tax : 10% (recoverable later from tax department)

Legal fees: Rs. 87,000

Consultancy fees for implementation : Rs. 1,20,000

cost of capital of the company is 10%.

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

Ans:

Particulars	Amount
Cash paid	600,000
Deferred consideration (Rs. 400,000/1.1)	3,63,636
Purchase Tax	1,00,000
Entry tax (not to be considered as it is a refundable tax)	-
Legal fees	87,000
Consultancy fees for implementation	1,20,000
Total Cost to be capitalised	12,70,636

Q 5: Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at Rs. 5,00,000 in the books of Sun Ltd. The Software is carried at Rs. 10,000 in the books of the Earth Ltd which is not the fair value.

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

1) Fair value of software is Rs. 5,20,000 and fair value of telecommunication license is Rs. 5,00,000.

2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at Rs. 4,90,000.

3) Neither Fair Value of Software nor Telecommunication license could be reliably measured.

Ans: INR in '000

Situation	Sun Ltd.	Earth Ltd.
1	Dr. Software 520 Cr. Telecommunication license 500 Cr. Profit on Exchange 20	Dr. Telecommunication license 500 Cr. Software 10 Cr. Profit on Exchange 490
2	Dr. Software 490 Dr. Loss on Exchange 10 Cr. Telecommunication license 500	Dr. Telecommunication license 490 Cr. Software 10 Cr. Profit on Exchange 480
	Note: The company may first recognise Impairment loss and then pass an entry. The effect is the same as impairment loss will also be charged to Income Statement.	
3	Dr. Software 500 Cr. Telecommunication license 500	Cr. Software 10 Dr. Telecommunication license 10

Q 6: Expenditure on a new production process in 20X1-20X2: INR

	INR
1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January 20X2. The amount estimated to be recoverable from the process is Rs. 1,000.

What is the carrying amount of the intangible asset at 31st March 20X2 and the charge to profit or loss for 20X1-20X2?

Expenditure incurred in FY 20X2-20X3 is Rs. 6,000.

At 31st March 20X3, the amount estimated to be recoverable from the process (including future cash outflows to complete the process before it is available for use) is Rs. 5,000.

What is the carrying amount of the intangible asset at 31st March 20X3 and the charge to profit or loss for 20X2-X3?

Ans:

Expenditure to be transfer to profit or loss in 20X1-20X2	INR
Total Expenditure	3,600
Less. Expenditure during Development phase	900
Expenditure to be transfer to profit or loss	2,700

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1) Carrying Amount of Intangible Asset on 31st March 20X2

Expenditure during Development Phase will be capitalised	Rs. 900
(Recoverable amount is higher being Rs. 1,000, hence no impairment)	

2) Expenditure to be charged to profit or loss in 20X2-20X3

	INR
Opening balance of Intangible Asset	900
Add. Further expenditure during development phase	6,000
Expenditure for development phase	6,900
Recoverable Amount	5,000
Amount charged to profit or loss (Impairment Loss)	1,900

3) Carrying Amount of Intangible Asset on 31st March 20X3

Value of Intangible Asset will be recoverable amount i.e.	Rs. 5,000

Q 7: Saturn Ltd. acquired an intangible asset on 31st March 20X1 for Rs. 1,00,000. The asset was revalued at Rs. 1,20,000 on 31st March 20X2and Rs. 85,000 on 31st March 20X3.

Jupiter Ltd. acquired an intangible asset on 31st March 20X1 for Rs. 1,00,000. The asset was revalued at Rs. 85,000 on 31st March 20X2 and at Rs. 1,05,000 on 31st March 20X3.

Assuming that the year-end for both companies is 31st March, and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements.

Ans: Saturn Ltd.

Rs. 20,000 revaluation increase on 31st March 20X2 should be credited to the revaluation reserve and recognised in other comprehensive income. Rs. 20,000 of the revaluation decrease on 31st March 20X3 should be debited to revaluation reserve and remaining Rs. 15,000 should be recognised as an expense.

Jupiter Ltd.

Rs. 15,000 revaluation decrease on 31st March 20X2 should be recognised as an expense in the Statement of Profit and loss. Rs. 15,000 out of the Rs. 20,000 increase on 31st March 20X3 should be recognised as income. The remaining Rs. 5,000 should be credited to revaluation reserve and recognised in other comprehensive income.

Q 8: X Limited engaged in the business of manufacturing fertilisers entered into a technical collabaration agreement with a foreign company Y Limited. As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid Rs. 10,00,00,000 for the use of know-how for a period of 5 years. X Limited estimates the production of fertiliser as follows:

Year (in metric tons)	
1	50,000
2	70,000

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3	1,00,000
4	1,20,000
5	1,10,000

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

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

Ans: Based on the above data, it may be suitable for X Ltd. to use unit of production method for amortisation of technical know-how.

The total estimated unit to be produced 4,50,00 MT. The technical know-how will be amortised on the basis of the ratio of yearly production to total production.

The first year charge should be a proportion of 50,000/4,50,000 on Rs. 10,00,00,000

= Rs. 1,11,11,111.

At the end of 2nd year, as per revised estimate the total number of units to be produced are 4,20,000 MT.

The amortisation for second year will be 65,000/4,20,000, and so on for remaining years unless the estimates are again revised.

The difference in amortisation for first year due to revision in estimates would also be provided in 2nd year. The actual amortisation provided for the 1st year is Rs. 1,11,11,111. The amortisation that would have provided on revised estimates is 50,000/4,20,000 on Rs. 10,00,00,000 = Rs. 1,19,04,762.

So, difference of Rs. 7,93,651 (Rs. 1,19,04,762 – Rs. 1,11,11,111) would also be provided in 2nd year.

Q 9: X Ltd. purchased a patent right on April 1, 20X1, for Rs. 3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method. As at April 1, 20X2, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of Rs. 1,50,000 and decides to amortise over 2 years. As at April 1, 20X3, having perfected the related production process, the asset is now appraised at a value of Rs. 3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year?

Ans: Value as on March 31, 20X2

Original cost	Rs. 3,00,000
Less: amortisation	(Rs. 60,000)
Net Value	Rs. 2,40,000

Value as on March 31, 20X1

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On April 1, 20X2, the impairment is recorded by writing down the asset to the estimated value of Rs. 1,50,000, which necessitates a Rs. 90,000 charge to profit & loss (carrying value, Rs. 2,40,000 less fair value Rs. 1,50,000).

Amortisation provided for the financial year 20X2-20X3 is Rs. 75,000 (Rs. 1,50,000/2) Net value is = Rs. 1,50,000 – Rs. 75,000 = Rs. 75,000.

Value as on March 31, 20X4

As of April 1, 20X3, the carrying value of the patent is Rs. 75,000. Revalued amount of patent is Rs. 3,00,000.

Out of total revaluation gain of Rs. 2,25,000, Rs. 90,000 will be charged to profit & loss and balance amount of Rs. 1,35,000 – (Rs. 2,25,000 – Rs. 90,000) will be credited to revaluation reserve.

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

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

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

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

Ans: X Ltd. should recognise an intangible asset in respect of the consideration paid towards 'Non-Compete Fee'.

However, amount paid for obtaining skilled staff amounting to Rs. 30,00,000 does not meet the definition of intangible asset since X Ltd. has not established any right over the resource and should be expensed. The entity has insufficient control over the expected future economic benefits arising from a team of skilled staff.

Therefore, Rs. 50,00,000 will be separately recognised as an intangible asset, whereas amount paid for obtaining skilled staff does not meet the recognition criteria. However, since it is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date.

The value of goodwill is Rs. 1,00,00,000 (Rs. 1,50,00,000 – Rs. 50,00,000).

Q 11. X Ltd. purchased a franchise from a restaurant chain at a cost of Rs. 1,00,00,000 and the franchise has 10 years life. In addition, the franchise agreement mentions that the franchisee would also pay the franchisor royalty as a percentage of sales made. Can the franchise rights be treated as an intangible asset under Ind AS 38?

Ans: The franchise rights meets the identification criterion in the definition of an intangible asset since it arises from the contractual rights. It is acquired separately and its cost can be measured reliably. In addition X Ltd. will have future economic benefits and control over them from the franchise rights.

X Ltd. should recognise the franchise right as intangible asset and amortise it over 10 years. Royalty as a percentage of sales paid to the franchisor would be a charge to the profit and loss in the books of the X Ltd.

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Q 12. An entity regularly places advertisements in newspapers advertising its products and includes a reply slip that informs individuals replying to the advertisement that the entity may pass on the individual's details to other sellers of similar products, unless the individual ticks a box in the advertisement.

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

Ans: In this situation, the entity has no legal rights to the customer relationship, but exchange transactions have taken place that evidence separability of the asset and the control that the entity is able to exercise over the asset. Therefore, the list is an intangible asset. However, the entity may not recognise the asset because the cost of generating the customer list internally cannot be distinguished from the cost of developing the business as a whole.

Q 13. A software company X Ltd. is developing new software for the telecom industry. It employs 100 employs engineers trained in that particular discipline who are engaged in the development of the software. X Ltd. feels that it has an excellent HR policy and does not expect any of its employees to leave in the near future. It wants to recognise these set of engineers as a human resources asset in the form of an intangible asset. What would be your advice to X Ltd?

Ans: Although, without doubt the skill sets of the employees make them extremely valuable to the company, however it does not have control over them. Merely having good HR policies would not make them eligible to be recognised as an intangible asset.

Q 14. X Ltd. has acquired a telecom license from Government to operate mobile telephony in two states of India. Can the cost of acquisition be capitalised as an intangible asset under Ind AS 38?

Ans: Cost of acquisition of the telecom license can be capitalised as an intangible asset under the head Licenses, as it will lead to future economic benefits for X Ltd.

Q 15. X Ltd. purchased a standardised finance software at a list price of Rs. 30,00,000 and paid Rs. 50,000 towards purchase tax which is non refundable. In addition to this, the entity was granted a trade discount of 5% on the initial list price. X Ltd. incurred cost of Rs. 7,00,000 towards customisation of the software for its intended use. X Ltd. purchased a 5 year maintenance contract with the vendor company of Rs. 2,00,000. At what cost the intangible asset will be recognised?

Ans: In accordance with Ind AS 38, the cost of a separately acquired intangible asset is its purchases price and non refundable purchase taxes, after deducting trade discounts and rebates and any directly attributable cost of preparing the asset for its intended use.

Therefore, the initial cost of the asset should be:

	Amount (Rs.)
List price	30,00,000
Less: trade discount (5%)	(1,50,000)
	28,50,000
Non refundable purchase tax	50,000

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Customisation cost	7,00,000
Total cost	36,00,000

The maintenance contract of Rs. 2,00,000 is an expense and therefore should be taken as a prepaid expense and charged to profit and loss over a period of 5 years

Q 16. X Limited in a business combination, purchased the net assets of Y Limited for Rs. 4,00,000 on March 31, 20X1. The assets and liabilities position of Y Limited just before the acquisition is as follows:

Assets	Cost (in Rs.)
Property, Plant & Equipment	1,00,000
Intangible asset 1	20,000
Intangible asset 2	50,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

The fair market value of the PPE, intangible asset 1 and intangible asset 2 is available and they are Rs. 1,50,000, Rs. 30,000 and Rs. 70,000 respectively.

How would X Limited account for the net assets acquired from Y Limited?

Ans: X Limited will account for the assets acquired from Y Limited in following manner:

Assets	Amount (Rs.)
Property, plant and equipment	1,50,000
Goodwill	70,000
Intangible asset 1	30,000
Intangible asset 2	70,000
Cash & Bank	1,30,000
Liabilities	
Trade payable	50,000

Note 1- Goodwill is the difference between fair value of net assets acquired and purchase consideration paid when is calculated as follow:

Goodwill = Rs. 4,00,000 – Rs. (1,50,000 + 70,000 + 30,000 + 1,30,000 – 50,000)= Rs. 70,000.

Q 17. X Ltd. acquired Y Ltd. on April 30, 20X1. The purchase consideration is Rs. 50,00,000. The fair value of the tangible assets is Rs. 45,00,000. The company estimates the fair value of "in-process research projects" at Rs. 10,00,000. No other Intangible asset is acquired by X Ltd. in the transaction. Further, cost incurred by X Ltd. in relation to that research project is as follows:

(a) Rs. 5,00,000 – as research expenses

(b) Rs. 2,00,000 – to establish technological feasibility

(c) Rs. 7,00,000 – for further development cost after technological feasibility is established.

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At what amount the intangible asset should be measured under Ind AS 38?

Ans: X Ltd. should initially recognise the acquired "in house research project'' at its fair value i.e., Rs. 10,00,000. Research cost of Rs. 5,00,000 and cost of Rs. 2,00,000 for establishing technical feasibility should be charged to profit & loss. Costs incurred from the point of technological feasibility/asset recognition criteria until the time when development costs are incurred are capitalised.

So the intangible asset should be recognised at Rs. 17,00,000 (Rs. 10,00,000 + Rs. 7,00,000).

Q 18. X Ltd. acquired a patent right of manufacturing drug from Y Ltd. In exchange X Ltd. gives its intellectual property right to Y Ltd. Current market value of the patent and intellectual property rights are Rs. 20,00,000 and Rs. 18,00,000 respectively. At what value patent right should be initially recognised in the books of X Ltd. in following two situations?

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

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

Ans: If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

The transaction at the fair value of the asset received adjusted for any cash received or paid. Therefore in case (a) patent is measured at Rs. 18,00,000, in case (b) it is measured at Rs. 20,00,000 (18,00,000 + 2,00,000).

Q 19. X Garments Ltd. spent Rs. 1,00,00,000 towards promotions for a fashion show by way of various on-road shows, contests etc.

After that event, it realised that the brand name of the entity got popular and resultantly, subsequent sales have shown a significant improvement. It is further expected that this hike will have an effect over the next 2-3 years.

How the entity should account for the above cost incurred on promoting such show?

Ans: Expenditure of Rs. 1,00,00,000 though increased future economic benefits, but it does not result in creation of an intangible asset.

Such promotional cost should be expensed off.

Q 20. An entity is developing a new production process. During 20X1-20X2, expenditure incurred was Rs. 1,000, of which Rs. 900 was incurred before March 1, 20X2 and Rs. 100 was incurred between March 1, 20X2 and March 31, 20X2. The entity is able to demonstrate that at March 1, 20X2, the production process met the criteria for recognition as an intangible asset. The recoverable amount of the know-how embodied in the process (including future cash outflows to complete the process before it is available for use) is estimated to be Rs. 500.

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

Ans: At the end of the financial year 20X2, the production process is recognised as an intangible asset at a cost of Rs. 100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X2). Rs. 900 expenditure incurred before March 1, 20X2 is

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recognised as an expense because the recognition criteria were not met until March 1, 20X2. This expenditure does not form part of the cost of the production process recognised in the balance sheet.

At the end of 20X3, the cost of the production process is Rs. 2,100 (Rs. 100 expenditure recognised at the end of 20X2 plus Rs. 2,000 expenditure recognised in 20X3). The entity recognises an impairment loss of Rs. 200 to adjust the carrying amount of the process before impairment loss (Rs. 2,100) to its recoverable amount (Rs. 1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in Ind AS 36 are met

Q 21. X Ltd. is engaged is developing computer software. The expenditures incurred by X Ltd. in pursuance of its development of software is given below:

(a) Paid Rs. 2,00,000 towards salaries of the program designers.

(b) Incurred Rs. 5,00,000 towards other cost of completion of program design.

(c) Incurred Rs. 2,00,000 towards cost of coding and establishing technical feasibility.

(d) Paid Rs. 7,00,000 for other direct cost after establishment of technical feasibility.

(e) Incurred Rs. 2,00,000 towards other testing costs.

(f) Cost of producing product masters for training material is Rs. 3,00,000.

(g) A focus group of other software developers was invited to a conference for the introduction of this new software. Cost of the conference aggregated to Rs. 70,000.

(h) On March 15, 20X0, the development phase was completed and a cash flow budget was prepared.

Net profit for the year was estimated to be equal Rs. 40,00,000. How X Ltd. should account for the above mentioned cost?

Ans: Costs incurred in creating computer software, should be charged to research & development expenses when incurred until technical feasibility/asset recognition criteria have been established for the product. Here, technical feasibility is established after completion of detailed program design.

In this case, Rs. 9,00,000 (salary cost of Rs. 2,00,000, program design cost of Rs. 5,00,000 and coding and technical feasibility cost of Rs. 2,00,000) would be recorded as expense.

Cost incurred from the point of technical feasibility are capitalised as software costs. But the conference cost of Rs. 70,000 would be expensed off.

In this situation, direct cost after establishment of technical feasibility of Rs. 7,00,000, testing cost of Rs. 2,00,000 and cost of producing product masters for training material of Rs. 3,00,000 will be capitalised.

The cost of software capitalised is = Rs. (7,00,000 + 2,00,000 + 3,00,000) = Rs. 12,00,000.

Q 22. X Ltd. has started developing a new production process in financial year 20X1-20X2. Total expenditure incurred till September 30, 20X3, was Rs. 1,00,00,000 . The expenditure on the development of the production process meets the recognition criteria on July 1, 20X1. The records of X Ltd. show that, out of total Rs. 1,00,00,000, Rs. 70,00,000 were incurred during

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July to September 20X1. X Ltd. publishes its financial results quarterly. How X Ltd. should account for the development expenditure?

Ans: X Ltd. should recognise the intangible asset at Rs. 70,00,000 and Rs. 30,00,000 which was already recognised as an expenses in first quarter should not be capitalised.

Q 23. X Ltd. decides to revalue its intangible assets on April 1, 20X1. On the date of revaluation, the intangible assets stand at a cost of Rs. 1,00,00,000 and accumulated amortisation is Rs. 40,00,000. The intangible assets are revalued at Rs. 1,50,00,000. How should X Ltd. account for the revalued intangible assets in its books of account?

Ans: The intangible assets are revalued to Rs. 1,50,00,000 on an amortised replacement cost basis, which is a 150% increase from its original cost. Thereby applying the existing ratio of accumulated depreciation to the cost the revalued gross amount would be Rs. 2,50,00,000 gross and Rs. 1,00,00,000 on amortisation.

Q 24: X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

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

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

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

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

   Cost incurred (accumulated) till March 31, 20X1 is Rs. 5,00,00,000.

   Balance cost incurred during the financial year 20X1-20X2 is Rs. 5,00,00,000.

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

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

Ans: X Pharmaceutical Ltd. is advised as under:

1. It should recognise the drug license as an intangible asset, because it is a separate external purchase, separately identifiable asset and considered successful in respect of feasibility and probable future cash inflows.

   The drug license should be recorded at Rs. 1,00,00,000.

2. It should recognise the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.

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The brand will be recorded at Rs. 3,00,00,000.

3. The advertisement expenses of Rs. 1,00,00,000 should be expensed off.

4. The development cost incurred during the financial year 20X1-20X2 should be capitalised.

   Cost of intangible asset (Drug A) as on March 31, 20X2

   Opening cost Rs. 5,00,00,000

   Development cost Rs. 5,00,00,000

   Total cost Rs. 10,00,00,000

5. Research expenses of Rs. 50,00,000 incurred for developing 'Drug B' should be expensed off since technological feasibility has not yet established.

Q 25: On 31st March 20X1, Earth India Ltd paid Rs. 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd's net assets had a fair value of Rs. 30,00,000. In addition Sun Ltd also held the following rights:

Trade Mark named "GRAND" – valued at Rs. 180,000 using a discounted cash flow technique.

Sole distribution rights to an electronic product. Future cash flows from which are estimated to be Rs. 150,000 per annum for the next 6 years.

10% is considered an appropriate discount rate.

The 6 year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

Ans:

Particulars	Amount	Amount
Purchase Consideration (A)		50,00,000
Net Asset acquired	30,00,000	
Trade Mark	1,80,000	
Distribution Rights (1,50,000 x 4.36)	6,54,000	
Total (B)		38,34,000
Goodwill on Acquisition		11,66,000

QUESTIONS FROM RTP/MTP/EXAMS

Q 26 A Ltd. intends to open a new retail store in a new location in the next few weeks. It has spent a substantial sum on a series of television advertisements to promote this new store. It has paid for advertisements costing Rs. 8,00,000 before 31st March, 2018. Rs. 7,00,000 of this sum relates to advertisements shown before 31st March, 2018 and Rs. 1,00,000 to advertisements shown in April, 2018. Since 31st March, 2018, A Ltd. has paid for further advertisements costing Rs. 4,00,000. The accountant charged all these costs as expenses in the year to 31 March 2018. However, CFO of A Ltd. does not want to charge Rs.12,00,000 against 2017-2018 profits. He believes that these costs can be carried forward as intangible assets because the company's market research indicates that this new store is likely to be highly successful.

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Examine and justify the treatment of these costs of Rs. 12,00,000 in the financial statements for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Ans: Ind AS 38 specifically prohibits recognising advertising expenditure as an intangible asset. Irrespective of success probability in future, such expenses have to be recognized in profit or loss. Therefore, the treatment given by the accountant is correct since such costs should be recognised as expenses.

However, the costs should be recognised on an accruals basis.

Therefore, of the advertisements paid for before 31st March, 2018, Rs. 7,00,000 would be recognised as an expense and Rs. 1,00,000 as a pre-payment in the year ended 31st March 2018.

Rs. 4,00,000 cost of advertisements paid for since 31st March, 2018 would be charged as expenses in the year ended 31st March, 2019.

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INVESTMENT PROPERTY (IND AS 40)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 X Limited owns a building which is used to earn rentals. The building has a carrying amount of Rs. 50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is Rs. 5,00,000. The original walls have a carrying amount of Rs. 1,00,000. How X Limited should account for the above costs?

Ans: Under the recognition principle, an entity recognises in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and the carrying amount of those parts that are replaced is derecognised.

So, X Limited should add the cost of new walls and remove the carrying amount of old walls. The new carrying amount of the building = Rs. 50,00,000 + Rs. 5,00,000 – Rs. 1,00,000 = Rs. 54,00,000.

Q 2 X Limited purchased a building for Rs. 30,00,000 in May 1, 20X1.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of Rs. 1,00,000 and Rs. 20,000 respectively were incurred in acquiring the building. In 20X1-20X2, X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

Rs. 2,00,000 planning permission.

Rs. 7,00,000 construction costs (including Rs. 40,000 refundable purchases taxes).

The redevelopment was completed and the retail shops were ready for rental on September 2, 20X1. What is the cost of building at initial recognition?

Ans: The cost of a purchased investment property comprises its purchase price and any direct attributable expenditure.

So, the cost of the building = Rs. (30,00,000 +1,00,000 + 20,000 + 2,00,000 + 7,00,000 - 40,000) = 39,80,000.

Q 3 X Limited purchased a land worth of Rs. 1,00,00,000. It has option either to pay full amount at the time of purchases or pay for it over two years for a total cost of Rs. 1,20,00,000. What should be the cost of the building under both the payments method?

Ans: Using either payment method, the cost will be Rs. 1,00,00,00. If the second payment option is used, Rs. 20,00,000 will be treated as interest expenses over the period of credit i.e., 2 years.

Q 4 X Limited (as the lessee) has taken a building under finance lease from the owner. It classifies its interest in the leasehold building as investment property and after initial recognition measures the property interest at fair value. The fair value is Rs. 50,000. The present value of the minimum lease payment is Rs. 40,000. At what value, X Limited will recognise its investment property?

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Ans: X Limited shall initially recognise the property interest at Rs. 40,000 i.e., lower of fair value of the property and present value of minimum lease payments. A corresponding lease liability of Rs. 40,000 will be recognised as follows:

Investment Property A/c Dr. Rs. 40,000

To Finance lease obligation Rs. 40,000.

Q 5 Moon Ltd has purchased a building on 1st April 20X1 at a cost of Rs. 10 million. The building was used as a factory by the Moon Ltd and was measured under cost model. The expected useful life of the building is estimated to be 10 years. Due to decline in demand of the product, the Company does not need the factory anymore and has rented out the building to a third party from 1st April 20X5. On this date the fair value of the building is Rs. 8 million. Moon ltd uses cost model for accounting of its investment property.

Ans:

	(Rs. Millions)
Carrying amount of the building after depreciation of 4 years	6
(10-10/10*4).	
The company has applied cost model under Ind AS 16 till now.	
There is no impairment as the fair value is greater than the carrying amount of building.	
Revaluation Surplus credited to Other Comprehensive Income	---
(not applicable since cost model is used under Ind AS 16)	
Building initially recognised as Investment Property	6
(Cost model Ind AS 40)	

Q 6 On April 1, 20X1 an entity acquired an investment property (building) for Rs. 40,00,000. Management estimates the useful life of the building as 20 years measured from the date of acquisition. The residual value of the building is Rs. 2,00,000. Management believes that the straight-line depreciation method reflects the pattern in which it expects to consume the building's future economic benefits. What is the carrying amount of the building on March 31, 20X2?

Ans: Cost of the asset is Rs. 40,00,000.

Depreciable amount = Cost less Residual value = Rs. (40,00,000 - 2,00,000) = Rs. 38,00,000

Depreciation for the year = Depreciable amount/useful life =Rs. 38,00,000/20

= Rs. 1,90,000.

Carrying amount = Cost less accumulated depreciation

= Rs. (40,00,000 - 1,90,000) = Rs. 38,10,000.

Q 7. X Limited has an investment property (building) which is carried in Balance Sheet on March 31, 20X1 at Rs. 15,00,000. During the year X Limited has stopped letting out the building and used it as its office premise. On March 31, 20X1, management estimates the recoverable amount of the building as Rs. 10,00,000 and its remaining useful life as 20 years and residual

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value is nil. How should X Limited account for the above investment property as on March 31, 20X1?

Ans: At March 31, 20X1, X Limited must transfer the property from investment property to property, plant and equipment since there is a change in use of the said building. The transfer should be made at its carrying amount i.e., Rs. 15,00,000. Since recoverable amount of the property as on March 31, 20X1 is Rs. 10 Lakhs, impairment loss Rs. 5 Lakhs should be recognised in the Statement of Profit and Loss.

The entity must disclose the reclassification.

From April 20X1, X Limited will depreciate the building over its remaining useful life of 20 years.

Q 8. In financial year 20X1-20X2, X Limited incurred the following expenditure in acquiring property consisting of 6 identical houses each with separate legal title including the land on which it is built.

The expenditure incurred on various dates is given below:

On April 1, 20X1 - Purchase cost of the property Rs. 1,80,00,000.

On April 1, 20X1 – Non-refundable transfer taxes Rs. 20,00,000 (not included in the purchase cost).

On April 2, 20X1- Legal cost related to property acquisition Rs. 5,00,000.

On April 6, 20X1- Advertisement campaign to attract tenants Rs. 3,00,000.

On April 8, 20X1 - Opening ceremony function for starting business Rs. 1,50,000.

Throughout 20X1-20X2, incurred Rs. 1,00,000 towards day-to-day repair maintenance and other administrative expenses.

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

How X Limited will account for all the above mentioned expenses in the books of account?

Ans: The cost of the property = Rs. (1,80,00,000 + 20,00,000 + 5,00,000) = Rs. 2,05,00,000.

Since five houses out of six are being rented, so 5/6th of the property cost will be accounted for as an investment property and 1/6th of the property cost will be accounted for as owner occupied property.

Cost of the investment property = Rs. 2,05,00,000 x 5/6 = Rs. 1,70,83,333

Cost of the owner occupied property = Rs. (2,05,00,000 - 1,70,83,333) = Rs. 34,16,667.

All other costs, i.e., Advertisement expenses, ceremony expenses and repair maintenance expenses will be expensed off as and when incurred.

QUESTIONS FROM RTP/MTP/EXAMS

Q 9. X Ltd. is engaged in the construction industry and prepares its financial statements up to 31st March each year. On 1st April, 2013, X Ltd. purchased a large property (consisting of land) for Rs. 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease.

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Annual rentals were Rs. 20,00,000. On 31st March, 2017, the fair value of the property was Rs. 2,60,00,000. Under the terms of the lease, Y Ltd. was able to cancel the lease by giving six months' notice in writing to X Ltd. Y Ltd. gave this notice on 31st March, 2017 and vacated the property on 30th September, 2017. On 30th September, 2017, the fair value of the property was Rs. 2,90,00,000. On 1st October, 2017, X Ltd. immediately began to convert the property into ten separate flats of equal size which X Ltd. intended to sell in the ordinary course of its business. X Ltd. spent a total of Rs. 60,00,000 on this conversion project between 30th September, 2017 to 31st March, 2018. The project was incomplete at 31st March, 2018 and the directors of X Ltd. estimate that they need to spend a further Rs. 40,00,000 to complete the project, after which each flat could be sold for Rs. 50,00,000.

Examine and show how the three events would be reported in the financial statements of X Ltd. for the year ended 31st March, 2018. as per Ind AS. **[RTP Nov 2018]**

Ans: From 1st April, 2013, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.

The property would be measured under the cost model. This means it will be measured at Rs. 2,00,00,000 at each year end.

On 30th September, 2017, the property ceases to be an investment property. X Ltd. begins to develop it for sale as flats. The increase in the fair value of the property from 31st March, 2017 to 30th September, 2017 of Rs. 30,00,000 (Rs. 29,00,000 – Rs. 26,00,000) would be recognised in P/L for the year ended 31st March, 2018.

Since the lease of the property is an operating lease, rental income of Rs. 10,00,000 (Rs. 20,00,000 x 6/12) would be recognised in P/L for the year ended 31st March, 2018.

When the property ceases to be an investment property, it is transferred into inventory at its then fair value of Rs. 2,90,00,000. This becomes the initial 'cost' of the inventory.

The additional costs of Rs. 60,00,000 for developing the flats which were incurred up to and including 31st March, 2018 would be added to the 'cost' of inventory to give a closing cost of Rs. 3,50,00,000.

The total selling price of the flats is expected to be Rs. 5,00,00,000 (10 x Rs. 50,00,000). Since the further costs to develop the flats total Rs. 40,00,000, their net realisable value is Rs. 4,60,00,000 (Rs. 5,00,00,000 – Rs. 40,00,000), so the flats will be measured at a cost of Rs. 3,50,00,000.

The flats will be shown in inventory as a current asset

Q 10. UK Ltd. has purchased a new head office property for Rs. 10 crores. The new office building has 10 floors and the organisation structure of UK Ltd. is as follows:

Floor	Use
1th	Waiting Area
2th	Admin
3th	HR
4th	Accounts

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5th	Inspection
6th	MD Office
7th	Canteen
8th, 9th and 10th	Vacant

Since UK Ltd. did not need the floors 8, 9 and 10 for its business needs, it has leased out the same to a restaurant on a long-term lease basis. The terms of the lease agreement are as follows:

- Tenure of Lease Agreement - 5 Years
- Non-Cancellable Period - 3 years
- Lease Rental-annual lease rental receivable from these floors are Rs. 10,00,000 per floor with an escalation of 5% every year.

Based on the certificate from its architect, UK Ltd. has estimated the cost of the 3 top floors as approximately Rs. 3 crores. The remaining cost of Rs. 7 crores can be allocated as 25% towards Land and 75% towards Building.

As on 31st March, 2018, UK Ltd. obtained a valuation report from an independent valuer who has estimated the fair value of the property at Rs. 15 crores. UK Ltd. wishes to use the cost model for measuring Property, Plant & Equipment and the fair value model for measuring the Investment Property. UK Ltd. depreciates the building over an estimated useful life of 50 years, with no estimated residual value.

Advise UK Ltd. on the accounting and disclosures for the above as per the applicable Ind AS.

Ans: Ind AS 16 'Property, Plant and Equipment' states that property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per Ind AS 40 'Investment property', investment property is a property held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business.

Further, as per para 8 of Ind AS 40, the building owned by the entity and leased out under one or more operating leases will be classified as investment property.

Here top three floors have been leased out for 5 years with a non-cancellable period of 3 years. The useful life of the building is 50 years. The lease period is far less that the useful life of the building leased out. Further, the lease rentals of three years altogether do not recover the fair value of the floors leased i.e. 15 crore x 30% = 4.50 crore. Hence the lease is an operating lease. Therefore, the 3 floors leased out as operating lease will be classified as investment property in the books of lessor ie. UK Ltd.

However, for investment property, Ind AS 40 states that an entity shall adopt as its accounting policy the cost model to all of its investment property. Ind AS 40 also requires that an entity shall disclose the fair value of such investment property(ies).

	Total	**PPE (70%)**		**Investment property (30%)**
		Land (25%)	Building (75%)	

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Cost	10	1.75	5.25	3
FV	15	2.625	7.875	4.5
Valuation model followed		Cost	Cost	Cost *
Value recognized in the books		1.75	5.25	3
Less: Depreciation		Nil	(5.25/50) = 0.105 crore	(3/50) = 0.06
Carrying value as on 31st March, 2018		1.75	5.145	2.94
Impairment loss		No impairment loss since fair value is more than the cost		

* (as per para 30 of Ind AS 40)

Q 11. 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 s	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 along with working for the same. **[May 2018]**

Ans: 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'.

<u>Property '1' and '2'</u>

Para 6 of Ind AS 16 'Property, Plant and Equipment' defines:

"Property, plant and equipment are tangible items that:

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

(b) are expected to be used during more than one period."

Paragraph 29 of Ind AS 16 states that:

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"An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment".

Further, paragraph 36 of Ind AS 16 states that:

"If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued".

Further, paragraph 39 of Ind AS 16 states that:

"If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss".

Further, paragraph 52 of Ind AS 16 states that:

"Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount".

Property '3'

Para 6 of Ind AS 40 'Investment property' defines:

"Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

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

(b) sale in the ordinary course of business".

Further, paragraph 30 of Ind AS 40 states that:

"An entity shall adopt as its accounting policy the cost model to all of its investment property".

Further, paragraph 79 (e) of Ind AS 40 requires that:

"An entity shall disclose the fair value of investment property".

Further, paragraph 54 (2) of Ind AS 1 'Presentation of Financial Statements' requires that:

"As a minimum, the balance sheet shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

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.

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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

Assets		**INR**
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**

Assets		INR
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.

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Borrowing Costs (IND AS 23)

QUESTIONS FROM ICAI STUDY MATERIAL

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

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

Ans: As per paragraph 5 of Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

As per paragraph 17 of Ind AS 23, an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

(a) It incurs expenditures for the asset.

(b) It incurs borrowing costs.

(c) It undertakes activities that are necessary to prepare the asset for its intended use or sale. The ship is a qualifying asset as it takes substantial period of time for its construction. Thus the related borrowing costs should be capitalised.

Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on April 1, 20X0. Thus condition (a) and (b) are met. However, condition (c) is met only on March 1, 20X1, and that too only with respect to one ship. Thus there is no capitalisation of borrowing costs during the financial year ended March 31, 20X1. Even during the financial year ended March 31, 20X2, borrowing costs relating to the 'one' ship whose construction had commenced from March 1, 20X2 will be capitalised from March 1, 20X2 to March 31, 20X2. All other borrowing costs are expensed.

Q 2. X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended March 31, 20X2, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	Amount (Rs.)
July 1, 20X1	2,50,000
December 1, 20X1	3,00,000

The details of borrowings and interest thereon are as under:

Particulars	Average Balance (Rs.)	Interest (Rs.)
Long term loan @ 10%	10,00,000	1,00,000
Working capital loan	5,00,000	65,000
	15,00,000	1,65,000

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Compute the borrowing costs that need to be capitalised.

Ans: The capitalisation rate is:

Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11% Interest will be capitalised as under:

— On Rs. 2,50,000 @ 11% p.a. for 9 months = Rs. 20,625

— On Rs. 3,00,000 @ 11% p.a. for 4 months = Rs. 11,000

Q 3 Alpha Ltd on 1St April 20X1 borrowed 9% Rs. 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April 20X1. The loan facility was availed on 1st April 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

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

Calculate the cost of the asset and the borrowing cost to be capitalized.

Ans:

Particulars	Factory Building	Office Building
Borrowing Costs	(10,00,000*9%) 90,000	(20,00,000*9%) 1,80,000
Less: Investment Income	(5,00,000*7%*6/12) (17,500)	(10,00,000*7%*6/12) (35,000)
	72,500	1,45,000
Cost of the asset:		
Expenditure incurred	10,00,000	20,00,000
Borrowing Costs	72,500	1,45,000
Total	10,72,500	21,45,000

Q 4 Beta Ltd had the following loans in place at the end of 31st March 20X2:

(Amounts in Rs. 000s) Loan	1st April 20X1	31st March 20X2
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July 20X1 but the development activities has yet to be started.

On 1st April 20X1, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: Rs 500,000 on 1st April 20X1 and Rs 2,500,000 on 1st January 20X2.

Required

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

Ans:

Capitalisation rate		16.5%
Borrowing Costs	(500,000 x 16.5%)+(2,500,000 x16.5% x 3/12)	Rs.1,85,625

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Q 5 X Ltd is commencing a new construction project, which is to be financed by borrowing. The key dates are as follows:

(i) 15 May 20X1: Loan interest relating to the project starts to be incurred

(ii) 2 June 20X1 : Technical site planning commences

(iii) 19 June 20X1 : Expenditure on the project started to be incurred

(iv) 18 July 20X1 : Construction work commences

Identify commencement date.

Ans: In the above case, the three conditions to be tested for commencement date would be:

Borrowing cost has been incurred on : 15 May 20X1

Expenditure has been incurred for the asset on : 19 June 20X1

Activities necessary to prepare asset for its intended use or sale: 2 June 20X1

Commencement date would be the date when the above three conditions would be satisfied in all i.e 19 June 20X1

Q 6: XYZ Ltd. has taken a loan of USD 10,000 on April 1, 20X3, for a specific project at an interest rate of 5% p.a., payable annually. On April 1, 20X3, the exchange rate between the currencies was Rs. 45 per USD. The exchange rate, as at March 31, 20X4, is Rs. 48 per USD. The corresponding amount could have been borrowed by XYZ Ltd. in local currency at an interest rate of 11 per cent per annum as on April 1, 20X3. Calculate borrowing cost and exchange loss. What will be your answer if interest rate on local currency borrowings is assumed to be 13% **[MTP May 2019]**

Ans: The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 6(e) of IND AS 23:

Interest for the period = USD 10,000 x 5%x Rs. 48/USD = Rs. 24,000/-

Increase in the liability towards the principal amount = USD 10,000 x (48-45) = Rs. 30,000/-

Interest that would have resulted if the loan was taken in Indian currency

= USD 10000 x 45 x 11%). = Rs. 49,500

Difference between interest on local currency borrowing and foreign currency borrowing

= Rs. 49,500 - Rs. 24,000 =Rs. 25,500

Therefore, out of Rs. 30,000 increase in the liability towards principal amount, only Rs. 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 49,500 being the aggregate of interest of Rs. 24,000 on foreign currency borrowings (covered by paragraph 6(a) of IND AS 23) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 25,500. Thus, Rs. 49,500 would be considered as the borrowing cost to be accounted for as per IND AS 23 and the remaining Rs. 4,500 would be considered as the exchange difference to be accounted for as per IND AS 21, The Effects of Changes in Foreign Exchange Rates.

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In the above example, if the interest rate on local currency borrowings is assumed to be 13% instead of 11%, the entire exchange difference of Rs. 30,000 would be considered as borrowing costs, since in that case the difference between the interest on local currency borrowings and foreign currency borrowings (i.e., Rs. 34,500 (Rs. 58,500 - Rs. 24,000) is more than the exchange difference of Rs. 30,000. Therefore, in such a case, the total borrowing cost would be Rs. 54,000 (Rs. 24,000 + Rs. 30,000) which would be accounted for under IND AS 23 and there would be no exchange difference to be accounted for under IND AS 21.

QUESTIONS FROM RTP/MTP/EXAMS

Q 7: An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1. Directly attributable expenditure at the beginning of the month on this asset are Rs. 100,000 in September 20X1 and Rs. 250,000 in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the asset, but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 10% debentures with a face value of Rs. 20 lacs and had an overdraft of Rs. 500,000, which increased to Rs. 750,000 in December 20X1. Interest was paid on the overdraft at 15% until 1 October 20X1, then the rate was increased to 16%.

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'. **[RTP May 2018]**

Ans: Since the entity has only general borrowing hence first step will be to compute the capitalisation rate. The capitalisation rate of the general borrowings of the entity during the period of construction is calculated as follows:

Finance cost on Rs. 20 lacs 10% debentures during September – December 20X1	Rs. 66,667
Interest @ 15% on overdraft of Rs. 5,00,000 in September 20X1	Rs. 6,250
Interest @ 16% on overdraft of Rs. 5,00,000 in October and November 20X1	Rs. 13,333
Interest @ 16% on overdraft of Rs. 750,000 in December 20X1	Rs. 10,000
Total finance costs in September – December 20X1	Rs. 96,250

Weighted average borrowings during period

= (20,00,000 x 4) + (500,000 x 4) +(750,000 x 1) /4 = Rs. 25,62,500

Capitalisation rate = Total finance costs during the construction period / Weighted average borrowings during the construction period

= 96,250 / 25,62,500 = 3.756%

Q 8: X Ltd. began construction of a new building on 1stJanuary, 2007. It obtained Rs.1 lakh special loan to finance the construction of the building on 1stJanuary, 2007 at an interest rate of 10%. The company's other outstanding two non–specific loans were:

Amount	**Rs.**
Rs.5,00,000	11%
Rs.9,00,000	13%

The expenditure that were made on the building project were as follows:

	Rs.
January 2007	2,00,000
April 2007	2,50,000
July 2007	4,50,000
December 2007	1,20,000

Building was completed by 31st December, 2007. Following the principles prescribed in AS–16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

Ans:

(i)	**Computation of average accumulated expenses**				
	Rs.2,00,000 x 12 / 12 =				2,00,000
	Rs. 2,50,000 x 9 / 12 =				1,87,500
	Rs. 4,50,000 x 6 / 12 =				2,25,000
	Rs. 1,20,000 x 1 / 12 =				10,000
					6,22,500
(ii)	**Calculation of average interest rate other than for specific borrowings**				
	Amount of loan (in Rs.)			**Rate of interest**	**Amount of interest (in Rs.)**
	5,00,000			11%	55,000
	9,00,000			13%	1,17,000
	14,00,000				1,72,000
	Weighted average rate of interest = (1,72,000/14,00,000)*100 = 12.285% (approx)				
(iii)	**Interest on average accumulated expenses**				
	Specific borrowings (Rs. 1,00,000 X 10%) =				10,000
	Non-specific borrowings (Rs. 5,22,500* X 12.285%) =				64,189
	Amount of interest to be capitalized =				74,189
	*(Rs. 6,22,500 – Rs. 1,00,000)				
(iv)	**Total expenses to be capitalized for building**				
	Cost of building Rs.(2,00,000 + 2,50,000 + 4,50,000 + 1,20,000)				10,20,000
	Add: Amount of interest to be capitalised				74,189
					10,94,189
(v)	**Journal Entry**				
	Date	**Particulars**		**Dr. (Rs.)**	**Cr. (Rs.)**
	31.12.2007	Building account -To Bank account (Being amount of cost of building and borrowing cost thereon capitalized)	Dr.	10,94,189	

AGRICULTURE (IND AS 41)

Q 1: ABC Ltd grows vines, harvests the grapes and produces wine. Which of these activities are in the scope of Ind AS 41?

Ans: The grape vines are bearer plants that continually generate crops of grapes which are covered by Ind AS 16, Property, Plant and Equipment.

When the entity harvests the grapes, their biological transformation ceases and they become agricultural produce covered by Ind AS 41, Agriculture.

Vine involves a lengthy maturation period. This process is similar to the conversion of raw materials to a finished product rather than biological transformation hence treated as inventory in accordance with Ind AS 2, Inventories.

Q 2: A farmer owned a dairy herd, of three years old cattle as at April 1, 20X1 with a fair value of Rs. 13,750 and the number of cattle in the herd was 250.

The fair value of three year cattle as at March 31, 20X2 was Rs. 60 per cattle. The fair value of four year cattle as at March 31, 20X2 is Rs.75 per cattle.

Calculate the measurement of group of cattle as at March 31, 20X2 stating price and physical change separately.

Ans:

Particulars	Amount (Rs.)
Fair value as at April 1, 20X1	13,750
Increase due to Price change [250 x {60 - (13,750/250)}]	1,250
Increase due to Physical change [250 x {75-60}]	3,750
Fair value as at March 31, 20X2	18,750

Q 3: XYZ ltd, on 1 December 20X3, purchased 100 sheep's from a market for Rs 500,000 with a transaction cost of 2%. Sheep's fair value increased from Rs 500,000 to Rs 600,000 on 31 March 20X4.

Determine the fair value on the date of purchase and pass necessary journal entries.

Ans: The fair value less cost to sell of sheep's on the date of purchase would be Rs 4,90,000 (5,00,000-10,000). Expense of Rs 10,000 would be recognised in profit and loss.

On date of Purchase

		Dr.	Cr.
Biological Asset	Dr.	4,90,000	
Expense on Purchase	Dr.	10,000	
To Bank			5,00,000
(Being biological asset purchased)			

On 31 March 20X4 sheep's would be measured at Rs. 5,88,000 as Biological Asset (6,00,000-12,000) and gain of Rs. 98,000 (5,88,000-4,90,000) would be recognised in profit or loss.

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At the end of reporting period

Biological Asset	Dr.	98,000	
To Gain – Change in fair value			98,000

(Being change in fair value recognised at the end of reporting period)

Q 4: Moon Ltd prepares financial statements to 31 March each year. On 1 April 20X1 the company carried out the following transactions:

-- Purchased a land for Rs. 50 Lakhs.

-- Purchased 200 dairy cows (average age at 1 April 20X1 two years) for Rs. 10 Lakhs.

-- Received a grant of Rs. 1 million towards the acquisition of the cows. This grant was non-refundable.

For the year ending 31 March 20X2, the company has incurred following costs:

-- Rs. 6 Lakh to maintain the condition of the animals (food and protection).

-- Rs. 4 Lakh as breeding fee to a local farmer.

On 1 October 20X1, 100 calves were born. There were no other changes in the number of animals during the year ended 31 March 20X2. As of 31 March 20X2, Moon Ltd had 3,000 litres of unsold milk in inventory. The milk was sold shortly after the year end at market prices.

Information regarding fair values is as follows:

Item	Fair Value less cost to sell		
	1 April 20X1	1 October 20X1	31 March 20X2
	Rs.	Rs.	Rs.
Land	50 Lakhs	60 Lakhs	70 Lakhs
New born calves (per calf)	1,000	1,100	1,200
Six month old calves (per calf)	1,100	1,200	1,300
Two year old cows (per cow)	5,000	5,100	5,200
Three year old cows (per cow)	5,200	5,300	5,500
Milk (per litre)	20	22	24

Prepare extracts from the Balance Sheet and Statement of Profit & Loss that would be reflected in the financial statements of the entity for the year ended 31 March 20X2.

Ans: Extract from the Statement of Profit & Loss

Income	WN	Amount
Change in fair value of purchased dairy cow	WN 2	1,00,000
Government Grant	WN 3	10,00,000
Change in the fair value of newly born calves	WN 4	1,30,000
Fair Value of Milk	WN 5	72,000
Total Income		13,02,000
Expenses		
Maintenance Costs	WN 2	6,00,000
Breeding Fees	WN 2	4,00,000

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Total Expense		(10,00,000)
Net Income		3,02,000

Extracts from Balance Sheet

Property, Plant and Equipment:		
Land	WN 1	50,00,000
Dairy Cow	WN 2	11,00,000
Calves	WN 4	1,30,000
		62,30,000
Inventory		
Milk	WN 5	72,000
		72,000

Working Notes:

1. Land: The purchase of the land is not covered by Ind AS 41. The relevant standard which would apply to this transaction is Ind AS 16. Under this standard the land would initially be recorded at cost and depreciated over its useful economic life. This would usually be considered to be infinite in the case of land and so no depreciation would be appropriate. Under Cost Model no recognition would be made for post-acquisition changes in the value of land. The allowed alternative treatment under Revaluation Model would permit the land to be revalued to market value with the revaluation surplus taken to the other comprehensive income. We have followed the Cost Model.

2. Dairy Cows: Under the 'fair value model' laid down in Ind AS 41 the mature cows would be recognised in the Balance Sheet at 31 March 20X2 at the fair value of 200 x Rs. 5,500 = Rs.11,00,000.

   Increase in price change 200 x (5,200-5,000) = 40,000

   Increase in physical change 200 x (5,500-5,200) = 60,000

   The total difference between the fair value of matured herd and its initial cost (Rs. 11,00,000 –Rs. 10,00,000 = a gain of Rs. 1,00,000) would be recognised in the profit and loss along with the maintenance costs and breeding fee of Rs. 6,00,000 and Rs. 4,00,000 respectively.

3. Grant: Grand relating to agricultural activity is not subject to the normal requirement of Ind AS 20. Under Ind AS 41 such grants are credited to income as soon as they are unconditionally receivable rather than being recognised over the useful economic life of the herd. Therefore, Rs. 10,00,000 would be credited to income of the company.

4. Calves: They are a biological asset and the fair value model is applied. The breeding fees are charged to income and an asset of 100 x Rs. 1,300 = Rs. 1,30,000 recognised in the Balance sheet and credited to Profit and loss.

5. Milk: This is agricultural produce and initially recognised on the same basis as biological assets. Thus the milk would be valued at 3,000 x Rs. 24 = Rs. 72,000. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

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QUESTIONS FROM RTP/MTP/EXAMS

Q 5 As at 31st March, 2017, a plantation consists of 100 Pinus Radiata trees that were planted 10 years earlier. The tree takes 30 years to mature, and will ultimately be processed into building material for houses or furniture. The enterprise's weighted average cost of capital is 6% p.a.

Only mature trees have established fair values by reference to a quoted price in an active market. The fair value (inclusive of current transport costs to get 100 logs to market) for a mature tree of the same grade as in the plantation is:

As at 31st March, 2017: 171

As at 31st March, 2018: 165

Assume that there would be immaterial cash flow between now and point of harvest. The present value factor of Rs. 1 @ 6% for 19th year = 0.331 20th year = 0.312

State the value of such plantation as on 31st March, 2017 and 2018 and the gain or loss to be recognised as per Ind AS. **[RTP Nov 2018]**

Ans: As at 31st March, 2017, the mature plantation would have been valued at 17,100 (171 x 100).

As at 31st March, 2018, the mature plantation would have been valued at 16,500 (165 x 100).

Assuming immaterial cash flow between now and the point of harvest, the fair value (and therefore the amount reported as an asset on the statement of financial position) of the plantation is estimated as follows:

As at 31st March, 2017: 17,100 x 0.312 = 5,335.20.

As at 31st March, 2018: 16,500 x 0.331 = 5,461.50.

Gain or loss

The difference in fair value of the plantation between the two year end dates is 126.30 (5,461.50 – 5,335.20), which will be reported as a gain in the statement or profit or loss (regardless of the fact that it has not yet been realised).

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Accounting for Government Grants and Disclosure of Government Assistance (IND AS 20)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 Government gives a grant of Rs. 10,00,000 for research and development of H1N1 vaccine to A Pharmaceuticals Limited. There is no condition attached to the grant. Examine how the Government grant be realized.

Ans: The entire grant should be recognised immediately in profit or loss.

Q 2 Government gives a grant of Rs. 10,00,000 for research and development of H1N1 vaccine to A Pharmaceuticals Limited even though similar vaccines are available in the market but are expensive. The entity has to ensure by developing a manufacturing process over a period of 2 years that the costs come down by at least 40%. Examine how the Government grant be realized.

Ans: The entire grant should be recognised immediately as deferred income and charged to profit or loss over a period of two years.

Q 3 A village of artisans in a district got devastated because of an earthquake. A Limited was operating in that district and was providing employment to the artisans. The government gave a grant of Rs. 10,00,000 to A Limited so that 100 artisans are rehabilitated over a period of 3 years. Government releases Rs. 2,00,000. Examine how the Government grant be realized.

Ans: A Limited will recognise Rs. 10,00,000 as government grant and set it up as a deferred income and will recognise it in its profit or loss over the period of three years as per the principles enunciated in Ind AS 20.

Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government or in the form of a non-monetary asset.

Q 4 A Limited received from the government a loan of Rs. 50,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized.

Ans: The fair value of the loan is calculated at Rs. 37,38,328.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on Rs.50,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	37,38,328	4,48,600	2,50,000	39,36,928

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2	39,36,928	4,72,431	2,50,000	41,59,359
3	41,59,359	4,99,123	2,50,000	44,08,482
4	44,08,482	5,29,018	2,50,000	46,87,500
5	46,87,500	5,62,500	52,50,000	Nil

A Limited will recognise Rs. 12,61,672 (Rs. 50,00,000 – Rs. 37,38,328) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	50,00,000
To Deferred Income		12,61,672
To Loan Account		37,38,328

Rs. 12,61,672 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate. (see Illustration 5 in this regard)

Q 5 Continuing with the facts given in the Q 4, state how the grant will be recognized in the statement of profit or loss assuming:

(a) the loan is an immediate relief measure to rescue the enterprise

(b) the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years

(c) the loan is to finance a depreciable asset.

Ans: Rs. 12,61,672 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate.

Assuming (a), the loan is an immediate relief measure to rescue the enterprise. Rs. 12,61,672 will be recognised in profit or loss immediately.

Assuming (b), the loan is a subsidy for staff training expenses, incurred equally, for a period of 4 years. Rs. 12,61,672 will be recognised in profit or loss over a period of 4 years.

Assuming (c), the loan is to finance a depreciable asset. Rs. 12,61,672 will be recognised in profit or loss on the same basis as depreciation.

Q 6: A Limited wants to establish a manufacturing unit in a backward area and requires 5 acres of land. The government provides the land on a leasehold basis at a nominal value of Rs. 10,000 per acre. The fair value of the land is Rs. 100,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

Ans: A limited will recognise Rs. 450,000 [(Rs. 100,000 – Rs. 10,000) x 5)] as government grant.

Q 7: A Limited establishes solar panels to supply solar electricity to its manufacturing plant. The cost of solar panels is Rs. 1,00,00,000 with a useful life of 10 years. The depreciation is provided on straight line method basis. The government gives Rs. 50,00,000 as a subsidy. Examine how the Government grant be realized.

Ans: A Limited will set up Rs. 50,00,000 as deferred income and will credit Rs. 5,00,000 equally to its statement of profit and loss over next 10 years.

Alternatively, A Ltd. may deduct Rs. 50,00,000 from the cost of solar panel of Rs. 1,00,00,000.

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Q 8: Continuing with the facts given in the Q 7 above, state how the same will be disclosed in the Statement of cash flows.

Ans: A Limited will show Rs. 1,00,00,000 being acquisition of solar panels as outflow in investing activities. The receipt of Rs. 50,00,000 from government will be shown as inflow under financing activities.

QUESTIONS FROM RTP/MTP/EXAMS

Q 9 A Limited received from the government a loan of Rs.1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset.

Ans: The fair value of the loan is calculated at Rs. 74,76,656.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on Rs.1,00,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	74,76,656	8,97,200	5,00,000	78,73,856
2	78,73,856	9,44,862	5,00,000	83,18,718
3	83,18,718	9,98,246	5,00,000	88,16,964
4	88,16,964	10,58,036	5,00,000	93,75,000
5	93,75,000	11,25,000	1,05,00,000	Nil

A Limited will recognise Rs. 25,23,344 (Rs. 1,00,00,000 – Rs. 74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	1,00,00,000
To Deferred Income		25,23,344
To Loan Account		74,76,656

Rs. 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognised as expenses the related costs for which the grant is intended to compensate.

If the loan is to finance a depreciable asset. Rs. 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

Q 10 How will you recognize and present the grants received from the Government in the following cases as per Ind AS 20?

(i) A Ltd. received one acre of land to setup a plant in backward area (fair value of land Rs. 12 lakh and acquired value by Government is Rs. 8 Iakhs).

(ii) B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.

(iii) D Ltd. received an amount of Rs. 25 lakh for immediate start-up of a business without any condition.

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(iv) S Ltd. received Rs. 10 lakh for purchase of machinery costing Rs. 80 lakh. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on straight line basis.

(v) Government gives a grant of Rs. 25 lakh to U Limited for research and development of medicine for breast cancer, even though similar medicines are available in the market but are expensive. The company is to ensure by developing a manufacturing process over a period of two years so that the cost comes down at least to 50%. **[Nov 2018]**

Ans:

(i) The land and government grant should be recognized by A Ltd. at fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income. (Refer footnote 1)

(ii) As per para 10A of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as Government grant.

(iii) Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per para 21 of Ind AS 20.

(iv) Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh / 10 years] should be credited to profit and loss each year over period of 10 years. (Refer footnote 2)

(v) As per para 12 of Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

Note 1: As per the amendment made by MCA in Ind AS 20 on 21st September, 2018, alternatively if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. Land will be shown in the financial statements at Rs. 1.

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Impairment of Assets (IND AS 36)

QUESTIONS FROM ICAI STUDY MATERIAL

Practical Questions on IND AS 36

Q 1: A mining entity owns a private railway to support its mining activities. The private railway could only be sold for scrap value and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the mine.

Ans: It is not possible to estimate the recoverable amount of the private railway because its value in use cannot be determined and is probably different from scrap value. Consequently, the entity estimates the recoverable amount of the cash-generating unit to which the private railway belongs (ie the mine as a whole).

Q 2: A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Ans: Because the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets are the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

Q 3: An entity owns three hotels in the same location. The hotels use the same pricing structure and are advertised by the owner as alternatives. They all use the entity's central reservations system. Guests are regularly transferred between hotels. The entity also owns a hotel in another location. This hotel uses the central reservation system but does not share advertising or guests with the other hotels.

Ans: The three hotels in the same location would form a single cash-generating unit because they are managed as one business. The fourth hotel, in a separate location, would be another cash-generating unit because it is likely to be managed independently of the entity's other hotels and its management are likely to be held accountable for the profitability of the hotel as an independent business.

Q 4: A publisher owns 150 magazine titles of which 70 were purchased and 80 were self-created. The price paid for a purchased magazine title is recognised as an intangible asset. The costs of creating magazine titles and maintaining the existing titles are recognised as an expense when incurred. Cash inflows from direct sales and advertising are identifiable for each magazine title. Titles are managed by customer segments. The level of advertising income for a magazine title depends on the range of titles in the customer segment to which the magazine title relates. Management has a policy to abandon old titles before the end of their economic lives and replace them immediately with new titles for the same customer segment. What is the cash-generating unit?

Ans: It is likely that the recoverable amount of an individual magazine title can be assessed. Even though the level of advertising income for a title is influenced, to a certain extent, by the other titles in the customer segment, cash inflows from direct sales and advertising are identifiable

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for each title. In addition, although titles are managed by customer segments, decisions to abandon titles are made on an individual title basis.

Therefore, it is likely that individual magazine titles generate cash inflows that are largely independent one from another and that each magazine title is a separate cash-generating unit.

Q 5: A significant raw material used for plant Y's final production is an intermediate product bought from plant X of the same enterprise. X's products are sold to Y at a transfer price that passes all margins to X. 80% of Y's final production is sold to customers outside of the reporting enterprise. 60% of X's final production is sold to Y and the remaining 40% is sold to customers outside of the reporting enterprise.

For each of the following cases, what are the cash-generating units for X and Y?

Case 1: X could sell the products it sells to Y in an active market. Internal transfer prices are higher than market prices.

Case 2: There is no active market for the products X sells to Y.

Ans: **Case 1**

X could sell its products on an active market and, so, generate cash inflows from continuing use that would be largely independent of the cash inflows from Y. Therefore, it is likely that X is a separate cash-generating unit, although part of its production is used by Y.

It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to customers outside of the reporting enterprise. Therefore, its cash inflows from continuing use can be considered to be largely independent.

Internal transfer prices do not reflect market prices for X's output. Therefore, in determining value in use of both X and Y, the enterprise adjusts financial budgets/forecasts to reflect management's best estimate of future market prices for those of X's products that are used internally.

Case 2

It is likely that the recoverable amount of each plant cannot be assessed independently from the recoverable amount of the other plant because:

(a) the majority of X's production is used internally and could not be sold in an active market. So, cash inflows of X depend on demand for Y's products. Therefore, X cannot be considered to generate cash inflows that are largely independent from those of Y; and

(b) the two plants are managed together.

As a consequence, it is likely that X and Y together is the smallest group of assets that generates cash inflows from continuing use that are largely independent.

Q 6: Enterprise M produces a single product and owns plants A, B and C. Each plant is located in a different continent. A produces a component that is assembled in either B or C. The combined capacity of B and C is not fully utilised. M's products are sold world-wide from either B or C. For example, B's production can be sold in C's continent if the products can be delivered faster from B than from C. Utilisation levels of B and C depend on the allocation of sales between

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the two sites. For each of the following cases, what are the cash-generating units for A, B and C?

Case 1: There is an active market for A's products.

Case 2: There is no active market for A's products.

Ans: Case 1

It is likely that A is a separate cash-generating unit because there is an active market for its products.

Although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually. Therefore, it is likely that B and C together is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

In determining the value in use of A and B plus C, M adjusts financial budgets/forecasts to reflect its best estimate of future market prices for A's products.

Case 2

It is likely that the recoverable amount of each plant cannot be assessed independently because:

(a) there is no active market for A's products. Therefore, A's cash inflows depend on sales of the final product by B and C; and

(b) although there is an active market for the products assembled by B and C, cash inflows for B and C depend on the allocation of production across the two sites. It is unlikely that the future cash inflows for B and C can be determined individually.

As a consequence, it is likely that A, B and C together (i.e., M as a whole) is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent.

Q 7 Apex Ltd. is engaged in manufacturing of steel utensils. It owns a building for its headquarters. The building used to be fully occupied for internal use. However, recently the company has undertaken a massive downsizing exercise as a result of which 1/3rd of the building became vacant. This vacant portion has now been given of on lease for 6 years. Determine the CGU of the building.

Ans: CGU of the building is Apex Ltd. as a whole as the primary purpose of the building is to serve as a corporate asset.

Q 8: Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of Rs. 36 million excludes the benefit to be derived from a future reorganization, but the second value of Rs. 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments. Whether the business segment needs to be Impaired?

Ans: The benefit of the future reorganization should not be taken into account in calculating value-in-use. Therefore, the net assets of the business segment will be impaired by Rs. 4 million

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because the value-in-use of Rs. 36 million is lower than the carrying value of Rs. 40 million. The value-in-use can be used as the recoverable amount as there is no active market for the sale of the business segment.

Q 9: Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31-03-20X4. The discount rate is 15%

Year	Cash Flow (INR Lakhs)
20X4-20X5	2,000
20X5-20X6	3,000
20X6-20X7	3,000
20X7-20X8	4,000
20X8-20X9	2,000
Residual Value at 31.03.20X9	500

Property, plant & equipment was purchased on 1.04.20X1 for Rs. 20,000 lakhs

Useful Life was 8 Years

Residual Value estimated at the end of 8 years Rs. 500 lakhs

Fair value less cost to disposal Rs. 10,000 lakhs

Q 10: Ram ltd. acquired plant on 1-4-1995 for Rs. 50 lakhs having 10 years useful life and provides depreciation on straight line basis with nil residual value. On 1-4-2000, Ram Ltd. revalued the plant at Rs. 29 lakhs against its book value of Rs. 25 lakhs and credited Rs. 4 lakhs to revaluation reserve. Additional depreciation on revalued amount was transferred to revenue reserve as per AS 10.

On 31-3-2002 the plant was impaired and its recoverable amount on this date was Rs. 14 lakhs calculated the impairment loss and how this loss should be treated in accounts.

Ans:

Impairment loss (17.40 – 14.00)	3.40
Impairment loss to be debited to revaluation Reserve	2.40
Impairment loss to be debited in Profit and Loss A/c as expense	1.00

Q 11. XYZ Limited has a cash-generating unit 'Plant A' as on April 1, 20X1 having a carrying amount of Rs. 1,000 crores. Plant A was acquired under a business combination and goodwill of Rs. 200 crores was allocated to it. It is depreciated on straight line basis. Plant A has a useful life of 10 years with no residual value. On March 31, 20X2, Plant A has a recoverable amount of Rs. 600 crores. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Ans:

(Rs. in crores)

Particulars	Goodwill	Identifiable assets	Total
Historical cost	200	1,000	1,200
Depreciation (20X1-20X2)	-	(100)	(100)

Carrying amount	200	900	1,100

Since, the recoverable amount is Rs. 600 crores, there is an impairment loss of Rs. 500 crores. The impairment loss of Rs. 500 crores should be allocated to goodwill first, and then to the other identifiable assets, i.e., Rs. 200 crores to goodwill and Rs. 300 crores to identifiable assets of Plant A.

(Rs. in crores)

Particulars	Goodwill	Identifiable assets	Total
Impairment loss	(200)	(300)	(500)
Carrying amount after impairment loss	-	600	600

Q 12. ABC Ltd. has three cash-generating units: A, B and C, the carrying amounts of which as on March 31, 20X1 are as follows:

Cash-generating units	Carrying amount (Rs. in crore)	Remaining useful life
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years.

(Rs. in crore)

Corporate asset	Carrying amount
X	600
Y	200

Remarks

The carrying amount of X can be allocated on a reasonable basis (i.e., pro rata basis) to the individual cash-generating units.

The carrying amount of Y cannot be allocated on a reasonable basis to the individual cash-generating units.

Recoverable amount as on March 31, 20X1 is as follows:

Cash-generating units	Recoverable amount (Rs. in crore)
A	600
B	900
C	1400
ABC Ltd.	3200

Calculate the impairment loss, if any. Ignore decimals. **[Nov 2018]**

Ans. Allocation of corporate assets

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The carrying amount of X is allocated to the carrying amount of each individual cash-generating unit. A weighted allocation basis is used because the estimated remaining useful life of A's cash-generating unit is 10 years, whereas the estimated remaining useful lives of B and C's cash-generating units are 20 years.

Particulars	A	B	C	Total
Carrying amount	500	750	1,100	2,350
Useful life	10 years	20 years	20 years	—
Weight based on useful life	1	2	2	—
Carrying amount (after assigning weight)	500	1,500	2,200	4,200
Pro-rata allocation of X	12% (500/4,200)	36% (1,500/4,200)	52% (2,200/4,200)	100%
Allocation of carrying amount of X	72	216	312	600
Carrying amount (after allocation of X)	572	966	1,412	2,950

Calculation of impairment loss

Step I: Impairment losses for individual cash-generating units and its allocation

(a) Impairment loss of each cash-generating units (Rs. in crore)			
Particulars	A	B	C
Carrying amount (after allocation of X)	572	966	1,412
Recoverable amount	600	900	1400
Impairment loss	-	66	12

(b) Allocation of the impairment loss (Rs. in crore)

Allocation to		B		C
X	15	(66 x 216/966)	3	(12 x 312/1,412)
Other assets in cash- generating units	51	(66 x 750/ 966)	9	(12 x 1,100/ 1,412)
Impairment loss	66		12	

Step II: Impairment losses for the larger cash-generating unit, i.e., ABC Ltd. as a whole

Particulars	A	B	C	X	Y	ABC Ltd.
Carrying amount	500	750	1,100	600	200	3,150
Impairment loss (Step I)	-	(51)	(9)	(18)	-	(78)
Carrying amount (after Step I)	500	699	1,091	582	200	3,072
Recoverable amount						3,200
Impairment loss for the 'larger' cash-generating unit						Nil

Q 13: Parent acquires an 80% ownership interest in Subsidiary for Rs. 2,100 on April 1, 20X1. At that date, Subsidiary's net identifiable assets have a fair value of Rs. 1,500. Parent chooses to measure the non-controlling interests as the proportionate interest of Subsidiary's net identifiable assets. The assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Because other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of Rs. 500 related to those synergies has been allocated to other cash-generating units within Parent. On March 31, 20X2, Parent determines that the recoverable amount of cash-generating unit Subsidiary is Rs. 1,000. The carrying amount of the net assets of Subsidiary, excluding goodwill, is Rs. 1,350. Allocate the impairment loss on March 31, 20X2.

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Ans: Non-controlling interests is measured as the proportionate interest of Subsidiary's net identifiable assets, i.e., Rs. 300 (20% of Rs. 1,500). Goodwill is the difference between the aggregate of the consideration transferred and the amount of the non-controlling interests (Rs. 2,100 + Rs. 300) and the net identifiable assets (Rs. 1,500), i.e., Rs. 900.

Since, the assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, therefore, Subsidiary is a cash-generating unit. Because other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of Rs. 500 related to those synergies has been allocated to other cash-generating units within Parent. Because the cash-generating unit comprising Subsidiary includes goodwill within its carrying amount, it should be tested for impairment annually, or more frequently if there is an indication that it may be impaired.

Testing Subsidiary (cash-generating unit) for impairment

Goodwill attributable to non-controlling interests is included in Subsidiary's recoverable amount of Rs. 1,000 but has not been recognised in Parent's consolidated financial statements. Therefore, the carrying amount of Subsidiary should be grossed up to include goodwill attributable to the non-controlling interests, before being compared with the recoverable amount of Rs. 1,000. Goodwill attributable to Parent's 80% interest in Subsidiary at the acquisition date is Rs. 400 after allocating Rs. 500 to other cash-generating units within Parent. Therefore, goodwill attributable to the 20% non-controlling interests in Subsidiary at the acquisition date is Rs. 100.

Testing subsidiary for impairment on March 31, 20X2

On March 31, 20X2	Goodwill of subsidiary (Rs.)	Net identifiable assets (Rs.)	Total (Rs.)
Carrying amount	400	1,350	1,750
Unrecognised non-controlling interests	100	-	100
Adjusted carrying amount	500	1,350	1,850
Recoverable amount			1,000
Impairment loss			850

Allocating the impairment loss

The impairment loss of Rs. 850 should be allocated to the assets in the unit by first reducing the carrying amount of goodwill.

Therefore, Rs. 500 of the Rs. 850 impairment loss for the unit is allocated to the goodwill. If the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss should be allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated. In this case, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership interest in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e., Rs. 400).

The remaining impairment loss of Rs. 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets.

Allocation of the impairment loss for Subsidiary on March 31, 20X2

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On March 31, 20X2	Goodwill of subsidiary (Rs.)	Net identifiable assets (Rs.)	Total (Rs.)
Carrying amount	400	1,350	1,750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	1,000	1,000

Q 14 A Ltd. purchased an asset of Rs. 100 lakh on April 1, 20X0. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
March 31, 20X1	Rs. 60 lakh
March 31, 20X2	Rs. 40 lakh
March 31, 20X3	Rs. 28 lakh

Calculate the amount of impairment loss or its reversal, if any, on March 31, 20X1, March 31, 20X2 and March 31, 20X3.

Ans: As on March 31, 20X1

Carrying amount of the asset (opening balance) Rs. 100 lakh

Depreciation (Rs. 100 lakh /4 years) Rs. 25 lakh

Carrying amount of the asset (closing balance) Rs. 75 lakh

Recoverable amount (given) Rs. 60 lakh

Therefore, an impairment loss of Rs. 15 lakh should be recognised as on March 31, 20X1. Depreciation for subsequent years should be charged on the carrying amount of the asset (after providing for impairment loss), i.e., Rs. 60 lakh.

As on March 31, 20X2

Carrying amount of the asset (opening balance) Rs. 60 lakh

Depreciation (Rs. 60 lakh /3 years) Rs. 20 lakh

Carrying amount of the asset (closing balance) Rs. 40 lakh

Therefore, no impairment loss should be recognised as on March 31, 20X2.

As on March 31, 20X3

Carrying amount of the asset (opening balance) Rs. 40 lakh

Depreciation (Rs. 40 lakh / 2 years) Rs. 20 lakh

Carrying amount of the asset (closing balance) Rs. 20 lakh

Recoverable amount (given) Rs. 28 lakh

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by Rs. 8 lakh, impairment loss recognised earlier should be reversed. However, reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

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Carrying amount as on March 31, 20X3 had no impairment loss being recognised would have been Rs. 25 lakh. Therefore, the reversal of an impairment loss of Rs. 5 lakh should be done as on March 31, 20X3.

Q 15: On March 31, 20X1, XYZ Ltd. makes following estimate of cash flows for one of its asset located in USA:

Year	Cash flows
20X1-20X2	US $ 80
20X2-20X3	US $ 100
20X3-20X4	US $ 20

Following information has been provided:

Particulars	India	USA
Applicable discount rate	15%	10%

Exchange rates are as follows:

As on	Exchange rate
March 31, 20X1	Rs. 45/US $
Expected Exchange rate	
March 31, 20X2	Rs. 48/US $
March 31, 20X3	Rs. 51/US $
March 31, 20X4	Rs. 55/US $

Calculate value in use as on March 31, 20X1.

Ans:

Year	Cash flows (US $)	Present value factor @ 10%	Discounted cash flows (US $)
20X1-20X2	80	0.9091	72.73
20X2-20X3	100	0.8264	82.64
20X3-20X4	20	0.7513	15.03
Total Discounted cash flows in		US $ 170.40	
Exchange rate as on March 31, 20X1, i.e., date of calculating value in use		Rs. 45/US $	
Value in use as on March 31, 20X1		Rs. 7,668	

Q 16 Cash flow is Rs. 100, Rs. 200 or Rs. 300 with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows.

Ans:

Cash flow	Probability	Expected cash flow
100	10%	10
200	60%	120

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300	30%	90
Total		220

The expected cash flow is Rs. 220.

Q 17: Cash flow of Rs. 1,000 may be received in one year, two years or three years with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows assuming applicable discount rate of 5%, 5.25% and 5.5% in year 1, 2 and 3, respectively.

Ans:

Years	Cash flow	P.V.F.	Present value	Probability	Expected cash flow
1	1,000	0.95238	952.38	10%	95.24
2	1,000	0.90273	902.73	60%	541.64
3	1,000	0.85161	851.61	30%	255.48
Total					892.36

The expected present value is Rs. 892.36.

Q 18: Calculate expected cash flows in each of the following cases:

(a) the estimated amount falls somewhere between Rs. 50 and Rs. 250, but no amount in the range is more likely than any other amount.

(b) the estimated amount falls somewhere between Rs. 50 and Rs. 250, and the most likely amount is Rs. 100. However, the probabilities attached to each amount are unknown.

(c) the estimated amount will be Rs. 50 (10 per cent probability), Rs. 250 (30 per cent probability), or Rs. 100 (60 per cent probability).

Ans: (a) the estimated expected cash flow is Rs. 150 [(50 + 250)/2].

(b) the estimated expected cash flow is Rs. 133.33 [(50 + 100 + 250)/3].

(c) the estimated expected cash flow is Rs. 140 [(50 × 0.10) + (250 × 0.30) + (100 × 0.60)].

Q 19 A Ltd. purchased a machinery of Rs. 100 crore on April 1, 20X1. The machinery has a useful life of 5 years. It has nil residual value. A Ltd. adopts straight line method of depreciation for depreciating the machinery. Following information has been provided as on March 31, 20X2:

Financial year	Estimated future cash flows (Rs. in crore)
20X2-20X3	15
20X3-20X4	30
20X4-20X5	40
20X5-20X6	10

Discount rate applicable : 10%

Fair value less costs to sell as on March 31, 20X2 : Rs. 70 crore

Calculate the impairment loss, if any.

Ans: Value in use of the machinery as on March 31, 20X2 can be calculated as follows:

Financial year	Estimated cash flows (Rs. in crore)	Present value factor @ 10%	Present value

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20X2-20X3	15	0.9091	13.64
20X3-20X4	30	0.8264	24.79
20X4-20X5	40	0.7513	30.05
20X5-20X6	10	0.6830	6.83
			75.31

The recoverable amount of the machinery is Rs. 75.31 crore (higher of value in use of Rs. 75.31 crore and fair value less costs to sell of Rs. 70 crore). Carrying amount of the machinery is Rs. 80 crore (after providing for one year depreciation @ Rs. 20 crore). Therefore, the impairment loss of Rs. 4.69 crore should be provided in the books.

Q 20 A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is Rs. 500, which is equal to the present value of the restoration costs.

The entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around Rs. 800. This price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately Rs. 1,200, excluding restoration costs. The carrying amount of the mine is Rs. 1,000.

Ans: The cash-generating unit's fair value less costs of disposal is Rs. 800. This amount considers restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs and is estimated to be Rs. 700 (Rs. 1,200 less Rs. 500). The carrying amount of the cash-generating unit is Rs. 500, which is the carrying amount of the mine (Rs. 1,000) less the carrying amount of the provision for restoration costs (Rs. 500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

Q 21: Earth Infra Ltd has two cash-generating units, X and Y. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for Rs. 20 million and CGU B for Rs. 30 million. The company has an office building which it is using as a office headquarter has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of Rs. 10 million. The recoverable amounts are based on value-in-use of Rs. 18 million for CGU A and Rs. 38 million for CGU B.

Required: Determine whether the carrying values of CGU A and B are impaired.

Ans: The office building is a corporate asset which needs to be allocated to CGU A and B on a reasonable and consistent basis:

	A	B	Total
Carrying value of CGUs	20	30	50
Allocation of office building	4	6	10
(office building is allocated in the ratio of			

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Carrying value of CGU's			
Carrying value of CGU after Allocation of corporate asset	24	36	60
Recoverable Amount	18	38	56
Impairment Loss	6	-	-

The impairment loss will be allocated on the basis of 4/24 against the building (Rs. 1 million) and 20/24 against the other assets (Rs. 5 million).

Q 22: A machine has suffered physical damage but is still working, although not as well as before it was damaged. The machine's fair value less costs of disposal is less than its carrying amount. The machine does not generate independent cash inflows. The smallest identifiable group of assets that includes the machine and generates cash inflows that are largely independent of the cash inflows from other assets is the production line to which the machine belongs. The recoverable amount of the production line shows that the production line taken as a whole is not impaired.

Assumption 1: budgets/forecasts approved by management reflect no commitment of management to replace the machine.

Assumption 2: budgets/forecasts approved by management reflect a commitment of management to replace the machine and sell it in the near future. Cash flows from continuing use of the machine until its disposal are estimated to be negligible.

Ans: 1. The recoverable amount of the machine alone cannot be estimated because the machine's value in use:

a) may differ from its fair value less costs of disposal; and

b) can be determined only for the cash-generating unit to which the machine belongs (the production line).

The production line is not impaired. Therefore, no impairment loss is recognised for the machine. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the machine. Perhaps a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the machine or the pattern in which economic benefits are expected to be consumed by the entity.

2. The machine's value in use can be estimated to be close to its fair value less costs of disposal. Therefore, the recoverable amount of the machine can be determined and no consideration is given to the cash-generating unit to which the machine belongs (i.e. the production line). Because the machine's fair value less costs of disposal is less than its carrying amount, an impairment loss is recognised for the machine.

Q 23: At the end of 2000 an entity tests a machine for impairment. The machine was bought five years earlier for Rs. 300,000, when its useful life was estimated to be 15 years and the estimated residual value was nil. At 31 December 2000, after recognising the depreciation charge for 2000, the machine's carrying amount was Rs. 200,000 and its remaining useful life was estimated at 10 years. The machine's value in use calculated using a pre-tax discount rate

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of 14 per cent per year is Rs. 179,310. Management believes "fair value less cost to sell" is lower than the value in use.

At 31 December 2004, management has reassessed the future cash flows based on changed circumstances since the end of 2000 and determined value in use at the end of 2004 to be Rs. 122,072 at 31 December 2004. Management believes "fair value less costs to sell" is less than value in use. Calculate impairment loss at the end of 2000 and reversal of impairment loss at the end of 2004.

Ans:

End of 2000	Machine
Carrying amount before impairment loss	Rs. 200,000
Less: Recoverable amount	(Rs.179,310)
Impairment loss	Rs. 20,690
Carrying amount after impairment loss (ie recoverable amount)	Rs. 179,310

Note: In this case, in subsequent periods (ie 2001–2010), assuming all variables remain the same as at the end of 2000, the depreciable amount will be Rs. 179,310, so the depreciation charge will be Rs. 17,931 per year (ie Rs. 179,310 ÷ 10 years).

End of 2004

Recoverable amount		Rs. 122,072
Carrying amount, before the reversal of the impairment loss recognised at 31/12/04		
Carrying amount as on 01/01/2001	Rs.1,79,310	
Less: Accumulated depreciation till 2004 (17,931 x 4)	Rs.71,724	Rs. 107,586
Difference		Rs. 14,486

The difference is only an indication of the amount of the reversal because the reversal cannot increase the carrying amount of the asset above the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

End of 20X4	Machine
Cost	300,000
Less Notional depreciation since acquisition until 31/12/20X4 [3,00,000/15 x 9]	(180,000)
Notional carrying amount at 31/12/20X4 if no impairment loss	
been Recognised for the asset in 2000	120,000
Less: Carrying amount at the year ended 31/12/2004,	
before the reversal of the impairment loss recognised in prior reporting periods	107,586
Maximum Reversal of prior year's impairment loss	12,414

Note: In subsequent periods (ie 2005–2010), assuming that all variables remain the same as at the end of 2004, the depreciable amount will be Rs. 120,000, so the annual depreciation charge will be Rs. 20,000 (ie Rs. 120,000 depreciable amount ÷ 6 years remaining useful life).

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Q 24: On 1st April 20X1, Venus ltd acquired 100% of Saturn ltd for Rs. 4,00,000. The fair value of the net identifiable assets of Saturn ltd was Rs. 3,20,000 and goodwill was Rs. 80,000. Saturn ltd is in coal mining business. On 31st March 20X3 the government has cancelled licenses given to it in few states.

As a result Saturn's ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result Venus ltd has to estimate the recoverable amount of goodwill and net assets of Saturn ltd on 31st March 20X3.

Venus ltd uses straight line depreciation. The useful life of Saturn's ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So the entire operation of Saturn ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn ltd as a CGU. Its value in use is estimated by the management at Rs. 2,12,000.

Suppose by 31st March 20X5 the government reinstates the licenses of Saturn ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's ltd net asset is re-estimated. The value in use is expected to be Rs. 3,04,000 and net selling price is expected to be Rs. 2,90,000.

Ans: Since the fair value less costs of disposal is not determinable the recoverable amount of the CGU is its value in use. The carrying amount of the assets of the CGU on 31st March 20X3 is as follows:

Calculation of Impairment loss INR

	Goodwill	Other assets	Total
Historical Cost	80,000	3,20,000	4,00,000
Accumulated Depreciation (3,20,000/20) x 2	-	(32,000)	(32,000)
Carrying Amount	80,000	2,88,000	3,68,000
Impairment Loss	(80,000)	(76,000)	(1,56,000)
Revised Carrying Amount			

Impairment Loss = Carrying Amount – Recoverable Amount (Rs. 3,68,000 - Rs. 2,12,000) = Rs. 1,56,000 is charged in statement of profit and loss for the period ending 31st March 20X3 as impairment loss.

Impairment loss is allocated first to goodwill Rs. 80,000 and remaining loss of Rs. 76,000 (Rs. 1,56,000 – Rs. 80,000) is allocated to the other assets.

Reversal of Impairment loss

Reversal of impairment loss is recognised subject to:-

The impairment loss on goodwill cannot be reversed.

The increased carrying amount of an asset after reversal of an impairment loss not to exceed the carrying amount that would have been determined had no impairment loss been recognised in prior years.

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Calculation of carrying amount of identifiable assets had no impairment loss is recognised

	INR
Historical Cost	3,20,000
Accumulated Depreciation for 4 years (3,20,000/20) x 4	(64,000)
Carrying amount had no impairment loss is recognised on 31st March 20X5	2,56,000
Carrying amount of other assets after recognition of impairment loss	INR
Carrying amount on 31st March 20X3	2,12,000
Accumulated Depreciation for 2 years (2,12,000/18) x 2	(24,000)
[rounded off to nearest thousand for ease of calculation]	
Carrying amount on 31st March 20X5	1,88,000

The impairment loss recognised previously can be reversed only to the extent of lower of re-estimated recoverable amount is Rs.3,04,000 (higher of fair value less costs of disposal Rs. 2,90,000 and value in use Rs. 3,04,000) the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods ie., Rs. 2,56,000

Impairment loss reversal will be Rs. 68,000 i.e. (Rs. 2,56,000 – Rs. 1,88,000). This amount is recognised as income in the statement of profit and loss for the year ended 31st March 20X5.

The carrying amount of other assets at 31st March 20X5 after reversal of impairment loss will be Rs. 2,56,000.

From 1st April 20X5 the depreciation charge will be Rs. 16,000 i.e. (Rs. 2,56,000/16)

Q 25 Mercury ltd has an identifiable asset with a carrying amount of Rs. 1,000. Its recoverable amount is Rs. 650. The tax rate is 30% and the tax base of the asset is Rs. 800. Impairment losses are not deductible for tax purposes. The effect of the impairment loss is as follows:

Ans:

Carrying amount	1,000 - 350	650
Tax Base		800
Deductible temporary difference		150
Deferred tax asset at 30%		45

In accordance with Ind AS 12, the entity recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

Q 26 Sun ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July 20X1 Sun ltd acquired an 80% interest in Pluto ltd. Details of the acquisition were as follows:

– Sun ltd acquired 800,000 shares in Pluto ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July 20X1 was Rs. 4 per share and the fair value of a Pluto's share was Rs. 1·40 per share. The costs of issue were 5% per share.

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– Sun ltd incurred further legal and professional costs of Rs. 100,000 that directly related to the acquisition.

– The fair values of the identifiable net assets of Pluto Ltd at 1st July 20X1 were measured at Rs. 1·3 million. Sun ltd initially measured the non-controlling interest in Pluto ltd at fair value. They used the market value of a Pluto ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto ltd was required at 31st March 20X2 or 20X3.

Pluto ltd comprises three cash generating units A, B and C. When Pluto ltd was acquired the directors of Sun ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount
	Rs. '000	Rs. '000
A	600	740
B	550	650
C	450	400

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd in the consolidated Balance Sheet of Sun ltd at 31st March 20X4 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto ltd.

Ans:

1. Computation of goodwill on acquisition

Particular	Amount (Rs.'000)
Cost of investment (8,00,000 x 2/5 x Rs.4)	1,280
Fair value of non-controlling interest (2,00,000 x Rs.1·4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
So goodwill equals	260

Acquisition costs are not included as part of the fair value of the consideration given under Ind AS 103, Business Combination.

2. Calculation of impairment loss

Unit	Carrying value			Recoverable Amount	Impairment Loss
	Before Allocation	Allocation of goodwill (2:2:1)	After Allocation		
A	600	104	704	740	Nil
B	550	104	654	650	4

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C	400*	52	452	400	52

* After writing down assets in the individual CGU to recoverable amount

3. Calculation of closing goodwill

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4. Calculation of overall impairment loss

on goodwill (W3)	56
on assets in unit C (450 – 400)	50
So total loss equals	106

Rs. 21·2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

Q 27 Great Ltd., acquired a machine on 1st April, 2012 for Rs. 7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1st April, 2016, the carrying value of the machine was reassessed at Rs. 5.10 crore and the surplus arising out of the revaluation being credited to revaluation reserve. For the year ended March 2018, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs. 79 lakhs.

Calculate the loss on impairment of the machine and show how this loss is to be treated in the books of Great Ltd. Great Ltd., had followed the policy of writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation.

Ans: Statement Showing Impairment Loss

	(Rs. in crores)
Carrying amount of the machine as on 1st April, 2012	7.00
Depreciation for 4 years i.e. 2012-2013 to 2015-2016 (7 crores/7 years) ×4 years	(4.00)
Carrying amount as on 31.03.2016	3.00
Add: Upward Revaluation (credited to Revaluation Reserve account)	2.10
Carrying amount of the machine as on 1st April 2016 (revalued)	5.10
Less: Depreciation for 2 years i.e. 2016-2017 & 2017-2018 (5.10 crores/3 years) ×2 years	(3.40)
Carrying amount as on 31.03.2018	1.70
Less: Recoverable amount	(0.79)
Impairment loss	0.91
Less: Balance in revaluation reserve as on 31.03.2018:	
Balance in revaluation reserve as on 31.03.2016 2.10	
Less: Enhanced depreciation met from revaluation reserve	
2016-2017 & 2017-2018 = [(1.70 – 1.00) x 2 years] (1.40)	
Impairment loss set off against revaluation reserve balance as per para 58 of AS 28 “Impairment of Assets”	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

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Q 28: X Ltd. purchased a fixed asset four years ago for Rs. 150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalued the asset at Rs. 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs. 67.50 lakhs and expected disposal costs are Rs. 3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs. 60 lakhs? **[MTP, May 2019]**

Ans: **Treatment of Impairment Loss:** As per IND AS 36 "Impairment of assets", if the recoverable amount (higher of net selling price and its value in use) of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. In the given case, net selling price is Rs. 64.50 lakhs (Rs. 67.50 lakhs – Rs. 3 lakhs) and value in use is Rs. 60 lakhs.

Therefore, recoverable amount will be Rs. 64.50 lakhs. Impairment loss will be calculated as Rs. 10.50 lakhs [Rs. 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less Rs. 64.50 lakhs (Recoverable Amount)].

Thus impairment loss of 10.50 lakhs should be recognised as an expense in the Statement of Profit and Loss immediately since there was downward revaluation of asset which was already charged to Statement of Profit and Loss.

Working Note: Calculation of carrying amount of the fixed asset at the end of the fourth year on revaluation

	(Rs. in lakhs)
Purchase price of a fixed asset	150.00
Less: Depreciation for four years [(150 lakhs / 10 years) x 4 years]	(60.00)
Carrying value at the end of fourth year	90.00
Less: Downward revaluation charged to profit and loss account	(15.00)
Revalued carrying amount	75.00

Q 29: An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at Rs. 6,00,000. The estimated cost of destroying the asset is Rs. 70,000. How is the asset to be accounted for?

Ans: As per IND AS 36 "Impairment of Assets", impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount, where, recoverable amount is the higher of an asset's net selling price* and its value in use·. In the given case, recoverable amount will be nil [higher of value in use (nil) and net selling price (Rs.70,000)]. Thus impairment loss will be calculated as Rs. 6,00,000 [carrying amount (Rs.6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of Rs. 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss.

* Net selling price is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. In the given case, Net Selling Price = Selling price – Cost of disposal = Nil – Rs.70,000 = Rs. (70,000)

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

Q 30: Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for Rs. 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was Rs. 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs. 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs. 54 crore per annum and has a carrying amount of Rs. 3.46 crore. All such machines put together could fetch a sum of Rs. 4.44 crore if disposed. Discuss the applicability of Impairment loss.

Ans: As per provisions of IND AS 36 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

QUESTIONS FROM RTP/MTP/EXAMS

Q 31 Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India. There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to Rs. 2 Lakh and Goodwill amounting to Rs. 1.50 Lakhs is included in such CGU.

Machinery A was purchased on 1st April 2013 for Rs. 10 Lakhs and residual value is Rs. 50 thousands. Machinery B was purchased on 1st April, 2015 for Rs. 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

Year	Cash Flows from Machinery A
1	1,50,000
2	1,00,000
3	1,00,000
4	1,50,000
5	1,00,000 (excluding Residual Value)
Total	6,00,000

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is Rs. 7 lakhs. The valuation fee was Rs. 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is Rs. 1.50 lakhs. Specialised packaging cost would be Rs. 25 thousand and legal fees would be Rs. 75 thousand.

The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is Rs. 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment

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of recoverability of the CGU and found that the value of such CGU is Rs. 11 Lakhs ie on 31st March, 2019. The Recoverable value of Machine A is Rs. 4,50,000 and combined Machine A and B is Rs. 7,60,000 as on 31st March, 2019.

Required:

a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.

b) Compute the prospective depreciation for the year 2018-2019 on the above assets.

c) Compute the carrying value of CGU as at 31st March, 2019. **[RTP May 2019]**

Ans:

(a) Computation of impairment loss and carrying value of each of the asset in CGU after impairment loss

(i) Calculation of carrying value of Machinery A and B before impairment

Machinery A

Cost	(A)	Rs. 10,00,000
Residual Value		Rs. 50,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	Rs. 95,000
WDV as at 31st March, 2018 [A- (B x 5)]		Rs. 5,25,000

Machinery B

Cost	(C)	Rs. 5,00,000
Residual Value		-
Useful life		10 years
Useful life already elapsed		3 years
Yearly depreciation	(D)	Rs. 50,000
WDV as at 31st March, 2018 [C- (D x 3)]		Rs. 3,50,000

(ii) Calculation of Value-in-use of Machinery A

Period	Cash Flows (Rs.)	PVF	PV
1	1,50,000	0.909	1,36,350
2	1,00,000	0.826	82,600
3	1,00,000	0.751	75,100
4	1,50,000	0.683	1,02,450

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5	1,00,000	0.621	62,100
5	50,000	0.621	31,050
Value in use			4,89,650

(iii) Calculation of Fair Value less cost of disposal of Machinery A

	Rs.
Fair Value	7,00,000
Less: Dismantling cost	(1,50,000)
Packaging cost	(25,000)
Legal Fees	(75,000)
Fair value less cost of disposal	4,50,000

(iv) Calculation of Impairment loss on Machinery A

	Rs.
Carrying Value	5,25,000
Less:Recoverable Value ie higher of Value-in-use and	
Fair value less cost of disposal	4,89,650
Impairment Loss	35,350

(v) Calculation of Impairment loss of CGU

1. First goodwill will be impaired fully and then the remaining impairment loss of Rs. 75,000 will be allocated to Machinery A and B.
2. If we allocate remaining impairment loss to Machinery A and B on pro- rata basis, it would come to Rs. 45,000 on Machinery A. However, the impairment loss of Machinery A cannot exceed Rs. 35,350.Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	Rs.	Rs.	Rs.
Machinery A	5,25,000	35,350	4,89,650
Machinery B	3,50,000	39,650*	3,10,350
Inventory	2,00,000	-	2,00,000
Goodwill	1,50,000	1,50,000	-
Total	12,25,000	2,25,000	10,00,000

* Balancing figure.

(b) Carrying value after adjustment of depreciation

	Rs.
Machinery A [4,89,650 – {(4,89,650-50,000)/5}]	4,01,720

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Machinery B [3,10,350 – (3,10,350/7)]	2,66,014
Inventory	2,00,000
Goodwill	-
Total	8,67,734

(c) Calculation of carrying value of CGU as on 31st March, 2019

The revised value of CGU is Rs. 11 Lakh. However, impaired goodwill cannot be reversed. Further, the individual assets cannot be increased by lower of recoverable value or Carrying Value as if the assets were never impaired.

Accordingly, the carrying value as on 31st March, 2019 assuming that the impairment loss had never incurred, will be:

	Carrying Value	Recoverable Value	Final CV as at 31st Mar 2019
Machinery A	4,30,000	4,50,000	4,30,000
Machinery B	3,00,000	(7,60,000 – 4,50,000) 3,10,000	3,00,000
Inventory	2,00,000	2,00,000	2,00,000
Goodwill	-		
Total	9,30,000	9,60,000	9,30,000

Hence the impairment loss to be reversed will be limited to Rs. 62,266 only (Rs. 9,30,000 – Rs. 8,67,734).

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Accounting For Share Based Payments (IND AS 102)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1 - Equity Settled Shared Based Payment- Service conditions

ABC limited granted to its employees, share options with a fair value of INR 5,00,000 on 1 April 20X0, if they remain in the organization upto 31st March 20X3. On 31st March 20X1, ABC limited expects only 91% of the employees to remain in the employment. On 31st March 20X2, company expects only 89% of the employees to remain in the employment. However, only 82% of the employees remained in the organisation at the end of March, 20X3 and all of them exercised their options. Pass the Journal entries?

Answer:

Period	Proportion	Fair value	To be vested	Cumulative expenses	Expenses
	a	b	c	d= b x c x a	e = d-previous period d
Period 1	1/3	5,00,000	91%	1,51,667	1,51,667
Period 2	2/3	5,00,000	89%	2,96,667	1,45,000
Period 3	3/3	5,00,000	82%	4,10,000	1,13,333
					4,10,000

Question 2 - Cash Settled Shared Based Payment-Service conditions

XYZ issued 10,000 Share Appreciation Rights (SARs) that vest immediately to its employees on 1 April 2000. The SARs will be settled in cash. At that date it is estimated, using an option pricing model, that the fair value of a SAR is INR 95. SAR can be exercised any time upto 31 March 20X3. At the end of period on 31 March 2001 it is expected that 95% of total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% will be vested only at the end of the 3rd year. Fair Values at the end of each period have been given below:

Fair value of SAR	INR
31-Mar-20X1	112
31-Mar-20X2	109
31-Mar-20X3	114

Pass the Journal entries?

Period	Fair value	To be vested	Cumulative	Expense
	a	b	c= a x b x 10,000	d= c-prev. period c
Start	95	100%	9,50,000	9,50,000
Period 1	112	95%	10,64,000	1,14,000
Period 2	109	92%	10,02,800	(61,200)
Period 3	114	89%	10,14,600	11,800
				10,14,600

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Question 3 - Share Based Payment-Cash Alternative

On 1 January 20X1, ABC limited gives options to its key management employees to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken must be kept for 3 years.

Fair values of the shares are as follows:	INR
Share alternative fair value (with restrictions)	102
Grant date fair value on 1 Jan 20X1	113
Fair value on 31 Dec 20X1	120
Fair Value on 31 Dec 20X2	132

The key management exercises his cash option at the end of 20X2. Pass the journal entries.

Answer:

	1-Jan-20X1	31-Dec-20X1	31-Dec-20X2
	INR	INR	INR
Equity alternative (1,500 x 102)	1,53,000		
Cash alternative (1,000 x 113)	1,13,000		
Equity option (1,53,000 - 1,13,000)	40,000		
Cash Option (cumulative) (using period end fair value)		(1,000 x 120 x ½)	
		60,000	1,32,000
Equity Option (cumulative)		(40,000 x ½) 20,000	40,000
Expense for the period			
Equity option		20,000	20,000
Cash Option		60,000	72,000
Total		80,000	92,000

Question 4:

Tata Industries has issued a share based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

Option I	Period	INR
Cash settled shares		74,000
Service condition	3 years	
Option II		
Equity settled Shares		90,000
Conditions:		
Service	3 years	
Restriction to sell	2 years	
Fair values		
Equity price with a restriction of sale for 2 years		115
Fair value grant date		135

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Fair value	20X0	138
	20X1	140
	20X2	147

Pass the Journal entries?

Answer:

Fair value of Equity option component:		
Fair value of a share with restrictive clause		INR 115
No. of shares		90,000
Fair Value	A	INR 1,03,50,000
Fair value of a share at the date of grant		INR 135
No. of cash settled shares		74,000
Fair Value	B	INR 99,90,000
Fair value of Equity component in Compound Instrument (A-B)		INR 3,60,000

Journal Entries

31/12/20X0	Employee benefit expenses	Dr.	35,24,000	
	To Share based payment reserve (equity) (3,60,000/3)			1,20,000
	To Share based payment liability (138 x 74,000) / 3			34,04,000
	(Recognition of Equity option and cash settlement option)			
31/12/20X1	Employee benefits expenses	Dr.	36,22,667	
	To Share based payment reserve (equity) (3,60,000/3)			1,20,000
	To Share based payment liability (140 x 74,000) 2/3-34,04,000			35,02,667
	(Recognition of Equity option and cash settlement option)			
31/12/20X2	Employee benefits expenses	Dr.	40,91,333	
	To Share based payment reserve (equity) (3,60,000/3)			1,20,000
	To Share based payment liability			39,71,333
	(147 x 74,000) 3/3- (34,04,000 + 35,02,667)			
	(Recognition of Equity option and cash settlement option)			
	Upon cash alternative chosen			
	Share based payment liability (147 x 74,000)	Dr.	1,08,78,000	
	To Bank/ cash			1,08,78,000
	(Being settlement made in cash)			
	Upon equity alternative chosen			
	Share based payment liability (147 x 74,000)	Dr.	1,08,78,000	

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	To Share Capital			1,08,78,000

Question 5 - Equity Settled – Non market conditions-

Ankita Holding Inc. grants 100 shares to each of its 500 employees at 1st January 20X1, provided the employees remain in service during the vesting period. The shares will vest at the end of the

First year if the company's earnings is more than 12%;

Second year if the company's earnings is more than 20% over the two-year period;

Third year if the entity's earnings increase by more than 22% over the three-year period.

The fair value of one share at the grant date is INR 122. In 20X1, earnings was 10%, and 29 employees left the organisation. The company expects that earnings will continue at a similar rate in 20X2 and expects that the shares will vest at the end of the year 20X2. The company also expects that additional 31 employees will leave the organisation in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2. At the end of 20X2, company's earnings was 18%. Therefore, the shares did not vest. Only 29 employees left the organization during 20X2. Company believes that additional 23 employees will leave in 20X3 and earnings will further increase so that the performance target will be achieved in 20X3. At the end of the year 20X3, only 21 employees have left the organization. Assume that the company's earnings increased to desired level and the performance target had been met.

Required: Determine the expense for each year? **[Nov 2018]**

Answer: Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	20X2	20X3
Total employees	500	500	500
Employees left	(29)	(58)	(79)
Expected to leave in future	(31)	(23)	-
Year End	440	419	421
Shares/employee	100	100	100
Fair value	122	122	122
Vesting period	1/2	2/3	3/3
Expenses-20X1	26,84,000	34,07,867	51,36,200
Expenses-20X2		7,23,867	
Expenses-20X3			17,28,333

Question 6 - Equity Settled – Non market conditions (Reversals)

ACC limited granted 10,000 share options to one of its manager. In order to get the options, the manager has to work for next 3 years in the organization and reduce the cost of production by 10% over the next 3 years.

Fair value of the option at Grant date was 95

Cost reduction achieved-

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Year 1	12% Achieved
Year 2	8% Not expected to vest in future
Year 3	10% Achieved

How the expenses would be recorded?

Solution

It is a non-market related condition. Hence, the target to achieve cost reduction would be taken while estimating the number of options to be vested.

Year	Options	Fair value		FV of the options vested
Year 1	10,000	95	1/3	3,16,667
Year 2	10,000	95	0	(3,16,667)
Year 3	10,000	95	3/3	9,50,000

The condition to achieve 10% cost reduction each was not fulfilled in the year 2 and there was no expectation to vest this non-market condition in future as well and hence earlier expense amount was reversed in year 2. Since in the year 3 the non-market condition again met, hence all such expense will be charged to Profit and Loss.

Question 7 - Equity Settled – Market based conditions

Apple Limited has granted 10,000 share option to one of its directors for which he must work for next 3 years and the price of the share should be 20% on an average over next 3 years.

The share price has moved as per below details -

Year 1	22%
Year 2	19%
Year 3	25%

At the grant date, the fair value of the option was INR 120. How should we recognize the transaction?

Solution: The share price movement is a market based vesting condition hence its expectations are being taken into consideration in calculating fair value of the option.

Even the required market condition does not meet, so there is no requirement to reverse the expense previously booked.

Irrespective of the outcome of the market price (as it is already taken care in fair value of the option), each period an amount of (120 x 10,000)/3 = INR 4,00,000 will be charged to profit and loss.

Question 8 - Modifications- Equity Settled Share based payment

Marathon Inc. has issued 150 share option to each of its 1,000 employees subject to the service condition of 3 years. Fair value of the option given was calculated at INR 129. the below are the details and activities related to the SBP plan-

Year 1: 35 left, further 60 are expected to leave

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Share options re-priced (as MV of shares has fallen) as the FV had fallen to INR 50.

After the re-pricing they are now worth INR 80, hence expense is expected to increase by INR 30

Year 2: 30 left, further 36 expected to leave

Year 3: 39 left

How the modification/ re-pricing will be accounted?

Solution

The re-pricing has been done at the end of year 1, and hence the increased expense would be spread over next 2 years equally.

Total increased value due to modification is INR 30 (1/2 weight each years)

	Year 1	Year 2	Year 3
No. of employees	1,000	1,000	1,000
Employee left	(35)	(65)	104
Expected to leave	(60)	(36)	
Net employees	905	899	896
Options/ employee	150	150	150
Fair value of option	129	129	129
Period weight	1/3	2/3	3/3
Modification		30	30
Expense (original)	58,37,250	57,59,850	57,40,500
Modification	nil	20,22,750	20,09,250
		(899x150x30x1/2)	(896x150x30x2/2)-20,22,750)

Question 9 - Cancellation- Equity Settled Share based payment

Anara Fertilisers limited has issued 2000 Share options to its 10 directors for an exercise price of INR 100.The directors are required to stay with the company for next 3 years.

Fair value of the option estimated 130

Expected Directors to vest the option 8

During the year 2, there was a crisis in the company and Management decided to cancel the such scheme immediately, it was estimated further as below-

Fair value of option at the time of cancellation was 90

Market price of the share at the cancellation date was 99

There was a compensation which was paid to directors and since only 9 directors were currently in employment. During the date of cancellation of such scheme hence amount of 95 per option has been given to each of 9 directors.

How the cancellation would be recorded?

Solution

A)	Year 1	Year 2

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Expected directors to vest	8	9
Fair value of option	130	130
No. of options	2,000	2,000
Total	20,80,000	23,40,000
Expense weightage	1/3	Full, as it is cancelled
Expense for the year	6,93,333	16,46,667
Remaining amount since cancelled		
B) Cancellation compensation		
No. of directors		9
Amount agreed to pay		95
No. of options/ director		2,000
Compensation amount Refer W-1 & W-2 (9 x 95 x 2,000)		17,10,000
Working Notes:		
1. Amount to be deducted from Equity		
No. of directors		9
Fair value of option (at the date of cancellation)		90
No. of options/ director		2,000
Total		16,20,000
2. Amount transferred to Profit and Loss		
Total cancellation compensation		17,10,000
Less: To deduct from Equity		(16,20,000)
Balance transferred to Profit and Loss		90,000

Question 10 -Share based Payment- Purchase of Goods

Indian Inc. issued 995 shares in exchange for a purchase of Office building. The title has been transferred in the name of Indian Inc. on Feb 20X1 and shares were issued. Fair value of the office building was INR 2,00,000 and face value of each share of Indian Inc was INR 100.

Pass the journal entries?

Answer:

1/2/20X1	Office Building	Dr.	2,00,000	
	To Share capital (995 x 100)			99,500
	To Securities premium (balance)			1,00,500
	(Recognition of equity option and cash settlement option)			

Question 11 - Share Based Payment- Services

Reliance limited hired a maintenance company for its oil fields. The services will be settled by issuing 1,000 shares of Reliance. Period for which the service is to be provided is 1 April 20X1 to 1 July 20X1 and fair value of the service was estimated using market value of similar contracts for INR 1,00,000. Nominal value per share is INR 10.

Record the transactions?

Fair value of services	1,00,000
No. of months	4

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Monthly expense				25,000
1-Apr-20X1	Repair & Maintenance	Dr.	25,000	
	To Share based payment reserve (equity)			25,000
	(Recognition of Equity settled SBP using fair value of services rendered)			
1-May-20X1	Repair & Maintenance	Dr.	25,000	
	To Share based payment reserve (equity)			25,000
	(Recognition of Equity settled SBP using fair value of services rendered)			
1-Jun-20X1	Repair & Maintenance	Dr.	25,000	
	To Share based payment reserve (equity)			25,000
	(Recognition of Equity settled SBP using fair value of services rendered)			
1-Jul-20X1	Repair & Maintenance	Dr.	25,000	
	To Share based payment reserve (equity)			25,000
	(Recognition of Equity settled SBP using fair value of services rendered)			
	Share based payment reserve (equity)	Dr.	1,00,000	
	To Equity Shares (1000 x 10)			10,000
	To Securities premium (balancing figure)			90,000

Question 12:

Company P is a holding Company for Company B. A group Share based payment is being organized in which Parent issues its own Equity shares for the employee of Company B. The details are as below –

No. of employee of Company B	100 nos.
Grant date fair value of Shares	INR 87
No. of Shares to each employee granted	25 nos.
Vesting conditions	Immediately

Pass the journal entry in the books of Company P & Company B?

Answer:

Books of Company P

Investment in Company B	Dr.	INR 2,17,500	
To Equity (Issue of Shares)			INR 2,17,500

Books of Company B

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Expense	Dr.	INR 2,17,500	
To Capital contribution from Parent P			INR 2,17,500

Question 13:

Plastic manufacturing company “X” enters into an agreement with a Company “Y” to purchase 100kg of fiber which will be settled in cash at an amount equal to 10 Shares of X. However, X can settle the contract at any time by paying an amount of current share price less market value of fiber. There is intention taking delivery of such fiber. How the transaction would be evaluated under Ind AS 102?

Answer: A non-financial item which is not intended to use for its expected purchases/ sale and could be settled at net value would be covered as per Ind AS 109 ‘Financial Instruments’. The transaction would not be accounted under Ind AS 102.

Question 14:

An Entity P issues Share based payment to its employees based on the below details –

No. of employees	100 nos.
Fair value at Grant date	INR 25
Market condition	Share price to reach at INR 30
Service condition	To remain in service until market condition meets
Expected completion of market condition	4 years

Define expenses related to such Share based payment in each year subject to the below scenarios-

a) Market condition meets in the year 3, OR

b) Market condition meets in the year 5

Question 15:

MINDA issued 11,000 share appreciation rights (SARs) that vest immediately to its employees on 1 April 20X0. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is INR 100. SAR can be exercised any time up until 31 March 20X3. At the end of period on 31 March 20X1 it is expected exercise the option 95% of total employees, 92% at the end of next year and finally it was vested only 89% at the end of the 3rd year.

Fair value of SAR	INR
31-Mar-20X1	132
31-Mar-20X2	139
31-Mar-20X3	141
Pass the Journal entries?	

Answer:

Period	Fair value	To be vested	Cumulative	Expense
Start	100	100%	11,00,000	11,00,000
Period 1	132	95%	13,79,400	2,79,400
Period 2	139	92%	14,06,680	27,280
Period 3	141	89%	13,80,390	(26,290)
				13,80,390

Question 16:

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Entity X grants 10 shares to its 1000 employees on the conditions as below-

- Service condition to remain in service & Entity's PAT will reach to INR 100 Million,
- Expected to reach PAT of INR 100 Million by end of 3 years
- Fair value at Grant date is INR 100
- Expected for vesting right by 1st year 97%, then it revises to 95% by 2nd year and finally to 93% by 3rd year,

Calculate expenses for next 3 years on account of Share-based payment?

Answer: Entity's PAT is one of the non-market related condition and hence would be included while making an expectation of vesting shares and there is no requirement to make any changes in the non-market condition if it meets or not because it has already been considered in the expectation of vesting rights at the end of each year.

Year -1	1,000 x 10 x 100 x 97% x1/3 = 3,23,333
Year-2	1,000 x 10 x 100 x 95% x 2/3 - 3,23,333 = 3,10,000
Year -3	1,000 x 10 x 100 x 93% x 3/3 - 6,33,333 = 2,96,667

Question 17:

At 1 January 20X1, Ambani Limited grants its CEO to take either 800 shares equivalent cash amount or 990 shares. The minimum service requirement is 2 years. There are some 3 years restriction if shares are being taken and must be kept for 3 years.

Fair values of the shares	INR
Share alternative fair value (with restrictions)	212
Grant date fair value on 1 January, 20X1	213
Fair value on 31 December, 20X1	220
Fair value on 31 December, 20X2	232

The key management exercises his cash option at the end of 20X2.

Answer:

	1-Jan-20X1	31-Dec-20X1	31-Dec-20X2
Equity alternative (990 x 212)	2,09,880		
Cash alternative (800 x 213)	1,70,400		
Equity option (2,09,880 – 1,70,400)	39,480		
Cash Option (cumulative) (using period end fair value)		88,000	1,85,600
Equity Option (cumulative)		19,740	39,480
Expense for the period			
Equity option		19,740	19,740
Cash Option		88,000	97,600
Total		1,07,740	1,17,340

Journal Entries

31-Dec-20X0	Employee benefits expenses	Dr.	1,07,740	
	To Share based payment reserve (equity)			19,740

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	To Share based payment liability			88,000
	(Recognition of Equity option and cash settlement option)			
31-Dec 20X1	Employee benefits expenses	Dr.	1,17,340	
	To Share based payment reserve (equity)			19,740
	To Share based payment liability			97,600
	(Recognition of Equity option and cash settlement option)			
	Share based payment liability	Dr.	1,85,600	
	To Bank/ Cash			1,85,600
	(Settlement in cash)			

QUESTIONS FROM RTP/MTP/EXAMS

Question 18:

P Ltd. granted 400 stock appreciation rights (SAR) each to 75 employees on 1st April 2017 with a fair value Rs. 200. The terms of the award require the employee to provide service for four years in order to earn the award. The fair value of each SAR at each reporting date is as follows:

31st March 2018	Rs. 210
31st March 2019	Rs. 220
31st March 2020	Rs. 215
31st March 2021	Rs. 218

What would be the difference if at the end of the second year of service (i.e. at 31 st March 2019), P Ltd. modifies the terms of the award to require only three years of service. Answer on the basis of relevant Ind AS. **[RTP Nov 2018]**

Answer

Date	Particulars		Debit	Credit
31.03.2018	Profit and Loss account	Dr.	15.75	
	To Liability against SARs			15.75
	(Being expenses liability for stock appreciation rights recognised)			
31.03.2019	Profit and Loss account	Dr.	17.25	
	To Liability for SARs			17.25
	(Being expenses liability for stock appreciation rights recognised)			
31.03.2020	Profit and Loss account	Dr.	15.38	

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	To Liability for SARs			15.38
	(Being expenses liability for stock appreciation rights recognised)			
31.03.2021	Profit and Loss account	Dr.	17.02	
	To Liability for SARs			17.02
	(Being expenses liability for stock appreciation rights recognised)			

Journal entries in the books of P Ltd (with modification of service period of stock appreciation rights) (Rs. in lakhs)

31.03.2018	Profit and Loss account	Dr.	15.75	
	To Liability for SARs			15.75
	(Being expenses liability for stock appreciation rights recognised)			
31.03.2019	Profit and Loss account	Dr.	28.25	
	To Liability for SARs			28.25
	(Being expenses liability for stock appreciation rights recognised)			
31.03.2020	Profit and Loss account	Dr.	20.50	
	To Liability for SARs			20.50
	(Being expenses liability for stock appreciation rights recognised)			

Working Notes:

Calculation of expenses for issue of stock appreciation rights without modification of service period

For the year ended 31st March 2018

= Rs. 210 x 400 awards x 75 employees x 1 year /4 years of service

= Rs. 15,75,000

For the year ended 31st March 2019

= Rs. 220 x 400 awards x 75 employees x 2 years /4 years of service - Rs. 15,75,000 previous recognised

= Rs. 33,00,000 - Rs. 15,75,000 = Rs. 17,25,000

For the year ended 31st March 2020

= Rs. 215 x 400 awards x 75 employees x 3 years/4 years of service - Rs. 33,00,000 previously recognised

= Rs. 48,37,500 - Rs. 33,00,000 = Rs. 15,37,500

For the year ended 31st March 2021

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= Rs. 218 x 400 awards x 75 employees x 4 years / 4 years of service – Rs. 48,37,500 previously recognised

= Rs. 65,40,000 – Rs. 48,37,500 = Rs. 17,02,500

Calculation of expenses for issue of stock appreciation rights with modification of service period

For the year ended 31st March 2018

= Rs. 210 x 400 awards x 75 employees x 1 year / 4 years of service = Rs. 15,75,000

For the year ended 31st March 2019

= Rs. 220 x 400 awards x 75 employees x 2 years / 3 years of service - Rs. 15,75,000 previous recognised = Rs. 44,00,000 - Rs. 15,75,000 = Rs. 28,25,000

For the year ended 31st March 2020

= Rs. 215 x 400 awards x 75 employees x 3 years/ 3 years of service - Rs. 44,00,000 previous recognised = Rs. 64,50,000 - Rs. 44,00,000 = Rs. 20,50,000.

Question 19:

A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is Rs. 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two-year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options.

Pass the necessary journal entries for giving effect to the above arrangement. **[RTP May 2019]**

Answer:

As required by paragraph B53 of the Ind AS 102, over the two-year vesting period, the subsidiary measures the services received from the employees in accordance, the requirements applicable to equity-settled share-based payment transactions as given in paragraph 43B. Thus, the subsidiary measures the services received from the employees on the basis of the fair value of the share options at grant date. An increase in equity is recognised as a contribution from the parent in the separate or individual financial statements of the subsidiary.

The journal entries recorded by the subsidiary for each of the two years are as follows:

Year 1	Remuneration expense	Dr.		
	(200 x 100 employees x Rs. 30 x 80% x ½)		2,40,000	
	To Equity (Contribution from the parent)			2,40,000
Year 2	Remuneration expense	Dr.		
	[(200 x 81 employees x Rs. 30) – 2,40,000]		2,46,000	
	To Equity (Contribution from the parent)			2,46,000

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Question 21:

A Ltd. had on 1st April, 2015 granted 1,000 share options each to 2,000 employees. The options are due to vest on 31st March, 2018 provided the employee remains in employment till 31st March, 2018.

On 1st April, 2015, the Directors of Company estimated that 1,800 employees would qualify for the option on 31st March, 2018. This estimate was amended to 1,850 employees on 31st March, 2016 and further amended to 1,840 employees on 31st March, 2017.

On 1st April, 2015, the fair value of an option was Rs. 1.20. The fair value increased to Rs. 1.30 as on 31st March, 2016 but due to challenging business conditions, the fair value declined thereafter. In September 2016, when the fair value of an option was Rs. 0.90, the Directors repriced the option and this caused the fair value to increase to Rs. 1.05. Trading conditions improved in the second half of the year and by 31st March, 2017 the fair value of an option was Rs.1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30th September, 2016 should be spread over the remaining vesting period from 30th September, 2016 to 31st March, 2018.

The Company has requested you to suggest the suitable accounting treatment for these transaction as on 31st March, 2017. **[MTP May 2019]**

Answer:

Paragraph 27 of Ind AS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.

If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

Accordingly, the amounts recognised in years 1 and 2 are as follows:

	Calculation	Compensation expense for period	Cumulative compensation expense
		Rs.	Rs.
	[1,850 employees× 1,000 options × Rs. 1.20] × 1/3	7,40,000	7,40,000
	(1,840 employees× 1,000 options × [(Rs.1.20 × 2/3)+ {(Rs.1.05 - 0.90) ×0.5/1.5}] – 7,40,000	8,24,000	15,64,000

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Accounting and Reporting of Financial Instruments

ILLUSTRATIONS

Financial Instrument

Illustration 1: Trade receivables

A Ltd. makes sale of goods to customers on credit of 45 days. The customers are entitled to earn a cash discount@ 2% per annum if payment is made before 45 days and an interest @ 10% per annum is charged for any payments made after 45 days. Company does not have a policy of selling its debtors and holds them to collect contractual cash flows. Evaluate the financial instrument.

Solution: In the above case, the trade receivable recorded in books represents contractual cash flows that are solely payments of principal (and interest if paid beyond credit period). Further, Company' s business model is to collect contractual cash flows.

Hence, this meets the definition of financial assets carried at amortised cost.

Illustration 2: Deposits

Z Ltd. (the 'Company') makes sale of goods to customers on credit. Goods are carried in large containers for delivery to the dealers' destinations. All dealers are required to deposit a fixed amount of Rs. 10,000 as security for the containers, which is returned only when the contract with Company terminates. The deposits carry 8% per annum which is payable only when the contract terminates. If the containers are returned by the dealers in broken condition or any damage caused, then appropriate adjustments shall be made from the deposits at the time of settlement. How would such deposits be treated in books of the dealers?

Solution: In this case, deposits are receivable in cash at the end of contract period between the dealer and the Company. These deposits represent cash flows that are solely payments of principal and interest. Moreover, these deposits normally cannot be sold. Hence, they meet the definition of financial asset carried at amortised cost

Illustration 3: Creditors for sale of goods

A Ltd. (the 'Company') makes purchase of steel for its consumption in normal course of business. The purchase terms provide for payment of goods at 30 days credit and interest payable@12% per annum for any delays beyond the credit period. Analyse the nature of this financial instrument.

Solution: A Ltd. has entered into a contractual arrangement for purchase of goods at a fixed consideration payable to the creditor. A contractual arrangement that provides for payment in fixed amount of cash to another entity meets the definition of financial liability.

Illustration 4: Contract for exchange on unfavourable conditions

A Ltd. (the 'Company') makes a borrowing for INR 10 lacs from RBC Bank, with annual installments of INR 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards.

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The Company is required to pay INR 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

(a) Does the above instrument meet definition of financial liability? Please explain.

(b) Analyse the differential amount to be exchanged for one-time settlement.

Solution

(a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of financial liability.

(b) Let's compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –

♦ Loan principal amount = Rs. 10,00,000

♦ Amount payable at the end of 6th year = Rs. 12,54,400 [10,00,000 * 1.12 * 1.12 (Interest for 5th& 6th year in default plus principal amount)]

♦ One time settlement = INR 13,00,000

♦ Additional amount payable = Rs. 45,600

The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavourable to A Ltd. (owing to additional amount payable in comparison to amount that would have been paid without one time settlement). Hence, the rescheduled arrangement meets definition of 'financial liability'.

Illustration 5: Derivative contract:

Entity – B Ltd writes an option contract for sale of shares of Target Ltd. at a fixed price of Rs. 100 per share to C Ltd. This option is exercisable anytime for a period of 90 days ('American option'). Evaluate this under definition of financial instrument. Market price of shares id Rs. 120.

Solution: In the above case – B Ltd has written an option, which if exercised by C Ltd. will result in B Ltd. selling equity shares of Target Ltd. for fixed cash of Rs. 100 per share. Such option will be exercised by C Ltd. only if the market price of shares of Target Ltd. increases beyond Rs. 100, thereby resulting in contractual obligation over B Ltd. to settle the contract under potential unfavourable terms.

In the above case, market price is already Rs. 120 which means that if option is exercised by C Ltd, then B Ltd shall buy shares from the market at Rs. 120 per share and sell at Rs. 100, thereby resulting in a loss or exchange at unfavourable terms to B Ltd. Hence, it meets the definition of financial liability in books of B Ltd.

Illustration 6: Settlement in variable number of shares

Target Ltd. took a borrowing from Z Ltd. for Rs.10,00,000. Z Ltd. enters into an arrangement with Target Ltd. for settlement of the loan against issue of a certain number of equity shares of Target Ltd. whose value equals Rs.10,00,000. For this purpose, fair value per share (to determine total number of equity shares to be issued) shall be determined based on the market price of the shares of Target

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Ltd. at a future date, upon settlement of the contract. Evaluate this under definition of financial instrument.

Solution: In the above scenario, Target Ltd. is under an obligation to issue variable number of equity shares equal to a total consideration of Rs. 10,00,000. Hence, equity shares are used as currency for purpose of settlement of an amount payable by Target Ltd. Since this is variable number of shares are to be issued in a non-derivative contract for fixed amount of cash, it tantamounts to use of equity shares as 'currency' and hence, this contract meets definition of financial liability in books of Target Ltd.

Illustration 7: Settlement alternative is non-financial obligation

LMN Ltd. issues preference shares to PQR Ltd. These preference shares are redeemable at the end of 5 years from the date of issue.

The instrument also provides a settlement alternative to the issuer whereby it can transfer a particular commercial building to the holder, whose value is estimated to be significantly higher than the cash settlement amount. Examine the nature of the financial instrument.

Solution: Such preference shares are financial liability because the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation.

Non Financial Contracts

Illustration 8: Executory contract:

Entity XYZ enters into a fixed price forward contract to purchase 10,00,000 kilograms of copper in accordance with its expected usage requirements.

The contract permits XYZ to take physical delivery of the copper at the end of 12 months or to pay or receive a net settlement in cash, based on the change in fair value of copper. Is the contract covered under Financial Instruments standard?

Solution: The above contract needs to be evaluated to determine whether it falls within the scope of the financial instruments standards. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of copper and it is to be settled at a future date.

However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash, or of taking delivery of the copper and selling it within a short period after delivery for the purpose of generating a profit from short term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under Ind AS 109.

Instead, it is accounted for as an executory contract and if it becomes onerous then Ind AS 37 would apply.

FINANCIAL LIABILITIES VS EQUITY INSTRUMENT

Illustration 9: Redeemable preference shares with mandatory fixed dividend

A Company has issued 6% mandatorily redeemable preference shares with mandatory fixed dividends. Evaluate whether such preference shares are an equity instrument or a financial liability to the issuer entity?

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Solution: In determining whether a mandatorily redeemable preference share is a financial liability or an equity instrument, it is necessary to examine the particular contractual rights attaching to the instrument's principal and return components.

The instrument in this example provides for mandatory periodic fixed dividend payments and mandatory redemption by the issuer for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment of principal) to the shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

Illustration 10: Redeemable preference shares with mandatory cumulative dividend

A Ltd. (issuer) issues preference shares to B Ltd. (holder). Those preference shares are redeemable at the end of 10 years from the date of issue and entitle the holder to a cumulative dividend of 15% p.a. The rate of dividend is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Solution: This instrument provides for mandatory fixed dividend payments and redemption by the issuer for a fixed amount at a fixed future date. Since there is a contractual obligation to deliver cash (for both dividends and repayment of principal) to the preference shareholder that cannot be avoided, the instrument is a financial liability in its entirety.

Illustration 11: Redeemable debentures with discretionary dividend

X Co. Ltd. (issuer) issues debentures to Y Co. Ltd. (holder). Those debentures are redeemable at the end of 10 years from the date of issue. Interest of 15% p.a. is payable at the discretion of the issuer. The rate of interest is commensurate with the credit risk profile of the issuer. Examine the nature of the financial instrument.

Solution: This instrument has two components – (1) mandatory redemption by the issuer for a fixed amount at a fixed future date, and (2) interest payable at the discretion of the issuer. The first component is a contractual obligation to deliver cash (for repayment of principal with or without premium, as per terms) to the debenture holder that cannot be avoided. This component of the instrument is a financial liability.

Illustration 12: Perpetual loan with mandatory interest

P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder). The loan is perpetual and entitles the holder to fixed interest of 8% p.a. Examine the nature of the financial instrument.

Solution: This instrument has two components – (1) mandatory interest by the issuer for a fixed amount at a fixed future date, and (2) perpetual nature of the principal amount.

The first component is a contractual obligation to deliver cash (for payment of interest) to the lender that cannot be avoided. This component of the instrument is a financial liability.

Illustration 13: Optionally convertible redeemable preference shares

D Ltd. issues preference shares to G Ltd. The holder has an option to convert these preference shares to equity instruments of the issuer anytime up to a period of 10 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 10 years. Examine the nature of the financial instrument.

Solution: This instrument has two components – (1) contractual obligation that is conditional on holder exercising its right to redeem, and (2) conversion option with the holder.

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The first component is a financial liability because the entity does not have the unconditional right to avoid delivering cash.

The other component – the conversion option with the holder is a equity instrument.

INSTRUMENTS THAT WILL OR MAY BE SETTLED IN OWN EQUITY:

Illustration 14: Conversion into a number of equity instruments equivalent to a fixed value

CBA Ltd. issues convertible debentures to RQP Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into equity shares of CBA Ltd. using a pre-determined formula. The formula is:

$$\frac{100\ crores\ x\ (1+10\%)^{\wedge}5}{Fair\ value\ on\ the\ date\ of\ conversion}$$

Examine the nature of the financial instrument.

Solution: Such a contract is a financial liability of the entity even though the entity can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. The underlying thought behind this conclusion is that the entity is using its own equity instruments 'as currency'.

Illustration 15: Conversion into a fixed number of equity instruments

DF Ltd. issues convertible debentures to JL Ltd. for a subscription amount of Rs. 100 crores. Those debentures are convertible after 5 years into 15 crore equity shares of Rs. 10 each. Examine the nature of the financial instrument.

Solution: This contract is an equity instrument because changes in the fair value of equity shares arising from market related factors do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered.

Illustration 16: Written option for a fixed or variable number of equity instruments

ST Ltd. purchases an option from AT Ltd. entitling the holder to subscribe to equity shares of issuer at a fixed exercise price of Rs. 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs. 2 per option. Examine whether the financial instrument will be classified as equity.

Solution: For the issuer AT Ltd., this option is an equity instrument as it will be settled by the exchange of a fixed amount of cash for a fixed number of its own equity instruments.

If, on the other hand, if the exercise price of the option was variable, say benchmarked to an index or a variable, other than the market price of equity shares of AT Ltd., the written option will be classified as a "financial liability" in the books of the issuer, AT Ltd.

In the above illustration, if the instrument is classified as "equity instrument", any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. It must also be noted that changes in the fair value of an equity instrument are not recognised in the financial statements. (Ind AS 32.22)

On the contrary, if the derivative instrument (i.e. the written option) is classified as "financial liability", any consideration received is measured initially at fair value and subsequently also at fair value, with fair value changes recognised in profit or loss.

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Illustration 17: Written option with multiple exercise prices

WC Ltd. writes an option in favour of GT Ltd. wherein the holder can purchase issuer's equity instruments at prices that fluctuate in response to the share price of issuer.

As per the terms, if the share price of issuer is less than Rs. 50 per share, option can be exercised at Rs. 40 per share. If the share price is equal to or more than Rs. 50 per share, option can be exercised at Rs. 60 per share. Explain the nature of the financial instrument.

Solution: As the contract will be settled by delivery of fixed number of instruments for a variable amount of cash, it is a financial liability.

Illustration 18: Share swap arrangements

Acquirer Ltd. enters into an arrangement with shareholders of Target Ltd. wherein Acquirer Ltd. will purchase shares of Target Ltd. in a share swap arrangement. The share swap ratio is agreed as 1:5 i.e. 1 equity share of Acquirer Ltd. for every 5 equity shares held in Target Ltd. Examine whether the financial instrument will be classified as equity.

Solution: Such arrangements will not meet the condition for classification as "equity instrument" since the contract will be settled by delivery of fixed number of Acquirer Ltd.'s own equity instruments against a variable amount of cash i.e. market value of Target Ltd.'s equity shares.

Such a contract will likely result in a derivative liability or asset for both the parties.

Illustration 19: Conversion ratio changes with time

On 1 January 20X1, NKT Ltd. subscribes to convertible preference shares of VT Ltd. The conversion ratio varies as below:

Conversion upto 31 March 20X1: 1 equity share of VT Ltd. for each preference share held

Conversion upto 30 June 20X1: 1.5 equity share of VT Ltd. for each preference share held

Conversion upto 31 December 20X1: 2 equity share of VT Ltd. for each preference share held.

Examine whether the financial instrument will be classified as equity.

Solution:

The convertible preference shares can be classified as "equity instrument" in the books of the issuer, VT Ltd. The conversion ratio doesn't change corresponding to any underlying variable, it only varies in response to passage of time which is a certain event and hence fixed.

Illustration 20: Conversion ratio changes to protect rights of convertible instrument holders

On 1 January 20X1, HT Ltd. subscribes to convertible preference shares of RT Ltd. The preference shares are convertible in the ratio of 1:1.

The terms of the instrument entitle HT Ltd. to proportionately more equity shares of RT Ltd. in case of a stock split or bonus issue. Examine whether the financial instrument will be classified as equity.

Solution: The convertible preference shares can be classified as "equity instrument" in the books of the issuer, RT Ltd. The variability in the conversion ratio is only to protect the rights of the holder of convertible instrument vis-à-vis other equity shareholders.

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The conversion was always intended to be in a fixed ratio and hence the holder is exposed to the change in equity value. The variability is brought in to maintain holder's exposure in line with other holders.

Illustration 21: Conversion ratio changes if issuer subsequently issues shares to others at a lower price

On 1 January 20X1, PG Ltd. subscribes to convertible preference shares of BG Ltd. at Rs. 100 per preference share. The preference shares are convertible in the ratio of 10:1 i.e. 10 equity shares for each preference share held. On a fully diluted basis, PG Ltd. is entitled to 30% stake in BG Ltd.

If subsequent to the issuance of these convertible preference shares, BG Ltd. issues any equity instruments at a price lower than Rs. 10 per share, conversion ratio will be changed to compensate PG Ltd. for dilution in its stake below the expected dilution at a price of Rs. 10 per share. Examine the nature of the financial instrument.

Solution: The convertible preference shares will be classified as "financial liability" in the books of the issuer, BG Ltd. The variability in the conversion ratio underwrites the return on preference shares and not just protects the rights of convertible instrument holders vis-à-vis equity shareholders.

Illustration 22: Conversion ratio is variable in a narrow range

On 1 January 20X1, NG Ltd. subscribes to convertible preference shares of AG Ltd. at Rs. 100 per preference share. On a fully diluted basis, NG Ltd. is entitled to 30% stake in AG Ltd.

The preference shares are convertible at fair value, subject to, NG Ltd.'s stake not going below 15% and not going above 40%. Examine the nature of the financial instrument.

Solution: The convertible preference shares will be classified as "financial liability" in the books of the issuer, AG Ltd. The variability in the conversion ratio underwrites the return on preference shares to an extent and also restricts that return. The preference shareholder is not entitled to residual net assets of the issuer.

Illustration 23: Instrument convertible only at the option of issuer

XYZ Ltd. issues optionally convertible debentures with the following terms:

The debentures carry interest at the rate of 7% p.a.

Issuer has option to either:

Convert the instrument into a fixed number of its own shares at any time, or redeem the instrument in cash at any time. The redemption price is the fair value of the fixed number of shares into which the instrument would have converted if it had been converted.

The holder has no conversion or redemption options.

Debentures have a tenor of 12 years and, if not converted or redeemed earlier, will be repaid in cash at maturity, including accrued interest, if any.

Examine the nature of the financial instrument.

Solution

The issuer has the ability to convert the debentures into a fixed number of its own shares at any time. The issuer, therefore, has the ability to avoid making a cash payment or settling the debentures in a

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variable number of its own shares. Therefore, such a financial instrument is likely to be classified as equity.

However, it must be noted that mere existence of a right to avoid payment of cash is not conclusive. The instrument is to be accounted for as per its substance and hence it needs to be seen whether the conversion option is substantive.

In this particular situation, the issuer will need to determine whether it is favourable to exercise the conversion option or redemption option. In case of latter, the instrument will be classified as a financial liability (a hybrid instrument, whose measurement is dealt with in a subsequent section).

Illustration 24: Conversion ratio changes under independent scenarios

On 1 January 20X1, STAL Ltd. subscribes to convertible preference shares of ATAL Ltd.

The preference shares are convertible as below:

Convertible 1:1 if another strategic investor invests in the issuer within one year

Convertible 1.5:1: if an IPO is successfully completed within 2 years

Convertible 2:1: if a binding agreement for sale of majority stake by equity shareholders is entered into within 3 years

Convertible 3:1: if none of these events occur in 3 years' time.

Examine whether the financial instrument will be classified as equity.

Solution: In this case the four events can be viewed as discrete because the achievement of each one of these can occur independently of the other (as they relate to different periods). The arrangement can therefore be considered to be economically equivalent to four separate contracts. The price per share and the amount of shares to be issued is fixed in each of these discrete periods, with each event relating to a different year and therefore a separate risk. The "fixed for fixed" test is therefore met.

The instrument is therefore classified as "equity instrument".

Illustration 25: Conversion ratio changes under inter-dependent scenarios

On 1 January 20X1, RHT Ltd. subscribes to convertible preference shares of RDT Ltd.

The preference shares are convertible as below:

Convertible 1:1 if another strategic investor invests at an enterprise valuation (EV) of USD 100 million.

Convertible 1.5:1: if another strategic investor invests at EV of USD 150 million

Convertible 2:1: if another strategic investor invests at EV of USD 200 million

Convertible 3:1: if no strategic investment is made within a period of 3 years

Examine the nature of the financial instrument.

Solution: The four events are interdependent because the second event cannot be met without also meeting the first event, and the third event cannot be met unless the first two are met.

Therefore, this contract should be treated as a single instrument when applying the "fixed for fixed" test. The test is then failed because the number of shares to be exchanged for cash are variable.

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PUTTABLE INSTRUMENTS

Illustration 26: Cap on amount payable on liquidation

ABC Ltd. has two classes of puttable shares – Class A shares and Class B shares. On liquidation, Class B shareholders are entitled to a pro rata share of the entity's residual assets up to a maximum of Rs. 10,000,000. There is no limit to the rights of the Class A shareholders to share in the residual assets on liquidation. Examine the nature of the financial instrument.

Solution: The cap of Rs. 10,000,000 means that Class B shares do not have entitlement to a pro rata share of the residual assets of the entity on liquidation. They cannot therefore be classified as equity.

Illustration 27: Investment manager's share in a mutual fund

Mutual Fund X has an Investment Manager Y. At the inception of the fund, Y had invested a nominal or token amount in units of X. Such units rank last for repayment in the event of liquidation. Accordingly, they constitute the most subordinate class of instruments. Examine the nature of the financial instrument.

Solution: Resultantly, the units held by other unit holders are classified as financial liability as they are not the most subordinate class of instruments – they are entitled to pro rate share of net assets on liquidation, and their claim has a priority over claims of Y.

It may be noted that the most subordinate class of instruments may consist of two or more legally separate types of instruments.

Illustration 28: Differential voting rights

T Motors Ltd. has issued puttable ordinary shares and puttable 'A' ordinary shares whereby holders of ordinary shares are entitled to one vote per share whereas holders of 'A' ordinary shares are not entitled to any voting rights. The holders of two classes of shares are equally entitled to receive share in net assets upon liquidation. Examine whether the financial instrument will be classified as equity.

Solution: Neither of the two classes of puttable shares can be classified as equity, as they do not have identical features due to the difference in voting rights. It is not possible for T Motors Ltd. to achieve equity classification of the ordinary shares by designating them as being more subordinate than the 'A' ordinary shares, as this does not reflect the fact that the two classes of share are equally entitled to share in entity's residual assets on liquidation.

Illustration 29: Conversion into a variable number of equity instruments

S Ltd. has issued a class of puttable ordinary shares to T Ltd. Besides the put option (which is consistent with other classes of ordinary shares), T Ltd. is also entitled to convert the class of ordinary shares held by it into equity instruments of S Ltd. whose number will vary as per the market value of S Ltd. Examine whether the financial instrument will be classified as equity.

Solution The shares cannot qualify for equity classification in their entirety as in addition to the put option there is also a contractual obligation to settle the instrument in variable number of entity's own equity instruments.

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TREASURY SHARES

Illustration 30:

A Limited buys back 1,00,000 of its own equity shares in the market for Rs.5 per share. The shares will be held as treasury shares to enable A Limited to satisfy its obligations under its employee share option scheme.

Solution: The following entry will be made to recognise the purchase of the treasury shares as a deduction from equity:

Dr Equity Rs. 5,00,000

Cr Cash Rs. 5,00,000

ACCOUNTING TREATMENT OF INTEREST, DIVIDEND, LOSSES AND GAINS

Illustration 31:

Entity B places its privately held ordinary shares that are classified as equity with a stock exchange and simultaneously raises new capital by issuing new ordinary shares on the stock exchange. Transaction costs are incurred in respect of both transactions. Determine the treatment of the incurred transactions costs?

Solution: Since the issue of new shares is the issue of an equity instrument, but the placing of the existing equity instruments with the exchange is not, the transaction costs will need to be allocated between the two transactions.

Transaction costs in respect of the new shares issued will be recognised in equity whereas the transaction costs incurred in placing the existing shares with the stock exchange will be recognised in profit or loss.

Illustration 32:

An entity issues a non-redeemable callable subordinated bond with a fixed 6% coupon. The coupon can be deferred in perpetuity at the issuer‘s option. The issuer has a history of paying the coupon each year and the current bond price is predicated on the holders expectation that the coupon will continue to be paid each year. In addition the stated policy of the issuer is that the coupon will be paid each year, which has been publicly communicated. Evaluate?

Solution: Although there is both pressure on the issuer to pay the coupon, to maintain the bond price, and a constructive obligation to pay the coupon, there is no contractual obligation to do so. Therefore the bond is classified as an equity instrument.

Illustration 33:

A zero coupon bond is an instrument where no interest is payable during the instrument's life and that is normally issued at a deep discount to the value at which it will be redeemed. Evaluate?

Solution: Although there are no mandatory periodic interest payments, the instrument provides for mandatory redemption by the issuer for a determinable amount at a fixed or determinable future date. Since there is a contractual obligation to deliver cash for the value at which the bond will be redeemed, the instrument is classified as a financial liability.

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OFFSETTING A FINANCIAL ASSET AND A FINANCIAL LIABILITY

Illustration 34: offsetting

Company X owes Company Y Rs.20 million at the end of 31 March. As part of another contract, Company Y owes Company X Rs.15 million at 31 March. Company X has the legal right to set off the asset and liability but historically, Company X has settled one month after Company Y settles. Can Company X offset the asset and liability?

Sol: No, since Company X cannot demonstrate the intention to settle net or simultaneously for all payments.

COMPOUND FINANCIAL INSTRUMENTS

Illustration 35: Perpetual loan with mandatory interest

P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder). The loan is perpetual and entitles the holder to fixed interest of 8% p.a. Examine the nature of the financial instrument.

Solution: This instrument has two components – (1) mandatory interest by the issuer for a fixed amount at a fixed future date, and (2) perpetual nature of the principal amount.

The first component is a contractual obligation to deliver cash (for payment of interest) to the lender that cannot be avoided. This component of the instrument is a financial liability.

The other component, perpetual principal, is an equity feature because issuer is not required to pay cash or another financial asset in this respect.

Therefore, this instrument is concluded to be a compound financial instrument.

Illustration 36: Optionally convertible redeemable preference shares

D Ltd. issues preference shares to G Ltd. The holder has an option to convert these preference shares to equity instruments of the issuer anytime up to a period of 10 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 10 years. Examine the nature of the financial instrument.

Solution

This instrument has two components – (1) contractual obligation that is conditional on holder exercising its right to redeem, and (2) conversion option with the holder.

The first component is a financial liability because the entity does not have the unconditional right to avoid delivering cash.

The other component, conversion option with the holder, is an equity feature if the "fixed for fixed" test is satisfied. If the conversion option does not fulfil that test, say, because the conversion ratio varies in response to an underlying variable, it is a derivative liability. Such an instrument is called a "hybrid instrument".

Illustration 37:

On 1 January 1999, Entity A issued a 10 per cent convertible debenture with a face value of Rs. 1,000 maturing on 31 December 2008. The debenture is convertible into equity shares of Entity A at a conversion price of Rs.25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity

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A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

On 1 January 2006, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to Rs.20 if the debenture is converted before 1 March 2006 (i.e. within 60 days).The market price of Entity A's equity shares on the date the terms are amended is Rs.40 per share.

Solution: The fair value of the incremental consideration paid by Entity A is calculated as follows:

Number of equity shares to be issued to debenture holders under amended conversion terms:

Face amount	Rs. 1,000
New conversion price	Rs. 20 per share
Number of equity shares to be issued on conversion (A)	50 shares
Number of equity shares to be issued to debenture holders under original conversion terms:	
Face amount	Rs. 1,000
Original conversion price	Rs.25 per share
Number of equity shares issued upon conversion (B)	40 shares
Number of incremental equity shares issued upon conversion (A-B)	10 Shares
Value of incremental equity shares issued upon conversion	
Rs.40 per share x 10 incremental shares	Rs.400

FINANCIAL ASSETS: MEASUREMENT

Illustration 38: Loans with processing fee:

ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fee @ 1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

- Rs. 10 lacs for a term of 5 years
- Rs. 8 lacs for a term of 3 years.

Compute the fair value upon initial recognition of the loan in books of Target Ltd.

Solution: The loans from ABC Bank carry interest@ 10% and 12% for 5 year term and 3 year term respectively. Additionally, there is a processing fee payable @ 1% on the principal amount on date of transaction. It is assumed that ABC Bank charges all customers in a similar manner and hence, this is representative of the market rate of interest.

Accordingly, if the fair value is to be computed by discounting all future cash flows (including principal and interest) at the market rate of interest (which is the same as that of the respective loans), the fair value shall be the principal amount itself.

Further, any transaction costs like the aforementioned processing fees shall be reduced from the principal amount to arrive the value on day 1 upon initial recognition.

Fair value (5 year term loan) = 10,00,000 – 10,000 (1%*1,000,000) = 9,90,000

Fair value (3 year term loan) = 8,00,000 – 8,000 (1%*800,000) = 7,92,000.

Illustration 39: Deposits carrying off-market rate of interest:

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Containers Ltd provides containers for use by customers for multiple purposes. The containers are returnable at the end of the service contract period (3 years) between Containers Ltd and its customers. In addition to the monthly charge, there is a security deposit that each customer makes with Containers Ltd for Rs. 10,000 per container and such deposit is refundable when the service contract terminates. Deposits do not carry any interest. Analyse the fair value upon initial recognition in books of customers leasing containers. Market rate of interest for 3 year loan is 7% per annum.

Solution: In the above case, lessee (ie, customers leasing the containers) make interest free deposits, which are refundable at the end of 3 years. Now, this money if it was to lent to a third party would fetch interest @ 7% per annum.

Hence, discounting all future cash flows (ie, Rs. 10,000)

Fair value on initial recognition = 10,000/ (1+0.07)3 = 8,163.

Differential on day 1 = 10,000 – 8,163 = 1,837 is recognised in profit or loss

FINANCIAL LIABILITY: MEASUREMENT

Illustration 40: Trade creditors at market terms

A Company purchases its raw materials from a vendor at a fixed price of Rs. 1,000 per tonne of steel. The payment terms provide for 45 days of credit period, after which an interest of 18% per annum shall be charged. How would the creditors be classified in books of the Company?

Solution: In the above case, creditors for purchase of steel shall be carried at amortised cost, ie, fair value of amount payable upon initial recognition plus interest (if payment is delayed). Here, fair value upon initial recognition shall be the price per tonne, since the transaction is at market terms between two knowledgeable parties in an arms-length transaction and hence, the transaction price is representative of fair value.

Illustration 41:

An entity is about to purchase a portfolio of fixed rate assets that will be financed by fixed rate debentures. Both financial assets and financial liabilities are subject to the same interest rate risk that gives rise to opposite changes in fair value that tend to offset each other. Provide your comments.

Solution: The fixed rate assets provide for contractual cash flows and based on business model of the entity, such fixed rate assets may be classified as 'amortised cost' (if entity collects contractual cash flows) or fair value through other comprehensive income (FVOCI) (if entity manages through collecting contractual cash and sale of financial assets). In the absence of fair value option, the entity can classify the fixed rate assets as FVOCI with gains and losses on changes in fair value recognised in other comprehensive income and fixed rate debentures at amortised cost. However, reporting both assets and liabilities at fair value through profit and loss, ie, FVTPL corrects the measurement inconsistency and produces more relevant information. Hence, it may be appropriate to classify the entire group of fixed rate assets and fixed rate debentures at fair value through profit or loss (FVTPL).

Illustration 42: Issue of variable number of shares against issue of CCPS

A Ltd. issued compulsorily convertible preference shares (CCPS) at Rs. 100 each (Rs. 10 face value + Rs. 90 premium per share) for Rs. 10,00,000. These are convertible into equity shares at the end of 10 years, where the number of equity shares to be issued shall be determined based on fair value per equity share to be determined at the time of conversion.

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Evaluate if this is financial liability or equity? What if the conversion ratio was fixed at the time of issue of such preference shares?

Solution

i. As Per Ind AS 109, non-derivative contracts which will be settled against issue of variable number of own equity shares meet the definition of financial liability.

In this case, A Ltd. has issued CCPS which are convertible into variable number of shares. Hence, it is akin to use of own equity shares as currency for settlement of the liability of CCPS issued. Accordingly, it meets the definition of financial liability.

Measurement –

Initial measurement – this shall be measured at fair value on date of transaction. Being a transaction with third party and in the absence of any other indicators, the transaction price is representative of fair value.

Subsequent measurement – Such liability shall be carried at fair value through profit or loss.

ii. As Per Ind AS 109, a non-derivative contract that involves issue of fixed number of equity shares shall be classified as equity.

In this case, if the conversion of CCPS was into a fixed number of equity shares at the end of 10 years, then it meets the definition of equity and hence, shall be classified as 'equity instrument'.

An equity instrument is carried at cost and no further adjustments made to its carrying value after initial recognition.

DERECOGNITION OF FINANCIAL ASSET

Illustration 43: Assignment of receivables

ST Ltd. assigns its trade receivables to AT Ltd. The carrying amount of the receivables is Rs. 10,00,000. The consideration received in exchange of this assignment is Rs. 9,00,000. Customers have been instructed to deposit the amounts directly in a bank account for the benefit of AT Ltd. AT Ltd. has no recourse to ST Ltd. in case of any shortfalls in collections. State whether the derecognition principles will be applied or not.

Solution: In this situation, ST Ltd. has transferred the rights to contractual cash flows and has also transferred substantially all the risks and rewards of ownership (credit risk being the most significant risk in this situation).

Accordingly, ST Ltd. derecognises the financial asset and recognises Rs. 1,00,000, the difference between consideration received and carrying amount, as an expense in the statement of profit or loss.

Illustration 44:

Entity A (the transferor) holds a portfolio of receivables with a carrying value of Rs. 1,000,000. It enters into a factoring arrangement with entity B (the transferee) under which it transfers the portfolio to entity B in exchange for Rs. 900,000 of cash.

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Entity B will service the loans after their transfer and debtors will pay amounts due directly to entity B. Entity A has no obligations whatsoever to repay any sums received from the factor and has no rights to any additional sums regardless of the timing or the level of collection from the underlying debts.

Solution: Entity A has transferred its rights to receive the cash flows from the asset via an assignment to entity B. Furthermore, as entity B has no recourse to entity A for either late payment risk or credit risk, entity A has transferred substantially all the risks and rewards of ownership of the portfolio.

Hence, entity A derecognises the entire portfolio. The difference between the carrying value of Rs. 1,000,000 and cash received of Rs. 900,000 i.e. Rs. 100,000 is recognised immediately as a financing cost in profit or loss.

Had Entity A not transferred its rights to receive the cash flows from the asset or there would have been any credit default guarantee given by entity A, then it would have not led to complete transfer of risk and rewards and entity A could not derecognise the portfolio due to the same.

Illustration 45:

A Ltd. sells certain receivables, due in 6 months with a carrying amount of Rs. 1,00,000 to P ltd. for a cash payment of Rs. 95,000 with full right of recourse. Under the terms of the recourse provisions, the transferor is obliged to reacquire certain receivables at original price plus interest, if P ltd. chooses to return them. P ltd has unconditional put option on the assets transferred. Give the accounting treatment.

Solution: In this situation, A Ltd. has transferred the rights to contractual cash flows but not transferred substantially all the risks and rewards of ownership (credit risk being the most significant risk in this situation). Accordingly, A Ltd. the entity shall,

- continue to recognise the transferred asset in its entirety,
- recognise a financial liability for the consideration received at Rs. 95000. The liability is subsequently measured at amortised cost using the effective interest method, and
- in subsequent periods, recognise any income on the transferred asset and any expense incurred on the financial liability.

DERIVATIVES

Illustration 46:

Silver Ltd. has purchased 100 ounces of gold on 10 March 20X1. The transaction provides for a price payable which is equal to market value of 100 ounces of gold on 10 April 20X1 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction price at Rs. 10 per share on 10 April 20X1. Whether this is classified as liability or equity? Own use exemption does not apply.

Solution: In the above scenario, there is a contract for purchase of 100 ounces of gold whose consideration varies in response to changing value of gold. Analysing this contract as a derivative –

(a) Value of contract changes in response to change in market value of gold;

(b) There is no initial net investment

(c) It will be settled at a future date, i.e. 10 April 20X1.

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Since the above criteria are met, this is a derivative contract.

Now, a derivative contract that is settled in own equity other than exchange of fixed amount of cash for fixed number of shares is classified as 'liability'. In this case, since the contract results in issue of variable number of shares based on transaction price to be determined in future, hence, this shall be classified as 'derivative financial liability'. Per Ind AS 109.4.2.1 – A derivative financial liability shall be carried at fair value through profit or loss.

Illustration 47: Prepaid interest rate swap (fixed rate payment obligation prepaid at inception)

Entity S enters into a Rs. 100 crores notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C.

- ♦ The interest rate of the variable part of the swap is reset on a quarterly basis to three-month Mumbai Interbank Offer Rate (MIBOR).
- ♦ The interest rate of the fixed part of the swap is 10% p.a.
- ♦ Entity S prepays its fixed obligation under the swap of Rs. 50 crores (Rs. 100 crores × 10% × 5 years) at inception, discounted using market interest rates
- ♦ Entity S retains the right to receive interest payments on the Rs. 100 crores reset quarterly based on three-month MIBOR over the life of the swap.

Analyse.

Solution: The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond.

Therefore, the contract fulfils the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'.

Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

Illustration 48: Prepaid pay-variable, receive-fixed interest rate swap

- ♦ Entity S enters into a Rs. 100 crores notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C.
- ♦ The variable leg of the swap is reset on a quarterly basis to three-month MIBOR.
- ♦ The fixed interest payments under the swap are calculated as 10% of the swap's notional amount, i.e. Rs. 10 crores p.a.
- ♦ Entity S prepays its obligation under the variable leg of the swap at inception at current market rates. Say, that amount is Rs. 36 crores.
- ♦ It retains the right to receive fixed interest payments of 10% on Rs. 100 crores every year.

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Analyse.

Solution: In effect, this contract results in an initial net investment of Rs. 36 crores which yields a cash inflow of Rs. 10 crores every year, for five years. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions.

For this reason, the instrument fails the condition 'no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors'. Therefore, the contract is not accounted for as a derivative contract.

Illustration 49: prepaid forward

Entity XYZ enters into a forward contract to purchase 1 million ordinary shares of Entity T in one year

- ♦ The current market price of T is Rs. 50 per share
- ♦ The one-year forward price of T is Rs. 55 per share
- ♦ XYZ is required to prepay the forward contract at inception with a Rs. 50 million payment.

Analyse.

Solution

Purchase of 1 million shares for current market price is likely to have the same response to changes in market factors as the contract mentioned above. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

PRACTICE QUESTIONS

COMPOUND FINANCIAL INSTRUMENTS

Q 1: P Co. Ltd. (issuer) takes a loan from Q Co. Ltd. (holder) for Rs. 12 lakhs. The loan is perpetual and entitles the holder to fixed interest of 8% p.a. The rate of interest commensurate with credit risk profile of the issuer is 12% p.a. Calculate the value of the liability and equity components.

Ans: The values of the liability and equity components are calculated as follows:

Present value of interest payable in perpetuity (Rs. 96,000 discounted at 12%) = Rs. 800,000

Therefore, equity component = fair value of compound instrument, say, Rs. 1,200,000 less financial liability component i.e. Rs. 800,000 = Rs. 400,000.

In subsequent years, the profit and loss account is charged with interest of 12% on the debt instrument.

Q 2 ABC Company issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1 April 20X1 @ Rs 150 each. The rate of dividend is 10% payable every year. The

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preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% per annum. Transaction cost on the date of issuance is 2% of the value of the proceeds.

Key terms:

Date of Allotment	01-Apr-20X1
Date of Conversion	01-Apr-20X6
Number of Preference Shares	10,000
Face Value of Preference Shares	150
Total Proceeds	15,00,000
Rate Of dividend	10%
Market Rate for Similar Instrument	15%
Transaction Cost	30,000
Face value of equity share after conversion	10
Number of equity shares to be issued	5,000
The effective interest rate for liability component	15.86%

Ans: This is a compound financial instrument with two components – liability representing present value of future cash outflows and balance represents equity component.

a. Computation of Liability & Equity Component

Date	Particulars	Cash Flow	Discount Factor	Net present Value
01-Apr-20X1		0	1	0.00
31-Mar-20X2	Dividend	150,000	0.869565	130,434.75
31-Mar-20X3	Dividend	150,000	0.756144	113,421.6
31-Mar-20X4	Dividend	150,000	0.657516	98,627.4
31-Mar-20X5	Dividend	150,000	0.571753	85,762.95
31-Mar-20X6	Dividend	150,000	0.497177	74,576.55
Total Liability Component				502,823.25
Total Proceeds				1,500,000.00
Total Equity Component (Bal fig)				997,176.75

b. Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component	502,823	10,056	492,767
Equity Component	997,177	19,944	977,233
Total Proceeds	1,500,000	30,000	1,470,000

c. Accounting for liability at amortised cost:

- Initial accounting = Present value of cash outflows less transaction costs

- Subsequent accounting = At amortised cost, ie, initial fair value adjusted for interest and repayments of the liability.

	Opening Financial Liability A	**Interest B**	**Cash Flow C**	**Closing Financial Liability A+B-C**
01-Apr-20X1	492,767	-	-	4,92,767

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31-Mar-20X2	492,767	78,153	150,000	4,20,920
31-Mar-20X3	420,920	66,758	150,000	3,37,678
31-Mar-20X4	337,678	53,556	150,000	2,41,234
31-Mar-20X5	241,234	38,260	150,000	1,29,494
31-Mar-20X6	129,494	20,506	150,000	-

Q 3 You are required to

(i) Identify the Equity and Liability components;

(ii) Compute bond liability at the end of each year; and

(iii) Give necessary journal entries from the information given below:

Number, value and period of convertible Bonds	4,000 bonds, issued at the beginning of year 1, face value is Rs. 1,000 per bond (3 years validity)
Proceeds received	Rs. 40 lacs
Interest rate on the bond	6% p.a. payable annually
Conversion	At the bond holders'. discretion, Conversion into 250 ordinary shares for each bond of Rs. 1000
Prevailing market rate	9% per annum, for bonds issued Without conversion option
Present value factors for 9%	0.917, 0.841, 0.772

Ans:

(a)	**Ascertaining Fair Value of Liability Component**			
	Had the bonds been issued at 9% p.a. the present value would emerge as below:			
	Present value of Rs. 40 lacs repayable after 3rd year (40 lacs x 0.772)			30,88,000
	Present value of interest payable at the end of			
	Year 1 – (2,40,000 x 0.917)			2,20,080
	Year 2 – (2,40,000 x 0.841)			2,01,840
	Year 3 – (2,40,000 x 0.772)			1,85,280
	Liability component (Total of Present value)			36,95,200
(b)	**Ascertaining Equity Component**			
	Fair Value of Instrument			40,00,000
	Less: Liability component			(36,95,200)
	Equity component			3,04,800
(c)	**Initial Recognition at the inception of the Bond**		**Debit**	**Credit**
	Cash/Bank A/c	Dr.	40,00,000	
	To Convertible Bond Liability A/c			36,95,200
	To Equity A/c			3,04,800
(d)	**Bond liability at the end of each year**	**Year 1**	**Year 2**	**Year 3**
	Beginning	36,95,200	37,87,768	38,88,668
	Add: Interest @ 9%	3,32,568	3,40,900	3,49,980
		40,27,768	41,28,668	42,38,648
	Rounding off adjustment	-	-	1,352∗
	Less: Interest @ 6%	(2,40,000)	(2,40,000)	(2,40,000)
	Carrying amount	37,87,768	38,88,668	40,00,000
	∗ Rounding off is due to approximation of discounting factor @ 9%.			
(e)	**For recording Finance Charge of each year**		**Debit**	**Credit**
	Journal Entries			

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	End of Year 1			
	Finance Charges A/c	Dr.	3,32,568	
	To Bonds A/c			92,568
	To Cash or Bank A/c			2,40,000
	End of Year 2			
	Finance Charges A/c	Dr.	3,40,900	
	To Bonds A/c			1,00,900
	To Cash or Bank A/c			2,40,000
	End of Year 3			
	Finance Charges A/c To Bonds A/c To Cash or Bank A/c	Dr.	3,51,332*	

Q 4 K Ltd. issued 5,00,000, 6% Convertible Debentures off Rs. 10 each on the First of April2010. The debentures are due for redemption on 31st March, 2014 at a premium of 10% convertible into equity shares to the extent of 50% and the balance to be settled in cash to the debenture holders The interest rate on equivalent debentures without conversion rights was 10%. You are required to separate the debt & equity components at the time of the issue and show the accounting entry in the company's books at initial recognition.

Ans: Computation of Debt Component of Convertible Debentures as on 1.4.2014

Particulars			**Rs.**
Present value of the principal repayable after four years			
[50,00,000 x 50% × 1.10 × 0.68 (10% Discount factor)] (a)			18,70,000
Present value of Interest [3,00,000 x 3.17 (4 years cumulative 10% discount factor)](b)			9,51,000
Total present Value of debt component (I) (a+b)			28,21,000
Issue proceeds from convertible debenture(II) (c)			50,00,000
Value of equity component (I-II) (a+b-c)			21,79,000
Journal entry at initial recognition		Dr. (Rs.)	Cr. (Rs.)
Cash / Bank A/c	Dr.	50,00,000	
To 6% Debenture (Liability component) A/c To 6% Debenture (Equity component) A/c (Being the disbursement recorded at fair value)			28,21,000

Q 5: On 1 April 20X1, an 8% convertible loan with a nominal value of Rs. 6,00,000 was issued at par. It is redeemable on 31 March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 48,000 has already been paid and included as a finance cost.

How will the Company present the above loan notes in the financial statements for the year ended 31 March 20X2.

Ans:

Step 1 There is an 'option' to convert the loans into equity i.e. the loan note holders do not have to accept equity shares; they could demand repayment in the form of cash.

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Ind AS 32 states that where there is an obligation to transfer economic benefits there should be a liability recognised. On the other hand, where there is not an obligation to transfer economic benefits, a financial instrument should be recognised as equity.

In the above illustration we have both – 'equity' and 'debt' features in the instrument. There is an obligation to pay cash – i.e. interest at 8% per annum and a redemption amount – this is 'financial liability' or 'debt component'. The 'equity' part of the transaction is the option to convert. So it is a compound financial instrument.

Step 2 Debt element of the financial instrument so as to recognise the liability is the present value of interest and principal

The rate at which the same is to be discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting

Step 3 Calculation of the debt element of the loan note as follows:

8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

S. No	Year	Interest amount	PVF	Amount
Year 1	20X2	48,000	0.91	43,680
Year 2	20X3	48,000	0.83	39,840
Year 3	20X4	48,000	0.75	36,063
				1,19,583
Year 4	20X5	648,000	0.68	4,40,640
Amount to be recognised as a liability				5,60,223
Initial proceeds				(6,00,000)
Amount to be recognised as equity				**39,777**

Step 4 The next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. Therefore, the interest should be recognised at 10%.

As on date Rs. 48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.

The additional charge to be recognised in the income statement is calculated as:

Debt component of the financial instrument Rs. 5,60,000

Interest charge (5,60,000 x 10%)	Rs. 56,000
Already charged to the income statement	(Rs. 48,000)
Additional charge required	Rs. 8,000

Q 6 QA Ltd. has also issued 10,00,000 of 8% Long Term Bond-B Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. However, the bond holders of this series are entitled to convert the bonds to shares of Rs. 1 each on the date of maturity, instead of receiving the principal repayment. Interest rate on the similar bond without conversion option is 10%. QA Ltd. has requested you to suggest the following for this type of instrument:

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(a) What is entry to be passed at the date of issuance of the bond as per applicable Ind AS?

(b) What is entry to be passed at the date of conversion of the bond as per applicable Ind AS? **[MTP May 2019]**

Ans: (a)

Cash/Bank A/c	Dr.	Rs. 10,00,000
To 8% LT Bond Series B A/c		Rs. 9,50,263
To Share Option A/c		Rs. 49,737

Workings for the above

It is a compound instrument.

Calculation of initial recognition amount of 8% Long term Loan Bond B Series liability and equity component

Particulars		Rs.
Present value of the principal repayable after 3 years (10,00,000 x .751315)		7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]		1,98,948
Total Present Value of Long term Loan Bond B	I	9,50,263
Issue proceeds from convertible bond	II	10,00,000
Value of equity component	(II – I)	49,737

(b)

8% LT Bond Series B A/c	Rs. 10,00,000
Share Option A/c	Rs. 49,737
To Share Capital A/c	Rs. 10,00,000
To Other Equity A/c	Rs. 49,737

Reasoning:

As per para AG32 of Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.

CONVERSION OR EARLY SETTLEMENT OF COMPOUND FINANCIAL INSTRUMENTS

Q 7: On 1 January 1999, A Ltd issued a 10 per cent convertible debenture with a face value of Rs. 1,000 maturing on 31 December 2008. The debenture is convertible into equity shares of A Ltd at a conversion price of Rs.25 per share. Interest is payable half-yearly in cash. At the date of issue, A Ltd could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

On 1 January 2004, the convertible debenture has a fair value of Rs. 1,700. A Ltd makes a tender offer to the holder of the debenture to repurchase the debenture for Rs. 1,700, which the holder accepts. At the date of repurchase, A Ltd. could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 per cent. Show how an entity

accounts for (i) equity and liability at the inception and (ii) at the repurchase of the convertible instrument. **[RTP May 2018]**

Sol: At the inception

Computation of fair value of Liability Component			Rs.
Present value of 20 half yearly interest payments of Rs. 50,			
discounted @ 11% (Rs. 50 × 11.9504)			597
Present value of Rs. 1,000 due in ten years, discounted @ 11%			
compounded half yearly (Rs. 1,000 × 0.343)			343
Fair value of liability component			940
Computation of Equity Component			Rs.
Issue proceeds from convertible debenture			1,000
Less: Fair value of liability component			940
Fair value of Equity Component			60
Journal Entries		Debit (Rs.)	Credit (Rs.)
Cash/Bank A/c	Dr.	1,000	
To Liability component			940
To Equity component			
(Being issue of debentures recorded at fair values)			

At the time of repurchase			
The repurchase price is allocated as follows:			
	Carrying value	Fair Value	Difference
Liability component			
Present value of 10 remaining half-yearly interest payments of Rs. 50 discounted at 11%and 8% respectively	377	405	
Present value of Rs. 1,000 due in 5 years, discounted at 11% and 8% compounded half yearly, respectively	593	680	
	970	1085	115
Equity component	60	615	555
Total	1,030	1,700	670

Journal Entries			
		Debit Rs.	**Credit Rs.**
Liability Component	Dr.	970	
Debt settlement expenses (statement of profit and loss)	Dr.	115	
To Cash A/c			1085
(Being repurchase of the liability component)			
Equity component	Dr.	60	
Reserves and surplus	Dr.	555	
To Cash A/c			615
(Being cash paid for the equity component)			

Q 8 A Limited issues INR 1 crore convertible bonds on 1 July 20X1. The bonds have a life of eight years and a face value of INR 10 each, and they offer interest, payable at the end of each financial year, at a rate of 6 per cent annum. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Limited at any time in the next eight years.

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Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8 per cent per annum.

Required:

(a) Identify the present value of the bonds, and, allocating the difference between the present value and the issue price to the equity component, provide the appropriate accounting entries.

(b) Calculate the stream of interest expenses across the eight years of the life of the bonds.

(c) Provide the accounting entries if the holders of the option elect to convert the options to ordinary shares at the end of the third year. **[Nov 2018]**

Ans

(a) Applying the guidance for compound instruments, the present value of the bond is computed to identify the liability component and then difference between the present value of these bonds & the issue price of INR 1 crore shall be allocated to the equity component. In determining the present value, the rate of 8 per cent will be used, which is the interest rate paid on debt of a similar nature and risk that does not provide an option to convert the liability to ordinary shares.

Present value of bonds at the market rate of debt

Present value of principal to be received in eight years discounted at 8%

(10,000,000 X 0.5403) = 5,403,000

Present value of interest stream discounted at 8% for 8 years

(6,00,000 X 5.7466) = 3,447,960

Total present value = 8,850,960

Equity component = 1,149,040

Total face value of convertible bonds = 10,000,000

The accounting entries will be as follows:

		Dr. Amount	Cr. Amount
1 July 20X1			
Cash	Dr.	10,000,000	
To Convertible bonds (liability)			8,850,960
To Convertible bonds (equity component)			1,149,040

(Being entry to record the convertible bonds and the recognition of the liability and equity components)

30 June 20X2

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Interest expense Dr. 708,077

To Cash 600,000

To Convertible bonds (liability) 108,077

(Being entry to record the interest expense, where the expense equals the present value of the opening liability multiplied by the market rate of interest).

(b) The stream of interest expense is summarised below, where interest for a given year is calculated by multiplying the present value of the liability at the beginning of the period by the market rate of interest, this is being 8 per cent.

Date	Payment	Interest expense at 8%	Increase in bond liability	Total bond liability
01 July 20X1				8,850,960
30 June 20X2	600,000	708,077	108,077	8,959,037
30 June 20X3	600,000	716,723	116,723	9,075,760
30 June 20X4	600,000	726,061	126,061	9,201,821
30 June 20X5	600,000	736,146	136,146	9,337,967
30 June 20X6	600,000	747,037	147,037	9,485,004
30 June 20X7	600,000	758,800	158,800	9,643,804
30 June 20X8	600,000	771,504	171,504	9,815,308
30 June 20X9	600,000	784,692*	184,692	10,000,000

*for rounding off

(c) if the holders of the options elect to convert the options to ordinary shares at the end of the third year of the debentures (after receiving their interest payments), the entries in the third would be:

		Dr. Amount	Cr. Amount
30 June 20X4			
Interest expense	Dr.	726,061	
To Cash			600,000
To Convertible bonds (liability)			126,061
(Being entry to record interest expense for the period)			
30 June 20X4			
Convertible bonds (liability)	Dr.	9,201,821	
Convertible bonds (equity component)	Dr.	1,149,040	
To Contributed equity			10,350,861
(Being entry to record the conversion of bonds into shares of A Limited).			

TRADE DATE AND SETTLEMENT DATE ACCOUNTING

Q 9 On 1 January 20X1, X Ltd. enters into a contract to purchase a financial asset for Rs. 10 lakhs, which is its fair value on trade date. On 4 January 20X1 (settlement date), the fair value of the

asset is Rs. 10.5 lakhs. The amounts to be recorded for the financial asset will depend on how it is classified and whether trade date or settlement date accounting is used. Pass necessary journal entries.

Ans: Journal Entries in the Buyer's Books

Trade date accounting

Dr. / Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
1 January 20X1				
Dr.	Financial asset	10,00,000	10,00,000	10,00,000
Cr.	Financial liability (to pay)	(10,00,000)	(10,00,000)	(10,00,000)
4 January 20X1				
Dr.	Financial asset	-	50,000	50,000
Dr.	Financial liability (to pay)	10,00,000	10,00,000	10,00,000
Cr.	Profit or loss	-	(50,000)	-
Cr.	Other comprehensive income	-	-	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

Settlement date accounting

Dr. / Cr.	Particulars	Amortised cost	Fair value through P&L	Fair value through OCI
Dr.	Financial asset	10,00,000	10,50,000	10,50,000
Cr.	Profit or loss	-	(50,000)	-
Cr.	Other comprehensive income	-	-	(50,000)
Cr.	Cash	(10,00,000)	(10,00,000)	(10,00,000)

FINANCIAL ASSETS: MEASUREMENTS

Q 10 A Company invested in Equity shares of another entity on 15th March for Rs. 10,000 which was classified as FVTPL. Transaction Cost = Rs.200 (not included in Rs.10,000). Fair Value on Balance Sheet date i.e. 31st March 2015 = Rs. 12,000. Pass necessary Journal Entries

Ans:

Date	Particulars	Dr	Cr
15/3/2015	Investment A/c	10,000	
	Transaction Cost A/c	200	
	To Bank		10,200
31/3/2015	Investment A/c	2,000	
	To Fair Value Gain A/c		2,000
31/3/2015	P&L A/c	200	
	To Transaction Cost A/c		200
31/3/2015	Fair Value Gain A/c	2,000	
	To P&L A/c		2,000

Q 11: A Company invested in Equity shares of another entity on 15th March for Rs. 10,000 which was classified as FVTOCI. Transaction Cost = Rs. 200 (not included in Rs. 10,000). Fair Value on Balance Sheet date i.e. 31st March 2015 = Rs. 12,000. Pass necessary Journal entries.

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Ans:

Date	Particulars	Dr	Cr
15/3/2015	Investment A/c	10,200	
	To Bank		10,200
31/3/2015	Investment A/c	1,800	
	To Fair Value Gain A/c		1,800
31/3/2015	Fair Value Gain A/c	1,800	
	To OCI A/c		1,800
31/3/2015	OCI A/c	1,800	
	To Fair Value Reserve A/c		1,800

Q 12: A Company lends Rs. 100 lacs to another company @ 12% p.a. interest on 1/4/2015 which was classified as amortised cost It incurs Rs. 40,000 incremental costs for documentation. Loan tenure = 5 years with Interest charged annually. Fair Value of Loan on Balance Sheet date i.e. 31st March 2015= 99,40,000. Pass necessary Journal entries.

Ans: This is based on the assumption that interest rate is based on market rate of interest.

Date	Particulars	Dr	Cr
1/4/2015	Loan A/c	100 lacs	
	To Bank A/c		100 lacs
1/4/2015	Loan Processing Expense A/c	40,000	
	To Bank A/c		40,000
1/4/2015	Loan A/c	40,000	
	To Loan Processing Expense A/c		40,000

Q 13: A Ltd. invested in equity shares of C Ltd. on 15th March for Rs. 10,000. Transaction costs were Rs. 500 in addition to the basic cost of Rs. 10,000.On 31 March, the fair value of the equity shares was Rs. 11,200 and market rate of interest is 10% per annum for a 10 year loan. Pass necessary journal entries. Analyse the measurement principal and pass necessary journal entries.

Ans: The above investment is in equity shares of C Ltd and hence, does not involve any contractual cash flows that are solely payments of principal and interest. Hence, these equity shares shall be measured at fair value through profit or loss. Also, an irrecoverable option exists to designate such investment as fair value through other comprehensive income.

Journal Entries

Upon initial recognition –

Investment in equity shares of C Ltd.	Dr.	10,000	
Transaction Cost	Dr	500	
To Bank a/c			10,500

(Being investment recognized at fair value plus transaction costs upon initial recognition)

Profit and Loss A/c	Dr	500	
To Transaction Cost			500

Subsequently –

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Investment in equity shares of C Ltd.	Dr.	1,200	
To Fair value gain on financial instruments			1,200
(Being fair value gain recognized at year end in P&L)			
Fair value gain on financial instruments		1,200	
To Profit and Loss A/c			1,200

Q 14: Metallics Ltd. has made an investment in equity instrument of a company – Castor Ltd. for 19% equity stake. Significant influence not exercised. The investment was made for Rs. 5,00,000 for 10,000 equity shares on 01 April 20X1. On 30 June 20X1 the fair value per equity share is Rs.45. The Company has taken an irrevocable option to measure such investment at fair value through other comprehensive income.

Ans: The Company has made an irrecoverable option to carry its investment at fair value through other comprehensive income. Accordingly, the investment shall be initially recognised at fair value and all subsequent fair value gains/ losses shall be recognised in other comprehensive income (OCI).

Journal entries

Upon initial recognition –

Investment in equity shares of C Ltd.	Dr.	5,00,000	
To Bank a/c			5,00,000
(Being investment recognized at fair value plus transaction costs upon initial recognition)			

Subsequently –

Fair value loss on financial instruments	Dr.	50,000	
To Investment in equity shares of C Ltd.			50,000
(Being fair value loss recognised)			
Fair value reserve in OCI	Dr.	50,000	
To Fair value loss on financial instruments			50,000
(Being fair value loss recognized in other comprehensive income)			

Q 15: Comforts Ltd. granted Rs.10,00,000 loan to its employees on January 1, 2009 at a concessional interest rate of 4% per annum. Loan is to be repaid in five equal annual installments along with interest. Market rate of interest for such loan is 10% per annum. Following the principles of recognition and measurement as laid down in IND AS 109 'Financial Instruments: Recognition and Measurement', record the entries for the year ended 31st December, 2009 for the loan transaction, and also calculate the value of loan initially to be recognised and amortised cost for all the subsequent years.

Ans:

(i)	**Journal Entries in the books of Comfort Ltd. for the year ended 31st December, 2009 (regarding loan to employees)**				
				Dr.	**Cr.**

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	Staff loan A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Being the disbursement of loans to staff)			
	Staff cost A/c (10,00,000 – 8,54,763)[Refer part (ii)]			
	To Staff loan A/c	Dr.	1,45,237	
	(Being the write off of excess of loan balance over present value thereof, in order to reflect the loan at its present value of Rs. 8,54,763)			1,45,237
	Staff loan A/c	Dr.	85,476	
	To Interest on staff loan A/c			85,476
	(Being the charge of interest @ market rate of 10% to the loan)			
	Bank A/c	Dr.	2,40,000	
	To Staff loan A/c			2,40,000
	(Being the repayment of first instalment with interest for the year)			
	Interest on staff loan A/c	Dr.	85,476	
	To Profit and loss A/c			85,476
	(Being transfer of balance in staff loan Interest account to profit and loss account)			
	Profit and loss A/c	Dr.	1,45,237	
	To Staff cost A/c			1,45,237
	(Being transfer of balance in staff cost account to profit and loss account)			

(ii) **Calculation of initial recognition amount of loan to employees**

Cash Inflow					
Yearend	Principal	Interest @4%	Total	P.V. factor	Value
2009	2,00,000	40,000	2,40,000	0.9090	2,18,160
2010	2,00,000	32,000	2,32,000	0.8263	1,91,702
2011	2,00,000	24,000	2,24,000	0.7512	1,68,269
2012	2,00,000	16,000	2,16,000	0.6829	1,47,506
2013	2,00,000	8,000	2,08,000	0.6208	1,29,126
Present value or Fair value					8,54,763

(iii) **Calculation of amortised cost of loan to employees**

Year	Amortised cost (Opening balance) [1]	Interest to be recognised@10% [2]	Repayment [3]	Amortised Cost (Closing balance) [4]=[1]+ [2] –[3]
2009	8,54,763	85,476	2,40,000	7,00,239
2010	7,00,239	70,024	2,32,000	5,38,263
2011	5,38,263	53,826	2,24,000	3,68,089
2012	3,68,089	36,809	2,16,000	1,88,898
2013	1,88,898	19,102 (Bal. fig.)*	2,08,000	Nil

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Q 16: A Ltd has made a security deposit whose details are described below. Make necessary journal entries for accounting of the deposit. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	1-Apr-20X1
Date of Security Deposit (Finishing Date)	31-Mar-20X6
Description	Lease
Total Lease Period (Years)	5
Discount rate	12.00%
Security deposit (A)	10,00,000
Present value of deposit at beginning (B)	5,67,427
Prepaid lease payment at beginning (A-B)	4,32,573
Present value annuity factor	0.56743

Ans: The above security deposit is an interest free deposit redeemable at the end of lease term for Rs. 1,000,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement – Particulars	Details
Security deposit (A)	10,00,000
Total Lease Period (Years)	5
Discount rate	12.00%
Present value annuity factor	0.56743
Present value of deposit at beginning (B)	5,67,427
Prepaid lease payment at beginning (A-B)	4,32,573

Journal Entries

Security deposit a/c	Dr.	5,67,427	
Prepaid expenses	Dr.	4,32,573	
To Bank a/c			10,00,000

Subsequently, every annual reporting year, interest income shall be accrued@ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

For instance – year 1			
Security deposit a/c	Dr.	68,091	
To Interest income			68,091
Rent expense	Dr.	86,515	
To Prepaid expenses			86,515

At the end of 5 years, the security deposit shall accrue to Rs. 10,00,000 and prepaid expenses shall be fully amortised. Journal entry for realisation of security deposit –

Bank a/c	Dr.	10,00,000	
To Security deposit a/c			10,00,000

Q 17 A Ltd issued redeemable preference shares to a Holding Company – Z Ltd. The terms of the instrument have been summarized below. Account for this in the books of Z Ltd.

Nature	Non-cumulative redeemable preference shares
Repayment:	Redeemable after 5 years
Date of Allotment:	1-Apr-20X1

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Date of repayment:	31-Mar-20X6
Total period:	5.00 years
Value of preference shares issued:	100,000,000
Dividend rate	0.0001%
Market rate of interest	12.00% per annum
Present value factor	0.56743

[May 2018]

Ans: Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since A Ltd has issued preference shares to its Holding Company – Z Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by Z Ltd. in its subsidiary.

Following is the table summarising the computations on initial recognition:

Market rate of interest	12.00%
Present value factor	0.56743
Present value	56,742,686
Loan component	56,742,686
Investment in subsidiary	43,257,314

Subsequently, such preference shares shall be carried at amortised cost at each reporting date. The computation of amortised cost at each reporting date has been done as follows:

Year	Date	Opening Asset	Days	Interest @ 12%	Closing balance
1-Apr-20X1					
1	31-Mar-20X2	56,742,686	364	6,790,467	63,533,153
2	31-Mar-20X3	63,533,153	365	7,623,978	71,157,131
3	31-Mar-20X4	71,157,131	365	8,538,856	79,695,987
4	31-Mar-20X5	79,695,987	366	9,589,720	89,285,707
5	31-Mar-20X6	89,285,707	365	10,714,285	100,000,000

Journal Entries to be done at every reporting date

Particulars		Amount	Amount
Date of transaction			
Investment - Equity portion	Dr.	43,257,314	
Loan receivable	Dr.	56,742,686	
To Bank			(100,000,000)

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Interest income - March 31, 20X2

Loan receivable	Dr.	6,790,467	
To Interest income			(6,790,467)
Interest income - March 31, 20X3			
Loan receivable	Dr.	7,623,978	
To Interest income			(7,623,978)
Interest income - March 31, 20X4			
Loan receivable	Dr.	8,538,856	
To Interest income			(8,538,856)
Interest income - March 31, 20X5			
Loan receivable	Dr.	9,589,720	
To Interest income			(9,589,720)
Interest income - March 31, 20X6			
Loan receivable	Dr.	10,714,285	
To Interest income			(10,714,285)
Settlement of transaction			
Bank	Dr.	100,000,000	
To Loan receivable			(100,000,000)

Q 18 Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Principal amount: 1,000,000
- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 January 20X1
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Following table shows the contractually expected cash flows from the loan given to Mr. X:

(amount in Rs.)

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Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		200,000	28,000	16,000	600,000
31-Dec-20X3		200,000	14,000	16,000	400,000
31-Dec-20X4		200,000	-	16,000	200,000
31-Dec-20X5		200,000	-	8,000	-

Mr. S, pre-pays Rs. 200,000 on 31 December 20X2, reducing the outstanding principal as at that date to Rs. 400,000.

Following table shows the actual cash flows from the loan given to Mr. X, considering the pre-payment event on 31 December 20X2: (amount in Rs.)

Date	Outflows	Principal	Interest income 7%	Interest income 4%	Principal outstanding
1-Jan-20X1	(1,000,000)				1,000,000
31-Dec-20X1		200,000	42,000	16,000	800,000
31-Dec-20X2		400,000	28,000	16,000	400,000
31-Dec-20X3		200,000	-	16,000	200,000
31-Dec-20X4		200,000	-	8,000	-
31-Dec-20X5		-	-	-	-

Record journal entries in the books of Wheel Co. Limited considering the requirements of Ind AS 109.

Ans. As per requirement of Ind AS 109, a financial instrument is initially measured and recorded at its fair value. Therefore, considering the market rate of interest of similar loan available to Mr. X is 12%, the fair value of the contractual cash flows shall be as follows:

	Inflows				
Date	Principal	Interest income 7%	Rs. Interest income 4%	Discount factor @12%	PV
31-Dec-20X1	200,000	42,000	16,000	0.8929	2,30,357
31-Dec-20X2	200,000	28,000	16,000	0.7972	1,94,515
31-Dec-20X3	200,000	14,000	16,000	0.7118	1,63,709
31-Dec-20X4	200,000	-	16,000	0.6355	1,37,272
31-Dec-20X5	200,000	-	8,000	0.5674	1,18,025
		Total (fair value)			8,43,878

Benefit to Mr. X, to be considered a part of employee cost for Wheel Co. Rs. 1,56,121

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The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Mr. X must remain in service.

The amortization schedule of the Rs. 843,878 loan is shown in the following table:

Date	Loan outstanding	Total cash inflows (principal repayment + interest	Interest @ 12%
1-Jan-20X1	843,878		
31-Dec-20X1	687,143	258,000	101,265
31-Dec-20X2	525,600	244,000	82,457
31-Dec-20X3	358,672	230,000	63,072
31-Dec-20X4	185,713	216,000	43,041
31-Dec-20X5	(0)	208,000	22,287

Journal Entries to be recorded at every period end:

a. **1 January 20X1 –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan to employee A/c Dr. Pre-paid employee cost A/c Dr To Cash A/c (Being loan asset recorded at initial fair value)	843,879 156,121	 1,000,000

b. **31 December 20X1 –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Interest income (profit and loss) @12% A/c To loan to employee A/c (Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	258,000	 101,265 156,735
Employee benefit (profit and loss) A/c Dr. To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	31,224	 31,224

On 31 December 20X2, due to pre-payment of a part of loan by Mr. X, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31 December 20X2, first the realisation of the contractual cash flow as shown in (c) below and then the accounting for the pre-payment of Rs. 200,000 included in (d) below:

c. **31 December 20X2 –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Interest income (profit and loss) @12% A/c To loan to employee A/c	244,000	 82,457 161,543

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(Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)		
Employee benefit (profit and loss) A/c Dr To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	31,224	31,224

Computation of new carrying value of loan to employee:

	Inflows				
Date	**Principal**	**Interest income 7%**	**Interest income 4%**	**Discount factor @12%**	**PV**
31-Dec-20X3	200,000	-	16,000	0.8929	192,857
31-Dec-20X4	200,000	-	8,000	0.7972	165,816
Total (revised carrying value)					358,673
Less: Current carrying value					525,601
Adjustment required					166,928

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to pre-paid employee cost, which shall be amortised over the remaining tenure of the loan.

d. 31 December 20X2 prepayment–

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Pre-paid employee cost A/c To loan to employee A/c (Being gain to Wheel Co. Limited recorded as an adjustment to pre-paid employee cost)	200,000	33,072 166,928

The amortisation schedule of the new carrying amount of loan shall be as follows:

Date	Loan outstanding	Total cash inflows (principal repayment + interest	Interest @ 12%
31-Dec-20X2	358,673		
31-Dec-20X3	185,714	216,000	43,041
31-Dec-20X4	-	208,000	22,286

Amortisation of employee benefit cost shall be as follows:

Date	Balance	Amortised to P&L	Adjustment
1-Jan-20X1	156,121		
31-Dec-20X1	124,897	31,224	
31-Dec-20X2	60,601	31,224	33,072
31-Dec-20X3	30,300	30,300	
31-Dec-20X4	-	30,300	

e. 31 December 20X3 –

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Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Interest income (profit and loss) @12% A/c To loan to employee A/c (Being third instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	216,000	 43,041 172,959
Employee benefit (profit and loss) A/c Dr To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	30,300	 30,300

f. 31 December 20X4 –

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr To Interest income (profit and loss) @12% A/c To loan to employee A/c (Being last instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)	208,000	 22,286 185,714
Employee benefit (profit and loss) A/c Dr To Pre-paid employee cost A/c (Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)	30,300	 30,300

Q 19: COFEE Ltd., borrows a sum of Rs. 20 crore from COFEE Ltd., repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market is 8% FEE Ltd paid an origination fee of Rs. 2,40 crores to COFEE Ltd., to compensate COFEE Ltd., for the lower rate of interest. Apart from the above, there are no other transactions between the two parties. You are required to show the value at which COFEE Ltd., would recognize the loan and the annual interest thereon. **[Nov 2011, 4 Marks]**

Ans: Therefore, the fair value of the loan to Cofee Ltd. Is the present value of the interest it will receive over the next 5 years & the present value of repayment it will at the end of the 5th year.

P.V. of interest discounted @ 8% = [(20,00,00,000 × 5%) × 3.9926] =Rs. 3,99,36,000 (A)

P.V. of principal amount = Rs. 20,00,00,000 × discounted @ 8%= 20,00,00,000 × 0.6806 = 13,61,20,000 (B)

FV of Loan (A + B) i.e. Rs.17,60,46,000 (i.e. approximately 17,60,00,000 which is loan amount net of origination fees.

COFEE Ltd. will recognize the loan at Rs. 17.60 crores only.

COFEE Ltd will recognize the interest using the effective interest rate method as worked out below:

Year	Amortised	Interest income @	Total	Payment	Amortised
	Cost (Opening	8% to be		received	Cost (Closing

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		Recognised			Balance)
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	17,60,00,000	1,40,80,000	19,00,80,000	1,00,00,000	18,00,80,000
2	18,00,80,000	1,44,06,400	19,44,86,400	1,00,00,000	18,44,86,400
3	18,44,86,400	1,47,58,912	19,92,45,312	1,00,00,000	18,92,45,312
4	18,92,45,312	1,51,39,625	20,43,84,937	1,00,00,000	19,43,84,937
5	19,43,84,937	1,56,15,063*	21,00,00,000	21,00,00,000	Nil

*Note: The interest in the 5th year, has been adjusted in accordance to the value received on closure.

Q 20: KK Ltd. has granted an interest free loan of Rs. 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:

(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.

(ii) The said Loan is interest free and will be repayable after 3 years from the date of granting such loan. The current market rate of interest for similar loan is 10%. Considering the same, the fair value of the loan at initial recognition is Rs. 8,10,150.

(iii) The said loan is interest free and will be repaid as and when the YK Ltd. has funds to repay the Loan amount.

Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year for the above loan.

Further the Company is also planning to grant interest free loan from YK Ltd. to KK Ltd. in the subsequent period. What will be the accounting treatment of the same under applicable Ind AS? **[RTP May 2019]**

Ans: **Scenario (i)**

Since the loan is repayable on demand, it has fair value equal to cash consideration given. KK Ltd. and YK Ltd. should recognize financial asset and liability, respectively, at the amount of loan given (assuming that loan is repayable within a year). Upon, repayment, both the entities should reverse the entries that were made at the origination.

Journal entries in the books of KK Ltd.

At origination

Loan to YK Ltd. A/c Dr. Rs. 10,00,000

To Bank A/c Rs. 10,00,000

On repayment

Bank A/c Dr. Rs. 10,00,000

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To Loan to YK Ltd. A/c Rs. 10,00,000

Journal entries in the books of YK Ltd.

At origination

Bank A/c Dr. Rs. 10,00,000

To Loan from KK Ltd. A/c Rs. 10,00,000

On repayment

Loan from KK Ltd. A/c Dr. Rs. 10,00,000

To Bank A/c Rs. 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan receivable and loan payable will get set off.

Scenario (ii)

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

If a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of Rs. 10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recognition as Rs. 8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (for one year)

At origination

Loan to YK Ltd. A/c Dr. Rs. 8,10,150

Investment in YK Ltd. A/c Dr. Rs. 1,89,850

To Bank A/c Rs. 10,00,000

During periods to repayment- to recognise interest

Year 1 – Charging of Interest

Loan to YK Ltd. A/c Dr. Rs. 81,015

To Interest income A/c Rs. 81,015

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Transferring of interest to Profit and Loss

Interest income A/c Dr. Rs. 81,015

To Profit and Loss A/c Rs. 81,015

On repayment

Bank A/c Dr. Rs. 10,00,000

To Loan to YK Ltd. A/c Rs. 10,00,000

Note- Interest needs to be recognised in statement of profit and loss. The same cannot be adjusted against capital contribution recognised at origination.

Journal entries in the books of YK Ltd. (for one year)

At origination

Bank A/c Dr. Rs. 10,00,000

To Loan from KK Ltd. A/c Rs. 8,10,150

To Equity Contribution in KK Ltd. A/c Rs. 1,89,850

During periods to repayment- to recognise interest

Year 1

Interest expense A/c Dr. Rs. 81,015

To Loan from KK Ltd. A/c Rs. 81,015

On repayment

Loan from KK Ltd. A/c Dr. Rs. 10,00,000

To Bank A/c Rs. 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

Scenario (iii)

Generally, a loan which is repayable when funds are available, cannot be stated as loan repayable on demand. Rather the entity needs to estimate the repayment date and determine its measurement accordingly by applying the concept prescribed in Scenario (ii).

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

In case the subsidiary YK Ltd. is planning to grant interest free loan to KK Ltd., then the difference between the fair value of the loan on initial recognition and its nominal value should be treated as dividend distribution by YK Ltd. and dividend income by the parent KK Ltd.

DERECOGNITION OF FINANCIAL ASSETS

Q 21: A Ltd. has lent Rs. 50,000 yielding 18% interest p.a. for 10 years. The company transferred the right to receive principal Rs. 50,000 on maturity and the right to receive 14% interest per year.

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Of the balance 4% interest, 2% is due to the transferor, i.e. A Ltd. as service fee for collection of principal and interest. The expected cost for collection etc. is Rs. 400. A Ltd. has retained the right to receive the remaining 2% interest per year. Show important accounting entries in books of A Ltd. Assume expected yield rate 13% p.a.

Ans:

	Interest Transferred	**Principal Transferred**	**Interest Retained**	**Service Fee**
Cash inflow	7,000	50,000	1,000	1,000
Less: Cost of servicing loan	---	---	---	400
Net cash flow	7,000	50,000	1,000	600
Year	1 - 10	10	1 - 10	1 – 10
DF (13%)	5.43	0.29	5.43	5.43
Fair value of components	38,010	14,500	5,430	3,258

Allocation of carrying amount			
		Fair value	**Carrying amount**
	Rs.	**Rs.**	**Rs.**
Principal transferred	38,010		
Interest transferred	14,500	52,510	42,902
Servicing asset		3,258	2,662
Interest strip		5,430	4,436
Total		61,198	50,000

Journal Entries in the Books of A Ltd.			
Cash	Dr.	52,510	
To Loan			42,902
To Profit & Loss A/c			9,608
Servicing Asset	Dr.	2,662	
Interest Strip	Dr.	4,436	
To Loans			7,098

Q 22: Entity C agrees with factoring company D to enter into a debt factoring arrangement. Under the terms of the arrangement, the factoring company B agrees to pay Rs. 91.5 crores, less a servicing charge of Rs. 1.5 crores (net proceeds of Rs. 90 crores), in exchange for 100% of the cash flows from short-term receivables.

The receivables have a face value of Rs. 100 crores and carrying amount of Rs. 95 crores.

The customers will be instructed to pay the amounts owed into a bank account of the factoring company. Entity C also writes a guarantee to the factoring company under which it will reimburse any credit losses upto Rs. 5 crores, over and above the expected credit losses of Rs. 5 crores and losses of up to Rs. 15 crores are considered reasonably possible. The guarantee is estimated to have a fair value of Rs. 0.5 crores. Comment. Pass the necessary Journal Entry

Ans: In this situation, the "continuing involvement asset" will be recognised at Rs. 5 crores i.e. lower of:

i. the amount of the asset – Rs. 95 crores

ii. the guarantee amount – Rs. 5 crores

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- the entity also recognises an associated liability that is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:
  - ♦ the amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost, or
  - ♦ equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.

Recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other and shall not be offset. If the transferred asset is measured at amortised cost, the option in this Standard to designate a financial liability as at fair value through profit or loss is not applicable to the associated liability.

In case of guarantees, as per the application guidance in Ind AS 109, the associated liability is initially measured at

♦ the guarantee amount plus

♦ the fair value of the guarantee (which is normally the consideration received for the guarantee).

The associated liability is recognised at Rs. 5.5 crores, as below:

i. the guarantee amount (i.e. Rs. 5 crores) plus

ii. the fair value of the guarantee (i.e. Rs. 0.5 crores). Comment

- If an entity's continuing involvement is in only a part of a financial asset, the entity allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. The difference between:
  - ♦ the carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised and
  - ♦ the consideration received for the part no longer recognised

  shall be recognised in profit or loss.

The journal entries passed by Entity C on the date of derecognition is as below:

Cash	Dr.	Rs. 90 crores	
Loss on derecognition	Dr.	Rs. 5.5 crores	
Continuing involvement asset	Dr.	Rs. 5 crores	
To Receivables			Rs. 95 crores
To Associated liability			Rs. 5.5 crores

• the entity shall continue to recognise any income arising on the transferred asset to the extent of its continuing involvement and shall recognise any expense incurred on the associated liability

In the example above, the guarantee liability of Rs. 0.5 crores shall be amortised in profit or loss over the underlying period.

Q 23: Parikshit Ltd. holds Rs.1,00,000 of loans yielding 18 per cent interest per annum for their estimated lives of 9 years. The fair value of these loans, after considering the interest yield, is estimated at Rs.1,10,000.

The company securitises the principal component of the loan plus the right to receive interest at 14% to Susovana Corporation, a special purpose vehicle, for Rs.1,00,000. Out of the balance interest of 4 percent, it is stipulated that half of such balance interest, namely 2 per cent, will be due to Parikshit Ltd. as fees for continuing to service the loans. The fair value of the servicing asset so created is estimated at Rs.3,500. The remaining half of the interest is due to Parikshit Ltd. as an interest strip receivable, the fair value of which is estimated at Rs.6,500. Give the accounting treatment of the above transactions in the form of journal entries in the books of originator.

Ans:

Journal Entries in the Books of Originator

S.No.	Particulars		Debit	Credit
1.	Bank A/c	Dr.	1,00,000	
	To Loans (Cost of Securitised Component)			90,910
	To Profit on Securitisation			9,090
	(Being securitization of principal amount and right to receive interest at 14% interest rate)			
2.	Servicing Asset A/c	Dr.	3,180	
	Interest Strip A/c	Dr.	5,910	
	To Loans			9,090
	(Being creation of servicing asset and interest strip receivable)			

Working Notes:

1.	Fair value of securitized component of loan		Rs.
	Fair value of Loan		1,10,000
	Less: Fair value of servicing asset	3,500	
	Fair value of interest strip	6,500	10,000
			1,00,000

2.	**Apportionment of carrying amount based on relative Fair Values**			
	Particulars	Fair Value	% based on Total Fair Value	Carrying Amount/Cost
	Securitised component of the loan	1,00,000	90.91%	90,910
	Servicing Asset	3,500	3.18%	3,180
	Interest Strip Receivable	6,500	5.91%	5,910
		1,10,000	100.00%	1,00,000

3.	**Profit on Securitisation**	**Rs.**
	Net proceeds from securitisation	1,00,000
	Less: Cost (apportioned carrying amount) of securitized component of loan	90,910
		9,090

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FINANCIAL LIABILITIES: MEASUREMENTS

Q 24: A Ltd has made a borrowing from RBC Bank for Rs. 10,000 at a fixed interest of 12% per annum. Loan processing fees were additionally paid for Rs. 500 and loan is payable 4 half-yearly installments of Rs. 2,500 each. Details are as follows:

Particulars	Details
Loan amount	Rs. 10,000
Date of loan (Starting Date)	1-Apr-20X1
Date of loan (Finishing Date)	31-March-20X2
Description of repayment	Repayment of loan starts from 30-Sept-20X1 (To be paid half yearly)
Installment amount	Rs. 2,500
Interest rate	12.00%
Interest charge	Interest to be charged quarterly
Upfront fees	Rs. 500

How would loan be accounted in books of A Ltd?

Ans: The loan taken by A Ltd shall be measured at amortised cost as follows:

- Initial measurement – At transaction price less processing fees

= 10,000 – 500 = 9,500

- Subsequently – interest to be accrued using effective rate of interest as follows:

Date	Amount of Loan	Repayment	Upfront fees paid	Amount of Interest	Days	IRR Calculation	Revised Interest computed	Loan Balance
1-Apr-20X1	10,000	-	500	-	-	9,500	-	-
30-Jun-20X1	-	-	-	300	90	(300)	389	9,589
30-Sep-20X1	-	2500	-	300	92	(2,800)	401	7,190
31-Dec-20X1	-	-	-	225	92	(225)	301	7,266
31-Mar 20X2	-	2500	-	225	90	(2,725)	297	4,838
30-Jun-20X2	-	-	-	150	91	(150)	200	4,888
30-Sep-20X2	-	2500	-	150	92	(2,650)	204	2,442
31-Dec-20X2	-	-	-	75	92	(75)	102	2,473
31-Mar-20X3	-	2500	-	75	91	(2,575)	102	0
IRR						16.60%		

Q 25: QA Ltd. issued 10,00,000 of 8% Long Term bond-A Series of Rs. 1 each on 1st April, 2016. The bond tenure is 3 years. Interest is payable annually on 1st April each year. The investors expect an effective interest rate on the loan at 10%. QA Ltd. wants you to suggest the suitable accounting entries for the issue of these bonds as per applicable Ind AS. Consider the discounting factor 3 years, 10% discounting factor is 0.751315 and 3 years cumulative discounting factor is 2.48685.

(i) What is the principal value of the bond at the initial recognition at the time of issue of bond as per applicable Ind AS?

(ii) What is the present value of the interest payment to be recognised as part of the sale price of the bond as per applicable Ind AS?

(iii) What are the proceeds of the sale of the bond to be recognized at the time of initial recognition as per applicable Ind AS?

(iv) What is the accounting entry to be passed at the time of accounting for payment of interest for the first year? **[MTP May 2019]**

Ans: (i) Rs. 7,51,315

(ii) Rs. 1,98,948

(iii) Rs. 9,50,263

(iv) Bond Interest Expenses A/c Dr. Rs. 95,026

To Discount on Bond A/s Rs. 15,026

To Cash/Bank A/c Rs. 80,000

Workings for the above

Since the Effective interest rate on the loan is 10% while the Bond has been issued at 8%, the financial liability will be recognized at fair value determined as follows:

Calculation of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	**Rs.**
Present value of the principal repayable after 3 years (10,00,000 x .751315)	7,51,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	1,98,948
Total Present Value of Long term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method

= Rs.9,50,263 x 10% = Rs. 95,026

However, interest paid is @ 8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

Q 26: NAV Limited granted a loan of Rs. 120 lakh to OLD Limited for 5 years @ 10% p.a. which is Treasury bond yield of equivalent maturity. But the incremental borrowing rate of OLD Limited is 12%. In this case, the loan is granted to OLD Limited at below market rate of interest. Ind AS 109 requires that a financial asset or financial liability is to be measured at fair value at the initial recognition. Should the transaction price be treated as fair value? If not, find out the fair value. What is the accounting treatment of the difference between the transaction price and the fair value on initial recognition in the book of NAV Ltd.?

Present value factors at 12%: Year	1	2	3	4	5
PVF	0.892	0.797	0.712	0.636	0.567

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[Nov 2018]

Ans: Since the loan is granted to OLD Ltd at 10% i.e below market rate of 12%. It will be considered as loan given at off market terms. Hence the Fair value of the transaction will be lower from its transaction price & not the transaction price.

Calculation of fair value

Year	Future cash flow (in lakh)	Discounting factor @ 12%	Present value (in lakh)
1	12	0.892	10.704
2	12	0.797	9.564
3	12	0.712	8.544
4	12	0.636	7.632
5	120+12=132	0.567	74.844
			111.288

The fair value of the transaction be Rs. 111.288 lakh.

Since fair value is based on level 1 input or valuation technique that uses only data from observable markets, difference between fair value and transaction price will be recognized in Profit and Loss as fair value loss i.e Rs. 120 lakh– Rs. 111.288 lakh= Rs. 8.712 lakh.

Note: One may also calculate the above fair value by the way of annuity on interest amount rather than separate calculation.

DERECOGNITION OF FINANCIAL LIABILITIES

Q 27 Wheel Co. Limited borrowed Rs. 500,000,000 from a bank on 1 January 20X1. The original terms of the loan were as follows:

- Interest rate: 11%
- Repayment of principal in 5 equal instalments
- Payment of interest annually on accrual basis
- Upfront processing fee: Rs. 5,870,096

Effective interest rate on loan: 11.50%

On 31 December 20X2, Wheel Co. Limited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

- Interest rate 15%
- Repayment of outstanding principal in 10 equal instalments starting 31 December 20X3

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- Payment of interest on an annual basis

Record journal entries in the books of Wheel Co. Limited till 31 December 20X3, after giving effect of the changes in the terms of the loan on 31 December 20X2

Ans: On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Cash flows (principal)	Cash flows (interest and fee)	Amortised cost (opening + interest – cash flows)	Interest @ EIR (11.50%)
1-Jan-20X1	(500,000,000)	5,870,096	494,129,904	
31-Dec-20X1	100,000,000	55,000,000	395,954,843	56,824,939
31-Dec-20X2	100,000,000	44,000,000	297,489,650	45,534,807
31-Dec-20X3	100,000,000	33,000,000	198,700,959	34,211,310
31-Dec-20X4	100,000,000	22,000,000	99,551,570	22,850,610
31-Dec-20X5	100,000,000	11,000,000	(0)	11,448,430

a. **1 January 20X1 –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c Dr. To Loan from bank A/c (Being loan recorded at its fair value less transaction costs on the initial recognition date)	494,129,904	 494,129,904

b. **31 December 20X1 –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To Cash A/c (Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	98,175,061 56,824,939	 155,000,000

c. **31 December 20X2 – Before Wheel Co. Limited approached the bank –**

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Interest expense (profit and loss) Dr. To Loan from bank A/c To cash A/c (Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)	45,534,807	 1,534,807 44,000,000

Upon receiving the new terms of the loan, Wheel Co. Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

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Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31-Dec-20X2	(400,000,000)			
31-Dec-20X3	40,000,000	60,000,000	0.8969	89,686,099
31-Dec-20X4	40,000,000	54,000,000	0.8044	75,609,805
31-Dec-20X5	40,000,000	48,000,000	0.7214	63,483,092
31-Dec-20X6	40,000,000	42,000,000	0.6470	53,053,542
31-Dec-20X7	40,000,000	36,000,000	0.5803	44,100,068
31-Dec-20X8	40,000,000	30,000,000	0.5204	36,429,133
31-Dec-20X9	40,000,000	24,000,000	0.4667	29,871,422
31-Dec-20Y0	40,000,000	18,000,000	0.4186	24,278,903
31-Dec-20Y1	40,000,000	12,000,000	0.3754	19,522,235
31-Dec-20Y3	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650
Difference				54,033,141
Percentage of carrying amount				13.59%

Note: Calculation above done on full decimal, though in the table discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d. 31 December 20X2 – accounting for extinguishment

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank (old) A/c Dr Finance cost (profit and loss) Dr To Loan from bank (new) A/c (Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)	397,489,650 2,510,350	 400,000,000

e. 31 December 20X3

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Loan from bank A/c Dr. Interest expense (profit and loss) Dr. To cash A/c (Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)	40,000,000 60,000,000	 100,000,000

Q 28: JK Ltd. has an outstanding unsecured loan of Rs. 90 crores to a bank. The effective interest rate (EIR) of this loan is 10%. Owing to financial difficulties, JK Ltd. is unable to service the debt and approaches the bank for a settlement.

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The bank offers the following terms which are accepted by JK Ltd.:

- 60% of the debt is unsustainable and hence will be converted into 70% equity interest in JK Ltd. The fair value of net assets of JK Ltd. is Rs. 80 crores.
- 40% of the debt is sustainable and the bank agrees to certain moratorium period and decrease in interest rate in initial periods. The present value of cash flows as per these revised terms calculated using original EIR is Rs. 25 crores. The fair value of the cash flows as per these revised terms is Rs. 28 crores.

Fair value of the consideration paid is Rs. 56 crores (70% of Rs. 80 crores) plus Rs. 28 crores i.e. Rs. 84 crores.

Record journal entries in the books of JK Limited after giving effect of the changes in the terms of the loan.

IMPAIRMENT OF FINANCIAL ASSETS

Q 29: Entity A originates a single 10 year amortising loan for Rs. 1 million. Taking into consideration the expectations for instruments with similar credit risk (using reasonable and supportable information that is available without undue cost or effort), the credit risk of the borrower, and the economic outlook for the next 12 months, Entity A estimates that the loan at initial recognition has a probability of default (PD) of 0.5 per cent over the next 12 months and the entire loss that would arise on default is 25%. Entity A also determines that changes in the 12-month PD are a reasonable approximation of the changes in the lifetime PD for determining whether there has been a significant increase in credit risk since initial recognition. Calculate loss allowance.

Ans: At reporting date, no change in 12-month POD and entity assesses that there is no significant increase in credit risk since initial recognition – therefore lifetime ECL is not required to be recognised.

Particulars	Details
Loan	Rs.1,000,000 (A)
Loss %	25% (B)
POD – 12 months	0.5% (C)
Loss allowance (for 12-months ECL)	Rs.1,250 (A*B*C)

Q 47 On 1st April 2017, A Ltd. lent Rs. 2 crores to a supplier in order to assist them with their expansion plans. The arrangement of the loan cost the company Rs. 10 lakhs. The company has agreed not to charge interest on this loan to help the supplier's short -term cash flow but expected the supplier to repay Rs. 2.40 crores on 31st March 2019. As calculated by the finance team of the company, the effective annual rate of interest on this loan is 6.9% On 28th February 2018, the company received the information that poor economic climate has caused the supplier significant problems and in order to help them, the company agreed to reduce the amount repayable by them on 31st March 2019 to Rs. 2.20 crores. Suggest the accounting entries as per applicable Ind AS **[RTP Nov 2018]**

Ans: The loan to the supplier would be regarded as a financial asset. The relevant accounting standard Ind AS 109 provides that financial assets are normally measured at fair value.

If the financial asset in which the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these inflows rather than dispose of

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the asset to a third party, then Ind AS 109 allows the asset to be measured at amortised cost using the effective interest method.

If this method is adopted, the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value Rs. 2,10,00,000.

Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due. The income recognised in the current period is Rs. 14,49,000 (Rs. 2,10,00,000 x 6.9%) evidence that the financial asset suffered impairment at 31st March 2018.

The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be Rs. 2,05,79,981 (Rs. 2,20,00,000 / 1.069). The reduction in carrying value of Rs. 18,69,019 (Rs. 2,24,49,000 – 2,05,79,981) would be charged to profit or loss in the current period as an impairment of a financial asset.

Therefore, the net charge to profit or loss in respect of the current period would be Rs. 4,20,019 (18,69,019 – 14,49,000).

DERIVATIVES HELD FOR TRADING

Q 30: On 1st January 20X1, SamCo. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 20X1 for a rate equal to Rs. 68 per USD. SamCo. Ltd. did not pay any amount upon entering into the contract. SamCo Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March 20X1 – Rs. (25,000)

As at 30th June 20X1 - Rs. (15,000)

As at 30th September 20X1 - Rs. 12,000

Spot rate of USD on 31st December 20X1 - Rs. 66 per USD **[May 2018]**

Ans:

(i) **Assessment of the arrangement using the definition of derivative included under Ind AS 109.**

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

a) its value changes in response to the change in a Specified 'underlying'.

b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

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c) it is settled at a future date.

Upon evaluation of contract in question it is noted that the contract meets the definition of a derivative as follows:

a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

b) the initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 20,000 on inception.

c) the contract is settled in future

The derivative is a forward exchange contract.

As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

(ii) Accounting on 1st January 20X1:

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recorded on the date of entering into the contract.

(iii) Accounting on 31st March 20X1:

Profit and loss A/c	Dr.	25,000	
To derivative financial liability			25,000

(Being mark to market loss on forward contract recorded)

(iv) Accounting on 30th June 20X1:

The change in value of the derivative forward contract shall be recorded as a derivative financial liability in the books of SamCo Ltd. by recording the following journal entry:

Derivative financial liability A/c	Dr.	10,000	
To Profit and loss A/c			10,000

(being partial reversal of mark to market loss on forward contract recorded)

(v) Accounting on 30th September 20X1:

The value of the derivative forward contract shall be recorded as a derivative financial asset in the books of SamCo Ltd. by recording the following journal entry:

Derivative financial liability A/c	Dr	15,000	
Derivative financial asset A/c	Dr	12,000	
To Profit and loss A/c			27,000

(being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)

(vi) Accounting on 31st December 20X1:

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The settlement of the derivative forward contract by actual purchase of USD 20,000 shall be recorded in the books of SamCo Ltd. by recording the following journal entry:

Cash (USD Account) @ 20,000 * 66	Dr.	13,20,000	
Profit and loss A/c	Dr.	52,000	
To Cash @ 20,000 x 68			13,60,000
To Derivative financial asset A/c			12,000

(being loss on settlement of forward contract booked on actual purchase of USD)

Q 31: On February 1, 2009, Future Ltd. entered into a contract with Son Ltd. to receive the fair value of 1000 Future Ltd.'s own equity shares outstanding as on 31-01-2010 in exchange for payment of Rs. 1,04,000 in cash i.e., Rs. 104 per share. The contract will be settled in net cash on 31.01.2010. The fair values of this forward contract on the different dates were:

(i) Fair value of forward on 01-02-2009 Nil

(ii) Fair value of forward on 31-12-2009 Rs. 6,300

(iii) Fair value of forward on 31-01-2010 Rs. 2,000

Presuming that Future Ltd. closes its books on 31st December each year, pass entries:

(i) If net settled is in cash

(ii) If net is settled by Son Ltd. by delivering shares of Future Ltd. **[Nov 2010, 8 Marks]**

Ans:

(i)	**If net is settled in cash**				
	1.2.09	No entry is required because fair value of derivative is zero and no cash is paid or received			
	31.12.2009	Forward Asset A/c	Dr.	6,300	
		To Gain A/c			6,300
	31.01.2010	Loss A/c	Dr.	4,300	
		To Forward Asset A/c			4,300
	31.1.2010	Cash A/c	Dr.	2,000	
		To Forward Asset A/c			2,000
(ii)	**If net settled by delivery of share**				
	First three entries will be same. Only the last entry will change as under:				
		Equity A/c	Dr.	2,000	
		To Forward Asset A/c			2,000

SEPARATION OF NON-EQUITY EMBEDDED DERIVATIVES

Q 32 D Ltd. issues callable preference shares to G Ltd. for a consideration of Rs. 10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a.

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The prevailing market rate for similar preference shares, without the conversion feature or issuer's redemption option, is RBI base rate plus 4% p.a. On the date of contract, RBI base rate is 9% p.a. The value of call as determined using Black and Scholes model for option pricing is is Rs. 29,165

Calculate the value of the liability and equity components.

Ans: The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (Rs. 10 lakhs discounted at 13% for 3 years) = Rs. 6,93,050

Present value of interest payable in arrears for 3 years (Rs. 100,000 discounted at 13% for each of 3 years) = Rs. 2,36,115

The issuer's right to call the instrument in the event that interest rates go up makes a callable instrument less attractive to the holder than a plain vanilla instrument. This results in a derivative asset. The value of that early redemption option is Rs. 29,165

Net financial liability (A + B – C) = Rs. 9,00,000

Therefore, equity component = fair value of compound instrument, say, Rs. 1,000,000 less net financial liability component i.e. Rs. 9,00,000 = Rs. 1,00,000.

In subsequent years, the profit and loss account is charged with interest of RBI base rate plus 4% p.a. on the liability component at (A) above.

Q 33: Certain callable convertible debentures are issued at Rs. 60. The value of similar debentures without call or equity conversion option is Rs. 57. The value of call as determined using Black and Scholes model for option pricing is Rs. 2.Determine values of liability and equity component. **[May 2011, 5 Marks]**

Ans: A callable bond is one that gives the issuer a right to buy the bond from the bondholders at a specified price. This feature in effect is a call option written by the bondholder. The option premium (value of call) is payable by the issuer.

Liability component (disregarding the call) = Rs. 57

Value of call payable by issuer = Rs. 2

Liability component = Rs. 57 – Rs. 2 = Rs. 55

Equity component = Rs. 60 – Rs. 55 = Rs. 5

Q 34 Entity A (an INR functional currency entity) enters into a USD 1,000,000 sale contract on 1 January 20X1 with Entity B (an INR functional currency entity) to sell equipment on 30 June 20X1.

Spot rate on 1 January 20X1: INR/USD	45
Spot rate on 31 March 20X1: INR/USD	57
Three month forward rate on 31 March 20X1: INR/USD	45
Six month forward rate on 1 January 20X1: INR/USD	55
Spot rate on 30 June 20X1: INR/USD	60

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Let's assume that this contract has an embedded derivative that is not closely related and requires separation. Please provide detailed journal entries in the books of Entity A for accounting of such embedded derivative until sale is actually made.

Ans: The contract should be separated using the 6 month USD/INR forward exchange rate, as at the date of the contract (INR/USD = 55). The two components of the contract are therefore:

- A sale contract for INR 55 Million
- Forward contract to receive US Dollars and pay INR i.e. a notional payment in INR. In other words, a six-month currency forward contract to buy US Dollars 1 Million at INR 55 per US Dollar
- This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery

1. Entity A records the sales at the amount of the host contract = INR 55 Million
2. The embedded derivative is considered to expire.
3. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial asset on delivery.
4. In this case the carrying value of the currency forward at 30 June 20X1 on maturity is = INR (1,000,000*60-55*1,000,000)=Rs 5,000,000 (profit/asset)

Journal Entries to be recorded at every period end

a. 01 January 20X1 – No entry to be made

b. 31 March 20X1 –

Profit and loss A/c	Dr.	10,000,000	
To Derivative financial liability A/c			10,000,000

(being loss on mark to market of embedded derivative booked)

c. 30 June 20X1 –

Derivative financial asset A/c	Dr.	5,000,000	
Derivative financial liability A/c	Dr.	10,000,000	
To Profit and loss A/c			15,000,000

(being gain on embedded derivative based on spot rate at the date of settlement booked)

d. 30 June 20X1 –

Trade receivable A/c	Dr.	55,000,000	
To Sales A/c			55,000,000

(being sale booked at forward rate on the date of transaction)

e. 30 June 20X1 –

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Trade receivable A/c	Dr	5,000,000	
To Derivative financial asset A/c			5,000,000

(being derivative asset re-classified as a part of trade receivables, bringing it to spot rate on the date of sale)

Q 35: On 1 January 20X1, ABG Pvt. Ltd., a company incorporated in India enters into a contract to buy solar panels from A&A Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30 June 20X1

The purchase price for solar panels is US$ 50 million.

The functional currency of ABG is Indian Rupees (INR) and of A&A is Dirhams.

The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.

Exchange rates:

1. Spot rate on 1 January 20X1: USD 1 = INR 60
2. Six-month forward rate on 1 January 20X1: USD 1 = INR 65
3. Spot rate on 30 June 20X1: USD 1 = INR 66

Analyse

Ans: This contract comprises of two components:

- Host contract to purchase solar panels denominated in INR i.e. a notional payment in INR at 6-month forward rate (INR 3,250 million or INR 325 crores)
- Forward contract to pay US Dollars and receive INR i.e. a notional receipt in INR. In other words, a forward contract to sell US Dollars at INR 65 per US Dollar

It may be noted that the notional INR payment in respect of host contract and the notional INR receipt in respect of embedded derivative create an offsetting position.

Subsequently, the host contract is not accounted for until delivery. The embedded derivative is recorded at fair value through profit or loss. This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery ABG records the inventory at the amount of the host contract (INR 325 crores). The embedded derivative is considered to expire. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial liability that arises on delivery.

In this case the carrying value of the currency forward at 30 June 20X1 on maturity is INR 50 million X (66 minus 65) = INR 5 crores (liability/loss). The loss arises because ABG has agreed to sell US Dollars at Rs. 65 per US Dollar whereas in the open market, US Dollar can be sold at Rs. 66 per US Dollar.

No accounting entries are passed on the date of entering into purchase contract. On that date, the forward contract has a fair value of zero (refer section "option and non-option based derivatives" below)

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Subsequently, say at 30 June 20X1, the accounting entries are as follows (all in INR crores):

1.	Loss on derivative contract	5
	To Derivative liability	5
	(Being loss on currency forward)	
2.	Inventory	325
	To Trade payables (financial liability)	325
	(Being inventory recorded at forward exchange rate determined on date of contract)	
3.	Derivative liability	5
	To Trade payables (financial liability)	5
	(Being reclassification of derivative liability to trade payables upon settlement)	

The effect is that the financial liability at the date of delivery is INR 330 crores (= INR 325 crores + INR 5 crores), equivalent to US$ 50 million at the spot rate on 30 June 20X1.

Going forward, the financial liability is a US$ denominated financial instrument. It is retranslated at the dollar spot rate in the normal way, until it is settled.

Q36: On 1 January 2018, Entity X writes a put option for 1,00,000 of its own equity shares for which it receives a premium of Rs. 5,00,000.

Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time and to pay the option exercise price of Rs. 22,000,000. The option can only be settled through physical delivery of the shares (gross physical settlement). Examine the nature of the financial instrument and how it will be accounted assuming that the present value of option exercise price is Rs. 20,000,000?

Ans: This derivative involves Entity X taking delivery of a fixed number of equity shares for a fixed amount of cash. Even though the obligation for Entity X to purchase its own equity shares for Rs. 22,000,000 is conditional on the holder of the option exercising the option, Entity X has an obligation to deliver cash which it cannot avoid.

As per para 23 of Ind AS 32 'Financial Instruments: Presentation', the accounting for financial instrument will be as below:

- The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity. This would imply that a financial liability for an amount of present value of Rs. 22,000,000, say Rs. 20,000,000 will be recognised through a debit to equity. The initial premium received (Rs. 5,00,000) is credited to equity.
- Subsequently, the financial liability is measured in accordance with Ind AS 109. While a subsequent paragraph will deal with measurement of financial liabilities. The financial liability of Rs. 20,000,000 will be measured at amortised cost as per Ind AS 109 and finance cost of Rs. 2,000,000 will be recognised over the exercise period.

- If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity ie. an amount of Rs. 22,000,000 will be reclassified from financial liability to equity.

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Income Taxes (IND AS 12)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 An entity has a deductible temporary difference of Rs. 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to Rs. 60,000. The cost of implementing this tax planning strategy is Rs. 12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Ans: The entity should recognise a deferred tax asset of Rs. 14,400 @ 30% of Rs. 48,000 (Rs. 60,000 – Rs. 12,000).

The balance deferred tax asset of Rs. 600 @ 30% on Rs. 2,000 (Rs. 50,000 – Rs. 48,000) shall remain unrecognised.

Q 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 Rs. 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 the reporting date of A Limited's financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2.

Ans: The difference of Rs. 10,000 between the carrying value of interest receivable of Rs. 10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of Rs. 2,500 (Rs. 10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1.

It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted nor enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

Q 3 An asset which cost Rs. 150 has a carrying amount of Rs. 100. Cumulative depreciation for tax purposes is Rs. 90 and the tax rate is 25%. Calculate the tax base.

Ans: The tax base of the asset is Rs. 60 (cost of Rs. 150 less cumulative tax depreciation of Rs. 90). To recover the carrying amount of Rs. 100, the entity must earn taxable income of Rs. 100, but will only be able to deduct tax depreciation of Rs. 60. Consequently, the entity will pay income taxes of Rs. 10 (Rs. 40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of Rs. 100 and the tax base of Rs. 60 is a taxable temporary difference of Rs. 40. Therefore, the entity recognises a deferred tax liability of Rs. 10 (Rs. 40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

Q 4 A company had purchased an asset at Rs. 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 Rs. 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.

Ans: Let us first of all calculate the Book Value as per financial and tax purposes.

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Financial Accounting: Rs. 000's

Year	1	2	3	4	5
Gross Block Accumulated Depreciation	100 20	100 40	100 60	100 80	100 100
Carrying Amount	80	60	40	20	0

Tax Accounting: Rs. 000's

Year	1	2	3	4	5
Gross Block Accumulated Depreciation	100 25	100 50	100 75	100 100	100 100
Carrying Amount	75	50	25	0	0

Calculation of DTL: Rs. 000's

Year	1	2	3	4	5
Carrying Amount Tax Base	80 75	60 50	40 25	20 0	0 0
Difference	5	10	15	20	0
Deferred Tax Liability (Difference x 30%)	1.5	3	4.5	6	0

Q 5: A Ltd. Acquired B Ltd. The following assets and liabilities are acquired in a business combination:

	Fair Value	**Carrying amount**	**Temporary Difference**
Plant and Equipment	250	260	-10
Inventory	120	125	-5
Debtors	200	210	-10
	570	595	-25
9% Debentures	100	100	
	470	**495**	
Consideration paid	500	500	
Goodwill	30	5	-25

Ans: In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by 25,000. DTA would be Rs. 7,500 (25,000 x 30%)

Journal entry:

Plant and equipment ----------------------------------	Dr	250	
Inventory -- --	Dr	120	
Debtors -- --	Dr	200	
Goodwill ---	Dr	22.5 (30- 7.5)	
DTA ---	Dr	7.5	
To 9% Debentures			100
To Bank			500

Q 6: B Limited is a newly incorporated entity. Its first financial period ends on March 31, 2011. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of Rs. 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of Rs. 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 2011.

Ans: The year-wise anticipated reversal of temporary differences is as under:

Particulars	March 31, 2012	March 31, 2013	March 31, 2014	March 31, 2015
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (Rs. 9,000/3)	3,000	3,000	3,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (Rs. 4,000/4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of Rs. 2,700 on taxable temporary difference relating to accelerated depreciation of Rs. 9,000 @ 30%.

However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending March 31, 2014 amounting to Rs. 900 (Rs. 3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 2015 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on March 31, 2015 deferred tax asset on the remainder of Rs. 1,000 (Rs. 4,000 – Rs. 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

Q 7 An entity has unutilised deductible temporary difference of Rs. 1,000 at the end of year 1 that is going to be reversed in the year 2. In year 2, taxable profits are computed because of tax disallowances of unpaid statutory liabilities of Rs. 1,000 which can be claimed as deduction only in year 3, if paid, but cannot be carried forward. The entity expects nil taxable profit in year 3. How much DTA will be recognised in the Year 1 and 2 if Tax rate is 30%.

Q 8 An entity has unutilised deductible temporary difference of Rs. 1,000 at the end of year 1 that is going to be reversed in the year 2. In year 2, taxable profits are computed because of tax disallowances of unpaid statutory liabilities of Rs. 1,000 which can be claimed as deduction only in year 3, if paid, but cannot be carried forward. The entity expects taxable profit of Rs. 450 in year 3. How much DTA will be recognised in the Year 1 and 2 if Tax rate is 30%.

Q 9. 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

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Rs. 40. Calculate Deferred Tax Asset. What is if the entity gets a deduction of Rs. 19,00,000 (say as per tax law the share based payment is measured differently) instead of Rs. 19,44,000?

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for INR 4,373 crores. By 31st March, 20X5, XYZ Ltd had made profits of INR 5 crores, 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%.

Ans: A taxable temporary difference of INR 5 therefore exists between the carrying value of the investment in XYZ at the reporting date of INR 4,378 (INR 4,373 + INR 5) and its tax base of INR 4,373. Since a parent, by definition, controls a subsidiary, it will be able to control the reversal of this temporary difference, for example - through control of the dividend policy of the subsidiary. Therefore, deferred tax on such temporary difference is generally not provided unless it is probable that the temporary will reverse in the foreseeable future

Q 10. ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January 20X1 for INR 1000 crores. By 31st March, 20X5 PQR Ltd. had made profits of INR 50 crores (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%.

Ans: A taxable temporary difference of INR 50 therefore exists between the carrying value of the investment in PQR at the reporting date of INR 1,050 (INR 1,000 + INR 50) and its tax base of INR 1,000. As ABC Ltd. does not completely control PQR Ltd. it is not in a position to control the dividend policy of PQR Ltd. As a result, it cannot control the reversal of this temporary difference and deferred tax is provided on temporary differences arising on investments in joint venture. (50 x 15%).

Q 11. An entity has made an accounting profit of Rs. 1,00,000. The tax rate is 30%. In computing the accounting profit, a penalty of Rs. 10,000 has been considered which is not tax deductible. There are no other tax impacts. In this case, the taxable profits are Rs. 1,10,000 (Rs. 1,00,000 + Rs. 10,000) and tax expense @ 30% is Rs. 33,000. Explain the disclosure requirement.

Ans: The two types of disclosures are as under:

Particulars	**Amount (**Rs.**)**
Accounting profit Tax at the applicable tax rate of 30% Tax effect of expenses that are not deductible in determining taxable profits:- Penalties Tax expense	1,00,000 30,000 3,000 33,000
The effective tax rate is as per the national income-tax rate.	
Particulars	%
Applicable tax rate Tax effect of expenses that are not deductible in determining taxable profits:- Penalties Average effective tax rate	30 3 33

Q 12. In 20X2, an entity has accounting profit in its own jurisdiction (country A) of Rs. 1,500 (20X1: Rs. 2,000) and in country B of Rs. 1,500 (20X1: Rs. 500). The tax rate is 30% in country A and

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20% in country B. In country A, expenses of Rs. 100 (20X1: Rs. 200) are not deductible for tax purposes. Explain the reconciliation requirement.

Ans: The following reconciliation will be prepared:

Particulars	Amount (Rs.)	
	20X2	20X1
Accounting profit	3,000	2,500
Tax at the domestic rate of 30%	900	750
Tax effect of expenses that are not deductible for tax purposes	30	60
Effect of lower tax rates in country B	(150)	(50)
Tax expense	780	760

Q 13 A Ltd. operate in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the end of the reporting period, December 31, 20X1, the entity does not recognise a liability for dividends proposed or declared after the reporting period. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is Rs. 1,00,000. The net taxable temporary difference for the year 20X1 is Rs. 40,000.

Subsequently, on March 15, 20X2 the entity recognises dividends of Rs. 10,000 from previous operating profits as a liability.

Calculate Tax effect for the Year 20X1 and 20X2.

Ans: The entity recognises a current tax liability and a current income tax expense of Rs. 50,000. No asset is recognised for the amount potentially recoverable as a result of future dividends. The entity also recognises a deferred tax liability and deferred tax expense of Rs. 20,000 (Rs. 40,000 at 50%) representing the income taxes that the entity will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

On March 15, 20X2, the entity recognises the recovery of income taxes of Rs. 1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

Q 14 An entity declares a dividend of Rs. 5,000 to its shareholders (all shareholders have small shareholdings). The entity operates in a jurisdiction where it is required to withhold 25 per cent of the value of the dividend payable to shareholders and pay it to the tax authorities on behalf of those shareholders. Give accounting treatment.

Ans: The entity would make the following journal entries when it declares the dividend to shareholders:

Dr Retained earnings Rs. 5,000

Cr Payable (amount due to shareholders) Rs. 3,750

Cr Payable (amount due to tax authority) Rs. 1,250

To recognise dividends payable to shareholders.

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The entity recognises a financial liability for the amount withheld that will need to be paid to the tax authorities of Rs. 1,250 (ie Rs. 5,000 × 25%) and the net dividend payable to the shareholders of Rs. 3,750 (ie Rs. 5,000 less Rs. 1,250).

Q 15. An asset with a cost of Rs. 100 and a carrying amount of Rs. 80 is revalued to Rs. 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is Rs. 30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative tax depreciation of Rs. 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable. Calculate deferred tax in the following cases

a) If the entity expects to recover the carrying amount by using the asset

b) If the entity expects to recover the carrying amount by selling the asset

Ans: The tax base of the asset is Rs. 70 and there is a taxable temporary difference of Rs. 80 (Rs. 150 the revalued amount is the carrying amount).

If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of Rs. 150, but will only be able to deduct depreciation of Rs. 70. On this basis, there is a deferred tax liability of Rs. 24 (Rs. 80 at 30%).

If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of Rs. 150, the deferred tax liability is computed as follows:

(i)	Sale proceeds	Rs. 150
(ii)	Sale proceeds in excess of cost (Rs. 100)	Rs. 50
(iii)	Taxable proceeds	Rs. 100
(iv)	Tax base	Rs. 70
(v)	Taxable temporary difference Rs. 30	
(vi)	Tax rate	30%
(vii)	Deferred tax liability	Rs. 9

QUESTIONS FROM RTP/MTP/EXAMS

Q 16: X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, the following events affected the tax position of the group:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of Rs. 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities . Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore X Ltd. recognised a provision for closure costs of Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2019, X Ltd. expects to make taxable profits which are well in excess

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of Rs. 20,00,000. On 31st March, 2018, X Ltd. had taxable temporary differences from other sources which were greater than Rs. 20,00,000.

(iii) During the year ended 31 March 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was Rs. 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March 2018.

(iv) On 1 April 2017, X Ltd. borrowed Rs. 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1 April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2020 will be Rs. 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs. 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31 March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%. **[RTP Nov 2018]**

Ans.

(i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs. 30,00,000.

However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

(ii) The provision creates a potential deferred tax asset for the group since its carrying value is Rs. 20,00,000 and its tax base is nil.

This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of Rs. 20,00,000 in the year to 31st March, 2019.

The amount of the deferred tax asset will be Rs. 4,00,000 (Rs. 20,00,000 x 20%).

This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.

(iii) The development costs have a carrying value of Rs. 15,20,000 (Rs. 16,00,000 – (Rs. 16,00,000 x 1/5 x 3/12)).

The tax base of the development costs is nil since the relevant tax deduction has already been claimed.

The deferred tax liability will be Rs. 3,04,000 (Rs. 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.

(iv) The carrying value of the loan at 31st March, 2018 is Rs. 1,07,80,000 (Rs. 1,00,00,000 – Rs. 2,00,000 + (Rs. 98,00,000 x 10%)).

The tax base of the loan is Rs. 1,00,00,000.

This creates a deductible temporary difference of Rs. 7,80,000 (Rs. 1,07,80,000 – Rs. 1,00,00,000) and a potential deferred tax asset of Rs. 1,56,000 (Rs. 7,80,000 x 20%).

Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.

Q 17: QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS. QA Ltd. had acquired 40% shares in GK Ltd. for an aggregate amount of Rs. 45 crores. The shareholding gives QA Ltd. significant influence over GK Ltd. but not control and therefore the said interest in GK Ltd. is accounted using the equity method. Under the equity method, the carrying value of investment in GK Ltd. was Rs. 70 crores on 31st March, 2017 and Rs. 75 crores as on 31st March, 2018. As per the applicable tax laws, profits recognised under the equity method are taxed if and when they are distributed as dividend or the relevant investment is disposed of.

QA Ltd. wants you to compute the deferred tax liability as on 31st March, 2018 and the charge to the Statement of Profit for the same. Consider the tax rate at 20%. **[MTP N 2018]**

Ans. DTL created on accumulation of undistributed profits as on 31.3.2018

	31st March, 2017	31st March, 2018
Carrying value	70 crore	75 crore
Value as per tax records	45 crore	45 crore
Tax base	45 crore	45 crore
Taxable temporary differences	25 crore	30 crore
Total Deferred tax liability @ 20%	5 crore	6 crore
Charged to P&L during the year	5 crore	1 crore
		(6 crore – 5 crore)

Q 18 A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is Rs. 100 thousand and taxable profit for year 20X1-20X2 is Rs. 104 thousand. The difference between these amounts arose as follows:

On 1st February, 20X2, it acquired a machine for Rs. 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes. In the year 20X1-20X2, expenses of Rs. 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

You are required to 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.

[RTP May 2018]

Ans: Current tax= Taxable profit x Tax rate = Rs.104 thousand x 25% = Rs.26 thousand.

Computation of Taxable Profit:	Rs. in thousand
Accounting profit	100

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Add: Donation not deductible		8
Less: Excess Depreciation		(4)
Total Taxable profit		104
Rs. in thousand		Rs. in thousand
Profit & loss A/c Dr.	26	
To Current Tax		26

Deferred tax:

Machine's carrying amount according to Ind AS is Rs. 118 thousand (Rs. 120 thousand – Rs. 2 thousand) Machine's carrying amount for taxation purpose = Rs. 114 thousand (Rs. 120 thousand – Rs. 6 thousand)

Deferred Tax Liability = Rs. 4 thousand x 25%

		Rs. in thousand
Profit & loss A/c Dr.	1	
To Deferred Tax Liability		1

Tax reconciliation in absolute numbers:

Rs. in thousand	
Profit before tax according to Ind AS	100
Applicable tax rate	25%
Tax	25
Expenses not deductible for tax purposes (Rs. 8 thousand x 25%)	2
Tax expense (Current and deferred)	27

Tax rate reconciliation

Tax rate reconciliation Applicable tax rate	25%
Expenses not deductible for tax purposes	2%
Average effective tax rate	27%

Q 19. 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.

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- 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%.**[RTP May 2019]**

Ans: Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 2018

- The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is ` 30,00,000. However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.
- The development costs have a carrying value of ` 15,20,000 (` 16,00,000 – (` 16,00,000 x 1/5 x 3/12)). The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be ` 4,56,000 (` 15,20,000 x 30%). All deferred tax liabilities are shown as non- current.
- The carrying value of the loan at 31st March, 2018 is ` 1,07,80,000 (` 1,00,00,000 -` 200,000 + (` 98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ` 7,80,000 and a potential deferred tax asset of ` 2,34,000 (` 7,80,000 x 30%).

Q 20 QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:

(i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its books profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. The Company is recognising the MAT credit as a current asset under IGAAP. The amount of MAT credit as on 31st March, 2016 is Rs. 8.5 crores and as on 31st March, 2017 is Rs. 9.75 crores;

(ii) The Company measures its head office property using the revaluation model. The property is revalued every year as on 31st March. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs. 40 crores whereas its tax base was Rs. 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of Rs. 2 crores and claimed a tax deduction for tax depreciation of Rs. 1.25 crores. On 31st March, 2017, the property was revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation.

The Company has no other temporary differences other than those indicated above. The Company wants you to compute the deferred tax liability as on 31st March, 2017 and the

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charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Consider the tax rate at 20%. **[MTP May 2019]**

Ans: Computation of Deferred Tax Liability

(i) MAT credit as on 31st December of Rs. 9.75 crore will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be Rs. 1.25 crore (Rs. 9.75 crore – Rs. 8.50 crore)

(ii)

(a) In case defer tax is created only on account of depreciation

	Carrying value without revaluati on	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year
A	b	c	D	E= b-d	F = e x 20%	g
31st March, 2016	22 crore	22 crore	22 crore	nil	nil	nil
Less: Depreciation for the year 2016- 17	(2 crore)	(1.25 crore)				
Carrying value as on 31st March, 2017	20 crore	20.75 crore	20.75 crore	(0.75 crore)	DTA (0.15 crore)	DTA (0.15 crore)

(b) Computation of tax effect taking into account the revalued figures and adjusting impact of tax effect on account of difference in depreciation

S. No.		Carrying value after revaluati on	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year	Charged to OCI during the year
	a	b	c	d	E= b-d	F = e x 20%	g	h
I	31st March, 2016	40 crore	22 crore	22 crore	18 crore	DTL 3.6 crore	-	DTL 3.6 crore
IV	Revalued again on 31.3.2017 (It is assumed that revaluation has been done after taking into consideration the impact of Depreciation for the current year)	45 crore	20.75 crore (22- 1.25)	20.75 crore	24.25 crore	DTL 4.85 Crore	DTA (0.15 crore) (Refer table (a) above)	DTL 5 crore (Refer Note below) [5 DTL (B/F) – 0.15 DTA = 4.85 DTL]

V	Additional DTL/DTA required during the year (IV-I)					DTL 1.25 crore	DTA (0.15 crore) (Refer table (a))	DTL (1.40 crore) (Refer Note below)

Note:

As per para 65 of Ind AS 12, when an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur.

Here, it is important to understand that only the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income. However, tax effects on account of depreciation of asset and the adjustment of the tax base are recognized in profit and loss.

Accordingly, first of all the tax effect has been calculated assuming that there is no revaluation (Refer Table (a) above) [Since the information for the carrying value before revaluation has not been mentioned, it is assumed to be equal to the carrying amount as per the tax records]. Later the DTA arrived due to difference in depreciation is adjusted with the DTL created due to revaluation. DTA of Rs. 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of Rs. 1.40 crore will be charged to OCI. Net effect in the year 31.3.2017 will be DTL 1.25 crore (DTL 1.4 crore – DTA 0.15 crore) [Refer Table (b) above.

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CONSOLIDATED FINANCIAL STATEMENTS (AS PER IND AS)

ILLUSTRATIONS

ASSESSMENT OF CONTROL

Illustration 1: Identification of relevant activities

Entity PS Ltd. issues loan notes to investors in Rupees, but it purchases financial assets in Pound Sterling and USD. It hedges cash flow differences through currency and interest rate swaps. What would be its relevant activities?

Solution: Its relevant activities are as under:

- Selling and purchasing of assets
- Managing financial assets during their life
- Determining a funding structure and obtaining funding for its activities
- Hedging the currency and interest rate risks arising from its activities. These activities are likely to most significantly affect entity PS's returns

Illustration 2

B Ltd. and C Ltd. had incorporated BC Ltd. to construct & operate a toll bridge. Construction of toll bridge will take 3 years. B Ltd. is responsible for construction. The toll bridge will be operated by C Ltd. Can it be concluded during the construction phase that when B Ltd. has all the authority to take decision that C Ltd. controls BC Ltd.?

Solution: It may appear from the question that B Ltd. has the current ability to direct relevant activities, but this may not be correct. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision making rights. The investors shall reconsider this assessment over time if relevant facts or circumstances change.

Illustration 3

In continuation to the facts given in Illustration 2, further if it is given that the toll bridge will be constructed under supervision of NHAI by B Ltd. NHAI will reimburse the cost of construction. B Ltd. is entitled to a margin on the construction but from the cash flows of the toll collection before any payment to C Ltd. The toll revenue will be fixed by C Ltd. who is entitled to management fee. From the toll revenue amount the toll expenses will be paid, then margin will be paid to B Ltd. and then management fee will be paid to C Ltd. The balance will be shared equally by B Ltd. and C Ltd.

Solution: In this case C Ltd. has power since C Ltd. is able to direct the activities that most significantly affect the returns. Cost of construction of bridge that is the responsibility of B Ltd. is reimbursed by NHAI therefore it does not significantly affect the returns. Whereas the significant return to the investor is through toll collection activities being the responsibility of C Ltd

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Illustration 4

An investor holds a majority of the voting rights in the investee. Does the investor have current ability to direct the relevant activities given the fact that it takes 30 days to hold shareholder's meeting to take decisions regarding relevant activities?

Solution: The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.

Illustration 5

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. Is the investor's forward contract a substantive right even before settlement of contract?

Solution: The investor becomes majority shareholder in the investee after the settlement of forward contract in 25 days. As per the facts given in the 'Facts' above, the existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract would have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in Illustration 4 above (i.e. the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). Therefore, the investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Illustration 6

If in the illustration given above, the investor's forward contract shall be settled in 6 months instead of 25 days, would existing shareholders have the current ability to direct the relevant activities?

Solution: Since the date of settlement of forward contact is in 6 months, the existing shareholders can hold a meeting within 30 days and direct relevant activities at which point the forward contract would not be settled. Therefore, the existing shareholders have substantive rights currently.

Illustration 7

A Limited has 48% of the voting rights of B Limited. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Does A Limited have sufficiently dominant voting interest to meet power criterion?

Solution: In the above case, based on the absolute size of A Limited's holding (48%) and the relative size of the other shareholdings, A Limited may conclude that it has a sufficiently dominant voting interest to meet the power criterion.

Illustration 8

An investor A Limited holds 45% of the voting rights of an investee. Eleven other shareholders, each holding 5% of the voting rights of the investee. None of the shareholders has contractual arrangements to consult any of the others or make collective decisions. Can we conclude that investor A Limited has power over the investee?

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Solution: In this case, the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power over the investee. Additional facts and circumstances that may provide evidence that the investor has, or does not have, power shall be considered.

Illustration 9

A Limited holds 48% of the voting rights of B Limited. X Limited and Y Limited each hold 26% of the voting rights of B Limited. There are no other arrangements that affect decision-making. Who has power to take decisions in the present case?

Solution: In this case, the size of A Limited, voting interest and its size relative to the shareholdings of X Limited and Y Limited are sufficient to conclude that A Limited does not have power.

Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

Illustration 10

Investor A holds 40% of the voting rights of an investee and six other investors each hold 10% of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. Is the absolute size of the investor's holding and the relative size of the other shareholdings alone is conclusive in determining whether the investor has rights sufficient to give it power?

Solution: No, the absolute size of investor's holding and the relative size of other's shareholdings are not conclusive in determining whether investor has power. Investor A's contractual right to appoint, remove and set the remuneration of management is also to be considered to conclude that it has power over the investee. The fact that investor A might not have exercised this right or the likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

Illustration 11

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. Does the investor have ability to direct the relevant activities of the investee unilaterally?

Solution: The active participation of 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.

Illustration 12

Entity P Ltd. develops pharmaceutical products. It has acquired 47% of entity S Ltd with an option to purchase remaining 53%. Entity S is a specialist entity that develops latest technology and does

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research in pharmaceuticals. Entity P has acquired stake in S Ltd. to complement its own technological research. The remaining 53% is held by key management of P Ltd. who are key to running a major project that will market a medicine with features completely new to the industry. However, if P Ltd. exercises the option the management personnel are likely to leave. They have unique technological knowledge in relation to the specific medicine. Option strike price is 5 times the value of entity's share price. Is the option substantive?

Solution: The option may not be substantive if entity P would derive no economic benefit from exercising it. High strike price and likely loss of key management indicate that the option may not be substantive.

Illustration 13

AB Ltd holds 40% in BC Ltd. CD Ltd holds 60% in BC Ltd. BC Ltd. is controlled through voting rights. AB Ltd. has call option exercisable in next 3 years for further 40% of investee. The option is deeply out of money and is expected to be the same over the life of the option. Further, investor would not gain any non-financial benefits from the exercise of option. Investor CD has been exercising its votes and is actively directing the relevant activities of the investee. Is right of AB Ltd substantive?

Solution: The option of AB Ltd. is not substantive. This is because although AB Ltd. has current ability to exercise his right to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee) but option is deeply out of money and is likely to remain so during option period and there are no other benefits gained from the exercise.

Illustration 14

Investor A and two other investors each hold one 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 that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60% of the voting rights of the investee. Investor A would benefit from realizing synergies if the debt instruments were converted into ordinary shares. Does investor A have power over 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.

Illustration 15: link between power & 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 the investors as an investment in a diversified portfolio of equity securities of publicly traded entities. 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 to1% 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. Does the fund manager have control over the fund?

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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.

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.

Illustration 16

The fund manager also has a 2 per cent 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 its2 per cent investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract. Considering the facts given, does the fund manager control the fund?

Solution: The fund manager's 2 per cent 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. 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, in these circumstances we conclude fund manager does not control the fund.

Illustration 17

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. Does the fund manager in this case control the fund?

Solution: 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 (i.e. substantial pro rata 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. Therefore, we conclude that the fund manager controls the fund.

Note: Having considered fund manager's remuneration and the other factors, we might consider a 20 per cent 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.

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Illustration 18

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. Does the fund manager control the fund?

Solution: 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 example, 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, we conclude that it does not control the fund.

Illustration 19

An investee Noor Ltd. is floated to invest in a portfolio of equity oriented mutual funds, funded by fixed rate debentures and equity instruments. The equity instruments will 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 15% of the value of the assets purchased by Noor Ltd. A decision maker (the asset manager) of Noor Ltd. manages the portfolio by making investment decisions strictly as per investee's prospectus. For services rendered by manager, receives a fixed fee (i.e. 0.5 percent of assets under management) and performance-related fee (i.e. 2 percent of profits) if profits exceed 10% over & above of previous financial year. The asset manager holds 40per cent of the equity in the investee. The remaining 60 per cent of the equity, and all the debentures 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.

Solution: The asset manager is paid fixed and performance-related fees that depends on variability of portfolio performance backed by equity oriented mutual funds i.e the remuneration and interest of other investors aligns to increase the value of the fund. The asset manager has exposure to variability of returns from the relevant activities of the fund because it holds 40 per cent of the equity and from its remuneration.

Although operating within the guidelines 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 widely unrelated dispersed investors receive little weighting because those rights are held by a large number of widely unrelated dispersed investors.

In given illustration, the asset manager has greater exposure to variability of returns of the fund from its 40 per cent equity interest, which is subordinate to the debt instruments. Holding 40 per cent of

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the equity creates 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 and not mere an agent.

Therefore, it is concluded that the asset manager controls the investee Noor Ltd.

Illustration 20

A decision maker Aditya Birla Money Ltd. sponsors a debt oriented mutual fund, which issues its units instruments to unrelated third party investors. The transaction was marketed as an investment in a portfolio of highly AAA rated long-term & medium-term assets with minimal credit risk exposure of the assets in the portfolio. Various transferors sell above long term & 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-collateralization of the assets transferred to the fund. The sponsor (ABML) establishes the terms of the fund and manages the operations of the fund for a market-based fee. The sponsor (ABML) 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 is entitled to any residual return of the fund and also provides liquidity facilities to the fund. The credit enhancement provided by the sponsor absorbs losses of up to 5 per cent of all of the funds 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.

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 (ie 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 (ie 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.

INVESTMENT ENTITIES

Illustration 21

A fund has been set up by its manager; initially the manager is the only shareholder. As at its first period end, the fund has not been successful in receiving funds from other prospective shareholders; but it is actively soliciting new investors. The fund invests in global equities and equity-related derivatives; and it provides its one shareholder with investment management services (as mandated in its prospectus). Its prospectus states that it expects to buy and sell investments regularly, and it expects holding periods of more than one year to be rare.

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The fund generates returns from capital appreciations and investment income in the form of dividends. The fund fair values all investments and these valuations are the basis for subscriptions and redemptions into and out of the fund. Subscriptions and redemptions can occur daily.

Is the fund an investment entity?

Solution: The fund is an investment entity. It meets the definition of an investment entity:

- It has been set up to provide investment management services to its investors. For this period, it has only one manager-shareholder and so it is providing investment management services to itself, but this is not its longer-term manager intention.
- It is carrying on its investmentactivities with the objective of capital appreciation and investment income.
- It measures its underlying investments on a fair value basis and fair value is the basis for subscriptions and redemptions into and out of the fund.

The fund displays the following characteristics:

- It holds multiple investments.
- It does not have multiple investors; but, this is expected to be temporary and the fund manager is actively soliciting new investors.
- It does not have unrelated investors, because it has only a single investor.
- It issues ownership interests in the form of redeemable units that entitle the holders to a share of net assets.

Although the fund has a single investor, this is expected to be temporary. Failing to meet this typical characteristic does not mean that the fund is not an investment entity. In the context of the definition and the fund's overall business purpose, it is an investment entity. The fund is required to make appropriate disclosures in its financial statements on why it qualifies as an investment entity even when it has only one investor.

Illustration 22

A fund is set up by a corporate entity that runs a power plant. The corporate entity (which owns all of the units in the fund) needs to keep funds available in case of a technical failure of the power plant. The entity does not have the expertise to manage the fund, so it appoints a third party asset manager. The entity can remove the fund manager on four months' notice.

The fund invests in traded equity and debt instruments (as set out in the investment management agreement and fund founding documents) and its maximum exposure to one investment is not more than 11% of monies invested. The objective of the fund is to generate returns either from dividends and interest or from selling the instruments. The fund does not invest in the power industry and the corporate entity has no other relationship with the fund; for example, it does not have options to buy any of the investments made by the fund.

The fund reports fair value information internally and to its corporate parent; and its performance is evaluated against a benchmark stock exchange index.

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The fund issues units that are redeemable at any time. The redeemable shares pay the net asset value of the fund when liquidated, and they are accounted for by the fund as equity under Ind AS 32. The units do not carry voting rights.

Is the fund an investment entity? How does the corporate entity account for its interest in the fund?

Solution: The fund is an investment entity. It meets the definition of an investment entity to the extent that:

- It provides investment management services to its investor.
- Its business purpose is to invest in debt and equity instruments for capital appreciation and investment income.
- It measures and evaluates the performance of its investments on a fair value basis. The fund displays two of the four typical characteristics
- The fund holds multiple investments.
- The fund only has one investor but in these circumstances that is not inconsistent with its overall business purpose and with the definition of an investment entity.
- The fund does not have unrelated investors, because there is only one investor; but, again, in these circumstances this is not inconsistent with the definition of an investment entity.
- Units issued by the fund entitle the holder to a proportionate share of the net asset value of the fund.

Two of the characteristics are not satisfied because the fund has a single investor. When examining all the facts and circumstances, however, the fund concludes that it is an investment entity and that the failure to meet two of the typical characteristics is not inconsistent with the definition.

The corporate entity is not an investment entity. It consolidates the fund (including any controlled investments made by the fund).

UNIFORM ACCOUNTING POLICIES

Illustration 23

PQR Ltd. is the subsidiary company of MNC Ltd. In the standalone 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?

Solution

As per paragraph 60 and 61 of Ind AS 16, ‘Property, Plant and Equipment’, a change in the method of depreciation shall be accounted for as a change in an accounting estimate as per Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’.

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Therefore, the selection of the method of depreciation is an accounting estimate and not an accounting policy.

The entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the standalone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

INDIRECT INTEREST IN A SUBSIDIARY.

Illustration 24:

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 Rs. 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 OF JOINT CONTROL

Illustration 25

Two parties A & B agree in their contractual arrangement establish an arrangement. Each has 50% of the voting rights. The contract specifies that at least 51% of the voting rights are required to make decisions with respect to the relevant activities. Do A & B have joint control over the arrangement?

Solution: A & B have implicitly agreed that they have joint control of the arrangement as all the relevant decisions can be made only when both the A & B agree.

Illustration 26

There is an arrangement in which Ram and Shyam each have 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. Do Ram &Shyam have joint control over the arrangement?

Solution: Ram and Shyam have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both Ram and Shyam agreeing.

Illustration 27

An arrangement has three parties: Om has 50% of the voting rights in the arrangement and Jay and Jagdish each have 25%. The contractual arrangement between Om, Jay and Jagdish specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Discuss the different combinations of joint control that can affect the decision making of the relevant activities of the arrangement?

Solution: Om can block any decision, it does not control the arrangement because it needs the agreement of either Jay or Jagdish. Om, Jay and Jagdish collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75% of the voting rights (ie either Om and Jay or Om and Jagdish). 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.

Illustration 28

Hari and Ram enter into a contractual arrangement to buy a two storied music store, which they will lease to other parties. Hari will be responsible for leasing first floor and Ram will be responsible for leasing second floor. They can make all decisions related to their respective floors and keep all of the income with respect to their floors. Ground floor will be jointly managed — all decisions and with respect to ground floor must be unanimously agreed between Hari and Ram. Discuss the applicability of Ind AS 111.

Solution: There are three arrangements:

1. First floor that Hari controls and hence will not be accounted under Ind AS – 111.
2. Second floor that Ram controls and thus will not be accounted under Ind AS – 111.
3. Ground floors that Hari and Ram jointly control is a joint arrangement (within the scope of Ind - AS 111).

Illustration 29

Company AB and Company CD enter into an agreement for the production and sale of garments. In the industry, there are three activities that will significantly make impact on the returns of the arrangement:

a. Production of the garments — Company AB makes all the decisions for this activity

b. Sales and Marketing activities — Company CD is makes all the decisions for these activities

c. Both the companies must approve all financial related matters

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Discuss whether company AB and CD have joint control over the arrangement?

Solution: In first two matters, unanimous consent is not required as long as parties are working within the approved budgets and financial constraints. Thus, the parties have liberty to perform their respective responsibilities.

Here, the parties have to examine which of the three activities most significantly affect the returns of the arrangement. If any of the first two activities determine the profits of the arrangement significantly, there is no joint control over the arrangement.

However, there may be the case where the financial policies majorly impact the execution of other two activities and hence determine the profit of the arrangement. Since unanimous consent is required for financial policies, management may conclude that there is joint control.

Illustration 30 Agreements established by informal decisions

CDEF limited is a strategic co-operation between investors C, D, E and F to provide property development services. CDEF Limited is an incorporated entity, and the investors' share ownership is 20:30:25:25 respectively. There is a formal contractual agreement in place that requires a voting majority on all relevant activities. Investors C, D and E have informally agreed to vote together. This informal agreement has been effective in practice.

Does C, D & E have control over the joint arrangement?

Solution: To make decisions, it is sufficient to have agreement from any three out of the four investors. In this case, a single investor cannot prevent a majority decision. However, three of the investors have agreed to make unanimous decisions. Investors C, D and E, therefore, have joint control over CDEF Limited, with investor F having significant influence at best. The agreement between investors C, D and E does not have to be formally documented as long as there is evidence of its evidence (for example, via correspondence and minutes of meetings).

Illustration 31

Shareholders C and D form a new joint arrangement (entity CD). Entity CD's article of association including a clause stating that all shareholders must unanimously agree on the entity's relevant activities. The shareholders have not entered into any other agreement to manage the activities of entity CD. Determine whether clause in CD's articles of association is sufficient to meet the definition of joint arrangement?

Solution: Entity CD meets the definition of a joint arrangement even though there is no separate joint venture agreement. The clause in entity CD's articles of association is sufficient for meeting the definition of a joint arrangement, provided entity CD's articles of association are legally binding.

Illustration 32: Impact of managing an arrangement

ECL Limited has a wholly owned subsidiary, entity B, that holds a portfolio of buildings. ECL Limited wishes to reduce its exposure to this market. It sells 50% of its investment in entity B to Investment Bank. ECL Limited and Investment Bank enter into a contractual agreement, whereby decisions regarding entity B's relevant activities are made jointly. ECL Limited continues to act as asset manager of entity B for a specified fee, and decisions are made in line with the entity B's pre- approved budgets and business plan. Is entity B jointly controlled?

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Solution: Entity B is jointly controlled, as ECL Limited and investment bank are required to agree unanimously on relevant activities, and ECL Limited must manage the entity's operations in line with these decisions.

Illustration 33: Chairman with casting vote

M Limited and N Limited set up a joint venture company, MN Limited, by signing a joint operating agreement. Both investors delegate three directors each to entity MN's board of directors. Decisions are made by simple majority. In the event of a deadlock, the chairman (a director of N Limited) has the casting vote. Does N Limited has control over MN Limited?

Solution: It is likely that N Limited has control over MN Limited, as decisions made on behalf of N Limited cannot be prevented by M Limited.

Once it is established that there is a Joint Arrangement, it is required to classify whether the arrangement is joint venture or joint operation.

TYPES OF JOINT ARRANGEMENTS

Illustration 34: Joint Operation

Three separate aerospace companies form an alliance to jointly manufacture an aircraft. They carry responsibility for different areas of expertise such as :

- *Manufacturing engines*
- *Manufacturing fuselage and wings; and*
- *Aerodynamics*

They carry out different parts of the manufacturing process, each using its own resources and expertise in order to manufacture, market and distribute the aircraft jointly. The three entities share the revenues from the sale of aircraft and jointly incur expenses. The revenues and common costs are shared, as agreed in the consortium contract.

Parties also incur their own separate costs such as labour costs, manufacturing costs, supplies, inventory of unused parts and work in progress. Each party recognizes its separately incurred costs in full. Would the arrangement be classified as joint operation?

Solution: This arrangement is classified as a joint operation because:

- The arrangement is not structured through a separate vehicle;
- Each party has obligations for the costs it incurs separately; and
- The contractual agreement outlines that each party is entitled to a share of revenue and associated costs from the sale of aircrafts based on the pre-determined agreement.

Illustration 35

Two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity.

1. *Identify the type of arrangement?*

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2. *If the parties modify the features of corporation though a contractual arrangement such that each has an interest in assets and each is liable for liabilities what type of joint arrangement would that be?*

Solution

(i) On assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement. In this case it would be classified as joint venture.

(ii) If the parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion. Such contractual modifications to the features of a corporation can cause an arrangement to be a joint operation.

Illustration 36: Legal form may not provide separation

Entities B and C form a partnership to own and operate a crude oil refinery. Each party has a 50% interest in the net profits of the partnership. What considerations would the management have to consider in classifying the arrangement as joint venture or joint arrangement?

Solution*:* The joint arrangement is structured through a vehicle, and the venture parties each have a 50% interest in the net profits of the partnership; so this appears to be a joint venture. However, management needs to evaluate whether the partnership creates separation, that is simply are the assets and liabilities those of the separate vehicle or do the parties have direct rights to the assets and have direct obligations for the liabilities held by the entity . Should the parties to the partnership have a direct interest in the assets and liabilities, this would indicate a joint operation. Management should therefore, evaluate the terms of the partnership agreement to assess the rights and obligations of each party.

Illustration 37: Joint Construction and use of a pipeline

Two parties, W and V form a limited company to build and use a pipeline to transport gas. Each party has a 50% interest in the company. Under their contractual terms, entities W and F must each use 50% of the pipeline capacity; unused capacity is charged at the same price as used capacity. Entities W and F can sell their share of the capacity to a third party without consent from the both investors. The Price entities W and F pay for the gas transport is determined in a way that ensures all costs incurred by the company can be recovered. The Joint arrangement is structured through a separate vehicle. Each party has a 50% interest in the company. However, the contractual terms require a specific level of usage by each party and, because of the pricing structure, and the entities have an obligation for the company's liabilities. What type of joint arrangement the company might be?

Solution: This entity might be a joint operation despite its legal form.

Illustration 38

Two parties structure a joint arrangement in an incorporated entity (entity D) in which each party has a 50 per cent 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 D (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in entity D are the assets

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and liabilities of entity D. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity D.

1. What type of joint arrangement would entity D be?

2. Would your classification change if the parties instead of using the share of output themselves sold to third parties?

3. If the parties changed the terms of contractual arrangement such that entity D would be able to sell the output to third parties, would your answer be the same as in part (i) above?

Solution

(i) The legal form of entity D and the terms of the contractual arrangement indicate that the arrangement is a joint venture.

However, the parties also consider the following aspects of the arrangement:

- The parties agreed to purchase all the output produced by entity D in a ratio of 50:50. Entity D 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 D. On the basis of this operating model, the arrangement is intended to operate at a break- even level.

From the fact pattern above, the following facts and circumstances are relevant:

- The obligation of the parties to purchase all the output produced by entity D reflects the exclusive dependence of entity D upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of entity D.
- The fact that the parties have rights to all the output produced by entity D means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of entity D.

These facts and circumstances indicate that the arrangement is a joint operation.

(ii) The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in subsequent manufacturing process, the parties sold their share of the output to third parties.

(iii) If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in entity D assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

IMPLICIT JOINT CONTROL

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Illustration 39:

Entity C and entity D operates in a telecommunication industry and entered into a joint arrangement in order to combine their 4G access networks. The purpose of this arrangement is to reduce operating cost for both parties, make capital infrastructure savings and obtain economies of scale from jointly managing and maintaining a consolidated network.

All significant decisions about strategic investing and financing activities are decided by a simple majority of the voting rights. Entity C and entity D each have one vote in the decision making process.

Discuss whether it is a joint arrangement or not.

Solution: All decisions about the relevant activities require consent of both parties, so the arrangement is a joint arrangement. The contractual arrangement does not explicitly require unanimous consent, but the fact that all decisions must be made by majority leads to implicit joint control.

Illustration 40:

NFG Limited is owned by numerous shareholders with the following holdings:

- *Shareholders N owns 51%*
- *Shareholders F owns 30%*
- *The rest of the shares are widely held by other investors, altogether 19%.*

NFG Limited's articles of association require a 75% majority to approve decisions about any of the entity's relevant activities. They also outline that each shareholder is entitled to vote in proportion to its respective ownership interest. Is NFG ltd jointly controlled?

Solution: NFG Limited is jointly controlled by shareholders N and F. based on their ownership interest (collectively 81%), they must act together to make decisions regarding NFG Limited's relevant activities. Shareholder N does not control NFG Limited, as it cannot unilaterally make decisions because a 75% majority is required.

Illustration 41: Equal number of directors

Two entities, E and F, set up an entity and sign a joint operating agreement. The board contains three directors appointed by and representing each entity. The board is the entity's main decision- making body. Decisions are made by simple majority. Each party has a 50% interest in the net profit generated. Discuss whether the entity is jointly controlled by E & F.

Solution: Entities E and F are likely to have joint control, because each party has a 50% interest in net profit and both have a right to appoint three directors. This is because the three directors representing a single shareholder would generally be presumed to vote in accordance with the wishes of that shareholder. So the consent of both entity E and entity F would be required for decision making, and this would represent joint control.

However, if the directors are not obliged to represent one shareholder, decisions will be made by simple majority. It is possible that (say) one director of shareholder E agrees with three directors of shareholder F and takes a decision that is against the interest of shareholder E. Although this is expected to be unlikely in practice, such a situation would not represent joint control.

All relevant facts have to be considered before reaching such a conclusion.

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Illustration 42: Board of directors and operating committee

Entities P and Q set up a joint venture company, entity PQ by signing a joint operating agreement. Both investors delegate one director to entity PQ's board of directors. Both directors have to agree unanimously on the decisions on the annual budget. The joint operating agreement also sets up an operating committee and specifies power delegated by the board of directors to the committee.

The operating committee has the main operational decision-making responsibility. Decisions are made by simple majority in this committee. Only entity P can appoint members to the operating committee.

Discuss if Entity PQ is a joint arrangement or not.

Solution*:* Entity PQ is not a joint arrangement; entity P has control over entity PQ. Decisions about relevant activities are not made at the board of directors level but at the operating committee level. Entity P has control over the operating committee because it can appoint its members. The fact that the directors have veto rights over the annual budget is important, but the operating committee in this example has the power to control entity PQ's relevant activities.

DEFINITION OF ASSOCIATE

Illustration 43

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 suggestions 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 them from exerting significant influence. Whilst it appears the 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. In this situation, Y Ltd would not be an associate of X Ltd.

Illustration 44

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

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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.

Illustration 45

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

Illustration 46

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.

Illustration 47

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.

Illustration 48

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.

Illustration 49:

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 suggestions 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.? **[MTP May 2019]**

Answer: 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 the 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.

In this situation, Y Ltd would not be an associate of X Ltd.

PRACTICE QUESTIONS

Question 1:

XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for Rs. 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was Rs. 1,00,000 and the balance in the statement of Profit & Loss was Rs. 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of Rs. 20,000 and at the same time, declared and paid a dividend of Rs. 30,000.

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

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of non-controlling interest as on 1st April, 20X1 and 31st March, 20X2 using Fair Value method. Also pass a Journal entry on the acquisition Date.

∗This assumption is only for illustration purpose. However, in the practical scenarios, the fair value of NCI will be lower than the fair value of CI (Controlling Interest) since the consideration paid for acquiring controlling interest will include control premium.

Question 2:

From the following data, determine in each case:

(1) Non-controlling interest at the date of acquisition and at the date of consolidation using proportionate share method.

(2) Goodwill or Gain on bargain purchase.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be Rs. 2,00,000 in each case

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Case	Subsidiary Company	% of shares owned	Cost	Date ofAcquisition1.04.20X1		Consolidation date31.03.20X2	
				Share Capital	Retained Earnings	Share Capital	Retained earnings
				[A]	[B]	[C]	[D]
1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
3	C	80%	56,000	50,000	20,000	50,000	30,000
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.

Question 3:

A Ltd. acquired 70% of equity shares of B Ltd. on 1.04.20X1 at cost of Rs. 10,00,000 when B Ltd. had an equity share capital of Rs. 10,00,000 and other equity of Rs. 80,000. In the four consecutive years B Ltd. fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. experienced turnaround and registered an annual profit of Rs. 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. recorded annual profits of Rs. 1,00,000 and Rs. 1,50,000 respectively. Show the non- controlling interests and cost of control at the end of each year for the purpose of consolidation. Assume that the assets are at fair value.

Question 4:

On 31 March 20X2, Blue Heavens Ltd. acquired 75% ordinary shares carrying voting rights of Orange County Ltd. for Rs. 4,500 lakh in cash and it controlled Orange County Ltd. from that date.

The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. statement of financial position were:

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

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

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Question5:

Facts are same as in Question 21, Blue Heavens Ltd. acquires 75% of Orange County Ltd. Blue Heavens Ltd. pays Rs. 4,500 lakhs for the shares. At 31 March 20X3, i.e one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd.	Orange County Ltd.
	Carrying Amount Rs.(lakh)	Carrying Amount Rs.(lakh)
Assets		
Non-current assets		
Building and other PPE	6,500	2,750
Investment in Orange County Ltd.	4,500	
	11,000	2,750
Current assets		
Inventories	800	550
Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	16,350	5,020
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	16,350	5,020

Statements of comprehensive income for the year ended 31 March 20X3:

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	Blue Heavens Ltd.	Orange County Ltd.
	Carrying Amount Rs.(lakh)	Carrying Amount Rs.(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 20X2 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31st March 20X2 was sold during 20X3.

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd.

Question 6:

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 Rs.40 lakh. Entity D purchases the remaining 60% interest in entity E for Rs.600 lakh in cash. The fair value of the 40% previously held equity interest is determined to be Rs.400 lakh., the net aggregate value of the identifiable assets and liabilities measured in accordance with Ind AS 103 is determined to be identifiable Rs.880 lakh. The tax consequences have been ignored. How does entity D account for the business combination?

Solution:

The journal entry recorded on the date of acquisition of the 60% controlling interest is as follows:

			(Rs. in lakh)
Identifiable net assets	Dr.	880	
Goodwill	Dr.	120	
To Cash			600
To Associate interest			40
To Gain on equity interest (to be recognized in income statement)		360	

Goodwill is calculated as follows:	**Rs. in lakh**
Fair value of consideration transferred	600
Fair value of previously held equity interest	400
	1,000
Less: Recognised value of 100% of the identifiable net assets	(880)

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Goodwill recognised 120

The gain on the 40% previously held equity interest is recognized in the income statement. The fair value of the previously held equity interest less the carrying value of the previously held equity interest is Rs. 360 lakh (400 – 40).

Question 7: Sale of a 20% interest in a wholly- owned subsidiary

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

Solution: The accounting entry recorded on the disposition date for the 20% interest sold as follows:

		Rs. in Lakh	Rs. in lakh
Cash	Dr.	100	
To Non-controlling interest (20% * 300 lakh)			60
To Other Equity (Gain on sale of interest in subsidiary)			40

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (60 lakhs) is adjusted and fair value of consideration received (100 lakhs) to be attributed to parent in other equity ie. 40 lakhs.

Question 8: Acquisition of a 20% interest in a subsidiary

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

Solution: The accounting entry recorded for the purpose of the non- controlling interest is as follows:

		Rs.	Rs.
Non-controlling interest	Dr.	2,000	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2,000	
To Cash			4,000

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (Rs. 2,000) is adjusted and fair value of consideration received (Rs. 4,000) to be attributed to parent in other equity ie. Rs. 2,000.

Question 9:

A Ltd. acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance sheet finalized as on 1.4. 20X0:

	Rs. in thousand

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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 interest (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?

Solution: The following accounting entries are passed:

		Rs. '000	Rs. '000
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	400	
Non-controlling interest	Dr.	2,200	
To Bank			2,600

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (Rs. 22,00,000) is adjusted and fair value of consideration received (Rs. 26,00,000) to be attributed to parent in other equity ie. Rs. 4,00,000. Consolidated goodwill is not adjusted.

Question 10: Reduce interest in subsidiary

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

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

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

Solution: As per Ind AS 110, a change in ownership that does not result in a loss of control. The identifiable net assets (including goodwill) remain unchanged and any difference between the amount by which the non-controlling interest is recorded (including the non controlling interest portion of goodwill) and a fair value of the consideration received is recognized directly in equity and attributed to the controlling interest. For disposals that do not result in the loss of control, the change in the non-controlling interest is recorded at its proportionate interest of the carrying value of the subsidiary.

Gain on the sale of the investment of Rs. 5,00,000 in parent's separate financial statements calculated as follows: Rs.'000

Sale proceeds	900
Less: cost on investment in subsidiary (Rs. 10,00,000 X 40%)	(400)
Gain on sale in the parent's separate financial statement	500

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As discussed above, the group's consolidated income statement for 31st March 20X4 would show no gain on the sale of the interest in the subsidiary. Instead, the difference between the fair value of the consideration received and the amount by which the non controlling interest is recorded is recognized directly in equity.

	Rs.'000
Sale proceeds	900
Less: recognition of non controlling interest (Rs. 18,00,000 X 40%)	720
Credit to other equity	180

The entry recognized in the consolidated accounts under Ind AS 110 is :

		Rs.'000	Rs.'000
Cash	Dr.	900	
To Non controlling interest(1,800 X 40%)			720
To Other Equity (Gain on sale of interest on subsidiary)			180

The difference between the gain in the parent's income statement and the increase reported in the group's consolidated equity is Rs. 3,20,000. This difference represents the share of post acquisition profits retained in the subsidiary Rs. 3,20,000 [(that is, 18,00,000 – 10,00,000) X 40%] that have been reported in the groups income statement upto the date of sale.

The non-controlling interest immediately after the disposal will be 40% of the net carrying value of the subsidiary's net assets including goodwill in the consolidated balance sheet of Rs. 18,00,000, that is, Rs. 7,20,000.

Question 11:

A ltd. acquired 70% of shares of B ltd. On 1.4.20X0 when fair value of net assets of B Ltd. was Rs. 200 lakh. During 20X0-20X1, B ltd. made profit of Rs. 10 lakh. Stand-alone and consolidated balance sheets as on 31.3. 20X1 are as follows: (Rs. in lakhs)

	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**	**1,160**
Equity and Liabilities			
Share Capital	200	100	200
Other Equity	800	200	870
Non-controlling interest			90
	1,000	**300**	**1,160**

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A ltd. acquired another 10% stake in B ltd on 1.4. 20X0 at Rs. 32 lakh. The proportionate carrying amount of the non-controlling interest is Rs. 30 lakh. Show the stand alone and consolidated balance sheet of the group immediately after the change in non-controlling interest.

Question 12:

Ram Ltd. acquired 60% ordinary shares of Rs. 100 each of Krishan Ltd. on 1st October 20X1. On March 31, 20X2 the summarised 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**
Equities & Liabilities		
Equity Capital (Shares of Rs. 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 Rs. 60,000 on 1st April 20X1 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 20X1 was Rs. 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 20X1 which is to be considered while consolidating the Balance Sheets.

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

Prepare consolidated Balance Sheet as on March 31, 20X2. **[May 2018]**

Question 13: Calculation of gain on outright sale of subsidiary

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

Solution: The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of Rs. 40,000 calculated as follow:

	Rs. '000
Sale proceeds	200
Less: cost of investment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of Rs. 8,000 calculated as follows:

	Rs.'000
Sale proceeds	200
Less: share of net assets at date of disposal (Rs. 2,25,000 X 80%)	(180)
Goodwill on consolidation at date of sale (W.N 1)	(12)
	(192)
Gain on sale in the group's account	8

Working Note 1

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:Rs.'000

Fair value of consideration at the date of acquisition	160

Non- controlling interest measured at proportionate share of the acquiree's

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identifiable net assets (1,75,000 X 20%)	35
Less: fair value of net assets of subsidiary at date of acquisition	(175)
	(140)
Goodwill arising on consolidation	20
Impairment at 31 March 20X3	(8)
Goodwill at 31 March 20X4	12

Question 14: Partial disposal where subsidiary becomes an associate

AT Ltd. purchased a 100% subsidiary for Rs. 50,00,000 on 31st March 20X1 when the fair value of the BT Ltd. whose net assets was Rs. 40,00,000. Therefore, goodwill is Rs.10,00,000. The AT Ltd. sold 60% of its investment in BT Ltd. on 31st March 20X3 for Rs. 67,50,000, leaving the AT Ltd. with 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd., excluding goodwill is Rs. 80,00,000. Assume the fair value of the investment in associate BT Ltd. retained is proportionate to the fair value of the 60% sold, that is Rs. 45,00,000.

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

Solution: AT Ltd.'s statement for profit or loss of 20X2-20X3 would show a gain on the sale of investment of Rs. 37,50,000 calculated as follows:

	Rs.' lakhs
Sale proceeds	67.5
Less: cost on investment in subsidiary (Rs. 50,00,000 X 60%)	(30.0)
Gain on sale in the parent's financial statement	37.5

In the consolidated financial statements, the group will calculate the gain or loss on disposal differently. The carrying amount of all of the assets including goodwill is derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

The gain on the disposal will, therefore, be calculated as follows:

	Rs.' lakhs
Sale proceeds	67.5
Fair value of 40% interest retained	45.0
	112.5
Less: Net assets disposed, including goodwill (80,00,000+ 10,00,000)	(90.0)
Gain on sale in the group's financial statements	22.5

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of Rs. 13,50,000 [Rs. 67,50,000 – (Rs. 90,00,000 X 60%)] on the portion sold. However, it also includes a gain on remeasurement of the 40% retained interest of Rs. 9,00,000 (Rs. 36,00,000* to Rs. 45,00,000). The entity will need to disclose the portion of the gain that is attributable to remeasuring any remaining interest to fair value, that is, Rs. 9,00,000.

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* 90,00,000x 40%= 36,00,000

Question 15: Partial disposal where 10% investment in former subsidiary is retained.

The facts of this example as same as example 31, except that the group AT Ltd. disposes of a 90% interest for Rs. 85,50,000, leaving the AT Ltd. with a 10% investment. The fair value of the remaining interest is Rs. 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold).

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 20X1.

Solution: The parent's AT Ltd. income statement in its separate financial statements for 20X1 would show a gain on the sale of the investment of Rs. 40,50,000 calculated as follows:

	Rs. in lakhs
Sale proceeds	85.5
Less: cost on investment in subsidiary (Rs. 50,00,000 X 90%)	(45.0)
Gain on sale in the parent's financial statement	40.5

In the consolidated financial statements, all of the assets, including goodwill are derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

	Rs. in lakhs
Sale proceeds	85.5
Fair value of 10% interest retained	9.5
	95.0
Less: Net assets disposed, including goodwill (80,00,000+ 10,00,000)	(90.0)
Gain on sale in the group's financial statements	5.0

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of Rs. 4,50,000 related to the 90% portion sold [Rs. 85,50,000 – (Rs. 90,00,000 X 90%)] as well as Rs. 50,000 related to the remeasurement to fair value of 10% retained interest (Rs. 9,00,000 to Rs. 9,50,000)

Question 16: 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 Rs. 20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at Rs. 12 per share, raising Rs. 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were Rs. 4,50,000, excluding goodwill.

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

Solution: Shareholdings

	Before		After	
	No	%	No	%

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Group	30,000	60	30,000	40
Other party	20,000	40	45,000	60
	50,000	100	75,000	100
Net assets	Rs.'000	%	Rs.'000	%
Group's share	270	60	300	40
Other party's share	180	40	450	60
	450	100	750	100

Calculation of group gain on deemed disposal	**Rs.'000**
Fair value of 40% interest retained (Rs.12 X 30,000)**	360
Less:	
Net assets derecognized	(450)
Non-controlling interest derecognized	180
Goodwill	(20)
Gain on deemed disposal	70

** Note: For simplicity, it has been assumed the fair value per share is equal to the subscription price.

As control of the subsidiary is lost, the retained interest is recognized at its fair value at the date control is lost. The resulting remeasurement gain is recognized in profit and loss.

Question 17:

Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 20X2.

Reliance Ltd. consolidated statement of financial position and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (ie the amount included in that consolidated statement of financial position in respect of Reliance Jio Infocomm Ltd. assets and liabilities) at 31st March 20X2 are as follows

Particulars	Consolidated (Rs. In '000)	Group carrying amount of Reliance Jio Infocomm Ltd. asset and liabilities Ltd. (Rs. 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
Equities & Liabilities		
Equity		
- Share Capital	800	
Other Equity		
- Retained Earnings	2,130	
	2,930	
Current liabilities		
- Trade Payables	1,350	450

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Total Equity & Liabilities	4,280	450

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for Rs. 1000 (' 000).

Question 18:

Prepare the Consolidated Balance Sheet as on March 31, 20X1 of group of companies A Ltd., B Ltd. and C Ltd. Their summarized balance sheets on that date are given below:

Equity & Liabilities	A Ltd. Rs.	B Ltd. Rs.	C Ltd. Rs.
Share Capital (share of Rs.100 each)	1,25,000	1,00,000	60,000
Reserves	18,000	10,000	7,200
Retained Earnings	16,000	4,000	5,000
Trade Payable	7,000	3,000	-
Bills Payables			-
- A Ltd.	-	7,000	-
- C Ltd.	3,300		
Total	1,69,300	1,24,000	72,200
Assets			
Property Plant Equipment	28,000	55,000	37,400
Investment in shares			
B Ltd.	85,000	-	-
C Ltd.	-	53,000	-
Inventory	22,000	6,000	
Bills Receivables			-
- B Ltd.	7,000	-	-
- A Ltd.	-	-	3,300
- Others	1,000	-	-
Trade Receivables	26,300	10,000	31,500
Total	1,69,300	1,24,000	72,200

Other information:

(i) A Ltd. holds 750 shares in B Ltd. and B Ltd. holds 400 shares in C Ltd. These holdings were acquired on 30th September, 20X0

(ii) On 1st April, 20X0 the following balances stood in the books of B Ltd. and C Ltd.

	B Ltd. Rs.	C Ltd. Rs.
Reserves	8,000	6,000
Retained Earnings	1,000	1,000

(iii) C Ltd., sold goods costing Rs. 2,500 to B Ltd. for Rs. 3,100. These goods still remain unsold.

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The company has adopted an accounting policy to measure Non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume market price per share of B & C limited is same as face value. **[May 2018]**

Question 19:

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 Rs. 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 Rs. 10,25,000. At that time the building was assessed to have a useful life of 21 years and a residual value of Rs. 5,00,000. On 1 April 20X1 the carrying amount of the building was Rs. 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 Rs. 3,50,000. The method of depreciation is straight-line.

Pass necessary accounting entries in individual and consolidation situations:

Illustration 20

P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the Capital in PQ. However, the contractual terms of the joint arrangement state 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 capital share (i.e., 50%).

PQ's balance sheet is as follows (in Rs.):

Balance sheet			
Liabilities	*Rs.*	*Assets*	*Rs.*
Capital	*1,50,000*	*Machinery*	*2,50,000*
Bank Loan	*75,000*	*Cash*	*50,000*
Other Loan	*75,000*		
	3,00,000		*3,00,000*

What would you record in P's financial statements to account for its rights and obligations in PQ?

Solution: Under Ind AS 111, we would record the following in its financial statements, to account for its rights to the assets in PQ and its obligations for the liabilities in PQ. This may differ from the amounts recorded using proportionate consolidation.

Machinery	250,000
Cash	25,000
Capital	75,000
Bank Loan	75,000
Other Loan	32,500

Question 21

On 1st April 2017 Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be

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shared equally. The construction was completed on 30th September 2017 and utilisation of the property started on 1st January 2018 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was Rs. 40 crores. Besides internal accruals, the cost was partly funded by way of loan of Rs. 10 crores taken on 1st January 2017. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent Rs. 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as the accounting entries as per applicable Ind AS. **[RTP Nov 2018]**

Answer:

As provided in Ind- AS 111 - Joint Arrangements - this is a joint arrangement because two or more parties have joint control of the property under a contractual arrangement. The arrangement will be regarded as a joint operation because Alpha Ltd. and Gama Ltd. have rights to the assets and obligations for the liabilities of this joint arrangement. This means that the company and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the property should under the principles of Ind AS 23 'Borrowing Costs', be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is Rs. 50,00,000 (Rs. 10,00,00,000 x 10% x 6/12).

The total cost of the asset is Rs. 40,50,00,000 (Rs. 40,00,00,000 + Rs. 50,00,000)

Rs. 20,25,00,000 crores is included in the property, plant and equipment of Alpha Ltd. and the same amount in the property, plant and equipment of Gama Ltd.

The depreciation charge for the year ended 31 March 2018 will therefore be Rs. 1,01,25,000 (Rs. 40,50,00,000 x 1/20 x 6/12) Rs. 50,62,500 will be charged in the statement of profit or loss of the company and the same amount in the statement of profit or loss of Gama Ltd. (finance cost for the second half year of Rs. 50,00,000 plus maintenance costs of Rs. 4,00,000) will be charged to the statement of profit or loss of Alpha Ltd. and Gama Ltd. in equal proportions- Rs. 27,00,000 each.

Question 22:

Amar Ltd. acquires40% shares of Ram Ltd. On 1 Apr 20X1, the price paid is Rs. 10,00,000. Ram Ltd has reported a profit of Rs. 2,00,000 and paid dividend of Rs. 1,00,000. Make necessary journal entries in the books of Amar Ltd

Solution:

		Amount Rs.	Amount Rs.
Investment in Associate A/c	Dr.	10,00,000	
To Cash A/c			10,00,000
Investment in Associate A/c [2,00,000 x 40%]	Dr.	80,000	
To Share in Profit from Associate A/c			80,000

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Cash A/c [1,00,000x40%]	Dr.	40,000	
To Investment in Associate A/c			40,000

Adjustments to the carrying amount may also be necessary for a change in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in other comprehensive income of the investor

Question 23:

B Ltd acquired a 30% interest in D Ltd and achieved significant influence. The cost of the investment was Rs. 2,50,000. The associate has net assets of Rs. 5,00,000 at the date of acquisition. The fair value of those net assets is Rs. 6,00,000 as a fair value of property, plant & equipment is Rs. 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 Rs. 1,00,000 and paid a dividend out of these profits of Rs. 9,000. D Ltd has also recognized exchange losses of Rs. 20,000 directly in other comprehensive income. Calculate B Ltd's interest in D Ltd at the end the year by using equity method.

Solution: B Ltd's interest in D Ltd at the end the year is calculated as follows:

	Rs.
Balance on requisition under the equity method (including goodwill of Rs. 70,000)	
(Rs. 2,50,000 – (30% X Rs. 6,00,000))	2,50,000
B Ltd's share of D Ltd's after tax profit (30% X Rs.1,00,000)	30,000
Elimination of dividend received by B Ltd from D Ltd (30% X Rs.9,000)	(2,700)
B Ltd's share of D Ltd's exchange differences (30% X Rs.20,000)	(6,000)
B Ltd's share of amortisation of fair value uplift (30% X Rs.10,000)	(3,000)
B Ltd's interest in D Ltd at the end of the year under the equity method	
(including goodwill)	2,68,300

D Ltd has net assets at the end of the year of Rs. 5,71,000 (that is, net assets at the start of the year of Rs. 5,00,000 , plus profit during the year of Rs. 1,00,000 , less dividend of Rs. 9,000 , less foreign exchange losses of Rs. 20,000).

B Ltd's interest in D Ltd at the end of the year is made up of:

B Ltd's share of D Ltd's net assets (30%X Rs.5,71,000)	1,71,300
Goodwill	70,000
B Ltd's share of D Ltd's fair value adjustments (the initial fair value difference of	
Rs.1,00,000 has been reduced by Rs.10,000 due to depreciation in the year)	
(30% X Rs.90,000)	27,000
B Ltd's interest in D Ltd	2,68,300

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Question 24:

Angel Ltd. has adopted Ind AS with a transition date of 1st April, 2017. Prior to Ind AS adoption, it followed Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as "IGAAP").

It has made investments in equity shares of Pharma Ltd., a listed company engaged in the business of pharmaceuticals. The shareholding pattern of Pharma Ltd. is given below:

Shareholders (refer Note 1)	Percentage shareholding as on 1st April, 2017
Angel Ltd.	21%
Little Angel Ltd. (refer Note 2)	24%
Wealth Master Mutual Fund (refer Note 3)	3%
Individual public shareholders (refer Note 4)	52%

Notes:

(1) None of the shareholders have entered into any shareholders' agreement.

(2) Little Angel Ltd. is a subsidiary of Angel Ltd. (under Ind AS) in which Angel Ltd. holds 51% voting power.

(3) Wealth Master Mutual Fund is not related party of either Little Angel Ltd. or Pharma Ltd.

(4) Individual public shareholders represent 17,455 individuals. None of the individual shareholders hold more than 1% of voting power in Pharma Ltd.

All commercial decisions of Pharma Ltd. are taken by its directors who are appointed by a simple majority vote of the shareholders in the annual general meetings ("AGM"). The following table shows the voting pattern of past AGMs of Pharma Ltd.:

Shareholders	AGM for the financial year:		
	2013-14	2014-15	2015-16
Angel Ltd.	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions
Little Angel Ltd.	Attended and voted as per directions of Angel Ltd.	Attended and voted as per directions of Angel Ltd	Attended and voted as per directions of Angel Ltd
Wealth Master Mutual Fund	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the Reappointment of the retiring directors

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Individuals	7% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	8% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	6% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.

Pharma Ltd. has obtained substantial long term borrowings from a bank. The loan is payable in 20 years from 1st April, 2017. As per the terms of the borrowing, following actions by Pharma Ltd. will require prior approval of the bank:

- Payment of dividends to the shareholders in cash or kind;
- Buyback of its own equity shares;
- Issue of bonus equity shares;
- Amalgamation of Pharma Ltd. with any other entity; and
- Obtaining additional loans from any entity.

Recently, the Board of Directors of Pharma Ltd. proposed a dividend of ` 5 per share. However, when the CFO of Pharma Ltd. approached the bank for obtaining their approval, the bank rejected the proposal citing concerns over the short-term cash liquidity of Pharma Ltd. Having learned about the developments, the Directors of Angel Ltd. along with the Directors of Little Angel Ltd. approached the bank with a request to re-consider its decision. The Directors of Angel Ltd. and Little Angel Ltd. urged the bank to approve a reduced dividend of at least ` 2 per share. However, the bank categorically refused to approve any payout of dividend.

Under IGAAP, Angel Ltd. has classified Pharma Ltd. as its associate. As the CFO of Angel Ltd., you are required to comment on the correct classification of Pharma Ltd. on transition to Ind AS.

[RTP May 2019]

Answer:

To determine whether Pharma Limited can be continued to be classified as an associate on transition to Ind AS, we will have to determine whether Angel Limited controls Pharma Limited as defined under Ind AS 110.

An investor controls an investee if and only if the investor has all the following:

(a) Power over investee

(b) Exposure, or rights, to variable returns from its involvement with the investee

(c) Ability to use power over the investee to affect the amount of the investor's returns.

Since Angel Ltd. does not have majority voting rights in Pharma Ltd. we will have to determine whether the existing voting rights of Angel Ltd. are sufficient to provide it power over Pharma Ltd.

Analysis of each of the three elements of the definition of control:

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Elements / conditions	Analysis
Power over investee	Angel Limited along with its subsidiary Little Angel Limited (hereinafter referred to as "the Angel group") does not have majority voting rights in Pharma Limited. Therefore, in order to determine whether Angel group have power over Pharma Limited. we will need to analyse whether Angel group, by virtue of its non-majority voting power, have *practical ability to unilaterally direct the relevant activities* of Pharma Limited. In other words, we will need to analyse whether Angel group has *de facto* power over Pharma Limited. Following is the analysis of *de facto* power of Angel over Pharma Limited: The public shareholding of Pharma Limited (that is, 52% represents thousands of shareholders none individually holding material shareholding, The actual participation of Individual public shareholders in the general meetings is minimal (that is, in the range of 6% to 8%). Even the public shareholders who attend the meeting do not consult with each other to vote. Therefore, as per guidance of Ind AS 110, the public shareholders will not be able to outvote Angel group (who is the largest shareholder group) in any general meeting. Based on the above-mentioned analysis, we can conclude that Angel group has *de facto* power over Pharma Limited.
Exposure, or rights, to variable returns from its involvement with the investee	Angel group has exposure to variable returns from its involvement with Pharma Limited by virtue of its equity stake.
Ability to use power over the investee to affect the amount of the investor's returns	Angel group has ability to use its power (in the capacity of a principal and not an agent) to affect the amount of returns from Pharma Limited because it is in the position to appoint directors of Pharma Limited who would take all the decisions regarding relevant activities of Pharma Limited. Here, it is worthwhile to evaluate whether certain rights held by the bank would prevent Angel Limited's ability to use the power over Pharma Limited to affect its returns. It is to be noted that, all the rights held by the bank in relation to Pharma Limited are protective in nature as they do not relate to the relevant activities (that is, activities that significantly affect he Pharma Limited's returns) of Pharma Limited.

	As per lnd AS 110, 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. Therefore, the protective rights held by the bank should not be considered while evaluating whether or not Angel Group has control over Pharma Limited.

Conclusion: Since all the three elements of definition of control is present, it can be concluded that Angel Limited has control over Pharma Limited.

Since it has been established that Angel Limited has control over Pharma Limited, upon transition to lnd AS, Angel Limited shall classify Pharma Limited as its subsidiary.

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Related Party Disclosures (IND AS) 24

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1: Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited Required : Examine related party relationships of various entities.

Ans:

- In Separate Financial Statements of P Limited, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SA Limited, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SB Limited, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SC Limited, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of associates A1 Limited, A2 Limited and A3 Limited; P Limited, SA Limited, SB Limited and SC Limited are related parties.
- A1 Limited, A2 Limited and A3 Limited are not related to each other.
- In Consolidated Financial Statements of P Limited, A1 Limited, A2 Limited and A3 Limited are not part of the Group since Group includes only parent and subsidiaries.

Q 2: Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.

Required

(a) Examine related party relationships from the perspective of C Limited for A Limited.

(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

(c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

(d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited.

Ans: (a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.

(b) Still A Limited will be related to C Limited.

(c) No, Still A Limited will be related to C Limited.

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(d) Yes, A Ltd. is not controlled by Mr. X. Therefore, despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.

Q 3: Mr. X has an investment in A Limited and B Limited.

Required

(i) Examine when can related party relationship be established

(a) from the perspective of A Limited's financial statements:

(b) from the perspective of B Limited's financial statements:

(ii) Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited

Ans: (i)

(a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Mr. X has control, joint control or significant influence over Entity B.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to Entity B when Mr. X has control, joint control or significant influence over Entity B.

(ii) No, A Ltd. & B Ltd., will not be considered as related party since no direct or indirect control is exercised on each other in any of the manner.

Q 4: Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1.

Required

Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

Ans: For Entity A's financial statements, the exemption of Ind AS 24 applies to:

(a) transactions with Government G; and

(b) transactions with Entities 1 and 2 and Entities B, C and D. However, that exemption does not apply to transactions with Person X.

Q 5: Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from Power Limited. Power Limited whose financial year ends on March 31, 20X2, acquired 100% shareholding of Transmission Limited on July 15, 20X1. However, the entire shareholding is disposed of on March 21, 20X2. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.

Required

What related party disclosures should Power Limited make in its financial statements for the year ended March 31, 20X2 with respect to transactions with Transmission Limited.

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Ans: Power Limited should in its financial statements for the year ended March 31, 20X2 make related party disclosures for the period from July 15, 20X1 to March 21, 20X2 when Transmission Limited was its subsidiary.

Q 6: Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Limited and Ms. Y has an investment in B Limited.

Required

(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements:

(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements:

(c) Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited:

Ans: (a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Ms. Y has control, joint control or significant influence over B Limited.

(b) If Mr. X controls or jointly controls A Limited , A Limited is related to B Limited when Ms. Y has control, joint control or significant influence over B Limited.

(c) No, Significant influence does not lead to direct/indirect control between the A Ltd. & B Ltd.

Q 7: A Limited has both (i) joint control over B Limited and (ii) joint control or significant influence over C Limited

Required

(a) Examine related party relationship from the perspective of C Limited's financial statements:

(b) Examine related party relationship from the perspective of B Limited's financial statements:

Ans: (a) C Limited is related to B Limited

(b) B Limited is related to C Limited

QUESTIONS FROM RTP/MTP/EXAMS

Q8: ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in

XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 2017. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 2017 to 31st May 2017 totalled ` 8,00,000. Following the shares purchased by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 2017 to 31st March 2017 totalled ` 60,00,000. On 31st March 2018, the trade receivables of XYZ Ltd. included ` 18,00,000 in respect of amounts owing by ABC Ltd.

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Analyse and show how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2018 and mention the disclosure requirements also as per Ind AS. **[RTP Nov 2018]**

Ans: XYZ Ltd. would include the total revenue of ` 68,00,000 (` 60,00,000 + ` 8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2018 within its revenue and show ` 18,00,000 within trade receivables at 31st March 2018.

Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd.

From 1st June 2017, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.

Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:

– The nature of the related party relationship.

– The revenue of ` 60,00,000 from ABC Ltd. since 1st June 2017.

– The outstanding balance of ` 18,00,000 at 31st March 2018.

In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

Q9. Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the Management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of Rs. 2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged Rs. 1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

[RTP May 2018]

Ans: As per paragraph 9 of Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

Accordingly, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per paragraph 7 and 9 of Ind AS 19, 'Employee Benefits', an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

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Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.

Paragraph 17 of Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity shall disclose key management personnel compensation in total i.e. disclosure of directors' fee of (Rs. 10,00,000 + Rs. 7,50,000) Rs. 17,50,000 is to be made as employees benefits (under various categories).

Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

Q10. An Indian company has a parent company out side India. Parent company negotiates software licenses with end vendor and based on number of licences, parent company get its reimbursement from Indian company. Say, license cost of Rs. 12 Lac is charged for calendar year of 2018. Parent company generates is invoice in February'18. Indian company accounts full invoice in February'18 and then for Indian financial year, accounts Reimbursement expense of Rs. 3. 00 Lac during FY 1718 (for licencing cost relating to period January'18 to March'18) and Prepaid expenses of Rs. 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of Rs. 9 Lac is accounted for in FY 18-19.

What amount should be disclosed at Related party transaction? **[MTP May 2019]**

Ans: Paragraph 9 of Ind AS 24 Related Party Disclosures defines Related Party Transactions as under:

"A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged."

Paragraph 6 of Ind AS 24 states as under:

"6 A related party relationship could have an effect on the profit or loss and financial position of an entity…"

In the given case, there is a transfer of resources to the extent of Rs.12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to Rs.3 lac of software license cost which is recognise in profit or loss. The benefits relating to Rs.9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in balance sheet as prepaid expenses.

Paragraph 18 of Ind AS 24 states as under:

"18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:

a. The amount of the transactions;

b. The amount of outstanding balances, including commitments, and;

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(i) Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

(ii) Details of any guarantees given or received;

c. Provisions for doubtful debts related to the amount of outstanding balances; and

d. The expense recognised during the period in respect of bad and doubtful debts due from related parties."

Therefore, the company has to disclose:

1. The amount of transaction with the parent of Rs.12 lac towards software license;
2. Outstanding balance of Rs.9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.
3. The amount of Rs.3 lac recognised as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.

Paragraph 113 of Ind AS 1 Presentation of Financial Statements states as under:

"113 An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes."

Therefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in balance sheet to the notes disclosing related party transactions.

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The Effects of Changes in Foreign Exchange Rates (Ind AS 21)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1

Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$ What is the functional currency of Future Ltd.?

Solution: The functional currency of Future Ltd. is the L$ Looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

Question 2

Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is Small's functional currency?

Solution: Small, although based in India with its cash inflows generated within India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big for financing and goods to be sold, despite the fact that goods are sold within India and in Indian Rupees. Therefore, Small is not a self contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on the parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India Private Limited would have the US Dollar as it functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than the US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

Question 3

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

Solution

The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was not due for three years (for example) or even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

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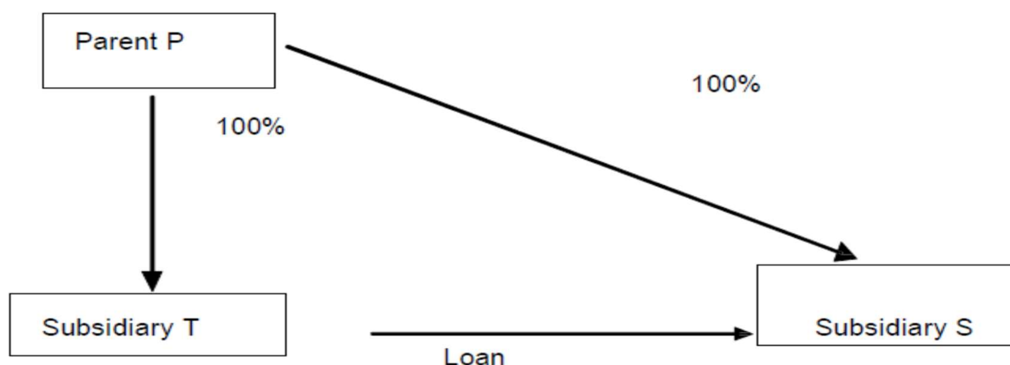
The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by P on the EURO 500 loan should be recognised in profit or loss in P's separate financial statements, but recognised in other comprehensive income and presented within equity in the consolidated financial statements.

Question 4

Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where should the exchange differences be recognised?

Solution



Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

Question 5

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements?

Solution

At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary's statement of profit and loss has no equivalent gain in the parent's financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

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The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

Question 6

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for Rs. 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is Rs. 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of Rs. 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of Rs.180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is Rs. 20 lakhs

Calculate P's gain on disposal.

Ans: P's gain on disposal would be calculated in the following manner:

	(Rs. in Lakhs)
Sale proceeds	1500
Net assets of S	(1000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

Question 7

Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following is the statement of financial position of Infotech Global Ltd. prior to translation:

	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	9,85,000	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit for the year	20,000	
Accounts payable	8,40,000	
Accrued liabilities	47,000	
Total equity and liabilities	9,85,000	

Required:

Translate the statement of financial position of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre- populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

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Rate at end of the year L$ 1 = USD 1.13

Answer:

Translation of the financial statements

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	9,85,000		8,71,682
Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	9,85,000		8,47,306
Foreign Currency Translation Reserve			24,376
(proof below)			
Total equity and liabilities L$			8,71,682

Working of the cumulative balance of the FCTR

Particulars	Actual translated amount in L$	Amount	Difference translated at closing rate of 1.13
Issued capital	30,055	44,247	14,192
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
[Difference of 1 is rounding]	62,350	86,725	24,375

QUESTIONS FROM RTP/MTP/EXAMS

Question 8

On 1st January, 2018, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= Rs. 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1 = Rs. 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.

Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Answer:

As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 2018. Therefore, the amount initially recognised would be Rs. 1,36,00,000 ($ 2,00 000 x Rs. 68).

The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2018. This makes the closing liability of Rs. 1,30,00,000 ($ 2,00,000 x Rs. 65).

The loss on re-translation of Rs. 6,00,000 (Rs. 1,36,00,000 – Rs. 1,30,00,000) is recognised in the Statement of profit or loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of Rs. 68 to $ 1.

Depreciation of Rs. 8,50,000 (Rs. 1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 2018.

The closing balance in property, plant and equipment would be Rs. 1,27,50,000 (Rs. 1,36,00,000 – Rs. 1,30,00,000). This would be shown as a non-current asset in the statement of financial position.

Question 9

On 30th January, 20X1, A Ltd. purchased a machinery for $5,000 from USA supplier on credit basis. A's Ltd. functional currency is the Rupee. The exchange rate on the date of transaction is 1$= Rs. 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$= Rs. 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$= Rs. 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. **[RTP May 2018]**

Answer: Journal Entries

Purchase of Machinery on credit basis on 30th January 20X1:

	Rs.	Rs.
Machinery A/c (5,000 x $ 60) Dr.	3,00,000	
To Creditors		3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31st March 20X1:

	Rs.	Rs.
Machinery A/c [(5,500 x $ 65) – (5,000 x $ 60)] Dr.	57,500	
To Revaluation Surplus a/c (OCI)		57,500
Profit & Loss A/c [(5,000 x $ 65) – (5,000 x $ 60)] Dr.	25,000	
To Creditors		20,000

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

	Rs.	Rs.
Creditors A/c (5,000 x $65) Dr.	3,25,000	
Profit & loss A/c [(5,000 x ($ 67 -$ 65)] Dr.	10,000	
To Bank A/c		3,35,000

Question 10

Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and

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revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are Rs. 72 per USD and Rs. 75 per USD respectively.

[RTP May 2019]

Answer: This is the case of Revenue recognised at a single point in time with multiple payments. As per the guidance given in Appendix B to Ind AS 21:

A Ltd. will recognise a non-monetary contract liability amounting Rs. 1,440 million, by translating USD 20 million at the exchange rate on 1st January, 2018 ie Rs. 72 per USD.

A Ltd. will recognise revenue at 31st March, 2018 (that is, the date on which it transfers the goods to the customer).

A Ltd. determines that the date of the transaction for the revenue relating to the advance consideration of USD 20 million is 1st January, 2018. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31st March, 2018.

On 31st March, 2018, A Ltd. will:

- derecognise the non-monetary contract liability of USD 20 million and recognise USD 20 million of revenue using the exchange rate as at 1st January, 2018 ie Rs. 72 per USD; and
- recognise revenue and a receivable for the remaining USD 30 million, using the exchange rate on 31st March, 2018 ie Rs. 75 per USD.
- The receivable of USD 30 million is a monetary item, so it should be translated using the closing rate until the receivable is sett

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BUSINESS COMBINATION AS PER IND AS 103

ILLUSTRATIONS

Illustration 1: Identification of Business

Whether the following development stage entities will qualify as a business?

a) Company B is a development stage pharma company with a license to develop a new drug. Company A acquires all of the outstanding shares in Company B. Due to lack of funds, Company B has no employees and no other assets. Clinical trials and/or development are not being performed and Company A has no intention to peruse the plan to produce outputs in future. Company A plans to raise funds in the entity and commence initial clinical trials for the drug. Whether Company B represents a business?

b) Company D is a development stage pharma company that has a license for a new drug, final clinical trials are currently being performed by Company D's employees (one of whom founded Company D and discovered the drug) and it has a plan to eventually produce the drug. Company D's administrative and accounting functions are performed by contract employees. Company C acquires all of the shares in Company D. Whether Company D represents a business?

Answer: Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

Paragraph 3 of Ind AS 103 states that, "an entity shall determine whether a transaction or other event is a business combination by applying the definition in this Ind AS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition."

Paragraph B7 of Ind AS 103, inter alia, provides that a business consists of Educational Material on Ind AS 103 inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.

Further, paragraph B10 of Ind AS 103 provides some factors which are including but not limited, to consider in determining whether an integrated set of activities and assets in the development stage is a business:

- planned principal activities have commenced;
- there are employees, intellectual property and other inputs and there are processes that could be applied to those inputs;
- a plan to produce outputs is being pursued; and
- there will be an ability to obtain access to customers who will purchase the outputs.

Not all of these factors need to be present for the acquired set to be considered a business.

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a) In this scenario, while Company B has an input (license to develop a new drug), however, it lacks processes to apply to the license in order to create outputs. Also, Company B has no employees and is not pursuing a plan to produce outputs as presently no research and development is being performed. Therefore Company B does not represent a business and accordingly Company A should account for this as an asset acquisition as prescribed in paragraph 3 of Ind AS 103.

b) Company D is performing final clinical trials and is pursuing a plan to produce outputs (i.e. a commercially developed drug to be sold or licensed). Accordingly, acquisition of shares in Company D results in Company C acquiring inputs (license for drug and employees) and processes (operational and management processes associated with the performance and supervision of the clinical trials). Hence, in the given scenario, the acquisition of shares in Company D represents a business combination.

Illustration 2: Identification of Business

Whether group of assets in the following cases constitutes a business?

a) Development stage entity

Company ABC acquires Company PQR, which is engaged in software development business. PQR's main operation was to build customised software for banking industry. Currently PQR is engaged in researching and developing its first product and creating an active market for the software. PQR has not generated any revenues and has no existing customers. PQR's workforce is composed primarily of software engineers and programmers. PQR has the intellectual property, software and fixed assets required to develop the customised software for banks. Whether the above acquisition is to be treated as a business and consequently accounted for as a business combination or whether acquisition should be accounted for as an asset acquisition?

b) Investment Property

Company A Ltd. purchases five investment properties that are fully rented to tenants. A Ltd. also takes over the contract with the property management company, which has unique knowledge related to investment properties in the area and makes all decisions, both of strategic nature and related to the daily operations of the property. Ancillary activities necessary to fulfill the obligations arising from these lease contracts are also in place, specifically activities related to maintaining the building and administering the tenants. Whether the acquired set constitutes a business or not?

Answer:

a) Development stage entity

In the instant case, the elements in the acquisition seems to contain both inputs and processes. Inputs being the intellectual property used to design the customised software, fixed assets and employees. The processes being the strategic and operational process for developing the software. Accordingly, given that Company PQR has access to inputs and processes necessary to manage and produce outputs, acquisition of Company PQR can be considered to be a business combination. The lack of outputs, such as revenue and a product, does not prevent the entity from being considered a business.

b) Investment Property

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As per paragraph 14A of Ind AS 40, Investment Property, judgement is required to decide whether the acquisition of set of investment properties meets the definition of a business (to be accounted for as per Ind AS 103) or whether it is an acquisition of investment properties (to be accounted for under Ind AS 40). In applying judgement to determine whether an acquired set of investment properties qualifies as a business, reference should be made to Ind AS 103. Factors that may be relevant in making the determination include whether property management services are acquired and the nature of those services, and the level and nature of ancillary services - e.g. security, cleaning and maintenance.

In the instant case, the acquired set of investment properties can be construed to be a business because it contains all of the inputs and processes necessary for it to be capable of creating outputs to provide a return to A Ltd.

Inputs: Non-current assets (land and buildings) and contracts.

Processes: Management with unique knowledge related to investment properties in the area.

Outputs: The intended outputs include rental income.

In contrast, if the property management contract is not taken over, then the group of assets might not be a business. The acquired set might not represent an integrated set of activities and assets because the key element of the infrastructure of the business, i.e. property management, is not taken over. If so, then A Ltd. would account for the transaction as the purchase of individual investment properties, and not as the purchase of a business.

Deciding whether acquisition of investment properties in the given case constitutes a business is a matter of professional judgement which requires careful assessment of facts and circumstances.

Illustration 3: Identification of Business

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company's has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A. Does Company A constitute a business in accordance with Ind AS 103?

Answer: The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.

When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

Illustration 4: Identification of Business

Modifying the above question, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

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Answer: Though the sales force has not been taken over, however, if the missing inputs (i.e., sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

Illustration 5: Identification of Business Combination

Which of the following scenario represents a Business Combination?

a) Case A: On 1 January 2012, ABC Ltd. owns a majority share of its investee's voting equity interests. The other investors in the investee hold contractual rights (for example, board membership rights accompanied by veto rights on operating matters, or other substantive participation rights) which preclude ABC Ltd. from exercising control over the investor. The contractual rights of other investors were for 5 years which lapsed on 31 December 2016 as per the terms of the contract.

b) Case B: PQR Ltd. owns an equity investment in an investee that gives it significant influence but not control. During the year, the investee repurchased its own shares from other parties and the same were extinguished which resulted in an increase in the PQR Ltd.'s proportional interest in the investee (to 60% of the voting rights), which results in PQR Ltd. acquiring control of the investee.

Answer:

a) In Case A, on 1 January 2017, it represents a change in the rights of other shareholders (elimination or expiration of the contractual rights precluding control) which result in ABC Ltd. obtaining control of the investee and qualifying as a business combination.

b) In Case B, the repurchase by investee of its own shares from other parties results in PQR Ltd. obtaining control of the investee (presuming no other indicator impacting control). This transaction qualifies as a business combination and the acquisition method would be applied by PQR Ltd.

It has been presumed that in both the cases above, the activities of the investee meet the definition of business.

Illustration 6: Acquisition date

On April 1 Company X agrees to acquire the share of Company B in an all equity deal. As per the binding agreement Company X will get the effective control on 1 April however the consideration will be paid only when the shareholders' approval is received. The shareholders meeting is scheduled to happen on 30 April. If the shareholder approval is not received for issue of new shares, then the consideration will be settled in cash. What is the acquisition date?

Answer: The acquisition date in the above example is 1 April. In the above scenario even if the shareholder don't approve the shares consideration can be settled through payment of cash.

Illustration 7: Acquisition date

On 9 April 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10 May 20X2, the board of directors of Shyam authorized their management to pursue the merger with Ram Ltd. On 15 May 20X2, management of Shyam Ltd offered management of Ram Ltd 12,000 shares of Shyam Ltd against their total share

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outstanding. On 31 May 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder vote. On 2 June 20X2 both the companies jointly made a press release about the proposed merger.

On 10 June 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15 June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

Date	Price
9 April	70
10 May	75
15 May	60
31 May	70
2 June	80
10 June	85
15 June	90

What is the acquisition date and what is purchase consideration in the above scenario?

Answer: As per paragraph 8 of Ind AS 103, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the aquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10 June but the shares were issued only on 15 June and accordingly the 90 will be considered as the market price.

Illustration 8: Acquisition date

Can an acquiring entity can account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?

Answer: No. as per the requirement of the standard a non- binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

Illustration 9: Options are out of the money

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Answer: Though the options are out of the money, they are currently exercisable and if exercised, these options would increase Company P's ownership to 80 per cent ownership interest and voting rights. The existence of the potential voting rights determined that Entity A controls Entity C.

Illustration 10: Transaction which is not a part of Business combination

Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31 March 20X2, Progressive Ltd recognised a INR 10 million liability related to this litigation.

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On 30 July 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for INR 500 million. On that date, the estimated fair value of the expected settlement of the litigation is INR 20 million.

Answer: In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the INR 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

Illustration 11: Transaction which is not a part of business combination

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

- the EBIDTA margins of the Company after 2 years after the acquisition is 21%.
- the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.

Answer: In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns. Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS standards.

Illustration 12: Contingent consideration

Entity ABC Ltd. acquired entity PQR Ltd. for INR 5 crores. To protect ABC for false representations and warranties (if any) asserted by the sellers of entity PQR Ltd. the acquisition agreement provides that ABC Ltd. will pay INR 4.5 crores at the acquisition date and place the balance INR 50 Lakhs in an escrow account (being a protective clause). If no violation of the representations and warranties is reported or noticed within one year of the acquisition date, the amount of INR 50 Lakhs in the escrow account will be released to the sellers. Should INR 50 Lakhs lying in escrow be accounted for as contingent consideration by entity ABC Ltd.?

Answer: Ind AS 103 defines contingent consideration as follows: Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met.

In the present case, the funds lying in escrow are released to the sellers based on the validity of conditions that existed at the acquisition date and are not dependent on the future performance of entity PQR Ltd. Further, as the escrow arrangement is only protective in nature. Therefore, INR 50 Lakhs will not be considered as a contingent consideration. It is instead required to be treated as part of the consideration for the business combination on the date of acquisition and consequently should be considered for computation of goodwill in relation to the acquisition.

Illustration 13: Contingent consideration

ABC Ltd. agrees to acquire PQR Ltd. for INR 60 crores as per an agreement dated 15 March 2017. The acquisition is however subject to the successful completion of the closing conditions. As per the

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agreement between ABC Ltd. and PQR Ltd., to the extent the working capital (that is, inventory, receivables and payables) at the acquisition date (on successful completion of closing conditions) exceeds a specified minimum level of 10 crores, ABC Ltd. will pay additional consideration to the seller. For instance, if PQR's working capital is INR 11 crores, ABC will pay an additional INR 1 crores. Should ABC Ltd. account for the working capital adjustment as contingent consideration?

Answer: The working capital adjustment mentioned above in relation to ABC Ltd.'s acquisition of PQR Ltd. is a mechanism to determine the working capital as of the acquisition date. While the working capital computation may be completed post the acquisition date, the computation does not consider the impact of any future event, conditions, contingencies etc.

Accordingly, given that the working capital adjustment reflects the consideration to be paid as of the acquisition date, the same may not be treated as contingent consideration.

Illustration 14: Contingent consideration

ABC Ltd. (the acquiree) is owned by Mr. S who is also the chief executive officer of the company. ABC Ltd. is purchased by PQR Ltd. (the acquirer) in a business combination. As per the purchase agreement, PQR Ltd. will pay Mr. S an additional consideration for the acquisition based upon ABC Ltd achieving specific earnings before interest, tax, depreciation and amortisation (EBITDA) levels over the two-year period following the acquisition. The additional payment is based on PQR Ltd's belief that retaining the services of Mr. S for at least two years is critical to transition of ABC Ltd's ongoing business. Accordingly, any rights to the additional consideration will be forfeited, if Mr. S is not an employee of ABC Ltd. at the end of the two years. Should the arrangement be treated as remuneration for the post-combination services or does it represent contingent consideration for the acquisition of ABC Ltd.?

Answer: An acquirer may enter into an arrangement for payments to employees or selling shareholders of the acquiree that are contingent on a post-acquisition event. The accounting for such arrangements depends on whether the payments represent contingent consideration issued in the business combination (which are included in the acquisition accounting), or are separate transactions (which are accounted for in accordance with other relevant Ind AS).

Paragraph B55 of Ind AS 103 provides indicators to be evaluated when determining whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration. However, judgement will be required for such evaluation.

Further, paragraph B55 (a) of Appendix B to Ind AS 103, inter alia, provides an indication that a contingent consideration arrangement in which payments are automatically forfeited if employment terminates is remuneration for post combination services.

Therefore, in the given case, the arrangement should be treated as remuneration for the post-combination services as the right to the additional consideration will be forfeited if Mr. S quits before the stipulated period of time.

Illustration 15: Contingent consideration

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ABC Ltd. acquires all of the outstanding shares of XYZ Ltd. in a business combination. XYZ Ltd. had three shareholders with equal shareholdings, two of whom were also senior-level employees of XYZ Ltd. and would continue as employee post acquisition of shares by ABC Ltd.

- The employee shareholders each will receive INR 60,00,000 plus an additional payment of INR 1,50,00,000 to 2,00,00,000 based on a multiple of earnings over the next two years.
- The non-employee shareholders each receive INR 1,00,00,000.

The additional payment of each of these employee shareholders will be forfeited if they leave the employment of XYZ Ltd. at any time during the two years following its acquisition by ABC Ltd. The salary received by them is considered reasonable remuneration for their services. How much amount is attributable to post combination services?

Answer: Paragraph B55(a) of Ind AS 103 provides an indication that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

In accordance with the above, in the instant case, the additional consideration of INR 1,50,00,000 to INR 2,00,00,000 represents compensation for post-combination services, as the same represents that part of the payment which is forfeited if the former shareholder does not remain in the employment of XYZ for two years following the acquisition - i.e., only INR 60,00,000 is attributed to consideration in exchange for the acquired business.

Illustration 16: Consideration transferred- Deferred consideration

ABC Ltd. acquired the entire equity share capital of PQR Ltd. for INR 8 crores. ABC Ltd. paid INR 2 crores in cash and the balance INR 6 crores has been agreed to be paid to the seller in 5 years as a deferred consideration. How should the deferred consideration be valued for determining the consideration transferred in relation to computation of goodwill?

Answer: The deferred consideration issued is required to be measured at its fair value. The deferred consideration will be valued at its net present value determined with reference to an appropriate discount rate (e.g. the rate at which entity ABC Ltd. could issue the same amount of debt in a separate market transaction with the appropriate adjustment for credit rating) for the purpose of computation of the consideration transferred.

Subsequent unwinding of the discounting discussed above is required to be recognised as finance cost in the respective years' statement of profit and loss.

Illustration 17: Recognition of Intangible Assets

Company A, FMCG company acquires an online e-commerce company E, with the intention to start doing retailing. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?

Answer: In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful other players and E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not.

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Illustration 18: Reacquired Right

Vadapav Limited is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd is one of the franchisee of Vadapav Ltd and is and operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1 April 20X2. On the acquisition date, Vadapav determines that the license agreement reflects current market terms.

Answer: Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

Illustration 19: Contingent liability

ABC Ltd. is in the process of acquiring PQR Ltd., an entity engaged in the business of software related products and services. PQR Ltd. has been sued for one of the software licenses it uses in its business. The entity's lawyer has advised that, in his opinion, it is probable that the case could be successfully defended. Accordingly, no provision has been included in the PQR Ltd.'s financial statements immediately prior to the acquisition. However, post-acquisition, ABC Ltd.'s management has decided that the case should be settled out of court in order to avoid a protracted court case. Should the acquirer recognise the contingent liability?

Answer: Ind AS 103 states that the requirements in Ind AS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably.

Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

In accordance with the above, in the given case, although the case is probable to be successfully defended, the contingent liability will have a fair value on the assumption that there is some risk that the case may not be successfully defended. To the extent that the fair value can be reliably measured, the contingent liability would be recognised as part of the business combination accounting.

The financial effect of the acquirer's decision not to defend the case would be reflected as a current –that is, post combination event.

Exceptions to recognition and measurement principles -

Illustration 20: Indemnification assets

a) ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage.

   PQR Ltd. is being sued for damages of INR 2 crores. XYZ Ltd. Has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to INR 1 crore. The fair value of the contingent liability for the court case is INR 70 lakhs.

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How should ABC Ltd. account for the contingent liability and the indemnification asset?

b) ABC Ltd. acquires PQR Ltd. in July 2017. PQR Ltd. is in dispute with local tax authorities over its tax return for 2015. ABC Ltd. receives an indemnity from the selling shareholder(s) of PQR Ltd. to cover the outcome of the tax dispute. ABC Ltd. ascertains that an outflow in relation to the tax case is probable and estimates the amount expected to be paid as INR 25 lakhs i.e., the full amount being claimed by the tax authorities. The fair value of the liability is INR 17.4 lakhs.

Paragraph 24 of Ind AS 103 requires the acquirer to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes. Thus, ABC Ltd. recognised a liability of INR 25 lakhs. If the tax authorities require this amount to be paid, the seller of PQR Ltd. will pay ABC Ltd. the full INR 25 lakhs. ABC Ltd. considers the credit worthiness of selling shareholders' of PQR Ltd. to be such that the indemnification asset is fully collectible. How should indemnification asset be accounted for?

c) ABC Ltd. pays INR 50 crores to acquire PQR Ltd. from XYZ Ltd. PQR Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass. XYZ Ltd. agrees to indemnify ABC Ltd. for the adverse results of any court cases up to an amount of INR 10 crores. The class actions have not specified amounts of damages and past experience suggests that claims may be up to INR 1 crore each, but that they are often settled for small amounts. ABC Ltd. makes an assessment of the court cases and decides that due to the potential variance in outcomes, the contingent liability cannot be measured reliably and accordingly no amount is recognised in respect of the court cases. How should indemnification asset be accounted for?

Answer: An acquirer recognises indemnification asset at the same time and measures them on the same basis as the indemnified item, subject to contractual limitations and adjustments for collectability, if applicable.

a) In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at INR 70 lakhs and also recognises a corresponding asset of INR 70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil. However, in the case where the liability's fair value is more than INR 1 crore (for example INR 1.2 crores), the asset will be limited to INR 1 crore.

b) ABC Ltd. recognises an indemnification asset of INR 25 lakhs which is measured on the same basis as the indemnified liability as no adjustment has been required for collectability or contractual limitations on the indemnified amount.

c) Since no liability is recognised in the given case, ABC Ltd. will also not recognise an indemnification asset as part of the business combination accounting.

Further, ABC Ltd. is required to make the necessary disclosures for contingent consideration arrangements and indemnification assets as required by paragraph B64 (g) of Ind AS 103.

Illustration 21: Operating Lease

Motu Ltd acquired Chotu Ltd. During the analysis of the financial statement they discovered that Chotu Ltd has an existing lease arrangement where Chotu Ltd. is a lessee. The lease term is 5 years

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and is an operating lease for an office space at a prime location. The remaining lease period under the arrangement is 3 years. Motu Ltd.'s M&A head assess that that:

(i) the lease is 'at-market'; and

(ii) other market participants would not be willing to pay a premium for it.

The annual rentals are:

Year 1: INR 2,000

Year 2: INR 2,100

Year 3: INR 2,200

Year 4: INR 2,300

Year 5: INR 2,400

Chotu Ltd financial statements include an annual rent expense of INR2,200 (determined on a straight-line basis) as lease rental increase is not linked to inflation and a deferred rent liability of INR 300 at the acquisition date.

Please discuss the treatment of the lease arrangement in the business combination accounting?

Answer: The accrued rent for straight-lining does not represent a liability and accordingly it is not recorded as a liability on the acquisition date. However, the rental expenses will be recorded based on straight-lining (which will be computed based on the remaining lease period) for INR 2,300 per year.

Illustration 22: Measurement period

A Ltd. prepares financial statements for annual periods ending on 31 December and does not prepare interim financial statements. A Ltd. was the acquirer in a business combination on 30 September 20X4. The entity sought an independent appraisal for an item of property, plant and equipment acquired in the combination. However, the appraisal was not finalised by the time the entity completed its 20X4 annual financial statements. The entity recognised in its 20X4 annual financial statements a provisional fair value for the asset of Rs. 30,000, and a provisional value for acquired goodwill of Rs. 100,000. The item of property, plant and equipment had a remaining useful life at the acquisition date of five years.

Four months after the acquisition date, the entity received the independent appraisal, which estimated the asset's fair value at the acquisition date at Rs. 40,000. Give the treatment done by A Ltd.

Answer: As outlined in IND AS 103, the acquirer is required to recognise any adjustments to provisional values as a result of completing the initial accounting from the acquisition date.

Therefore, in the 20X5 financial statements, an adjustment is made to the opening carrying amount of the item of property, plant and equipment. That adjustment is measured as the fair value adjustment at the acquisition date of Rs. 10,000, less the additional depreciation that would have been recognised had the asset's fair value at the acquisition date been recognised from that date (Rs. 500 for three months' depreciation to 31 December 20X4). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of Rs. 10,000, and the 20X4 comparative

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information is restated to reflect this adjustment and to include additional depreciation of Rs. 500 relating to the year ended 31 December 20X4.

In accordance with IND AS 103, the entity discloses in its 20X4 financial statements that the initial accounting for the business combination has been determined only provisionally, and explains why this is the case. The entity discloses in its 20X5 financial statements the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, the entity discloses that:

- the fair value of the item of property, plant and equipment at the acquisition date has been increased by Rs. 10,000 with a corresponding decrease in goodwill; and
- the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of Rs. 500 relating to the year ended 31 December 20X4

Illustration 23: Measurement period

A Ltd prepares financial statements for annual periods ending on 31 December and does not prepare interim financial statements. A Ltd. was the acquirer in a business combination on 30 September 20X1. As part of the initial accounting for that combination, the entity recognised goodwill of Rs. 100,000. The carrying amount of goodwill at 31 December 20X1 was Rs. 100,000.

During 20X2, the entity becomes aware of an error relating to the amount initially allocated to property, plant and equipment assets acquired in the business combination. In particular, Rs. 20,000 of the Rs. 100,000 initially allocated to goodwill should be allocated to property, plant and equipment assets that had a remaining useful life at the acquisition date of five years. Give the treatment done by A Ltd.

Answer: As outlined in IND AS 103, IND AS 8 requires the correction of an error to be accounted for retrospectively, and for the financial statements to be presented as if the error had never occurred by correcting the error in the comparative information for the prior period(s) in which it occurred.

Therefore, in the 20X2 financial statements, an adjustment is made to the opening carrying amount of property, plant and equipment assets. That adjustment is measured as the fair value adjustment at the acquisition date of Rs. 20,000 less the amount that would have been recognised as depreciation of the fair value adjustment (Rs. 1,000 for three months' depreciation to 31 December 20X1). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of Rs. 20,000, and the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of Rs. 1,000 relating to the year ended 31 December 20X1.

In accordance with IND AS 8, the entity discloses in its 20X2 financial statements the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been increased by Rs. 20,000 with a corresponding decrease in goodwill; and
- the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of Rs. 1,000 relating to the year ended 31 December 20X1.

Illustration 24: Measurement period

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Entity X acquired 100% shareholding of Entity Y on 1 April 20X1 and had complete the preliminary purchase price allocation and accordingly recorded net assets of INR 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31 March 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31 March 20X2. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

Answer: No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31 March 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

Illustration 25: Measurement period

Scenario 1: New information on the fair value of an acquired loan

Bank F acquires Bank E in a business combination in October 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B's financial statements for the year ended September 30, 20X1, which indicate significant decrease in Borrower B's income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.

Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period

Bank F acquires Bank E in a business combination in October 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.

Required: Comment on the treatment done by Bank F.

Answer:

Scenario 1: The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.

Scenario 2: Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, Financial Instruments: Recognition and Measurement, with a corresponding charge to profit or loss; goodwill is not adjusted.

Illustration 26: Measurement after acquisition accounting – Adjustments to provisional amounts

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ABC Ltd. acquires XYZ Ltd. in a business combination on 15 January 2017. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract.

ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises INR 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October 2017 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be INR 2 crores.

ABC Ltd. continues to receive and evaluate information related to the claim after October 2017. Its evaluation doesn't change till February 2018 (i.e. after the measurement period), when it concludes that the fair value of the liability for the claim at the date of acquisition is INR 1.9 crores. ABC determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February 2018 is INR 2.2 crores.

How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?

Answer:

- The consolidated financial statements of ABC Ltd. for the year ended 31 March 2017 should include INR 1 crore towards the contingent liability in relation to the customer claim.
- When the customer presents additional information in support of its claim, the incremental liability of INR 1crore (INR 2,00,00,000 – INR 1,00,00,000) will be adjusted as a part of acquisition accounting as it is within the measurement period. In its financial statements for the year ending on 31 March 2018, ABC will disclose the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31 March 2017 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by INR 1 crore, resulting in a corresponding increase in goodwill.
- The information resulting in the decrease in the estimated fair value of the liability for the claim in February 2018 was obtained after the measurement period. Accordingly, the decrease is not recognised as an adjustment to the acquisition accounting. If the amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to INR 20 lakhs (INR 2.2 crores– INR 2 crores) is recognised in profit or loss.

Illustration 27: Provisional accounting-Adjustment of comparatives

ABC Ltd. acquired XYZ Ltd. on 28 February 2017. As part of the acquisition accounting, ABC Ltd. recognised a provisional amount of INR 1 crore in respect of a patent developed by XYZ Ltd. However, the technology covered by the patent was new and ABC Ltd. expected the cash flows to be generated by the patent to increase beyond those being generated at the time. Accordingly, ABC Ltd. sought an independent valuation report from a third party consultant, which was not expected to be finalised

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for several months. ABC Ltd. assessed the useful life of the patent to be 10 years. Goodwill of INR 1.2 crores was recognised in the provisional accounting.

The consolidated financial statements of ABC Ltd. as at 31 March 2017 included appropriate disclosures about the provisional accounting. The valuation report is finalised subsequent to the issuance of the financial statements of the year 2016-17 but before the end of the measurement period. Based on the valuation, ABC Ltd. concludes that the fair value of the patent was INR 1.5 crores. Management does not revise the estimated useful life of the patent, which remains at 10 years.

Whether ABC Ltd. is required to restate the comparative information for the year 2016-17 presented in the financial statements of the year 2017-18?

Answer: Paragraph 45 of Ind AS 103 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer should retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

In accordance with above, the acquirer should revise comparative information for prior periods presented in financial statements as required, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

Based on above, the comparative information presented in the financial statements for the year 2017-18 needs to be restated for the measurement period adjustment as follows:

	31 March 2017	As stated originally Revised
Profit or loss (patent amortisation)	83,333(1)	125,000 (2)
Goodwill	1,20,00,000	70,00,000 (3)
Patent	99,16,667 (4)	1,48,75,000 (5)

Notes:

1. 1,00,00,000 x 1 /10 x 1 / 12

2. 1,50,00,000 x 1 / 10 x 1 / 12

3. 1,20,00,000 – 50,00,000

4. 1,00,00,000 – 83,333

5. 1,50,00,000 – 125,000

Illustration 28: Gain on bargain purchase

Company A acquires 70 percent of Company S on January 1, 20X1 for consideration transferred of Rs. 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at Rs. 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.

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Required: State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process.

Answer: 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.

	(Rs.)
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

Illustration 29: Business combination under Common control

Company X, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X's shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y. Is the transaction meets the definition of a common control combination and is outside the scope of Ind AS 103

Answer: In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y are now owned by Company Z, all two companies are still ultimately owned and controlled by Company A. From the perspective of Company X, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is outside the scope of Ind AS 103.

Illustration 30: NCI

Company A acquired 90% equity interest in Company B on April 1, 2010 for a consideration of Rs. 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at Rs. 15 crores and Rs. 100 crores respectively.

Required: Find the value at which NCI has to be shown in the financial statements

Answer: In this case, Company A has the option to measure NCI as follows:

- Option 1: Measure NCI at fair value i.e., Rs. 15 crores as derived by the valuer;
- Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., Rs. 10 crores (100 crores x 10%)

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Illustration 31: Step Acquisition

On April 1, 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 March 31, 20X2, A carried its investment in B at fair value and reported an unrealised gain of Rs. 5,000 in other comprehensive income, which was presented as a separate component of equity. On April 1, 20X2, A obtains control of B by acquiring the remaining 95 percent of B.

Required: Comment on the treatment to be done based on the facts given in the question.

Answer: At the acquisition date A recognises the gain of Rs. 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.

PRACTICE QUESTIONS

Question 1:

An entity acquires an equipment and a patent in exchange for INR 1,000 crores cash and land. The fair value of the land is INR 400 crores and its carrying value is INR 100 crores. The fair values of the equipment and patent are estimated to be INR 500 crores and INR 1,000 crores, respectively. The equipment and patent relate to a product that has just recently been commercialised. The market for this product is still developing. Assume the entity incurred no transaction costs. For ease of convenience, the tax consequences on the gain have been ignored. How should the transaction be accounted for?

Answer: As per paragraph 2(b) of Ind AS 103, the standard does not apply to "the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill".

In the given case, the acquisition of equipment and patent does not represent acquisition of a business.

The cost of the asset acquisition is determined based on the fair value of the assets given, unless the fair value of the assets received is more reliably determinable. In the given case, the fair value measurement of the land appears more reliable than the fair value estimate of the equipment and patent. Thus, the entity should record the acquisition of the equipment and patent as INR 1,400 crores (the total fair value of the consideration transferred).

Thus, the fair value of the consideration given, i.e., INR 1,400 crores is allocated to the individual assets acquired based on their relative estimated fair values. The entity should records a gain of INR 300 crores for the difference between the fair value and carrying value of the land.

The equipment is recorded at its relative fair value ((INR 500 / INR 1,500) × INR1,400 = INR 467 crores).

The patent is recorded at its relative fair value ((INR 1,000 / INR 1,500) × INR1,400 = INR 933 Crores).

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Question 2:

Entity A acquires 80% of the share capital of Entity B, which holds a single asset, or a group of assets not constituting a business. The remaining 20% of the share capital is held by Entity M, an unrelated third party. The fair value of the asset is Rs. 20,000. Entity A controls Entity B, as defined in Ind AS 110 Consolidated Financial Statements. Cash paid for the acquisition is Rs. 16,000 and fair value of non-controlling interest is Rs. 4,000. How does an acquirer account for the acquisition of a controlling interest in another entity that is not a business?

Answer: Under Ind AS 110, an entity must consolidate all investees that it controls, not just those that are businesses, and recognise any non-controlling interest in non-wholly owned subsidiaries.

When the acquisition of an entity is not a business combination, the requirements of acquisition accounting of Ind AS 103 relating to the allocation of the consideration transferred to the identifiable assets and liabilities and the recognition of goodwill are not applicable.

Paragraph 2(b) of Ind AS 103 states that upon the acquisition of an asset or a group of assets that does not constitute a business, the acquirer shall identify and recognise the individual identifiable assets acquired and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

Ind AS 16, Property, Plant and Equipment and Ind AS 38, Intangible Assets state that "Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction. Therefore, when an asset is acquired, its cost is the amount of consideration paid, plus the amount of non-controlling interest (NCI) recorded related to that asset- as this represents a 'claim' relating to that asset.

With respect to case above, the following entries would be recorded:

Asset	Dr	20,000
NCI	Cr	4,000
Cash	Cr	16,000

Question 3:

Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On November 1, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

- Consideration: Company A transfers cash of Rs. 59,00,000 and issues 1,00,000 shares on November 1. The market price of Company A's shares on the date of issue is Rs. 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 Rs. 7,00,000 if the cumulative profits of Company B exceed Rs. 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be Rs. 3,00,000 at the acquisition date.

- Transaction costs: Company A pays acquisition-related costs of Rs. 1,00,000.
- Non-controlling interests (NCI): The fair value of the NCI is determined to be Rs. 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.
- Previously held non-controlling equity interest: Company A has owned 25% of the shares in Company B for several years. At November 1, the investment is included in Company A's consolidated statement of financial position at Rs. 6,00,000, accounted for using the equity method; the fair value is Rs. 20,00,000.

The fair value of Company B's net identifiable assets at November 1 is Rs. 60,00,000, determined in accordance with Ind AS 103.

Required: Determine the accounting under acquisition method for the business combination by Company A.

Solution:

1. Let us evaluate each of the steps discussed in the above analysis:

Identify the acquirer

In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquirer.

Determine acquisition date

As the control over the business of Company B is transferred to Company A on November 1, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise the following:

Cash consideration	Rs. 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	Rs. 10,00,000
Contingent consideration (at fair value)	Rs. 3,00,000
Fair value of previously held interest	Rs. 20,00,000
As such, the total purchase consideration is	Rs. 92,00,000.

Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of Rs. 1,00,000 should be recognised in Statement of profit and loss.

Determine fair value of identifiable assets and liabilities

The fair value of identifiable net assets is determined at Rs. 60,00,000.

Measure NCI

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The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at Rs. 7,50,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, the Company A exercised significant influence over Company B. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in Statement of Profit and Loss. As such, an amount of Rs. 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:	(Rs.)
Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000
Less: fair value of Lila-Domestic's net identifiable assets	(60,00,000)
Goodwill	39,50,000

Question 4:

How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

(i) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;

b. a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.

i. The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs.25 lakhs.

ii. During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded Rs.1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is Rs.25 per share.

(ii) Continuing with the fact pattern in (a) above except for:

c. The number of shares to be issued after one year is not fixed.

d. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs.40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs.1 crore. A Ltd. issued shares with Rs.40 lakhs after a year.

[RTP May 2019]

Answer: Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of

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(a) the acquisition-date fair values of the assets transferred by the acquirer,

(b) the liabilities incurred by the acquirer to former owners of the acquiree and

(c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

(i) In the given case the amount of purchase consideration to be recognized on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x Rs.20)	Rs.2,00,00,000
Fair value of contingent consideration	Rs.25,00,000
Total purchase consideration	Rs.2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

(i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

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Here, the obligation to pay contingent consideration amounting to Rs.25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.

(ii) The amount of purchase consideration to be recognized on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x Rs.20)	Rs.2,00,00,000
Fair value of contingent consideration	Rs.25,00,000
Total purchase consideration	Rs.2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs.15,00,000 (Rs.40,00,000 - Rs.25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (Rs.40,00,000/25) shares at a premium of Rs.15 per share.

Question 5:

Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: INR 500
- replacement awards: INR 600.

As of the acquisition date, all awards are expected to vest.

Solution:

Pre-combination period

The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (INR 500) will be multiplied by the service rendered upto acquisition date (2 years) multiplied by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, 500 x 2/5= 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- Combination period

The fair value of the award on the acquisition date is 600 which means the difference between the replacement award which is 600 and the amount allocated to pre-combination period (200) is 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

Question 6:

P a real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is INR 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102).

Solution: The market based measure or the fair value of the award on the acquisition date of 500 is allocated NCI and post combination employee compensation expense. The portion allocable to pre-combination period is 500 x 2/5 = 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.

The remaining expense which is 500-200= 300 is accounted over the remaining vesting period of 2 years as an compensation expenses.

Question 7:

Calculation of goodwill

P acquired Q in two stages.

- In 20X1, P acquired a 30% equity interest for cash consideration of Rs. 32,000 when the fair value of Q's identifiable net assets was Rs. 100,000.
- In 20X5, P acquired a further 50% equity interest for cash consideration of Rs. 75,000. On the acquisition date, the fair value of Q's identifiable net assets was Rs. 120,000. The fair value of P's original 30% holding was Rs. 40,000 and the fair value of the 20% non-controlling interest is assessed as Rs, 28,000.

Solution: Goodwill is calculated, on the alternative bases that P records non-controlling interests (NCI) at their share of net assets, or at fair value, as follows:

	NCI @ % of net assets	NCI @fair value
Fair value of consideration	75,000	75,000
Non-controlling interests [1,20,000 x 20%]	24,000	28,000
Previously-held interest	40,000	40,000
	139,000	143,000
Fair value of identifiable net assets	120,000	120,000
Goodwill	19,000	23,000

Question 8:

In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of Rs. 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

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	Rs. in lakhs
Assets	
Cash	780
Receivables (net)	5,200
Plant and equipment	7,000
Deferred tax asset	360
Liabilities	
Payables	1,050
Borrowings	4,900
Employee entitlement liabilities	900
Deferred tax liability	300

The plant and equipment has a fair value of Rs. 8,000 lakhs and a tax written down value of Rs. 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of Rs. 300 lakhs.

Bad debts are deductible for tax purposes when written off against the allowance account by Dorman Ltd. Employee benefit liabilities are deductible for tax when paid.

Dorman Ltd. owns a popular brand name that meets the recognition criteria for intangible assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of Rs. 4.300 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

The tax rate of 30% can be considered for all items. Assume that unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to:

1. Calculate deferred tax assets and liabilities arising from the business combination (do not offset deferred tax assets and liabilities)
2. Calculate the goodwill that should be accounted on consolidation. (10 Marks)

Answer:

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

					Rs. In lakhs
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780[1]	780 [1]	-	-
Receivables	5,200	5,200[1]	5,500[3]	(300)	90
Plant and equipment	7,000	8,000[2]	6,000[4]	2,000	(600)
Brands		4,300[2]	-[5]	4,300	(1,290)
Goodwill (Balancing figure)		2,100[9]			
Deferred tax asset	360	3,60[7]			

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Total assets		20,740			
Payables	(1,050)	(1,050) [1]	(1,050) [1]		
Borrowings	(4,900)	(4,900) [1]	(4,900) [1]		
Employee Entitlement liabilities	(900)	(900) [1]	- [6]	(900)	270
Deferred tax liability	(300)	(1,890) [8]			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs. 5,200 + Rs. 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs.

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Question 9

On 1 April 2016, Company PQR Ltd. acquired 30% of the voting ordinary shares of Company XYZ Ltd. for INR 8,000 crores. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28, Investments in Associates and Joint Ventures. At 31 March 2017, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(Amounts in INR-crores)
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 31 March 2017 was therefore 8,850 (8,000 + 700 + 100 + 50).

On 1 April 2017, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash of INR 25,000 crores. The following additional information is relevant at that date

	(Amount in INR-crores)
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?

Answer: Paragraph 42 of Ind AS 103 provides that 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 or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements:

(Amounts in INR-crores)

	Debit	Credit
Identifiable net assets of XYZ Ltd.	30,000	
Goodwill(1)	4,000	
Foreign currency translation reserve	100	
PPE revaluation reserve	50	
Cash	25,000	
Investment in associate -XYZ Ltd.		8,850
Retained earnings(2)		50
Gain on previously held interest in XYZ recognised in Profit or loss (3)		250

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(To recognise acquisition of XYZ Ltd.)

Notes:

1. Goodwill calculated as follows: INR

Cash consideration	25,000
Fair value of previously held equity interest in XYZ Ltd.	9,000
Total consideration	34,000
Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealised gain of INR 50 crores in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in XYZ Ltd. is calculated as follows: INR

Fair Value of 30% interest in XYZ Ltd. at 1 April 2017	9,000
Carrying amount of interest in XYZ Ltd. at 1 April 2017	(8,850)
	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

Question 10:

On September 30, 20X1 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

The fair value of each ordinary share of Entity B at September 30, 20X1 is 40. The quoted market price of Entity A's ordinary shares at that date is 16. The fair values of Entity A's identifiable assets and liabilities at September 30, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at September 30, 20X1 is 1,500.

The statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A	**Entity B**
	(legal parent, accounting acquiree)	**(legal subsidiary, accounting acquirer)**
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		

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Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

Prepare consolidated balance sheet. Also calculate earnings per share from the following information:

Entity B's earnings for the annual period ended December 31, 20X0 were 600 and that the consolidated earnings for the annual period ended December 31, 20X1 were 800. There was no change in the number of ordinary shares issued by Entity B during the annual period ended December 31, 20X0 and during the period from January 1, 2006 to the date of the reverse acquisition on September 30, 20X1.

Solution:

Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer (while Entity A is the legal acquirer).

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	

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Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	**6,000**
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	**6,000**

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to December 31, 20X1	250
Weighted average number of ordinary shares outstanding [(150 × 9/12) + (250 × 3/12)]	175
Earnings per share [800/175]	4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

Question 11:

Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was:

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(Rs. in crores)

	Laptops	Mobiles	Total
Fixed assets cost	250	500	750
Depreciation	(225)	(400)	(625)
Net Assets (A)	25	100	125
Current assets:	200	500	700
Less: Current liabilities	(25)	(400)	(425)
(B)	175	100	275
Total (A+B)	200	200	400
Financed by:			
Loan funds	-	300	300
Capital : Equity Rs. 10 each	25	-	25
Surplus	175	(100)	75
	200	200	400

Division Mobiles along with its assets and liabilities was sold for Rs. 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of Rs. 10 each at a premium of Rs. 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise ltd was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.

(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd.

Balance Sheet prepared for (ii) and (iii) above should comply with the relevant Ind AS and Schedule III of the Companies Act, 2013. Provide Notes to Accounts, for 'Other Equity' in case of (ii) and 'Share Capital' in case of (iii), only. **[May 2018]**

Question 12:

Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

	Maxi division	Mini division	Total
			(in crores)
Fixed assets:			
Cost	600	300	900
Depreciation	(500)	(100)	(600)
W.D.V. (A)	100	200	300
Net current assets:			
Current assets	400	300	700
Less: Current liabilities	(100)	(100)	(200)
(B)	300	200	500
Total (A+B)	400	400	800
Financed by :			

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Loan funds (A)	–	100	100
(secured by a charge on fixed assets)			
Own funds:			
Equity capital			50
(fully paid up Rs. 10 shares)			
Reserves and surplus			650
(B)	?	?	700
Total (A+B)	**400**	**400**	**800**

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures the assets and liabilities of that division. Mini Ltd. is to allot 5 crores equity shares of Rs. 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "shareholders wealth".

Question 13:

AX Ltd. and BX Ltd. amalgamated on and from 1st January 20X2. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X2 INR in '000

ASSETS	**Note No.**	**AX Ltd**	**BX Ltd**
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investments		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivable		1,800	4,000
Cash and Cash equivalent		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of INR 10 each)		6,000	7,000
Other equity		3,050	2,700
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		3,000	4,000

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Current liabilities			
Trade payable		1,000	1,500
		13,050	**15,200**

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

a. Assuming that both the entities are under common control

b. Assuming BX ltd is a larger entity and their management will take the control of the entity. The fair value of net assets of AX and BX limited are as follows:

Assets	AX Ltd. ('000)	BX Ltd. ('000)
Fixed assets	9,500	1,000
Inventory	1300	2900
Fair value of the business	11,000	1,4000

Question 14:

The balance sheet of Professional Ltd and Dynamic Ltd as of 31 March 20X2 is given below:

		Rs. In lacs
Assets	**Professional Ltd**	**Dynamic Ltd**
Non-Current Assets:		
Property plant and equipment	300	500
Investments	400	100
Current assets:		
Inventories	250	150
Financial assets	400	230
Trade receivable	450	300
Cash and cash balances	200	100
Total	**2,000**	**1,380**
Equity and Liabilities		
Equity		
Share capital- Equity shares of Rs. 100 each	500	400
Reserve and surplus	730	180
OCI	80	45
Non-Current liabilities:		
Long term borrowings	250	200
Long term provisions	50	70
Deferred tax	40	35
Current Liabilities:		
Short term borrowings	100	150
Trade payable	250	300
Total	**2,000**	**1,380**

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Other information

a. Professional acquired 70% of Dynamic Ltd on 1 April 20X2 for by issuing its own share in the ratio of 1 share of Professional Ltd for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was 400.

b. The fair value exercise resulted in the following: (all nos in Lakh)

   a. PPE fair value on 1 April 20X2 was 350.

   b. Professional Ltd also agreed to pay an additional payment that is higher of 35 lakh and 25% of any excess of Dynamic Ltd in the first year after acquisition over its profits in the preceding 12 months. This additional amount will be due after 2 years. Dynamic Ltd has earned 10 lakh profit in the preceding year and expects to earn another 20 Lakh.

   c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of 20 lakh provided he stays with the Company for two year after the acquisition.

   d. Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:

      i. Original award- INR 5

      ii. Replacement award- INR 8.

   e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of 50. Management reliably estimated the fair value of the liability to be 5.

   f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1 April 20X2.

Question 15:

H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1st November, 2016	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 2017	45%	

Both the above-mentioned companies have INR as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 2017. Following is the Balance Sheet of S Ltd. as on that date:

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Particulars	Carrying value (Rs. in crore)	Fair value (Rs. in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets	100.0	350.0
- Investments		
Current assets		
(a) Inventories	20.0	20.0
(b) Financial assets		
- Trade receivables	20.0	20.0
- Cash held in functional currency	4.0	4.5
(c) Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	208	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value Rs.100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities		
- Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
TOTAL EQUITY AND LIABILITIES	208.0	

Other information:

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of Rs. 1 crore and fair value of Rs. 1.2 crore. The date of inception of the lease was 1st April, 2010. On the inception of the lease, S Ltd. had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 2017 are considered, the lease would be classified as an operating lease.

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 2017:

Particulars	Fair value (Rs. In crore)	Remarks

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Law suit filed by a customer for a claim of Rs. 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.
Income tax demand of Rs. 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of Rs. 1 crore.

Rs. 1 crore represents the acquisition date fair value of the indemnification undertaking.

Any amount which would be received in respect of the above undertaking shall not be taxable.

The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.

Carrying value of non-current asset held for sale of Rs. 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.

In consideration of the additional stake purchased by H Ltd. on 1st January, 2017, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 2017 is Rs. 10,000 per share.

On 1st January, 2017, H Ltd. has paid Rs. 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 2019, H Ltd. will pay Rs. 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 2019 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 2017 and 31st March, 2017 as Rs. 22 crore and Rs. 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:

As on November, 2016	Rs. 350 per share
As on 1st January, 2017	Rs. 395 per share
As on 31st March, 2017	Rs. 420 per share

On 31st May, 2017, H Ltd. learned that certain customer relationships existing as on 1st January, 2017, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 2017. The fair value of such customer relationships as on 1st January, 2017 was Rs. 3.5 crore (assume that

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there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 2017 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 2017 to 31st March, 2017, the fair value of such customer relationships has increased to Rs. 4 crore as on 31st March, 2017.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.

You are required to provide your detailed responses to the following, along with reasoning and computation notes:

a. What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 2017. For this purpose, measure non-controlling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

b. Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 2017?

   If yes, provide relevant journal entries.

c. What should be the accounting treatment of the contingent consideration as on 31st March, 2017? **[MTP May 2019]**

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Earnings Per Share (IND AS 33)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 An entity has following preference shares in issue at the end of 20X4:

- 5% redeemable, non-cumulative preference shares: These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – Rs. 100,000.
- Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%: The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, Rs. 18,000. These shares are classified as equity – Rs. 200,000.
- 8% non-redeemable, non-cumulative preference shares: At the beginning of the year, the entity had Rs. 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased Rs. 50,000 of these at a discount of Rs. 1,000 – Rs. 50,000.
- 7% cumulative, convertible preference shares (converted in the year): These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of Rs. 300 – Nil.

The profit attributable to ordinary equity holders for the year 20X4 is Rs. 150,000.

Determine the adjustments for the purpose of calculating EPS.

Ans: Adjustments for the purpose of calculating EPS are made as follows:

Particulars	Amount (Rs.)	Amount (Rs.)
Profit for the year attributable to the ordinary equity holders		150,000
Amortisation of discount on issue of increasing-rate preference shares (Refer Note 1)	(18,000)	
Discount on repurchase of 8% preference shares (Refer Note 2)	1,000	(17,000)
Profit attributable to ordinary equity holders for basic EPS (Refer Note 3-5)		1,33,000

Notes:

1. The original discount on issue of the increasing-rate preference shares is treated as amortised to retained earnings, and treated as preference dividends for EPS purposes and adjusted against profit attributable to the ordinary equity holders. There is no adjustment in respect of dividend, because these do not commence until 20X5. Instead, the finance cost is represented by the amortisation of the discount in the

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dividend-free period. In future years, the accrual for the dividend of Rs. 20,000 will be deducted from profits.

2. The discount on repurchase of the 8% preference shares has been credited to equity so should be added to profit.

3. The dividend on the 5% preference shares has been charged to the income statement, because the preference shares are treated as liabilities, so no adjustment is required for it from the profit.

4. No accrual for the dividend on the 8% preference shares is required, because they are non-cumulative. If a dividend had been declared for the year, it would have been deducted from profit for the purpose of calculating basic EPS, because the shares are treated as equity and the dividend would have been charged to equity in the financial statements.

5. The 7% preference shares were converted at the beginning of the year, so there is no adjustment in respect of the 7% preference shares, because no dividend accrued in respect of the year. The payment of the previous year's cumulative dividend is ignored for EPS purposes, because it will have been adjusted for in the prior year. Similarly, the excess of the fair value of additional ordinary shares issued on conversion of the convertible preference shares over the fair value of the ordinary shares to which the shareholders would have been entitled under the original conversion terms would already have been deducted from profit attributable to the ordinary shareholders, and no further adjustment is required.

Q 2: ABC Company issues 9% preference shares of FV of Rs. 10 each on 1.4.20X1. Total value of the issue is Rs. 10,00,000. The shares are issued at a discount of Rs. 0.50 each, for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at Rs. 11 each.

At the end of the year 3, i.e. on 31.3.20X4, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at Rs. 12 each instead of original agreement of Rs. 11. Comment on the earnings for the year 20X3-20X4.

Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.

Ans: In the given situation, Rs. 1 per share is the excess payment made by the company amounting to Rs. 1,00,000 in all. The amount of Rs. 1,00,000 will be deducted from the earnings of the year 20X3-20X4 while calculating the basic EPS of year 20X3-20X4.

Q 3: Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS as per Ind AS 33

. S. No.	Date	Particulars	No of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	100,000
2	15-Jun-20X1	Issue of equity shares	75,000
3	8-Nov-20X1	Conversion of convertible pref shares in Equity	50,000
4	22-Feb-20X2	Buy back of shares	(20,000)

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5	31-Mar-20X2	Closing balance of outstanding equity shares	205,000

Q 4: On 31 March, 20X2, the issued share capital of a company consisted of Rs. 100,000,000 in ordinary shares of Rs. 25 each and Rs. 500,000 in 10% cumulative preference shares of Re 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalization of reserves in the proportion 1:4 for the year ended 31 March, 20X3.

Profit for 20X1-20X2 and 20X2-20X3 is Rs. 450,000 and Rs. 550,000 respectively.

Calculate the basic EPS for 20X1-20X2 and 20X2-20X3.

Ans:

	20X2-20X3	20X1-20X2
Calculation of earnings	Rs.'000	Rs.'000
Profit for the year	550	450
Less: Preference shares dividend	(50)	(50)
Earnings (A)	500	400
Number of ordinary shares	in '000	in '000
Shares in issue for full year	4,000	4,000
Capitalization issue at 1 October 20X2	1,000	1,000
Number of shares (B)	5,000	5,000
Earnings per ordinary share (A/B)	10 Paise	8 Paise*

*The comparative EPS for 20X1-20X2 can alternatively be calculated by adjusting the previously disclosed EPS in 20X1-20X2 (in this example, 10 Paise) by the following factor:

Number of shares before the bonus issue/ Number of shares after the bonus issue

*Adjusted EPS for 20X1-20X2 10 Paise x (4,000/ 5,000) = 8 Paise

Q 5: X Ltd.

1 January	1,000,000 shares in issue
28 February	Issued 200,000 shares at fair value
31 August	Bonus issue 1 share for 3 shares held
30 November	Issued 250,000 shares at fair value

Calculate the number of shares which would be used in the basic EPS calculation. Consider reporting date as December end.

Q 6: Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.

Entity A's results for 20X2 showed a profit before tax of Rs. 80,000 and a profit after tax of Rs. 64,000 (for simplicity, a tax rate of 20% is assumed in this example).

Calculate Earnings for the purpose of diluted EPS.

Ans: For the purpose of calculating diluted EPS, the earnings should be adjusted for the reduction in the interest charge that would occur if the debentures were converted, and for the increase in the management bonus payment that would arise from the increased profit.

	Amount (Rs.)
Profit after tax	64,000

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Add: Reduction in interest cost (25,000 × 4%) (Refer Note)	1,000
Less: Tax expense (1,000 × 20%)	(200)
Less: Increase in management bonus (1,000 × 1%)	(10)
Add: Tax benefit (10 × 20%)	2
Earnings for the purpose of diluted EPS	64,792

Note: For simplicity, this illustration does not classify the components of the convertible debenture as liabilities and equity, as required by Ind AS 32.

Q 7: ABC Ltd. has 1,000,000 Rs. 1 ordinary shares and 1,000 Rs. 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period.

ABC Ltd.'s share price is Rs. 4.50 per share and earnings for the period are Rs. 500,000. The tax rate applicable to the entity is 21%.

Calculate earnings per incremental share for the convertible bonds.

Ans: Basic EPS is Rs. 0.50 per share (ie 500,000/1,000,000)

The earnings per incremental share for the convertible bonds is calculated as follows:

Earnings effect = No. of bonds x nominal value x interest cost - tax deduction @ 21%

= 1,000 x 100 x 10% x (1- 0.21)

= Rs. 7,900.

Incremental shares calculation

Assume all bonds are converted to shares, even though this converts Rs. 100 worth of bonds into 20 shares worth only Rs. 90 and is therefore not economically rational. This gives 1000 x 20 = 20,000 additional shares.

Earnings per incremental share = Rs. 7,900 / 20,000 = Rs. 0.395

Diluted EPS = (Rs. 500,000 + Rs. 7,900) / (1,000,000 + 20,000) = Rs. 0.498 per share.

Q 8: At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of Rs. 1 each. On 1 October 20X1, the entity issued Rs. 1,250,000 of 8% convertible loan stock for cash at par. Each Rs. 100 nominal of the loan stock may be converted, at any time during the years ended 20X6 to 20X9, into the number of ordinary shares set out below:

30 June 20X6: 135 ordinary shares;

30 June 20X7: 130 ordinary shares;

30 June 20X8: 125 ordinary shares; and

30 June 20X9: 120 ordinary shares.

If the loan stocks are not converted by 20X9, they would be redeemed at par. There are two different ways of assessing these instruments under Ind AS 32: the conversion option, to convert to a number of shares which varies only with time, could be viewed as either an option to convert to a variable or a fixed number of shares and recognised as either a liability or equity respectively.

This illustration assumes that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of Rs. 2,500 and Rs. 2,650 respectively. It is assumed that there are no tax consequences arising from these losses.

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The profit before interest, fair value movements and taxation for the year ended 30 June 20X2 and 20X3 amounted to Rs. 825,000 and Rs. 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.

Calculate Basic and Diluted EPS.

Ans:

		20X3	20X2
	Trading results	Rs.	Rs.
A.	Profit before interest, fair value movements and tax	895,000	825,000
B.	Interest on 8% convertible loan stock (20X2: 9/12 × Rs.100,000)	(100,000)	(75,000)
C.	Change in fair value of embedded option	(2,650)	(2,500)
	Profit before tax	792,350	747,500
	Taxation @ 33% on (A-B)	(262,350)	(247,500)
	Profit after tax	530,000	500,000
	Calculation of basic EPS		
	Number of equity shares outstanding	1,500,000	1,500,000
	Earnings	Rs. 530,000	Rs. 500,000
	Basic EPS	35 paise	33 paise

Calculation of diluted EPS

Test whether convertibles are dilutive:

The saving in after-tax earnings, resulting from the conversion of Rs. 100 nominal of loan stock, amounts to Rs. 100 × 8% × 67% + Rs. 2,650/12,500 = Rs. 5.36 + Rs. 0.21 = Rs. 5.57.

There will then be 135 extra shares in issue.

Therefore, the incremental EPS is 4 paise (ie. Rs. 5.57/135). As this incremental EPS is less than the basic EPS at the continuing level, it will have the effect of reducing the basic EPS of 35 paise. Hence the convertibles are dilutive.

	20X3	20X2
Adjusted earnings	Rs.	Rs.
Profit for basic EPS	530,000	500,000
Add: Interest and other charges on earnings saved as a result of the conversion (100,000 + 2,650) (75000+ 2500)	102,650	77,500
Less: Tax relief thereon	(33,875)	(25,575)
Adjusted earnings for equity	598,775	551,925

Adjusted number of shares

From the conversion terms, it is clear that the maximum number of shares issuable on conversion of Rs. 1,250,000 loan stock after the end of the financial year would be at the rate of 135 shares per Rs. 100 nominal (that is, 1,687,500 shares).

	20X3	20X2
Number of equity shares for basic EPS	1,500,000	1,500,000
Maximum conversion at date of issue 1,687,500 × 9/12	–	1,265,625

Maximum conversion after balance sheet date	1,687,500	–
Adjusted capital	3,187,500	2,765,625
Adjusted earnings for equity	Rs. 598,775	Rs. 551,925
Diluted EPS (approx.)	19 paise	20 paise

Q 9: At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of Rs. 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at Rs. 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to Rs. 500,000 and Rs. 600,000 respectively (wholly relating to continuing operations).

Average market price of share:

Year ended 31 December 20X7 = Rs. 120

Year ended 31 December 20X8 = Rs. 160

Calculate basic and diluted EPS.

Ans: Calculation of basic EPS

	20X8	20X7
Profit after tax	Rs. 600,000	Rs. 500,000
Number of shares	4,000,000	4,000,000
Basic EPS (approx.)	15 paise	13 paise.

Calculation of diluted EPS

Adjusted number of shares		
Number of shares under option:		
Issued at full market price:		
(630,000 × 70) ÷ 120	367,500	
(630,000 × 70) ÷ 160		275,625
Issued at nil consideration — dilutive	354,375	262,500
Total number of shares under option	630,000	630,000
Number of equity shares for basic EPS	4,000,000	4,000,000
Number of dilutive shares under option	354,375	262,500
Adjusted number of shares (A)	4,354,375	4,262,500
Profit after tax (B)	Rs. 600,000	Rs. 500,000
Diluted EPS (B/A)	14 paise	12 paise
Percentage dilution	7.00%	6.40%

Note: If options had been granted or exercised during the period, the number of 'nil consideration' shares in respect of these options would be included in the diluted EPS calculation on a weighted average basis for the period prior to exercise.

Q 10: Ordinary shares outstanding during 2001 10,00,000

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An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

- 5,000 additional ordinary shares for each new retail site opened during 2001
- 1,000 additional ordinary shares for each Rs. 1,000 of consolidated profit in excess of Rs. 20,00,000 for the year ended 31 December 2001

Retail sites opened during the year:

- one on 1 May 2001
- one on 1 September 2001

Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:

- Rs. 11,00,000 as of 31 March 2001
- Rs. 23,00,000 as of 30 June 2001
- Rs. 19,00,000 as of 30 September 2001 (including a Rs. 4,50,000 loss from a discontinued operation)
- Rs. 29,00,000 as of 31 December 2001

Calculate basic and diluted EPS

Ans: **Basic earnings per share**

	Full year
Numerator (Rs.)	29,00,000
Denominator:	
Ordinary shares outstanding	10,00,000
Retail site contingency	5,000 (5,000 shares × $^{8}/12$) + (5,000 shares × $^{4}/12$)
Earnings contingency	-
Total shares	10,05,000
Basic earnings per share (Rs)	2.89

Note: The earnings contingency has no effect on basic earnings per share because it is not certain that the condition is satisfied until the end of the contingency period. The effect is negligible for the fourth-quarter and full-year calculations because it is not certain that the condition is met until the last day of the period.

Diluted earnings per share

	Full year
Numerator (Rs.)	29,00,000
Denominator:	
Ordinary shares	
Outstanding	10,00,000
Retail site contingency	10,000
Earnings contingency	9,00,000*
Total shares	19,10,000
Diluted earnings	

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per share (Rs.)	1.52

* [(Rs. 29,00,000 — Rs. 20,00,000) ÷ 1,000] × 1,000 shares = 9,00,000 shares.

Q 11 An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of Rs. 1,000 per bond, giving total proceeds of Rs. 20,00,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is Rs. 3. Income tax is ignored.

Profit attributable to ordinary equity holders of the parent entity Year 1	Rs. 10,00,000
Ordinary shares outstanding	Rs. 12,00,000
Convertible bonds outstanding	2,000

Calculate basic and diluted EPS when

Ans: Allocation of proceeds of the bond issue:

Liability component	Rs. 18,48,122*
Equity component	Rs. 1,51,878
	Rs. 20,00,000

The liability and equity components would be determined in accordance with IND AS 32 Financial Instruments: Presentation. These amounts are recognised as the initial carrying amounts of the liability and equity components.

*This represents the present value of the principal and interest discounted at 9% Rs. 20,00,000 payable at the end of three years; Rs. 1,20,000 payable annually in arrears for three years.

Basic earnings per share Year 1:

Rs. 10,00,000 / 1,200,000 = Rs. 0.83 per ordinary share

Diluted earnings per share Year 1:

It is presumed that the issuer will settle the contract by the issue of ordinary shares. The dilutive effect is therefore calculated as under.

[Rs. 1,000,000 + Rs166,331[2]] / [1,200,000 + 500,000[3]] = Rs. 0.69 per ordinary share

[2] Profit is adjusted for the accretion of Rs. 166,331 (Rs. 1,848,122 × 9%) of the liability because of the passage of time.

[3] 500,000 ordinary shares = 250 ordinary shares × 2,000 convertible bonds

Q 12: An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares

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• 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of Rs. 5 per share before any dividends are paid on the ordinary shares. Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above Rs. 2 at a rate of 50% of any additional dividend payable on an ordinary share.

The entity's profit for the year is Rs. 100,000, and dividends of Rs. 2 per share are declared on the ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Ans: The calculation of basic EPS is as follows:

	Rs.	Rs.
Profit		100,000
Less Dividends payable for the period:		
Preference (5,000 × Rs. 5)	25,000	
Ordinary (10,000 × Rs. 2)	20,000	(45,000)
Undistributed earnings		55,000

Allocation of undistributed earnings:

Allocation per ordinary share = A

Allocation per preference share = B where B = 50% of A

(A × 10,000) + (50% × A × 5,000) = Rs. 55,000

A = 55,000 / (10,000 + 2,500) = Rs. 4.4

B = 50% of A

B = Rs. 2.2

Dividend per share are:	Preference shares Rs. per share	Ordinary shares Rs. per share
Distributed earnings	5.00	2.00
Undistributed earnings	2.20	4.40
Totals	7.20	6.40

Proof: (5,000 × Rs. 7.2) + (10,000 × Rs. 6.4) = Rs.100,000

Q 13:

Profit attributable to equity holders of the parent entity	Rs. 100,000
Ordinary shares outstanding	10,000
Non-convertible preference shares	6,000
Non-cumulative annual dividend on preference shares	Rs. 5.50 per share
(before any dividend is paid on ordinary shares)	

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After ordinary shares have been paid a dividend of Rs. 2.10 per share, the preference shares participate in any additional dividends on a 20:80 ratio with ordinary shares

Calculate Basic EPS.

Q 14 An entity issues 100,000 ordinary shares of Re 1 each for a consideration of Rs. 2.50 per share. Cash of Rs. 1.75 per share was received by the balance sheet date. The partly paid shares are entitled to participate in dividends for the period in proportion to the amount paid.

Calculate number of shares for calculation of Basic EPS.

Ans: The number of ordinary share equivalents that would be included in the basic EPS calculation on a weighted basis is as follows:

(100,000 × Rs. 1.75) / Rs. 2.50 = 70,000 shares.

Q 15:

1 January	Shares in issue	1,000,000
	5% Convertible bonds	Rs. 100,000
	(terms of conversion 120 ordinary shares for Rs. 100)	
31 March	Holders of Rs. 25,000 bonds converted to ordinary shares.	

Profit for the year ended 31 December Rs. 200,000

Tax rate 30%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements.

Ans:

	Number of shares	Profit Rs.
Profit		200,000
Outstanding shares	1,000,000	
New shares on conversion (weighted average)		
9/12 × Rs. 25,000 / 100 × 120	22,500	-
Figures for basic EPS	1,022,500	200,000
Basic EPS is (Rs. 200,000 / 1,022,500) = 0.196 per share		
Dilution adjustments		
Unconverted shares Rs. 75,000 / 100 × 120	90,000	
Interest: Rs. 75,000 × 5% × 0.7		2,625
Converted shares pre conversion adjustment		
3/12 × Rs. 25,000 / 100 × 120	7,500	
Interest: [3/12 × Rs. 25,000 × 5% × 0.7]		219
	1,120,000	202,844

Diluted EPS is (Rs. 202,844 / 1,120,000) = 0.181

Q 16: Calculate Subsidiary's and Group's Basic EPS and Diluted EPS, when:

Parent

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Profit attributable to ordinary equity holders of the parent entity	Rs. 12,000 (excluding any earnings of, or dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Instruments of subsidiary owned by the parent	800 ordinary shares
30 warrants exercisable to purchase ordinary shares of subsidiary	
300 convertible preference shares	
Subsidiary:	
Profit	Rs. 5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	Rs. 10
Average market price of one ordinary share	Rs. 20
Convertible preference shares	400, each convertible into one ordinary share
Dividends on preference shares	Re 1 per share
No inter-company eliminations or adjustments were necessary except for dividends.	
Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.	

Ans: Subsidiary's earnings per share

Basic EPS	Rs. 5.00 calculated:	Rs. 5,400 (a) – Rs.400 (b)
		1,000 (c)
Diluted EPS	Rs. 3.66 calculated:	Rs. 5,400 (d)
		(1,000 + 75 (e) + 400(f))

Notes:

(a) Subsidiary's profit attributable to ordinary equity holders.

(b) Dividends paid by subsidiary on convertible preference shares.

(c) Subsidiary's ordinary shares outstanding.

(d) Subsidiary's profit attributable to ordinary equity holders (Rs. 5,000) increased by Rs. 400 preference dividends for the purpose of calculating diluted earnings per share.

(e) Incremental shares from warrants, calculated: [(Rs. 20 – Rs. 10) ÷ Rs. 20] × 150.

(f) Subsidiary's ordinary shares assumed outstanding from conversion of convertible preference shares, calculated: 400 convertible preference shares × conversion factor of 1.

Consolidated earnings per share

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Consolidated earnings per share		
Basic EPS	Rs. 1.63 calculated:	Rs. 12,000(a) + Rs. 4,300(b)
		10,000(c)
Diluted EPS	Rs. 1.61 calculated:	Rs. 12,000 + Rs. 2,928(d) + Rs. 55(e) + Rs. 1,098(f)
		10,000

Notes:

(a) Parent's profit attributable to ordinary equity holders of the parent entity.

(b) Portion of subsidiary's profit to be included in consolidated basic earnings per share, calculated: (800 × Rs. 5.00) + (300 × Re 1.00).

(c) Parent's ordinary shares outstanding.

(d) Parent's proportionate interest in subsidiary's earnings attributable to ordinary shares, calculated: (800 ÷ 1,000) × (1,000 shares × Rs. 3.66 per share).

(e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 ÷ 150) × (75 incremental shares × Rs. 3.66 per share).

(f) Parent's proportionate interest in subsidiary's earnings attributable to convertible preference shares, calculated: (300 ÷ 400) × (400 shares from conversion × Rs. 3.66 per share).

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FIRST-TIME ADOPTION OF IND AS (Ind AS 101)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1: Previous GAAP

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?

Solution: Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its statutory reporting requirements in India (emphasis added) immediately before adopting Ind AS. For instance, companies preparing their financial statements in accordance with the Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 shall consider those financial statements as previous GAAP financial statements.

Accordingly, the previous GAAP of the foreign subsidiary for the purpose of consolidation under Ind-AS with the parent company would be accounting standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts)

Rules, 2014 and not the IFRS as issued by the IASB since the first time adoption has to be considered in the context of India only.

Question 2: First Ind AS financial statements

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, the 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 be first Ind AS financial statements.

Question 3: Date of Transition

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X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for20X0-20X1. 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 1, 20X0 which will be considered as date of transition.

Question 4: Change in accounting policy

X Ltd. was using cost model for its property, plant and equipment (tangible fixed assets) till March31, 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 change in accounting policy.

Question 5: Non-controlling interests

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?

Solution: In case an entity elects not to restate past business combinations, Ind AS 101 requires the measurement of non-controlling interests (NCI) to follow from the measurement of other assets and liabilities on transition to Ind AS. However, Ind AS 101 contains a mandatory exception that prohibits retrospective allocation of accumulated profits between the owners of the parent and the NCI. In case an entity elects not to restate past business combinations, the previous GAAP carrying value of NCI is not changed other than for adjustments made(remeasurement of the assets and liabilities subsequent to the business combination) as part of the transition to Ind AS. As such, the carrying value of NCI in the opening Ind AS balance sheet cannot have a deficit balance on account of recognition of the losses attributable tithe minority interest, which was not recognised under the previous GAAP as part of NCI in the absence of contract to contribute assets to fund such a deficit. However, the NCI could have a deficit balance due to remeasurement of the assets and liabilities subsequent to the business combination as part of the transition to Ind AS. In case an entity restates past business combination, Ind AS 101 requires that the balance in NCI as at the date of transition shall be determined retrospectively in accordance with Ind AS, taking into account the impact of other elections made as part of the adoption of Ind AS. As such, the NCI could have a deficit balance on account of losses attributable to the NCI, even if there is no obligation on the holders of NCI to contribute assets to fund such a deficit.

Question 6: Business combination

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. In that case, does the carrying amount of investment required to be adjusted for this transaction?

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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 7: Business combination

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 a 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?

Solution: Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no consolidated financial statements were required under previous GAAP), then the subsidiary's assets and liabilities would be included in the parent's opening consolidated financial statements at such values as would appear in the subsidiary's separate financial statements if the subsidiary were to adopt the Ind AS as at the parent's date of transition. For this purpose, the subsidiary's separate financial statements would be prepared as if it was a first-time adopter of Ind AS i.e. after availing relevant first-time adoption mandatory exceptions and voluntary exemptions. In other words, the parent will adjust the carrying amount of the subsidiary's assets and liabilities to the amounts that Ind AS would require in the subsidiary's balance sheet.

The deemed cost of goodwill equals the difference at the date of transition between:

(a) the parent's interest in those adjusted carrying amount; and

(b) the cost in the parent's separate financial statements of its investment in the subsidiary.

The measurement of non-controlling interest and deferred tax follows from the measurement of other assets and liabilities.

It may be noted here that the above exemption is available only under those circumstances where the parent, in accordance with the previous GAAP, has not presented consolidated financial statements for the previous year; or where the consolidated financial statements were prepared in accordance with the previous GAAP but the entity was not treated as a subsidiary, associate or joint venture under the previous GAAP. As such, if the consolidated financial statements were required to be prepared and there is a change in classification of the entity from subsidiary to associate or vice versa in accordance with Ind AS, then the above exemption does not apply.

Question 8: Business combination

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

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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?

Solution: As per Ind AS 101: "A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X0, it shall restate all business combinations that occurred between 30 June 20X0 and the date of transition to Ind AS, and it shall also apply Ind AS 110 from 30 June 20X0." Based on the above, if A Ltd. restates past business combinations, it would have to be applied to all business combinations of the group including those by subsidiary B Ltd. for the purpose of Consolidated Financial Statements. Ind AS 101 states, "However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary." Thus, in case where the parent adopts Ind AS later than the subsidiary then it does not change the amounts already recognised by the subsidiary.

Question 9: Business combination

Company A intends to restate its past business combinations with effect 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?

Solution: Ind-AS 101 prescribes that an entity may elect to use one or more of the exemptions of the Standard. As such, an entity may choose to adopt a combination of optional exemptions in relation to the underlying account balances.

When the past business combinations after a particular date (30 June 2010 in the given case)are restated, it requires retrospective adjustments to the carrying amounts of acquiree's assets and liabilities on account of initial acquisition accounting of the acquiree's net assets, the effects of subsequent measurement of those net assets (including amortisation of non-current assets that were recognised at its fair value), goodwill on consolidation and the consolidation adjustments. Therefore, the goodwill and equity (including non-controlling interest (NCI)) cannot be computed by considering the deemed cost exemption for PPE.

However, the entity may adopt the deemed cost exemption for its property, plant and equipment other than those acquired through business combinations.

Question 10: Deemed cost for PPE and intangible assets

X Ltd. is the holding company of Y Ltd. X Ltd. is required to adopt Ind AS from April 1, 2016. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of its 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 statements. Also, examine whether different entities in a group can use

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different basis for arriving at deemed cost for property, plant and equipment in their respective standalone financial statements

Solution: Where there is no change in its functional currency on the date of transition to Ind AS, a first time adopter to Ind AS may elect to continue with the carrying value of all of its property, plant and equipment as at the date of transition measured as per the previous GAAP and use that as its deemed cost at the date of transition after making necessary adjustments. If a first time adopter chooses this option then the option of applying this on selective basis to some of the items of property, plant and equipment and using fair value for others is not available. Nothing prevents different entities within a group to choose different basis for arriving at deemed cost for the standalone financial statements. However, in Consolidated Financial Statements, the entire group should be treated as one reporting entity. Accordingly, it will not be permissible to use different basis for arriving at the deemed cost of property, plant and equipment on the date of transition by different entities of the group for the purpose of preparing Consolidated Financial Statements.

Question 11: Deemed cost for PPE and intangible assets

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 12: Deemed cost for PPE and intangible assets

Is it possible for an entity to allocate cost as per the previous GAAP to a component based on its fair value on the date of transition even when it does not have the component-wise historical cost?

Solution: Yes, an entity can allocate cost to a component based on its fair value on the date of transition. This is permissible even when the entity does not have component-wise historical cost.

Question 13: Deemed cost for PPE and intangible assets

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 a general or specific price index. What is the acceptable time gap of such revaluation from 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 from 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 14: Deemed cost for PPE and intangible assets

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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?

Solution: In the instant case, X Ltd. is using revaluation model for property, plant and equipment for the first annual Ind AS financial statements and using fair value of property, plant and equipment on the date of the transition, as deemed cost. Since the entity is using fair value at the transition date as well as in the first Ind AS financial statements, there is no change in accounting policy and mere use of the term 'deemed cost' would not mean that there is a change in accounting policy.

Question 15: Long- term foreign currency monetary

Y Ltd. is a 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 Rs. 60 crores (US $ 10million converted at an exchange rate of US $ 1 = Rs. 21 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 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.

If the Company wants to avail the option prospectively

The Company cannot avail the exemption given in Ind AS 101 and cannot exercise option under paragraph 46/46A of AS 11, prospectively, on the date of transition to Ind AS in respect of Long term foreign currency monetary liability existing on the date of transition as the company has not availed the option under paragraph 46/46A earlier. Therefore, the Company need to recognise the exchange differences in accordance with the requirements of Ind AS 21, The Effects of Changes in Foreign Exchange Rates.

If the Company wants to avail the option retrospectively

The Company cannot avail the exemption given in Ind AS 101 and cannot exercise the option under paragraph 46/46A of AS 11 retrospectively on the date of transition to Ind AS in respect of long term foreign currency monetary liability that existed on the date of transition since the option is available only if it is in continuation of the accounting policy followed in accordance with the previous GAAP. Y Ltd. has not been using the option provided in Para 46/ 46A of AS 11, hence, it will not be permitted to use the option given in Ind AS 101 retrospectively.

Question 16: long- term foreign currency monetary

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

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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 17: long- term foreign currency monetary

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 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?

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. Ind AS 101gives an option to continue the existing accounting policy. Hence, Y Ltd. may opt for discontinuation of accounting policy as per previous GAAP and follow the requirements of Ind AS 21. The cumulative amount lying in the FCMITDA should be derecognised by an adjustment against retained earnings on the date of transition.

Question 18: long- term foreign currency monetary

A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101.However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to 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?

Solution: Ind AS 101 permits to continue with the carrying value for all of its property, plant and equipment as per the previous GAAP and use that as deemed cost for the purposes of first time adoption of Ind AS. Accordingly, the carrying value of property, plant and equipment as per previous GAAP as at the date of transition need not be adjusted for the exchange fluctuations capitalized to property, plant and equipment. Separately, it allows a company to continue with its existing policy 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. Accordingly, given that Ind AS 101 provides these two choices independent of each other, it may be possible for an entity to choose the deemed cost exemption for all of its property, plant and equipment and not elect the exemption of continuing the previous GAAP policy of capitalising exchange fluctuation to property, plant and equipment. In such a case, in the given case, a harmonious interpretation of the

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two exemptions would require the company to recognise the property, plant and equipment at the transition date at the previous GAAP carrying value (without any adjustment for the exchanges differences capitalized under previous GAAP) but for the purposes of the first (and all subsequent) Ind AS financial statements, foreign exchange fluctuation on all long term foreign currency borrowings would be recognised in the statement of profit and loss.

Question 19: Investment in subsidiaries, joint ventures and associates

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. In 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, 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 20: Shares Based Payment

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 disclosed 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 AS 102.

    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 21: Compound financial instruments

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On April 1, 2014, Sigma Ltd. issued 30,000 6% convertible debentures of face value of Rs. 100 per debenture at par. The debentures are redeemable at a premium of 10% on 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 how should Sigma Ltd. account for this compound financial instrument on the date of transition. The present value of Rs. 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

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).

	(Rs.)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6 × 3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110 × 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 Rs. 30,00,000 being the amount of debentures will be split as under:

Debt	Rs. 28,14,600
Equity	Rs. 1,85,400

Notes:

1. 3.17 is PV of Annuity Factor of Rs. 1 at a discount rate of 10% for 4 years.

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2. On maturity, Rs. 110 will be paid (Rs. 100 as principal payment + Rs. 10 as premium)

Question 22

H Ltd. has the following assets and liabilities as at March 31, 2016, prepared in accordance with previous GAAP:

Particulars	Notes	Amount (Rs.)
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 Rs. 4,50,000 and was classified as investment property as per Ind AS 40.

   ♦ Exchange differences of Rs. 1,00,000 were capitalised to depreciable fixed assets on which accumulated depreciation of Rs. 40,000 was recognised.

   ♦ There were no asset retirement obligations.

   ♦ The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.

2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for Rs. 48,00,000 that carried a fair value of Rs. 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. Financial instruments:

♦ VAT deferral loan Rs. 60,00,000 :

The VAT deferral loan of Rs. 60,00,000 was obtained on March 31, 2016, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 2016, is Rs. 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan

4. The retained earnings of the Company contained the following:

♦ ESOP reserve of Rs. 20,000:

The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised Rs. 12,000 towards the vested options and Rs. 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been Rs. 15,000 and Rs. 9,000 for the vested and unvested shares respectively. The Company intends to avail 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 :

Rs. 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of Rs. 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero.

Solution: Adjustments for opening balance sheet as per Ind AS 101

1. Fixed assets: As the land held 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 Rs. 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 discounted at an appropriate discounting factor. Consequently, the VAT deferral loan should be recognised at Rs. 37,25,528and the remaining Rs. 22,74,472 would be recognised as deferred government grant.

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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 Rs. 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. If a first-time adopter uses this exemption the 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 Rs. 1,00,000should be transferred to retained earnings

6. Retained earnings should be increased by Rs. 20,99,000 on account of the following:

	Rs.
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 earnings (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:

Particulars	**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

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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**

QUESTIONS FROM RTP/MTP/EXAMS

Question 23:

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.

[RTP May 2018]

Solution: Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity.

Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 'First Time Adoption of Ind AS'. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that, which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities."

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Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

Question 24:

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 voluntary adopt Ind AS w.e.f 1st April, 2018 with a transition date of 1st April, 2017.

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	31.03.2018	31.03.2017
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

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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, 2017. **[RTP May 2019]**

Solution: As per paras D31AA and D31AB of Ind AS 101, when changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture at transition date to Ind AS.

That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The balance of the investment in joint venture at the date of transition to Ind AS, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at initial recognition.

Accordingly, the deemed cost of the investment will be

Property, Plant & Equipment	1,200
Goodwill (Refer Note below)	119
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Total Assets	2054
Less: Trade Payables	75
Short Term Provisions	35
Deemed cost of the investment in JV	1944

Calculation of proportionate goodwill share of Joint Venture ie ABC Pvt. Ltd.

Property, Plant & Equipment	22,288
Goodwill	1,507
Long Term Loans & Advances	6,350
Trade Receivables	1,818
Other Current Assets	104
Total Assets	32,067
Less: Trade Payables	8,455
Short Term Provisions	475
	23,137

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Proportionate Goodwill of Joint Venture

= [(Goodwill on consolidation of subsidiary and JV/Total relative net asset) x Net asset of JV]

= (1507 / 23,137) x 1825 = 119 (approx.)

Accordingly, the proportional share of assets and liabilities of Joint Venture will be removed from the respective values assets and liabilities appearing in the balance sheet on 31.3.2017 and Investment in JV will appear under non-current asset in the transition date balance sheet as on 1.4.2017.

Adjustments made in I GAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Particulars	**31.3.2017**	**Ind AS Adjustment**	**Transition date Balance Sheet as per Ind AS**
Non-Current Assets	22,288	(1,200)	21,088
Property Plant & Equipment			
Intangible assets - Goodwill			
on Consolidation	1,507	(119)	1,388
Investment Property	5,245	-	5,245
Long Term Loans & Advances	6,350	(405)	5,945
Non- current investment in JV	-	1,944	1,944
Current Assets	-		
Trade Receivables	1,818	(280)	1,538
Investments	3,763	-	3,763
Other Current Assets	104	(50)	54
Total	41,075	(110)	40,965
Shareholder's Funds			
Share Capital	7,953	-	7,953
Reserves & Surplus	16,597	-	16,597
Non-Current Liabilities			
Long Term Borrowings	1,000		1,000
Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	41,075	(110)	40,965

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FAIR VALUE MEASUREMENT (IND AS 113)

QUESTIONS FROM ICAI STUDY MATERIAL

Questions:

1. An asset is sold in 2 different active markets (a market in which transaction for the asset or liability takes place 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).

   You are required to calculate:

   (i) The fair value of the asset, if market A is the principal market, and

   (ii) The fair value of the asset, if none of the markets is principal market. **[Nov 2018]**

Ans: If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs (24).

If neither market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

Because the entity would maximise the net amount that would be received for the asset in Market B (22), the fair value of the asset would be measured using the price in that market (25), less transport costs (2), resulting in a fair value measurement of 23.

2. Company J acquires 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

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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.

Ans: The highest and best use of the land is determined by comparing the following:

- The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and
- The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory's operating cash flows) and its assets and liabilities (e.g., the factory's working capital).

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CORPORATE SOCIAL RESPONSIBILITY

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1

ABC Ltd. is a company which is formed with charitable objects under Section 8 of the Companies Act, 2013. As a result, the management of the company believes that as all the activities of the company will be with the intent of charity, the CSR provisions are not applicable to ABC Ltd. as these activities are activities in normal course of business.

Whether the provisions of CSR are applicable to ABC Ltd. provided it fulfils the criteria of Section 135 of the Act?

Solution: Section 135 of the Companies Act is applicable to every company meeting the specified criteria. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This would imply that companies set up for the purposes of CSR/public welfare are also required to comply with the provisions of CSR.

Question 2

ABC Ltd. is a company which has a net worth of INR 200 crores, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

The previous year's financials state: (INR in Crores)

	March 31, 20X4 (Current year)	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Required

Does the Company have an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year? **[May 2018]**

Solution:

(i) As per section 135 of the Companies Act 2013

Every company having either

a. net worth of Rs. 500 crore or more, or

b. turnover of Rs. 1,000 crore or more or

c. a net profit of Rs. 5 crore or more

during ***immediate preceding financial year*** shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors (including at least one independent director).

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(ii) A company which meets the net worth, turnover or net profits criteria in immediate preceding financial years, will need to constitute a CSR Committee and comply with provisions of sections 135 (2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

1) Net worth greater than or equal to INR 500 Crores: This criterion is not satisfied.
2) Sales greater than or equal to INR 1000 Crores: This criterion is not satisfied.
3) Net Profit greater than or equal to INR 5 Crores: This criterion is satisfied in financial year ended March 31, 20X3.

Hence, the Company will be required to form a CSR committee.

Question 3

ABC Ltd. manufactures consumable goods like bath soap, tooth brushes, soap cases etc. As part of its CSR policy, it has decided to that for every pack of these goods sold, INR 0.80 will go towards the 'Save trees foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 25,000 such packs and a total of INR 20,000 was recognised as CSR expenditure. However, this amount was not paid to the foundation at the end of the financial year.

Required

Will the amount of INR 20,000 qualify to be a CSR expenditure? **[Nov 2018]**

Solution: By earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount to be CSR expenditure, it has to be spent. Hence, INR 20,000 will not be automatically considered as CSR expenditure until and unless it is spending on CSR activities.

Question 4

How can companies with small CSR funds take up CSR activities in a project/ program mode?

Solution: It has been clarified that companies can combine their CSR programs with other similar companies by pooling their CSR resources.

As per Rule 4 of the CSR Rules, a company may collaborate with other companies for undertaking projects or for CSR activities in such a manner that the CSR committees of the relevant companies are in a position to report separately on such projects in accordance with the prescribed Rules.

Question 5

Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the Financial Statements for the year 20X1-X2, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge Corporate Social Responsibility.

Required

State whether the treatment done by the management of management is correct. Explain with reasons.

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Solution: The Companies Act, 2013 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

The statutory guidelines relating to CSR also require the deployment of funds for the benefit of the local area of the Company. Since Nepal is another country the expenditure done there i.e. in Nepal shall not qualify to be accounted as CSR expenditure.

Further, it is presumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the company. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Question 6

ABC Ltd. is a company which comes under the ambit of Section 135 and CSR Rules. The Board of ABC Ltd did not appropriate the CSR funds and as a result there was no annual report on CSR in the Board's report for financial year ended March 31, 20X1.

Required**:** Is this a non-compliance as per the Act?

Solution: It has been clarified that as per Rule 9 of the CSR Rules, the Board's Report of a company qualifying under section 135 shall include an annual report on CSR, containing particulars specified in Annexure to CSR Rules. Reporting of CSR policy of the company in the Board's Report is a mandatory requirement. If the disclosure requirements are not fulfilled, penal consequences may be attracted under section 134(8) of the Companies Act.

Question 7

A building is used for CSR activities of the company. The same is capitalised as 'an asset' in the books and depreciation is charged on the same as per the Companies Act, 2013. The Company claims the cost of the building as 'CSR expenditure' and also the depreciation thereon.

Required: Is this the correct treatment as per the Act?

Solution: In case the expenditure incurred by the company is of such nature which may give rise to an 'Asset', it should be recognised by the company in its balance sheet, provided the control over the asset is with the Company and future economic benefits are expected to flow to the company. Where any CSR asset is recognized in its balance sheet, the same may be classified under natural head (e.g. Building, Plant & Machinery etc.) with specific sub-head of 'CSR Asset' if the expenditure satisfies the definition of 'asset'.

For example, a building used for CSR activities where the beneficial interest has not been relinquished for lifetime by a company and from which any economic benefits flow to a company, may be recognised as 'CSR Building' for the purpose of reflecting the same in the balance sheet.

If an amount spent on an asset has been shown as CSR spend, then the depreciation on such asset cannot be claimed as CSR spend again. Once cost of the asset is included for CSR spend, then the depreciation on such asset will not be included for CSR spend even if the asset is capitalized in the books of accounts and depreciation charged thereon.

Question 8

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ABC Ltd is a Company which is covered under the ambit of CSR rules. As part of its CSR contribution an amount of INR 15,00,000 was spent as CSR expense towards the education of girl child. The average net profit of the company for the past three years was INR 70,00,000. As the Company incurred a CSR expense in excess of what is required by the rules, it decided to utilise this expense as a carry forward to the next year and reduce next year's CSR spend by INR 1,00,000.

Required: Can the excess expenditure towards CSR be carried forward to next financial year?

Solution: There is no provision for carrying forward the excess CSR expenditure spent in a particular year. Any expenditure over 2% could be considered as voluntary higher CSR spend for that year.

Question 9

After the havoc caused by flood in Jammu and Kashmir, a group of companies undertakes during the period from October, 20X1 to December, 20X1 various commercial activities, with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 20X1-20X2.

Required: State whether the management's intention is correct or not and why?

Solution: Corporate Social Responsibility (CSR) Reporting is an information communiqué with respect to discharge of social responsibilities of corporate entity. Through 'CSR Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

Section 135 of the Companies Act, 2013 mandated the companies fulfilling the criteria mentioned in the said section to spend certain amount of their profit on activities as specified in the Schedule VII to the Act. Companies not falling within that criteria can also spend on CSR activities voluntarily. However, besides the requirements of constitution of a CSR committee and a CSR policy, the corporate entities should also take care that expenditure incurred for CSR should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Here, it is assumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the companies. Therefore, the intention of the management to highlight the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Question 10

ABC Ltd. carries out CSR activities from rented premises in Pune. The rent paid for such premises is disclosed as CSR expenditure and subsequently ABC Ltd. also claimed deduction of the same under the Income-tax Act. Is this permissible?

Solution: Based on the Explanatory Memorandum to the Bill, CSR expenditure which is of the nature described under the section 30 to 36 of the Income-tax Act shall be allowed as a deduction. Rent expenses can be claimed under section 30 of the Act and hence it can be claimed as a deduction.

Question 11:

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A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the financials regarding this?

Answer: Item 5 (a) of the General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of profit and loss. The note should also disclose the details with regard to the expenditure incurred in construction of a capital asset under a CSR project.

Question 12:

State whether any unspent amount of CSR expenditure (any shortfall in the amount that was expected to be spent as per the provisions of the Companies Act on CSR activities) at the reporting date shall be provided for? Also state in case the excess amount has been spent (ie more than what is required as per the provisions of the Companies Act on CSR activities), can it be carry forward to set-off against future CSR expenditure.

Ans:

(i) Treatment of any unspent amount of CSR expenditure

Since the expenditure on CSR activities is to be disclosed only in the Board's Report, no provision for the amount which is not spent, (i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period) may be made in the financial statements.

The Act requires that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount.

However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial statements.

(ii) Treatment of excess amount spent on CSR Activities

Since 2% of average net profits of immediately preceding three years is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future.

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FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 Entity A sells goods to Mr. X on November, 20X1 and received payments on January 31, 20X2. The entity follows December 31, 20X1 as its annual closing of financial statements. State how this business transaction should be accounted.

Ans: The goods have been sold off in the month of November, 20X1 and the payment has been received in the year 20X2 whereas the Entity A follows calendar year annual closing. Now, assuming that all recognition criteria (risk and rewards) has been met while selling off the goods in the month of November, 20X1, Entity A will recognize the sale in the Income statement with corresponding effect in accounts receivables for the year ending December 31, 20X1. This is called accrual accounting where the transaction is being recorded in the same year when it meets other recognition criteria and not when actual cash has been received/ paid.

Now, it is clear to understand that had this sale not been shown in the financial statement ending December 31, 20X1, the sale would have been understated by the same amount. Hence it has been recorded in the same period when the transaction has taken place and met recognition criteria as per applicable accounting standards.

Q 2 Balance sheet of a trader on 31st March, 20X1 is given below:

Particulars	Rs.
Assets	
Non-current assets	
Property, Plant and Equipment	65,000
Current assets	
Inventories	30,000
Financial assets	
Trade receivables	20,000
Other asset	10,000
Cash and cash equivalents	5,000
	1,30,000
Equity and Liabilities	
Equity	
Share capital	60,000
Other Equity - Profit and Loss Account	25,000
Non-current liabilities	
10% Loan	35,000
Current liabilities	

Financial liabilities	
Trade payables	10,000
	1,30,000

Additional information

a) The remaining life of Property, Plant and Equipment is 5 years. The pattern of use of the asset is even. The net realisable value of Property, Plant and Equipment on 31.03.20X2 was Rs. 60,000.

(b) The trader's purchases and sales in 20X1-20X2 amounted to Rs. 4 lakh and Rs. 4.5 lakh respectively.

(c) The cost and net realisable value of inventories on 31.03.20X2 were Rs. 32,000 and Rs. 40,000 respectively.

(d) Employee benefit expenses for the year amounted to Rs. 14,900.

(e) Other asset is written off equally over 4 years.

(f) Trade receivables on 31.03.20X2 is Rs. 25,000, of which Rs. 2,000 is doubtful. Collection of another Rs. 4,000 depends on successful re-installation of certain product supplied to the customer.

(g) Cash balance on 31.03.20X2 is Rs. 37,100 before deduction of interest paid on loan.

(h) There is an early repayment penalty for the loan Rs. 2,500.

The Profit and Loss Accounts and Balance Sheets of the trader are shown below in two cases (i) assuming going concern (ii) not assuming going concern.

Ans: Profit and Loss Account for the year ended 31st March, 20X2

	Case (i)	Case (ii)
	Rs.	Rs.
Revenue from operations – Sales (A)	4,50,000	4,50,000
Expenses		
Purchases	4,00,000	4,00,000
Changes in inventories	(2,000)	(10,000)
Employee benefit expenses	14,900	14,900
Finance cost	3,500	6,000
Depreciation and amortisation expenses	15,500	15,000
Other expenses - Provision for doubtful debts	2,000	6,000
Total Expenses (B)	4,33,900	4,31,900
Profit for the period (A-B)	16,100	18,100

Balance Sheet as at 31st March, 20X2

	Case (i) Rs.	Case (ii) Rs.
Assets		
Non-current assets		
Property, Plant and Equipment	52,000	60,000
Current Asset		

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Inventories	32,000	40,000
Financial assets		
Trade receivables (less provision)	23,000	19,000
Other asset	7,500	Nil
Cash and cash equivalents (after interest paid on loan)	33,600	33,600
	1,48,100	1,52,600
Equity and Liabilities		
Equity		
Share Capital	60,000	60,000
Other Equity - Profit & Loss A/c	41,100	43,100
Non-current liabilities		
10% Loan	35,000	37,500
Current liabilities		
Trade payables	12,000	12,000
	1,48,100	1,52,600

Q 3: Entity A is having inventory amounting INR 100,000 in total with the details as below:

Spare parts	INR 30,000
Finished goods	INR 25,000
Work in progress	INR 40,000
Tools	INR 5,000
TOTAL	INR 1,00,000

Materiality limit has been assessed INR 30,000 based on the management estimation pertaining to annual profit basis. What should be the presentation requirement under the "Materiality" criteria?

Ans: Entity A has estimated its materiality limit of INR 30,000 which suggests that everything which is more than this amount will be required to present separately, subject to its nature (nature means the components of inventory in this example). Hence, Entity needs to show Inventory as below by way of notes to account –

Work in progress	INR 40,000
Spare parts	INR 30,000
Finished goods & Tools	INR 30,000
TOTAL	INR 1,00,000

Since, Work in progress and Spare parts are more than materiality limits, hence, they have been shown separately based on its defined separate nature whereas finished goods & Tools have amount lower than materiality limits and same has been clubbed together.

Q 4: A legal case has been filed against the Company A however, expected outcome at the yearend cannot be evaluated. What would be relevant information and what would be reliable in it?

Ans: It may be inappropriate for the entity to recognise the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Q 5: An asset has been sold from Company A to Mr. X and immediately after this transaction, Mr. X has leased out the same to Company A. What would be the correct form to record the transaction using concept of "substance over form"?

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Ans: The asset has been actually transferred to pass on legal title of the asset to Mr. X and convert that into a lease asset. Hence, in substance, the economic benefits still is being enjoyed by Company A. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Q 6: A Ltd. has entered into a binding agreement with P Ltd. to buy a custom-made machine INR 40,000. At the end of 20X1-20X2, before delivery of the machine, A Ltd. had to change its method of production. The new method will not require the machine ordered and shall be scrapped after delivery. The expected scrap value is nil. State at which amount the liability shall be recognised.

Ans: A liability is recognised when outflow of economic resources will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In the given case, A Ltd. should recognise a liability of INR 40,000 to P Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognised as an expense. The accounting entry is suggested below:

Profit and Loss Account (Loss due to change in production method)	Dr.	40,000
To P Ltd.		40,000

Q 7 A trader commenced business on 01/01/20X1 with INR 12,000 represented by 6,000 units of a certain product at INR 2 per unit. During the year 20X2 he sold these units at INR 3 per unit and had withdrawn INR 6,000. Calculate Retained Profit under **Financial Capital Maintenance at historical costs**

Ans: Thus:

Opening Equity = INR 12,000 represented by 6,000 units at INR 2 per unit.

Closing Equity = INR 12,000 (INR 18,000 – INR 6,000) represented entirely by cash.

Retained Profit = INR 12,000 – INR 12,000 = Nil

The trader can start year 20X3 by purchasing 6,000 units at INR 2 per unit once again for selling them at INR 3 per unit. The whole process can repeat endlessly if there is no change in purchase price of the product.

Q 8 In the previous example A, suppose that the average price indices at the beginning and at the end of year are 100 and 120 respectively. Calculate Retained Profit under **Financial Capital Maintenance at current purchasing power**

Ans: Opening Equity = INR 12,000 represented by 6,000 units at INR 2 per unit.

Opening equity at closing price = (INR 12,000 / 100) x 120 = INR 14,400 (6,000 x INR 2.40)

Closing Equity at closing price

= INR 12,000 (INR 18,000 – INR 6,000) represented entirely by cash.

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Retained Profit = INR 12,000 – INR 14,400 = (-) INR 2,400

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund INR 12,000 is not sufficient to buy 6,000 units again at increased price INR 2.40 per unit. In fact, he should have restricted his drawings to INR 3,600 (INR 6,000 – INR 2,400).

Had the trader withdrawn INR 3,600 instead of INR 6,000, he would have left with INR 14,400, the fund required to buy 6,000 units at INR 2.40 per unit.

Q 9 In the previous example A, suppose that the price of the product at the end of year is INR 2.50 per unit. In other words, the specific price index applicable to the product is 125. Calculate Retained Profit under **Physical Capital Maintenance**

Current cost of opening stock = (INR 12,000 / 100) x 125 = 6,000 x INR 2.50 = INR 15,000

Current cost of closing cash = INR 12,000 (INR 18,000 – INR 6,000)

Opening equity at closing current costs = INR 15,000

Closing equity at closing current costs = INR 12,000

Retained Profit = INR 12,000 – INR 15,000 = (INR 3,000)

The negative retained profit indicates that the trader has failed to maintain his capital. The available fund INR 12,000 is not sufficient to buy 6,000 units again at increased price INR 2.50 per unit. The drawings should have been restricted to INR 3,000 (INR 6,000 – INR 3,000).

Had the trader withdrawn INR 3,000 instead of INR 6,000, he would have left with INR 15,000, the fund required to buy 6,000 units at INR 2.50 per unit.

Capital maintenance can be computed under all three bases as shown below:

Financial Capital Maintenance at historical costs

	INR	INR
Closing capital (At historical cost)	12,000	
Less: Capital to be maintained		
Opening capital (At historical cost)	12,000	
Introduction (At historical cost)	Nil	(12,000)
Retained profit		Nil

Financial Capital Maintenance at current purchasing power

	INR	INR
Closing capital (At closing price)	12,000	
Less: Capital to be maintained		
Opening capital (At closing price)	14,400	
Introduction (At closing price)	Nil	(14,400)
Retained profit		(2,400)

Physical Capital Maintenance

	INR	INR
Closing capital (At current cost)		12,000

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Less: Capital to be maintained		
Opening capital (At current cost)	15,000	
Introduction (At current cost)	Nil	(15,000)
Retained profit		(3,000)

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Presentation of Financial Statements (IND AS 1)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 An entity prepares its financial statements that contain an explicit and unreserved statement of compliance with Ind AS. However, the auditor's report on those financial statements contains a qualification because of disagreement on application of one Accounting Standard. In such case, is it acceptable for the entity to make an explicit and unreserved statement of compliance with Ind AS?

Ans: Yes, it is possible for an entity to make an unreserved and explicit statement of compliance with Ind AS, even though the auditor's report contains a qualification because of disagreement on application of Accounting Standard(s), as the preparation of financial statements is the prerogative of the management. In case the management has a bonafide reason to believe that it has complied with all Ind AS, it can make an explicit and unreserved statement of compliance with Ind AS.

Q 2 Entity XYZ is a large manufacturer of plastic products for the local market. On 1 April 20X6 the newly elected government unexpectedly abolished all import tariffs, including the 40 per cent tariff on all imported plastic products. Many other economic reforms implemented by the new government contributed to the value of the country's currency (CU) appreciating significantly against most other currencies. The currency appreciation severely reduced the competitiveness of the entity's products. Before 20X6 entity XYZ was profitable. However, because it was unable to compete with low priced imports, entity XYZ reported a loss of CU 4,000 for the year ended 31 March 20X7. At 31 March 20X7, entity XYZ's equity was CU 1,000. Management restructured entity B's operations in the second quarter of 20X7. That restructuring helped reduce losses for the third and fourth quarters to CU 400 and CU 380, respectively.

In January 20X7 the local plastic industry and labour union lobbied government to reinstate tariffs on plastic. On 15 March 20X7, the government announced that it would reintroduce limited plastic import tariffs in 20X8. However, it emphasised that those tariffs would not be as protective as the tariffs enacted by the previous government. In its latest economic forecast, the government predicts a stable currency exchange rate in the short term with a gradual weakening of the jurisdiction's currency in the longer term. Management of entity XYZ undertook a going concern assessment at 31 March 20X7. Management projects/forecasts that imposition of a 10 per cent tariff on the import of plastic products would, at current exchange rates, result in entity XYZ returning to profitability. How should the management of entity XYZ disclose the information about the going concern assessment in entity XYZ's 31 March 20X7 annual financial statements?

Ans: Going concern is a general feature of Presentation of Financial Statements. As per Ind AS 1, when preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its

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assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. An entity is required to disclose the facts, if the financial statements are not prepared on a going concern basis. Along with the reason, as to why the financial statements are not prepared on a going concern basis.

While assessing the going concern assumption, an entity is required to take into consideration all factors covering at least but not limited to 12 months from the end of reporting period.

On the basis of Ind AS 1 and the facts and circumstances of this case, the following disclosure is appropriate:

Extracts from the notes to entity XYZ's 31 XYZ 20X7 financial statements

Note 1: Basis of preparation

On the basis of management's assessment at 31 March 20X7, the financial statements have been prepared on the going concern basis. However, management's assessment assumes that the government will reintroduce limited plastic import tariffs and that the currency exchange rate will remain constant. On 15 March 20X7, the government announced that limited import tariffs will be imposed in 20X8. However, the government emphasised that the tariff would not be as protective as the 40 percent tariff in effect before 20X7.

Provided that the CU does not strengthen, management projects/forecasts that a 10 percent tariff on all plastic products would result in entity XYZ returning to profitability. At31 March 20X7 entity XYZ had net assets of CU1,000. If import tariffs are not imposed and currency exchange rates remain unchanged, entity XYZ's liabilities could exceed its assets by the end of the third quarter of 20X8. On the basis of their assessment of these factors, management believes that entity XYZ is a going concern.

Q 3: Is offsetting of revenue against expenses, permissible in case of a company acting as an agent and having sub-agents, where commission is paid to sub-agents from the commission received as an agent?

Ans: On the basis of the above, net presentation in the given case would not be appropriate, as it would not reflect substance of the transaction and would detract from the ability of users to understand the transaction. The commission received by the company as an agent is the gross revenue of the company. The amount of commission paid by it to the sub-agent should be considered as an expense and should not be offset against commission earned by it.

Q 4 An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

(a) How should such loan be classified in the balance sheet of the entity?

(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?

(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?

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(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

Ans:

(a) The loan is not due for payment at the end of the reporting period. The entity and the bank have agreed for the said roll over prior to the end of the reporting period for a period of 5 years. Since the entity has an unconditional right to defer the settlement of the liability for at least twelve months after the reporting period, the loan should be classified as non-current.

(b) Yes, the answer will be different if the arrangement for roll over is agreed upon after the end of the reporting period, since assessment is required to be made based on terms of the existing loan facility. As at the end of the reporting period, the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Hence the loan is to be classified as current.

(c) Yes, loan facility arranged with new bank cannot be treated as refinancing, as the loan with the earlier bank would have to be settled which may coincide with loan facility arranged with a new bank. In this case, loan has to be repaid within a period of 9 months from the end of the reporting period, therefore, it will be classified as current liability.

(d) Yes, the answer will be different and the loan should be classified as current. This is because, as per paragraph 73 of Ind AS 1, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Q 5: In December 2XX1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual installments starting from December 2XX5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2XX2, failing which the loan becomes payable on demand. As on March 24, 2XX2, the entity has not been able to get the promoter's contribution. On March 25, 2XX2, the entity approached the bank and obtained a grace period up to June 30, 2XX2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 2XX2.

(a) As on March 31, 2XX2, how should the entity classify the loan?

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 2XX2, the entity approached the bank and got the compliance date extended up to June 30, 2XX2 for getting promoter's contribution. In this case will the loan classification as on March 31, 2XX2 be different from (a) above?

Ans:

(a) Paragraph 75 of Ind AS 1, inter alia, provides, "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate

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repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 2XX2, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 2XX2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 2XX2, the loan will retain its classification as non-current.

Q 6 An entity manufactures passenger vehicles. The time between purchasing of underlying raw materials to manufacture the passenger vehicles and the date the entity completes the production and delivers to its customers is 11 months. Customers settle the dues after a period of 8 months from the date of sale.

(a) Will the inventory and the trade receivables be current in nature?

(b) Assuming that the production time was say 15 months and the time lag between the date of sale and collection from customers is 13 months, will the answer be different?

Ans: Inventory and debtors need to be classified in accordance with the requirement of Ind AS 1, which provides that an asset shall be classified as current if an entity expects to realise the same, or intends to sell or consume it in its normal operating cycle.

(a) In this case, time lag between the purchase of inventory and its realisation into cash is 19 months [11 months + 8 months]. Both inventory and the debtors would be classified as current if the entity expects to realise these assets in its normal operating cycle.

(b) No, the answer will be the same as the classification of debtors and inventory depends on the expectation of the entity to realise the same in the normal operating cycle. In this case, time lag between the purchase of inventory and its realisation into cash is 28 months [15 months + 13 months]. Both inventory and debtors would be classified as current if the entity expects to realise these assets in the normal operating cycle.

Q 7 In December 2XX1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual instalments starting from December 2XX5. One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 2XX2, failing which the loan becomes payable on demand. As on March 24, 2XX2, the entity has not been able to get the promoter's contribution. On March 25, 2XX2, the entity approached the bank and obtained a grace period upto June 30, 2XX2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 2XX2.

(a) As on March 31, 2XX2, how should the entity classify the loan?

(b) Assume that in anticipation that it may not be able to get the promoter's contribution by due date, in February 2XX2, the entity approached the bank and got the compliance date extended upto June 30, 2XX2 for getting promoter's contribution. In this case will the loan classification as on March 31, 2XX2 be different from (a) above?

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Ans:

(a) Ind AS 1, inter alia, provides, "An entity classifies the liability as non-current if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment." In the present case, following the default, grace period within which an entity can rectify the breach is less than twelve months after the reporting period. Hence as on March 31, 2XX2, the loan will be classified as current.

(b) Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loan covenant and does not deal with the classification in case of expectation of breach. In this case, whether actual breach has taken place or not is to be assessed on June 30, 2XX2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 2XX2, the loan will retain its classification as non-current.

Q 8: Company A has taken a long term loan arrangement from Company B. In the month of December 20X1, there has been a breach of material provision of the arrangement. As a consequence of which the loan becomes payable on demand on March 31, 20X2. In the month of May 20X2, the Company started negotiation with the Company B for not to demand payment as a consequence of the breach. The financial statements were approved for the issue in the month of June 20X2. In the month of July 20X2, both company agreed that the payment will not be demanded immediately as a consequence of breach of material provision.

Advise on the classification of the liability as current / non –current. **[RTP May 2018]**

Ans: As per para 74 of Ind AS 1 "Presentation of Financial Statements" where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

In the given case, Company B (the lender) agreed for not to demand payment but only after the financial statements were approved for issuance. The financial statements were approved for issuance in the month of June 20X2 and both companies agreed for not to demand payment in the month of July 20X2 although negotiation started in the month of May 20X2 but could not agree before June 20X2 when financial statements were approved for issuance.

Hence, the liability should be classified as current in the financial statement for the year ended March 31, 20X2.

Q 9: Entity A has undertaken various transactions in the financial year ended March 31, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1.

	Rs.
Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000

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Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

Ans: **Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1**

	(Rs.)
Current service cost	1,75,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Income tax expense	35,000
Share based payments cost	3,35,000

Items impacting the other comprehensive income for the year ended 31st March, 20X1

	(Rs.)
Remeasurement of defined benefit plans	2,57,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000

Q 10 On 1 April 20X3 Charming Ltd issued 100,000 Rs 10 bonds for Rs 1,000,000. On 1 April each year interest at the fixed rate of 8 per cent per year is payable on outstanding capital amount of the bonds (ie the first payment will be made on 1 April 20X4). On 31 March each year (i.e from 31 March 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at Rs 10 per bond. How should Charming Ltd. classify such Bonds: current or non-current?

Ans: In its statement of financial position at 31 March 20X4, Charming Ltd must present Rs 80,000 accrued interest and Rs 100,000 current portion of the non-current bond (ie the portion repayable on 31 Mach 20X4) as current liabilities. The Rs 900,000 due later than 12 months after the end of the reporting period is presented as a noncurrent liability.

Q 11 Inventory or trade receivables of X Ltd. are normally realised in 15 months. How should X Ltd. classify such inventory/trade receivables: current or non-current if these are expected to be realised within 15 months?

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Ans: These should be classified as current.

Q 12 B Ltd. produces aircrafts. The length of time between first purchasing raw materials to make the aircrafts and the date the company completes the production and delivery is 9 months. The company receives payment for the aircrafts 7 months after the delivery.

(a) What is the length of operating cycle?

(b) How should it treat its inventory and debtors?

Ans:

(a) The length of the operating cycle will be 16 months.

(b) Assuming the inventory and debtors will be realised within normal operating cycle, i.e., 16 months, both the inventory as well as debtors should be classified as current.

Q 13 X Ltd provides you the following information:

Raw material stock holding period : 3 months

Work-in-progress holding period : 1 month

Finished goods holding period : 5 months

Debtors collection period : 5 months

You are requested to compute the operating cycle of X Ltd.

Ans: The operating cycle of X Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Finished goods holding period + Debtors collection period = 3 + 1 + 5 + 5 = 14 months.

Q 14 In the above Illustration, what would happen if the trade payables of the Company are paid in 12.5 months? Should these be classified as current or non-current?

Ans: Since the operating cycle of X Ltd. is 14 months, trade payables expected to be settled in 12.5 months. The same should be classified as a current liability.

Q 15 Entity A has two different businesses, real estate and manufacture of passenger vehicles. With respect to the real estate business, the entity constructs residential apartments for customers and the normal operating cycle is three to four years. With respect to the business of manufacture of passenger vehicles, normal operating cycle is 15 months. Under such circumstance where an entity has different operating cycles for different types of businesses, how classification into current and non-current be made?

Ans: As per paragraph 66(a) of Ind AS 1, an asset should be classified as current if an entity expects to realise the same, or intends to sell or consume it in its normal operating cycle. Similarly, as per paragraph 69(a) of Ind AS 1, a liability should be classified as current if an entity expects to settle the liability in its normal operating cycle. In this situation, where businesses have different operating cycles, classification of asset/liability as current/non- current would be in relation to the normal operating cycle that is relevant to that particular asset/liability. It is advisable to disclose the normal operating cycles relevant to different types of businesses for better understanding.

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Q 16 An entity has placed certain deposits with various parties. How the following deposits should be classified, i.e., current or non-current?

(a) Electricity Deposit

(b) Tender Deposit/Earnest Money Deposit [EMD]

(c) Sales Tax/Excise Deposit paid under dispute

Ans:

(a) At all points of time, the deposit is recoverable on demand, when the connection is not required. However, practically, such electric connection is required as long as the entity exists. Hence, from a commercial reality perspective, an entity does not expect to realise the asset within twelve months from the end of the reporting period. Hence, electricity deposit should be classified as a non-current asset.

(b) Generally, tender deposit/EMD are paid for participation in various bids. They normally become recoverable if the entity does not win the bid. Bid dates are known at the time of tendering the deposit. But until the date of the actual bid, one is not in a position to know if the entity is winning the bid or otherwise. Accordingly, depending on the terms of the deposit if entity expects to realise the deposit within a period of twelve months, it should be classified as current otherwise non-current.

(c) Classification of sales tax/excise deposits paid to the Government authorities in the event of any legal dispute, which is under protest would depend on the facts of the case and the expectation of the entity to realise the same within a period of twelve months. In the case the entity expects these to be realised within 12 months, it should classify such amounts paid as current else these should be classified as non-current.

Q 17 Paragraph 69(a) of Ind AS 1 states "An entity shall classify a liability as current when it expects to settle the liability in its normal operating cycle". An entity develops tools for customers and this normally takes a period of around 2 years for completion. The material is supplied by the customer and hence the entity only renders a service. For this, the entity receives payments upfront and credits the amount so received to "Income Received in Advance". How should this "Income Received in Advance" be classified, i.e., current or non- current?

Ans: Ind AS 1 provides "Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period."

In accordance with the above, income received in advance would be classified as current liability since it is a part of the working capital, which the entity expects to earn within its normal operating cycle.

Q 18 Identify Current and Non-current assets

A) An entity produces whisky from barley, water and yeast in a 24-month distillation process. At the end of the reporting period the entity has one month's supply of barley and yeast raw materials, 800 barrels of partly distilled whisky and 200 barrels of distilled whisky.

Ans: All raw materials (barley and yeast) work in process (partly distilled whisky) and finished goods (distilled whisky) are inventories. The raw materials are expected to be realised (ie turned into

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cash after being processed into whisky) in the entity's normal operating cycle. Therefore, even though the realisation is expected to take place more than twelve months after the end of the reporting period, the raw materials, work in progress and finished goods are current assets.

B) An entity owns a machine with which it manufactures goods for sale. It also owns the building in which it carries out its commercial activities.

Ans: The machine and the building are non-current assets—they are not cash or cash equivalents; they are not expected to be realised or consumed in the entity's normal operating cycle; they are not held for the purpose of trading; and they are not expected to be realised within twelve months of the end of the reporting period.

C) On 31 December 20x2 an entity replaced a machine in its production line. The replaced machine was sold to a competitor for Rs. 300,000. Payment is due 15 months after the end of the reporting period.

Ans: The receivable is a non-current asset—it is not cash or a cash equivalent; it is not expected to be realised or consumed in the entity's normal operating cycle; it is not held for the purpose of trading; and it is not expected to be realised within twelve months of the end of the reporting period.

Note: If payment was due in less than twelve months of the end of the reporting period it would be a current asset.

D) On 1 April 20X2 XYZ Ltd invested Rs. 15,00,000 surplus funds in corporate bonds that bear interest at 8 per cent per year. Interest is payable on the corporate bonds on 1 April of each year. The capital is repayable in three annual instalments of Rs.500,000 starting on 31 March 20X3.

Ans: In its statement of financial position at 31 March 20X3 the entity must present the Rs. 1,20,000 accrued interest and Rs. 500,000 current portion of the non-current loan (ie the portion repayable on 31 March 20X3) as current assets—they are expected to be realised within twelve months of the end of the reporting period. The instalments of Rs.10,00,000 due later than twelve months after the end of the reporting period is presented as a non-current asset—it is not cash or a cash equivalent; it is not expected to be realised or consumed in the entity's normal operating cycle; it is not held for the purpose of trading; and it is not expected to be realised within twelve months of the end of the reporting period.

E) At the end of the reporting period a citrus grower's fruit trees bear partially developed oranges. Citrus trees bear fruit over many years.

Ans: The citrus trees and the fruit they bear are accounted for as a single biological asset until the point of harvest. The trees and the fruit they are bearing are classified as non-current assets. Once harvested the fruit would be classified as current.

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STATEMENT OF CASH FLOWS (IND AS 7)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 Company has provided the following information regarding the various assets held by company on 31st March 2017. Find out, which of the following items will be part of cash and cash equivalents for the purpose of preparation of cash flow statement as per the guidance provide in Ind AS 7:

Sr. No.	Name of the Security	Additional Information
1.	Government Bonds	5%, open ended, main purpose was to park the excess funds for temporary period
2.	Fixed deposit with SBI	12%, 3years maturity on 1st Jan 2020
3.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30.06.2017
4.	Redeemable Preference shares in ABC ltd	The redemption is due on 30th April 2017
5.	Cash balances at various banks	All branches of all banks in India
6.	Cash balances at various banks	All international branches of Indian banks
7.	Cash balances at various banks	Branches of foreign banks outside India
8.	Bank overdraft of SBI Fort branch	Temporary O/d, which is payable on demand
9.	Treasury Bills	90 days maturity

Ans:

Reno.	Name of the Security	Additional Information	Decision
1.	Government Bonds	5%, open ended, main purpose was to park the excess funds for temporary period	Included as intention is not to hold long term
2.	Fixed deposit with SBI	12%, 3years maturity on 1st Jan 2020	Not to be considered – long term
3.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30.06.2017	Exclude as original maturity is less than 90 days from the date of acquisition
4.	Redeemable Preference shares in ABC ltd	The redemption is due on 30th April 2017	Include as due within 90 days from the date of acquisition
5.	Cash balances at various banks	All branches of all banks in India	Include
6.	Cash balances at various banks	All international branches of Indian banks	Include
7.	Cash balances at various banks	Branches of foreign banks outside India	Include

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8.	Bank overdraft of SBI Fort branch	Temporary O/d, which is payable on demand	Include
9.	Treasury Bills	90 days maturity	Include

Q 2: From the following transactions, identify which transactions will be qualified for the calculation of operating cash flows, if company is into the business of trading of mobile phones

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

Q 3 From the following transactions taken from a private sector bank operating in India, identify which transactions will be classified as operating and which would be classified as Investing activity.

S. No.	**Nature of transaction paid**	**Operating / Investing / Not to be considered**
1	Interest received on loans	Operating – Main revenue generating activity
2	Interest paid on Deposits	Operating – Main expenses of operations
3	Deposits accepted	Exclude – financing activity
4	Loans given to customers	Operating – in case of financial institutes
5	Loans repaid by the customers	Operating – in case of financial institutes

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6	Deposits repaid	Exclude – Financing activity
7	Commission received	Operating – Main revenue generating activity
8	Lease rentals paid for various branches	Operating – Main expenses of operations
9	GST paid	Operating – Main expenses of operations
10	Furniture purchased for new branches	Investing – Assets purchased
11	Implementation of upgraded banking software	Investing – Purchased for long term purpose
12	Purchase of shares in 100% subsidiary for opening a branch in Abu Dhabi	Investing – strategic investment
13	New cars purchased from Honda dealer, in exchange of old cars	Investing
14	Provident fund paid for the employees	Operating
15	Issued employee stock options	Not to be considered. No cash flow

Q 4 From the following transactions taken from a parent company having multiple businesses and multiple segments, identify which transactions will be classified as operating Investing and Financing:

Sr. No.	Nature of transaction	**Operating / Investing / Financing /Not to be considered**
1	Issued preference shares	Financing
2	Purchased the shares of 100% subsidiary company	Investing
3	Dividend received from shares of subsidiaries	Investing
4	Dividend received from other companies	Investing / operating
5	Bonus shares issued	No cash flow
6	Purchased license for manufacturing of special drugs	Investing
7	Royalty received from the goods patented by the company	Operating
8	Rent received from the let out building (letting out is not main business)	Investing
9	Interest received from the advances given	Operating
10	Dividend paid	Financing
11	Interest paid on security deposits	Financing
12	Purchased goodwill	Investing
13	Acquired the assets of a company by issue of equity shares (not parting any cash)	Not to be considered
14	Interim dividends paid	Financing
15	Dissolved the 100% subsidiary and received the amount in final settlement	Investing

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Q 5 Find out the cash from operations by direct method and indirect method from the following information:

Operating statement of ABC Co for the year ended 31.3.2017

Particulars	Rs.
Sales	500,000.00
Less: Cost of goods sold	350,000.00
Administration & Selling Overheads	55,000.00
Depreciation	7,000.00
Interest Paid	3,000.00
Loss on sale of asset	2,000.00
Profit before tax	83,000.00
Tax	(30,000.00)
Profit After tax	53,000.00

Balance Sheet as on 31st March

	2017	2016
Equity and Liabilities		
Shareholders' Funds	60,000.00	50,000.00
Non-current Liabilities	25,000.00	30,000.00
Current Liabilities		
Creditors	12,000.00	8,000.00
Creditors for Expenses	10,000.00	7,000.00
Provisions	8,000.00	5,000.00
Total	115,000.00	100,000.00
Assets		
Fixed Assets	75,000.00	65,000.00
Investment	12,000.00	10,000.00
Current Assets		
Inventories	12,000.00	13,000.00
Debtors	10,000.00	7,000.00
Cash	6,000.00	5,000.00
Total	115,000.00	100,000.00

Ans: Cash flow from Operations by Direct Method

Particulars	Rs.	See Note
Cash Sales	497,000.00	1
Less: Cash Purchases	345,000.00	2
Overheads	52,000.00	3
Interest – Financing		
Depreciation - Non cash item		
Loss - Non cash item		
Cash profit	100,000.00	
Less: Tax	30,000.00	
Cash profit after tax	70,000.00	

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Note No 1 - Cash Receipts from Sales and debtors	
Particulars	Rs.
Sales	500,000.00
Add : Opening Debtors	7,000.00
Less : Closing Debtors	(10,000.00)
Cash Receipts	497,000.00
Note No 2 :- Payment to creditors for Purchases	
Particulars	Rs.
COGS	350,000.00
Closing stock	12,000.00
Less: Opening stock	(13,000.00)
Purchases	349,000.00
Add: Opening creditors	8,000.00
Less: Closing creditors	(12,000.00)
Payment to creditors	345,000.00
Note No 3 :- Payment to creditors for Expenses	
Particulars	Rs.
Overheads	55,000.00
Add: Opening	7,000.00
Less: Closing creditors	(10,000.00)
Payment for O/Ds	52,000.00
2. Cash flow from Operations by Indirect Method	
Indirect Method	Rs.
Profit After Tax	53,000.00
Add/(Less) : Depreciation	7,000.00
Loss on Asset	2,000.00
Interest paid	3,000.00
Decrease in Inventory	1,000.00
Increase in Debtors	(3,000.00)
Increase in Creditors	4,000.00
Increase in Creditors for expenses	3,000.00
Total	70,000.00

Note: Cash flow derived from operations Rs. 70,000 is same both from Direct Method and Indirect Method.

Q 6 A firm invests in a five year bond of another company with a face value of Rs. 10,00,000 by paying Rs. 5,00,000. The effective rate is 15%. The firm recognises proportionate interest income in its income statement throughout the period of bond.

Based on the above information answer the following question:

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

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

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

Q 7 X Limited has paid an advance tax amounting to Rs. 5,30,000/- during the current year. Out of the above paid tax, Rs. 30,000 is paid for tax on long term capital gains.

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

Ans: Cash flows arising from taxes on income should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities. In the case of X Limited, the tax amount of Rs. 30,000 is specifically related with investing activities. Rs. 5,00,000 to be shown under operating activities. Rs. 30,000 to be shown under investing activities.

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

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

Q 9 An entity has bank balance in foreign currency aggregating to USD 100 (equivalent to Rs. 4,500). Presuming no other transaction taking place, the entity reported a profit before tax of Rs. 100 on account of exchange gain on the bank balance in foreign currency. What would be the closing cash and cash equivalents as per the balance sheet?

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

Amount	(Rs.)
Profit before tax	100
Less: unrealised exchange gain	(100)
Cash flow from operating activities	Nil
Cash flow from investing activities	Nil
Cash flow from financing activities	Nil
Net increase in cash and cash equivalents during the year	Nil
Add: Opening balance of cash and cash equivalents	4,500
Cash and cash equivalents as at the year end	4,500

Reconciliation of cash and cash equivalents

Cash and cash equivalents as per statement of cash flows	4,500
Add: Unrealised gain on cash and cash equivalents	100
Cash and cash equivalents as per the balance sheet	4,600

Q 10: Use the following data of ABC Ltd. to construct a statement of cash flows using the direct and indirect methods:

		(Amount in Rs.)
	20X2	20X1

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Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500

Statement of profit and Loss

	20X2
Sales	2,00,000
Cost of Goods Sold	(1,23,000)
Depreciation	(15,000)
Insurance Expense	(11,000)
Wages	(50,000)
Net Profit	1,000

During the financial year 20X2 company ABC Ltd. declared and paid dividends of Rs. 2,500.

During 20X2, ABC Ltd. paid Rs. 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

Ans:

1. A. DIRECT METHOD

Cash flows from operating activities		20X2
Cash received from customers	2,07,500	
Cash paid for inventory	(1,24,000)	
Cash paid for insurance	(9,000)	
Cash paid for wages	(53,000)	
Net cash flow from operating activities		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issuance of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		(10,000)
Opening Cash Balance		14,000
Closing Cash Balance		4,000

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B. INDIRECT METHOD

Cash flows from operating activities		20X2
Net Profit	1,000	
Adjustments for Depreciation	15,000	
	16,000	
Decrease in accounts receivable	7,500	
Decrease in prepaid insurance	2,000	
Increase in inventory	(3,000)	
Increase in accounts payable	2,000	
Decrease in wages payable	(3,000)	
Net cash flow from operating activities		21,500
Cash flows from investing activities		
Purchase of fixed assets		(46,000)
Cash flows from financing activities		
Dividend paid	(2,500)	
Proceeds from issue of debentures	13,000	
Proceeds from issue of equity	4,000	
Net cash flows from financing activities		14,500
Net decrease in cash and cash equivalents		(10,000)
Opening Cash Balance		14,000
Closing Cash Balance		4,000

Working notes:

Fixed Assets Account			
Particulars	**Amount**	**Particulars**	**Amount**
To balance b/d	2,70,000	By balance c/d	3,16,000
To Cash (Purchase of Fixed Assets)	46,000		
	3,16,000		3,16,000
Inventory Account			
To balance b/d	34,000	By Cost of goods sold	1,23,000
To Creditors account (credit purchase)	2,000	By Balance c/d	37,000
To Purchase (Bal. Figure)	1,24,000		
	1,60,000		1,60,000
Accounts Payable Account			
To Balance c/d	18,000	By Balance b/d	16,000
		By Inventory Account	
		(credit purchase) (Bal. Fig.)	2,000
	18,000		18,000

Q 11: From the following summary cash account of XYZ Ltd, prepare cash flow statement for the year ended March 31, 20X1 in accordance with Ind AS 7 using direct method.

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

	Rs. '000		Rs. '000
Balance on 1.4.20X0	50	Payment to creditors	2,000

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Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from customers	2,800	Overhead Expenses	200
Sale of Fixed Assets	100	Payroll	100
		Tax Payment	250
		Dividend	50
		Repayment of Bank loan	300
		Balance on 31.3.20X1	150
	3,250		3,250

Ans: XYZ Ltd.

Cash Flow Statement for the year ended March 31, 20X1 (Using the Direct Method)

Cash flows from operating activities	Rs. '000	Rs. '000
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flow from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid		(50)
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at the beginning of the period		50
Cash at end of the period		150

Q 12 Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US $ 100,000 and US $ 102,000 respectively. The exchange rate on December 31, 2017 was US $ 1 = Rs. 45. The same on 31.12.2018 was US $ 1 = Rs. 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at Rs. 45,00,000 in the balance sheet as on December 31, 2017. It was reported at Rs. 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7?

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

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balance, the exchange difference Rs. 500,000, should be added to the opening balance in note to cash flow statement.

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

QUESTIONS FROM RTP/MTP/EXAMS

Q 13 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 Rs. 15,00,000

(b) 200,000 equity shares having face of Rs. 10 and fair value of Rs. 15 per share.

On the date of acquisition, Company B has cash and cash equivalent balance of Rs. 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 Rs. 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7. **[RTP May 2018]**

Ans: As per para 39 of Ind AS 7, the aggregate cash flows arising from obtaining control of subsidiary shall be presented separately and classified as investing activities.

As per para 42 of Ind AS 7, the aggregate amount of the cash paid or received as consideration for obtaining subsidiaries is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Further, investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

As per para 42A of Ind AS 7, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss. Such transactions are accounted for as equity transactions and accordingly, the resulting cash flows are classified in the same way as other transactions with owners.

Considering the above, for the financial year ended March 31, 20X2 total consideration of Rs. 15,00,000 less Rs. 250,000 will be shown under investing activities as " Acquisition of the subsidiary (net of cash acquired)".

There will not be any impact of issuance of equity shares as consideration in the cash flow statement however a proper disclosure shall be given elsewhere in the financial statements in a way that provides all the relevant information about the issuance of equity shares for non-cash consideration.

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Further, in the statement of cash flows for the year ended March 31, 20X3, cash consideration paid for the acquisition of additional 10% stake in Company B will be shown under financing activities.

Q 14. Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US$ 100,000 and US$ 102,000 respectively. The exchange rate on December 31, 2017 was US$1 = Rs. 45. The same on 31.12.2018 was US$1 = Rs. 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at Rs. 45,00,000 in the balance sheet as on December 31, 2017. It was reported at Rs. 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7? **[RTP May 2019]**

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

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

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INTERIM FINANCIAL REPORTING (Ind AS 34)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 Company A expects to earn Rs. 15,000 pre-tax profit each quarter and has a corporate tax slab of 20 percent on the first Rs. 20,000 of annual earnings and 40 per cent on all additional earnings. Actual earnings match expectations. Calculate the amount of income tax to be shown in each quarter.

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

Expected Total Income = 15,000 x 4 = Rs. 60,000

Expected Tax as per slabs = 20,000 x 20% + 40,000 x 40% = Rs. 20,000

Average Annual Income tax rate = 20,000/60,000 x 100 = 33.33%

	Q1	Q2	Q3	Q4
Profit before tax	15,000	15,000	15,000	15,000
Tax expense	5,000	5,000	5,000	5,000

Q 2 ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of Rs. 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

(i) Bad debts of Rs. 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Extraordinary loss of Rs. 3,00,000 incurred during the quarter has been fully recognised in this quarter.

(iii) Additional depreciation of Rs. 4,50,000 resulting from the change in the method of depreciation.

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

Ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors. **[Nov 2018]**

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

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

Bad debts of Rs. 1,00,000 have been incurred during current quarter. Out of this, the company has deferred 50% (i.e.) Rs. 50,000 to the next quarter. This treatment is not correct as the expenses incurred during an interim reporting period should be recognised in the same period

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unless conditions mentioned in paragraph 39 of Ind AS 34 are fulfilled. Accordingly, Rs. 50,000 should be deducted from Rs. 20,00,000.

The treatment of extra-ordinary loss of Rs. 3,00,000 being recognised in the same quarter is correct. Recognising additional depreciation of Rs. 4,50,000 in the same quarter is correct and is in tune with Ind AS 34.

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

(i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

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

Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be Rs. 14,50,000 (Rs. 20,00,000 - Rs. 5,00,000 - Rs. 50,000).

Q 3: How the following should is recognized and measure in the interim financial statements:

(i) Gratuity and other defined benefit schemes :

(ii) Yearend bonus

(iii) Income-tax expense

(iv) Provisions

(v) Foreign currency translation gains and losses.

Ans:

(i) Calculated on a year to date basis by using actuarially determined rates at the end of the prior financial year, adjusting for significant events since that time.

(ii) Anticipate only, if there is a legal or other obligation and a reliable estimate can be made.

(iii) Apply estimated average annual effective income-tax rate to the pre-tax income of the interim period.

(iv) Same criteria as is used for yearend estimates.

(v) Apply same principles as are applied at year end.

Q 4: Sincere Corporation is dealing in seasonal product sales pattern of the product, quarter wise is as follows:

1st quarter	30th June	10%
2nd quarter	30th September	10%
3rd quarter	31st December	60%
4th quarter	31st March	20%

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Information regarding the 1st quarter ending on 30th June, 2006 is as follows:

Sales 80 crores

Salary and other expenses 60 crores

Advertisement expenses (routine) 4 crores

Administrative and selling expenses 8 crores

While preparing interim financial report for first quarter Sincere Corporation wants to defer Rs. 10 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and the expenditures are uniform throughout all quarters, calculate the result of the first quarter as per IND AS-34. Also give a comment on the company's view.

Ans:

Particulars	(Rs. In crores)
Result of first quarter ending 30th June, 2006	
Turnover	80
Other Income	Nil
Total (a)	80
Less: Changes in inventories	Nil
Salaries and other cost	60
Administrative and selling Expenses (4+8)	12
Total (b)	72
Profit (a)-(b)	8

According to IND AS-34 the Income and Expense should be recognized when they are earned and incurred respectively. Therefore seasonal incomes will be recognized when they occur. Thus the company's view is not as per IND AS 34.

As per IND AS 34, the costs should be anticipated or deferred only when

(i) it is appropriate to anticipate that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an enterprise.

Therefore, the argument given by I-Corp relating to deferment of Rs. 10 crores is not tenable as expenditures are uniform throughout all quarters.

Q 5: ABC India Ltd. has Rs. 1,02,000 net income for the quarter ended 31st December, 2003 including the following items:-

(a) Rs. 60,000 extraordinary gain received on July 30 2003, was allocated equally to the second, third and fourth quarter of financial year 2003-2004.

(b) Rs. 16,000 cumulative effect loss resulting from change in method of inventory valuation method was recognized on November 2, 2003. Out of this loss Rs. 10,000 relates to the previous quarters.

Compute the profit as per IND AS 34 for the quarter ended 31st December, 2003 of ABC India Ltd.

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Ans: ABC India Ltd.

Statement showing computation of the correct amount of profit attributable for the quarter

	Amount (Rs.)
Net income for the quarter as shown by the company	1,02,000
Extra ordinary gains should be recognized in the quarter in which it is accrued.	
Hence, allocation of Rs. 20,000 for current quarter should be adjusted	(20,000)
Effect of change in the method of inventory valuation pertaining to	
earlier period, to be adjusted	10,000
Net profit for the period	92,000

Q 6: The accounting year of X Ltd. ends on 30th September, 2006 and it makes its reports quarterly. However for the purpose of tax, year ends on 31st March every year. For the Accounting year beginning on 1-10-2005 and ends on 30-9-2006, the quarterly income is as under:-

1st quarter ending on 31-12-2005 Rs. 200 crores

2nd quarter ending on 31-3-2006 Rs. 200 crores

3rd quarter ending on 30-6-2006 Rs. 200 crores

4th quarter ending on 30-9-2006 Rs. 200 crores

Total Rs. 800 crores

Average actual tax rate for the financial year ending on 31-3-2006 is 20% and for financial year ending 31-3-2007 is 30%. Calculate tax expense for each quarter.

Ans: Calculation of tax expense

1st quarter ending on 31-12-2005	200×20%	Rs. 40 lakhs
2nd quarter ending on 31-3-2006	200×20%	Rs. 40 lakhs
3rd quarter ending on 30-6-2006	200×30%	Rs. 60 lakhs
4th quarter ending on 30-9-2006	200×30%	Rs. 60 lakhs

Q 7: Kaveri Ltd. shows the net profit of Rs. 5,40,000 for quarter III after incorporating the following:

(i) Bad debt of Rs. 30,000 incurred during the quarter. 50% of the bad debts have been deferred to next quarter.

(ii) Extraordinary loss of Rs. 28,000 incurred during the quarter has been fully recognized in this quarter.

(iii) Additional depreciation of Rs. 36,000 of third quarter, resulting from the change of method of depreciation.

Do you agree with the treatment adopted by the company? If not, find out correct quarterly income as per IND AS 34?

Ans: In the above case, the quarterly income has not been correctly stated. As per IND AS 34, the quarterly income should be adjusted and restated as follows:

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(i) Bad debt of Rs. 30,000 have been incurred during the current quarter. Out of this, the company has deferred 50% i.e., Rs. 15,000 to next quarter. This is not correct. Rs. 15,000 therefore, should be deducted from Rs. 5,40,000.

(ii) The treatment of extraordinary loss of Rs. 28,000 being recognized in the same quarter and recognizing the additional depreciation of Rs. 36,000 in the same quarter is correct and in tune with IND AS 34. So, no adjustment required for these two items.

The company should report the quarterly income as Rs. 5,25,000 (i.e., Rs. 5,40,000 – Rs. 15,000).

Q 8: In view of the provisions of IND AS 34 on interim Financial Reporting, on what basis will you calculate, for an interim period, the provision in respect of defined benefit schemes like pension, gratuity etc. for the employees ?

Ans: IND AS 34 suggests that provision in respect of defined benefit schemes like pension and gratuity for an interim period should be calculated based on the year-to date basis by using the actuarially determined rates at the end of the prior financial year, adjusted for significant market fluctuations since that time and for significant curtailments, settlements or other significant one-time events.

Q 9: On 30.6.2007, Asmitha Ltd. incurred Rs. 2,00,000, net loss from disposal of a business segment. Also, on 30.7.2007, the company paid Rs. 60,000 for property taxes assessed for the calendar year 2007. How the above transactions should be included in determination of net income of Asmitha Ltd. for the six months interim period ended on 30.9.2007. **[Nov 2008]**

Ans: According to IND AS 34 "Interim Financial Reporting", If an enterprise prepares and presents a complete set of financial statements in its interim financial report, the form and content of those statements should conform to the requirements as applicable to annual complete set of financial statements. As on 30.9.2007, Asmitha Ltd., would report the entire Rs. 2,00,000 loss on the disposal of its business segment since the loss was incurred during interim period. A cost charged as an expense in an annual period should be allocated to Interim periods on accrual basis. Since Rs.60,000 Property Tax payment relates to entire calendar year 2007, Rs.30,000 would be reported as an expense for six months ended on 30th September, 2007 while remaining Rs.30,000 would be reported as prepaid expenses.

Q 10: An enterprise reports quarterly, estimates an annual income of Rs. 10 lakhs. Assume tax rates on 1st Rs. 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are Rs. 75,000, Rs. 2,50,000, Rs. 3,75,000 and Rs. 3,00,000. Calculate the tax expense to be recognized in each quarter.

Ans: As per IND AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Estimated Annual Income	Rs.10,00,000
Tax expense:	
30% on Rs. 5,00,000	Rs. 1,50,000
40% on remaining Rs. 5,00,000	Rs.2,00,000
	Rs.3,50,000
Weighted average annual income tax rate = 3,50,000/10,00,000 =	35%

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Tax expense to be recognised in each of the quarterly reports	
Quarter I - Rs. 75,000 x 35%	Rs. 26,250
Quarter II - Rs. 2,50,000 x 35%	Rs. 87,500
Quarter III - Rs. 3,75,000 x 35%	Rs. 1,31,250
Quarter IV - Rs. 3,00,000 x 35%	Rs. 1,05,000
	Rs. 3,50,000

Q 11: Antarbarti Limited reported a Profit Before Tax (PBT) of Rs. 4 lakhs for the third quarter ending 30-09-2011. On enquiry you observe the following, give the treatment required under IND AS 34:

(i) Dividend income of Rs. 4 lakhs received during the quarter has been recognized to the extent of Rs. 1 lakh only.

(ii) 80% of sales promotion expenses Rs. 15 lakhs incurred in the third quarter has been deferred to the fourth quarter as the sales in the last quarter is high.

(iii) In the third quarter, the company changed depreciation method from WDV to SLM, which resulted in excess depreciation of Rs. 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only Rs. 3 lakhs.

(iv) Rs. 2 lakhs extra-ordinary gain received in third quarter was allocated equally to the third and fourth quarter.

(v) Cumulative loss resulting from change in method of inventory valuation was recognized in the third quarter of Rs. 3 lakhs. Out of this loss Rs. 1 lakh relates to previous quarters.

(vi) Sale of investment in the first quarter resulted in a gain of Rs. 20 lakhs. The company had apportioned this equally to the four quarters.

Prepare the adjusted profit before tax for the third quarter.

Ans: As per IND AS 34 "Interim Financial Reporting", seasonal or occasional revenue and cost within a financial year should not be deferred as of interim date untill it is appropriate to defer at the end of the enterprise's financial year. Therefore dividend income, extra-ordinary gain, and gain on sale of investment received during 3rd quarter should be recognised in the 3rd quarter only. Similarly, sales promotion expenses incurred in the 3rd quarter should also be charged in the 3rd quarter only.

Further, as per the standard, if there is change in the accounting policy within the current financial year, then such a change should be applied retrospectively by restating the financial statements of prior interim periods of the current financial year. The change in the method of depreciation or inventory valuation is a change in the accounting policy.

Therefore, the prior interim periods' financial statements should be restated by applying the change in the method of valuation retrospectively. Accordingly, the adjusted profit before tax for the 3rd quarter will be as follows: Statement showing Adjusted Profit Before Tax for the third quarter

	(Rs. in lakhs)
Profit before tax (as reported)	4
Add: Dividend income RRs. (4-1) lakhs	3
Add: Extra ordinary gain R Rs. (2-1) lakhs	1

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Add: Cumulative loss due to change in the method of inventory valuation	
should be applied retrospectively Rs. (3-2) lakhs	1
Less: Sales promotion expenses (80% of Rs. 15 lakhs)	(12)
Less: Gain on sale of investment (occasional gain should not be deferred)	(5)
Adjusted Profit before tax for the third quarter	(8)

Q 12: To comply with listing requirements and other statutory obligations Quaker Ltd. prepares interim financial reports at the end of each quarter. The company has brought forward losses of Rs. 700 lakhs under Income Tax Law, of which 90% is eligible for set off as per the recent verdict of the Court, that has attained finality. No Deferred Tax Asset has been recognized on such losses in view of the uncertainty over its eligibility for set off. The company has reported quarterly earnings of Rs. 700 lakhs and Rs. 300 lakhs respectively for the first two quarters of Financial year 2013-14 and ·anticipates a net earning of Rs. 800 lakhs in the coming half year ended March 2014 of which Rs. 100 lakhs will be the loss in the quarter ended Dec. 2013. The tax rate for the company is 30% with a 10% surcharge.

You are required to calculate the amount of Tax Expense to be reported for each quarter of financial year 2013-14.

Ans: Estimated tax liability on annual income

= [Income Rs.1,800 lakhs less b/f losses Rs. 630 lakhs (90% of 700)] x 33%

= 33% of Rs. 1,170 lakhs = Rs. 386.10 lakhs

As per IND AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Thus, estimated weighted average annual income tax rate = Rs. 386.10 lakhs divided by Rs. 1,800 lakhs=21.45%

Tax expense to be recognised in each quarter

		Rs. in lakhs
Quarter I -	Rs. 700 lakhs x 21.45%	150.15
Quarter II -	Rs. 300 lakhs x 21.45%	64.35
Quarter III -	(Rs. 100 lakhs) x 21.45%	(21.45)
Quarter IV -	Rs. 900 lakhs x 21.45%	193.05

Q 13:

Estimated annual income Rs. 1 lakh

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

Assumed Tax Rates:

On Capital Gains	10%
On other income:	
First Rs. 40,000	30%
Balance income	40%

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Assuming there is no difference between the estimated taxable income and the estimated accounting income, calculate tax expense and weighted average annual effective tax rate. Also, calculate tax expense for each quarter, when the estimated income of each quarter is Rs. 25,000 and income for 2nd quarter of Rs. 25,000 includes capital gain of Rs. 20,000.

Ans:

Tax Expense:	
On Capital Gains portion of annual income:	
10% of Rs. 20,000	Rs. 2,000
On other income: 30% of Rs. 40,000 + 40% of Rs.40,000	Rs.28,000
Total:	Rs.30,000
Weighted Average Annual Effective Tax Rate:	
On Capital Gains portion of annual income: 2000/20000 x 100 =	10%
On other income: 28,000/80,000 x 100 =	35%

The estimated income of each quarter is Rs.25,000, when income of Rs.25,000 for 2nd Quarter includes capital gains of Rs.20,000, the tax expense for each quarter will be calculated as below:

	Income	Tax Expense
Quarter I:	Rs. 25,000	35% of Rs. 25,000 = Rs. 8,750
Quarter II:	Capital Gains: Rs. 20,000	10% of Rs. 20,000 = Rs. 2,000
	Other: Rs. 5,000	35% of Rs. 5,000 = Rs. 1,750
Quarter III:	Rs. 25,000	35% of Rs. 25,000 = Rs. 8,750
Quarter IV:	Rs. 25,000	35% of Rs. 25,000 = Rs. 8,750
Total tax expense for the year		Rs. 30,000

Q 14: On 30-6-2011, X Limited incurred Rs. 3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid Rs. 80,000 for property taxes assessed for the calendar year 2011. How should the above transactions be included in determination of net income of X Limited for the six months interim period ended on 30-9-2011?

Ans: IND AS 34 “Interim Financial Reporting” states that revenues and gains should be recognised in interim reports on the same basis as used in annual reports. As at September 30, 2011, X Ltd. would report the entire Rs. 3,00,000 loss on the disposal of its business segment since the loss was incurred during the interim period.

A cost charged as an expense in an annual period should be allocated among the interim periods, which are clearly benefited from the expense, through the use of accruals and/or deferrals. Since Rs. 80,000 property tax payment relates to the entire 2011 calendar year, only Rs. 40,000 of the payment would be reported as an expense at September 30, 2011, while out of the remaining Rs. 40,000, Rs. 20,000 for Jan. 2011 to March, 2011 would be shown as payment of the outstanding amount of previous year and another Rs. 20,000 related to quarter October, 2011 to December, 2011, would be reported as a prepaid expense.

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Accounting Policies, Changes in Accounting Estimates and Errors (IND AS 8)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1

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

Answer:

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

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

(a) this fact; and

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

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

Question 2

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

i. Shall entity do such valuation retrospectively or prospectively?

ii. What is meant by retrospective application?

iii. If it is to be applied as if it was applied from July 2005, then what about the accounts already presented? Does entity need to change all the accounts?

iv. How would the effect be given?

Answer:

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

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

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

(iv) Ind AS 8 states that the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented.

Question 3

Continuing the above question, assume that company might be following the weighted average method of valuation of stock right from July 2X05. In reality, company might have applied other methods like specific identification, LIFO or FIFO etc. Company might have changed also the method during the period as it was not following any specific standard at that time. However, now, in F.Y. 2X16-2X17, the company decided to follow Ind AS and accordingly decides the weighted average method of valuation. Analyse

Answer: The company needs to calculate the closing inventory of every year since 2X05-2X06 assuming that it was following the said method from day 1.

This will change the figure of gross profit and net profit as inventory valuation will make direct impact on the profits of the company. Net profits will affect the equity as well. Similarly, the closing balances of inventory from year to year will also change. Thus, company will make the calculations from the year 2X05-2X06 to 2X15-2X16.

The provisions further state that company will adjust the opening balances of equity and other related amounts for the earliest prior period presented. It means, if company is presenting the accounts for F.Y. 2X16-2X17, it need to give comparative figures for F.Y. 2X15-2X16 also.

Therefore, the earliest prior period presented will be F.Y. 2X15-2X16 in the above mentioned case. Thus the net effect on profit of last 11 years (from F.Y. 2X05-2X06 to F.Y. 2X15-2X16) will be adjusted through the equity and inventory balances of the year 2X15-2X16.

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

Question 4

1. During 20X2, Beta Ltd. discovered that some products that had been sold during 20X1 were incorrectly included in inventory at March 31, 20X1 at Rs.6,500.

2 Beta's accounting records for 20X2 show sales of Rs. 1,04,000, cost of goods sold of Rs.86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.

3. In 20X1, Beta Ltd. reported:

• Sales of Rs. 73,500

• Cost of goods sold of Rs. 53,500

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• Profit before income taxes of Rs. 20,000

• Income taxes of Rs. 6,000

• Profit of Rs. 14,000

4. 20X1 opening retained earnings was Rs. 20,000 and closing retained earnings was Rs. 34,000.

5. Beta's income tax rate was 30 per cent for 20X2 and 20X1. It had no other income or expenses.

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

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

Solution: Beta Ltd.

Extract from the statement of profit and loss (Amount in Rs.)

	20X2	Restated 20X1
Sales	104,000	73,500
Cost of goods sold	(80,000)	(60,000)
Profit before income taxes	24,000	13,500
Income taxes	(7,200)	(4,050)
Profit	16,800	9,450

Beta Ltd.

Statement of changes in equity **(Amount in Rs.)**

	Share Capital	Retained Earnings	Total
Balance as at March 31, 20X0	5,000	20,000	25,000
Profit for the year ended March 31, 20X1, as restated		9,450	9,450
Balance as at March 31, 20X1	5,000	29,450	34,450
Profit for the year ended March 31, 20X2		16,800	16,800
Balance as at March 31, 20X2	5,000	46,250	51,250

Extract from the notes:

Some products that had been sold in 20X0-20X1 were incorrectly included in inventory at March 31, 20X1 at Rs. 6,500. The financial statements of March 31, 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is as summarised above. There is no effect in March 31, 20X2.

Question 5

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During 20X2, Delta Co. changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.

In years before 20X2, Delta's asset records were not sufficiently detailed to apply a components approach fully. At the end of 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did no permit this information to be reconstructed.

Delta's management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply Delta's new policy prospectively from the start of 20X2.

Additional information:

(i) Delta's tax rate is 30 per cent

(ii) Particulars Property, plant and equipment at the end of 20X1:

Cost	Rs. 25,000
Depreciation	Rs. 14,000
Net book value	Rs.11,000

(iii) Prospective depreciation expense for 20X2 (old basis) Rs.1,500

(iv) Some results of the engineering survey:

Valuation	Rs. 17,000
Estimated residual value	Rs. 3,000
Average remaining asset life	7 years

Depreciation expense on existing property, plant and equipment for 20X2 (new basis) Rs. 2,000

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

Answer:

Extract from the notes

From the start of 20X2, Delta Co. changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either

retrospectively, or prospectively from any earlier date. Accordingly, the adoption of the new policy has no effect on prior years.

The effect on the current year is to

- increase the carrying amount of property, plant and equipment at the start of the year by Rs. 6,000;
- increase the opening deferred tax provision by Rs. 1,800;
- create a revaluation surplus at the start of the year of Rs. 4,200;
- increase depreciation expense by Rs.500; and
- reduce tax expense by Rs. 150.

QUESTIONS FROM RTP/MTP/EXAMS

Question 6

ABC changed its accounting policy for inventory in 2016-2017. Prior to the change, inventory had been valued using the first in first out method (FIFO) . However, it was felt that in order to match current practice and to make the financial statements more relevant and reliable a weighted average valuation model should be used.

The effect of the change on the valuation of inventory was as follows:

- 31st March, 2015 - Increase of Rs. 10 million
- 31st March, 2016 - Increase of Rs. 15 million
- 31st March, 2017- Increase of Rs. 20 million

Profit or loss under the FIFO valuation model are as follows: Rs. in million

	2016-2017	**2015-2016**
Revenue	324	296
Cost of sales	(173)	(164)
Gross profit	151	132
Expenses	(83)	(74)
Profit	68	58

Retained earnings at 31st March, 2015 were Rs. 423 million.

Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8.**[RTP may 2019]**

Answer:

Profit or loss under weighted average valuation are as follows: Rs. in million

	2017	**2016 (Restated)**
Revenue	324	296
Cost of sales	(168)	(159)
Gross profit	**156**	**137**
Expenses	(83)	(74)

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Profit	**73**	**63**

Statement of changes in equity (extract) Rs. in million

	Retained earnings	Retained earnings (Original)
At 1st April, 2015	423	423
Change in inventory valuation policy	10	-
At 1st April, 2015 (Restated)	433	-
Profit for 2015-2016	63	58
At 31st March, 2016	496	481
Profit for 2016-2017	73	68
At 31st March, 2017	569	549

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Operating Segments (Ind AS 108)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1 ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages products B & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by the CODM. Identify reportable segments of ABC Ltd.

Ans: In this situation both the healthcare, and food and grocery product line meet the criteria for operating segments set out above. Therefore, it is likely that ABC Ltd.'s operating segments would be classified as being (i) healthcare and (ii) food and grocery segments.

Q 2 X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per the geographical location of the company. The CODM regularly reviews the operating results of both sets of components. How should X Ltd. identify its operating segments?

Ans: In this situation, both the geographical sales areas and product areas may meet the criteria for operating segment. However, in such situation, it is more difficult to determine clearly which set of components should be identified as the entity's operating segments. In such situation the entity should determine which set of components constitutes the operating segments by reference to the core principle. The core principle is that the entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The entity should also assess whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources. Therefore, X Ltd. should consider all the above factors and apply judgement to determine which component should be disclosed as operating segment.

Q 3 X Ltd. is engaged in the business of manufacturing and selling papers. Varieties of paper like adhesive paper, anti-rust paper, antique paper, art paper etc., are manufactured and sold by X Ltd. Should X Ltd. classify these papers into different segments?

Ans: Two or more operating segments may be aggregated into a single operating segment if the segments have similar economic characteristics, and the segments are similar with respect to various factors like nature of the product and production process, type of customers, method of distribution and regulatory requirement.

In case of X Ltd., so far as varieties of paper concerned, if all factors such as nature of the product and production process, type of customers, method of distribution and regulatory

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requirement are common, there is no need to create different segments for each type of paper.

Q 4 M/s XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are Rs. 10.00 crs. Segment X has Rs. 2.00 crs., segment Y has Rs. 3.00 crs. and segment Z has Rs. 5.00 crs. Deferred tax assets included in the assets of each segments are X – Rs. 0.50 crs., Y–Rs. 0.40 crs. and Z–Rs. 0.30 crs. The accountant contends that all the three segments are reportable segments. Comment.

Ans: According to IND AS 108 "Operating Segment", segment assets do not include income tax assets. Therefore, the revised total assets are 8.8 crores [10 crores – (0.5+0.4+0.3)]. Segment X holds total assets of 1.5 crores (2 crores – 0.5 crores); Segment Y holds 2.6 crores (3 crores – 0.4 crores); and Segment Z holds 4.7 crores (5 crores – 0.3 crores). Thus all the three segments hold more than 10% of the total assets, all segments are reportable segments.

Q 5 X Ltd. has identified the following business components.

Segment	Revenue (Rs.)		Profit (Rs.)	Assets (Rs.)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000
FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Others	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in Ind AS108?

Ans: Quantitative thresholds are calculated below:

Segments	Pharma	FMCG	Ayurveda	Others
% segment sales to total sales	63.40	2.61	1.96	32.03
% segment profit to total profits	66.67	8.33	6.67	18.33
% segment assets to total assets	61.11	27.78	4.44	6.67

Segment Pharma would separately reportable since they meet all three size criteria, though any one criteria is required. FMCG segment does not satisfy the revenue and profit test but does satisfy the asset test. So it would be separately reportable. Ayurveda segment does not meet any threshold. It may not be classified as reportable segment.

An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.

If the total external revenue reported by operating segments constitutes less than 75% of the entity's revenue, additional operating segments should be identified as reportable segments (even if they do not meet the criteria) until at least 75% of the entity's revenue is included in reportable segments.

Q 6 X Ltd. has identified 4 operating segments for which revenue data is given below:

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	External Sale (Rs.)	Internal Sale (Rs.)	Total (Rs.)
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
Total Sales	50,00,000	50,00,000	1,00,00,000

Additional information:

Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108?

Ans: Threshold amount is Rs. 10,00,000 (Rs. 1,00,00,000 × 10%).

Segment A exceeds the quantitative threshold (Rs. 30,00,000>Rs. 10,00,000) and hence reportable segment.

Segment D exceeds the quantitative threshold (Rs. 54,00,000>Rs. 10,00,000) and hence reportable segment.

Segment B & C do not meet the quantitative threshold amount and may not be classified as reportable segment.

However, the total external revenue generated by these two segments A & D represent only 70% (Rs. 35,000/50,000 x 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

In case of X Ltd., it is given that Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, X Ltd. designates this start-up segment C as a reportable segment, making the total external revenue attributable to reportable segments 87% (Rs. 43,50,000/ 50,00,000 x 100) of total entity revenues.

Q 7 X Ltd. is operating in coating industry. Its business segment comprises coating and others consisting of chemicals, polymers and related activities. Certain information for financial year 20X1-20X2 is given below: (Rs. in lakhs)

Segments	External sale	Tax	Other operating income	Result	Asset	Liabilities
Coating	2,00,000	5,000	40,000	10,000	50,000	30,000
Others	70,000	3,000	15,000	4,000	30,000	10,000

Additional information:

1. Unallocated revenue net of expenses is Rs. 30,00,00,000
2. Interest and bank charges is Rs. 20,00,00,000
3. Income tax expenses is Rs. 20,00,00,000 (current tax Rs. 19,50,00,000 and deferred tax Rs. 50,00,000)

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4. Investments Rs. 1,00,00,00,000 and unallocated assets Rs. 1,00,00,00,000.
5. Unallocated liabilities, Reserve & surplus and share capital are Rs. 2,00,00,00,000, Rs. 3,00,00,00,000 &Rs. 1,00,00,00,000 respectively.
6. Depreciation amounts for coating & others are Rs. 10,00,00,000 and Rs. 3,00,00,000 respectively.
7. Capital expenditure for coating and others are Rs. 50,00,00,000 and Rs. 20,00,00,000 respectively.
8. Revenue from outside India is Rs. 3,00,00,00,000 and segment asset outside India Rs. 1,00,00,00,000.

Based on the above information, how X Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 20X1-20X2?

[May 2018]

Ans: Segment information

(A) Information about operating segment

(1) the company's operating segments comprise :

Coatings: consisting of decorative, automotive, industrial paints and related activities.
Others: consisting of chemicals, polymers and related activities.

(2) Segment revenues, results and other information.

(Rs. in Lakhs)

	Revenue	Coating	Others	Total
1	**External sales (gross)**	2,00,000	70,000	2,70,000
	Tax	(5,000)	(3,000)	(8,000)
	External sales (net)	1,95,000	67,000	2,62,000
	Other operating income	40,000	15,000	55,000
	Total Revenue	2,35,000	82,000	3,17,000
2	**Results**			
	Segment results	10,000	4,000	14,000
	Unallocated income (net of unallocated expenses)			3,000
	Profit from operation before			17,000
	interest, taxation and exceptional items			
	Interest and bank charges			2,000
	Profit before exceptional items			15,000
	Exceptional items			Nil
	Profit before taxation			15,000
	Income Taxes -Current taxes -Deferred taxes			 1,950 50
	Profit after taxation			13,000
3	Other Information			

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(a)	**Assets**			
	Segment Assets	50,000	30,000	80,000
	Investments			10,000
	Unallocated assets			10,000
	Total Assets			**1,00,000**
(b)	**Liabilities/Shareholder's funds**			
	Segment liabilities	30,000	10,000	40,000
	Unallocated liabilities			20,000
	Share capital			10,000
	Reserves and surplus			30,000
	Total liabilities/shareholder's funds			**1,00,000**
(c)	**Others**			
	Capital Expenditure		5,000	2,000
	Depreciation		1,000	300
	Geographical Information			
		India (Rs.)	**Outside India (Rs.)**	**Total (Rs.)**
	Revenue	2,87,000	30,000	3,17,000
	Segment assets	70,000	10,000	80,000
	Capital expenditure	7,000		7,000

Notes:

(i) The operating segments have been identified in line with the Ind AS 108, taking into account the nature of product, organisation structure, economic environment and internal reporting system.

(ii) Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments. Unallocable assets include unallocable fixed assets and other current assets. Unallocable liabilities include unallocable current liabilities and net deferred tax liability.

(iii) Corresponding figures for previous year have not been provided. However, in practical scenario the corresponding figures would need to be given.

QUESTIONS FROM RTP/MTP/EXAMS

Q 8 An entity uses the weighted average cost formula to assign costs to inventories and cost of goods sold for financial reporting purposes, but the reports provided to the chief operating decision maker use the First-In, First-Out (FIFO) method for evaluating the performance of segment operations. Which cost formula should be used for Ind AS 108 disclosure purposes? **[RTP May 2019]**

Ans: The entity should use First-In, First-Out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108.

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However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

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Non-current Assets Held for Sale and Discontinued Operations (Ind AS 105)

QUESTIONS FROM ICAI STUDY MATERIAL

Question 1

An item of property, plant and equipment that is measured on the cost basis should be measured in accordance with Ind AS 16.

Entity ABC owns an item of property and it was stated at the following amounts in its last financial statements:

31st December, 20X1	Rs.
Cost	12,00,000
Depreciation	(6,00,000)
Net book value	6,00,000

The asset is depreciated at an annual rate of 10% ie. Rs. 1,20,000 p.a.

During July, 20X2, entity ABC decides to sell the asset and on 1st August it meets the conditions to be classified as held for sale. Analyse.

Answer:

At 31st July, entity ABC should ensure that the asset is measured in accordance with Ind AS 16. It should be depreciated by further Rs. 70,000 (Rs.1,20,000 x 7/12) and should be carried at Rs. 5,30,000 before it is measured in accordance with Ind AS 105.

Note: From the date the asset is classified as held for sale no further depreciation will be charged.

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Question 2:

S Ltd purchased a property for Rs. 6,00,000 on 1 April 20X1. The useful life of the property is 15 years. On 31 March 20X3 S ltd classify the property as held for sale. The impairment testing provides the estimated recoverable amount of Rs. 4,70,000.

The fair value less cost to sell on 31 March 20X3 was Rs. 4,60,000. On 31 March 20X4 management change the plan as property no longer met the criteria of held for sale. The recoverable amount as at 31 March 20X4 is Rs. 5,00,000.

Value the property at the end of 20X3 and 20X4.

Answer:

(a) Value of property immediately before the classification as held for sale as per Ind AS 16 as on 31 March 20X3 Rs.

Purchase Price	6,00,000

Less: Accumulated Depreciation (for two years)	80,000
Less: Impairment loss (5,20,000-4,70,000)	50,000
Carrying Amount	4,70,000

On initial classification as held for sale on 31 March 20X3, the value will be lower of:

Carrying amount	Rs. 4,70,000
Fair Value less Cost to sell	Rs. 4,60,000

On 31 March 20X3 Non-current classified as held for sale will be recorded at Rs. 4,60,000.

Depreciation of Rs. 40,000 and Impairment Loss of Rs. 60,000 (50,000 +10,000) is charged in profit or loss for the year ended 31 March 20X3.

(b) On 31 March 20X4 held for sale property is reclassified as criteria doesn't met. The value will be lower of:

Carrying amount had the asset is not classified as held for sale		
Carrying amount immediately before classification		
on 31 March 20X3	Rs. 4,70,000	
Less Depreciation based on 13 years balance life	Rs. 36,154	Rs. 4,33,846
Recoverable Amount		Rs. 5,00,000

Property will be valued at Rs. 4,33,846 on 31 March 20X4

Adjustment to the carrying amount of Rs. 26,154 (Rs. 4,60,000 - 4,33,846) is charged to the profit or loss.

Question 3:

Sun Ltd is a retailer of takeaway food like burger and pizzas. It decides to sell one of its outlets located in chandni chowk in New Delhi. The company will continue to run 200 other outlets in New Delhi.

All Ind AS 105 criteria for held for sale classification were first met at 1st October 20X1. The outlet will be sold in June 20X2.

Management believes that outlet is a discontinued operation and wants to present the results of outlet as 'discontinued operations'. Analysis

Answer: The chandni chowk outlet is a disposal group; it is not a discontinued operation as it is only one outlet. It is not a major line of business or geographical area, nor a subsidiary acquired with a view to resale.

Question 4

On November 30, 20X1, Entity X becomes committed to a plan to sell a property. However, it plans certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.

Can the property be classified as held for sale at the reporting date i.e. December 31, 20X1?

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Answer: The property cannot be classified as held for sale at the balance sheet date as it is not available for sale immediately in its present condition. Although the renovations are expected to be completed within a short span 2 months, this fact is not relevant for classification.

However, if the PPE meets the criteria for held for sale by January 31, 20X2 (i.e., 2 months from November 30, 20X1) and the accounts are not authorised by that date, then necessary disclosures need to be given in the financial statements.

Question 5

On March 1, 20X1, entity R decides to sell one of its factories. An agent is appointed and the factory is actively marketed. As on March 31, 20X1, it is expected that the factory will be sold by February 28, 20X2. However, in May 20X1, the market price of the factory deteriorated. Entity R believed that the market will recover and thus did not reduce the price of the factory. The company's accounts are authorised for issue on June 26, 20X1. Should the factory be shown as held for sale as on March 31, 20X1?

Answer: In this example, the factory ceases to meet the definition of held for sale post the balance sheet date but before the financial statements are authorised for issue, as it is not actively marketed at a reasonable price. But, since the market conditions deteriorated post the balance sheet date, the asset will be classified as held for sale as at March 31, 20X1.

Question 6

On June 1, 20X1, entity X plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 20X1, the Board of Directors approves and becomes committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity Y. However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 20X1 and the sale is expected to be completed by March 31, 20X2. Entity X follows December year end. The assets and liabilities attributable to this manufacturing unit are as under:

(Amount in Rs.)

Particulars	Carrying value as on December 31, 20X0	Carrying value as on July 31, 20X1
Goodwill	500	500
Plant and Machinery	1,000	900
Building	2,000	1,850
Debtors	850	1,050
Inventory	700	400
Creditors	(300)	(250)
Loans	(2,000)	(1,850)
	2,750	2,600

The fair value of the manufacturing unit as on December 31, 20X0 is Rs. 2,000 and as on July 31, 20X1 is Rs. 1,850. The cost to sell is 100 on both these dates. The disposal group is not sold at the period end i.e., December 31, 20X1. The fair value as on December 31, 20X1 is lower than the carrying value of the disposal group as on that date.

Required:

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1. Assess whether the manufacturing unit can be classified as held for sale and reasons there for. If yes, then at which date?
2. The measurement of the manufacturing unit as on the date of classification as held for sale.
3. The measurement of the manufacturing unit as at the end of the year.

Answer:

Assessing whether the manufacturing unit can be classified as held for sale

The manufacturing unit can be classified as held for sale due to the following reasons:

(a) The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group must be classified as held for sale is July 31, 20X1, i.e., the date at which management becomes committed to the plan.

(b) The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(c) A firm purchase agreement has been entered with the buyer.

(d) The sale is expected to be complete by March 31, 20X2, i.e., within one year from the date of classification.

Measurement of the manufacturing unit as on the date of classification as held for sale

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

This has been done and the carrying value of the disposal group as on July 31, 20X1 is determined at Rs. 2,600. The difference between the carrying value as on December 31, 20X0 and July 31, 20X1 is accounted for as per the relevant Ind AS i.e., (Ind AS 2 for inventory and Ind AS 39 for debtors, creditors and loans).

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The fair value less cost to sell of the disposal group as on July 31, 20X1 is Rs. 1,750 (i.e.1,850-100). This is lower than the carrying value of Rs. 2,600. Thus an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value. Thus, the assets will be measured as under:

Particulars	Carrying value – July 31, 20X1	Impairment	Carrying value as per Ind AS 105 – 31 July 31, 20X1
Goodwill	500	(500)	-
Plant and Machinery	900	(115)	785
Building	1,850	(235)	1,615
Debtors	1,050	-	1,050
Inventory	400	-	400

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Creditors Loans	(250) (1,850) 2,600	- - (850)	(250) (1,850) 1,750

Measurement of the manufacturing unit as on the date of classification as at the year end

The measurement as at the year-end shall be on similar lines as done above.

The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective Standards.

The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost to sell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale. It is provided that the fair value as on the year end is less than the carrying amount as on that date – thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.

QUESTIONS FROM RTP/MTP/EXAMS

Question 7

Following is the extract of the consolidated financial statements of A Ltd. for the year ended on:

Asset/(liability)	Carry amount as on 31st March, 20X1 (In Rs. '000)
Attributed goodwill	200
Intangible assets	950
Financial asset measured at fair value through other comprehensive income	300
Property, plant & equipment	1100
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	600
Current liabilities	(850)
Non-current liabilities – provisions	(300)
Total	2,250

On 15th September 20X1, Entity A decided to sell the business. It noted that the business meets the condition of disposal group classified as held for sale on that date in accordance with Ind AS 105. However, it does not meet the conditions to be classified as discontinued operations in accordance with that standard.

The disposal group is stated at the following amounts immediately prior to reclassification as held for sale.

Asset/ (liability)	Carry amount as on 15th September 20X1 (In Rs. '000)
Attributed goodwill	200
Intangible assets	930
Financial asset measured at fair value through other comprehensive income	360

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Property, plant & equipment	1,020
Deferred tax asset	250
Current assets – inventory, receivables and cash balances	520
Current liabilities	(870)
Non-current liabilities – provisions	(250)
Total	2,160

Entity A proposed to sell the disposal group at Rs. 19,00,000. It estimates that the costs to sell will be Rs. 70,000. This cost consists of professional fee to be paid to external lawyers and accountants.

As at 31st March 20X2, there has been no change to the plan to sell the disposal group and entity A still expects to sell it within one year of initial classification. Mr. X, an accountant of Entity A remeasured the following assets/ liabilities in accordance with respective standards as on 31st March 20X2:

Available for sale:	**(In** Rs. **'000)**
Financial assets	410
Deferred tax assets	230
Current assets- Inventory, receivables and cash balances	400
Current liabilities	900
Non- current liabilities- provisions	250

The disposal group has not been trading well and its fair value less costs to sell has fallen to Rs. 16,50,000.

Required:

What would be the value of all assets/ liabilities within the disposal group as on the following dates in accordance with Ind AS 105?

(a) 15th September, 20X1 and

(b) 31st March, 20X2 **[RTP Nov 2018]**

Answer:

(a) **As at 15 September, 20X1**

The disposal group should be measured at Rs. 18,30,000 (19,00,000-70,000). The impairment write down of Rs. 3,30,000 (Rs. 21,60,000 – Rs. 18,30,000) should be recorded within profit from continuing operations.

The impairment of Rs. 3,30,000 should be allocated to the carrying values of the appropriate non-current assets.

Asset/ (liability)	Carrying value as at 15 June 2004	Impairment	Revised carrying value as per IND AS 105
Attributed goodwill	200	(200)	-
Intangible assets	930	(62)	868
Financial asset measured at fair value through other comprehensive income	360	-	360
Property, plant & equipment	1,020	(68)	952

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Deferred tax asset	250	-	250
Current assets – inventory, receivables and cash balances	520	-	520
Current liabilities	(870)	-	(870)
Non-current liabilities – provisions	(250)	-	(250)
Total	2,160	(330)	1,830

The impairment loss is allocated first to goodwill and then pro rata to the other assets of the disposal group within Ind AS 105 measurement scope. Following assets are not in the measurement scope of the standard- financial asset measured at other comprehensive income, the deferred tax asset or the current assets. In addition, the impairment allocation can only be made against assets and is not allocated to liabilities.

(b) **As on 31 March. 20X2:**

All of the assets and liabilities, outside the scope of measurement under IFRS 5, are remeasured in accordance with the relevant standards. The assets that are remeasured in this case under the relevant standards are the Financial asset measured at fair value through other comprehensive income (Ind AS 109), the deferred tax asset (Ind AS 12), the current assets and liabilities (various standards) and the non-current liabilities (Ind AS 37).

Asset/ (liability)	Carrying amount as on 15 September, 20X1	Change in value to 31st March 20X2	Impairment	Revised carrying value as per Ind AS 105
Attributed goodwill	-	-	-	-
Intangible assets	868	-	(29)	839
Financial asset measured at fair value through other comprehensive income	360	50	-	410
Property, plant & equipment	952	-	(31)	921
Deferred tax asset	250	(20)	-	230
Current assets – inventory, receivables and cash balances	520	(120)	-	400
Current liabilities	(870)	(30)	-	(900)
Non-current liabilities – provisions	(250)	-	-	(250)
Total	**1,830**	**(120)**	**(60)**	**1,650**

PB Limited purchased a plastic bottle manufacturing plant for Rs. 24 lakh on 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017, PB Limited temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

Question 8

The accountant of PB Limited decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held

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for sale. The fair value less cost to sell on 30th September, 2017 and 31st March, 2018 was Rs. 13.5 lakh and Rs. 12 lakh respectively.

The accountant has made the following working:

Carrying amount on initial classification as held for sale	Rs.	Rs.
Purchase price of Plant	24,00,000	
Less: Accumulated Depreciation [(Rs. 24,00,000/8)x2.5 years]	7,50,000	16,50,000
Fair value less cost to sell as on 31st March, 2017		12,00,000
The value lower of the above two		12,00,000

Balance Sheet extracts as on 31st March, 2018

Particulars	Rs.
Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	12,00,000

Required:

Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the correct treatment showing necessary workings. **[Nov 2018]**

Answer: As per Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations', an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For asset to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. In such a situation, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in a distant future.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Further Ind AS 105 also states that an entity shall not classify as held for sale a non-current asset that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use.

An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

In addition to Ind AS 105, 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.

The Accountant of PB 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.

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Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. PB 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 will be as follows:

Calculation of carrying amount as on 31stMarch, 2018	Rs.
Purchase Price of Plant	24,00,000
Less: Accumulated depreciation (24,00,000/ 8 years) x 3 years	(9,00,000)
Carrying amount before impairment	15,00,000
Less: Impairment loss (Refer Working Note)	(3,00,000)
Revised carrying amount after impairment	12,00,000

Balance Sheet extracts as on 31stMarch 2018

Assets	Rs.
Non-Current Assets	
Property, Plant and Equipment	12,00,000

Working Note:

Fair value less cost to sell of the Plant = Rs. 12,00,000

Value in Use (not given) or = Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. Rs. 12,00,000

Impairment loss = Carrying amount – Recoverable amount

Impairment loss = Rs. 15,00,000 - Rs. 12,00,000 = Rs. 3,00,000.

Question 9

CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 2018. During the 3 months ended 30th June, 2018 following events occurred:

On 1st April, 2018, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1st April, 2018, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill – Rs. 60,000
- Property, Plant & Equipment
  (average remaining estimated useful life two years) - Rs. 20,00,000
- Inventories - Rs. 10,00,000

From 1st April, 2018, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 2018 the directors estimated that they would receive Rs. 32,00,000 from the sale of the division. Since 1st April, 2018, market condition has improved

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and as on 1st August, 2018 the Company received and accepted a firm offer to purchase the division for Rs. 33,00,000.

The sale is expected to be completed on 30th September, 2018 and Rs. 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 2018. During the period from 1st April to 30th June inventories of the division costing Rs. 8,00,000 were sold for Rs. 12,00,000. At 30th June, 2018, the total cost of the inventories of the division was Rs. 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale will be reported in the interim financial statements for the quarter ended 30th June, 2018 giving relevant explanations.

[RTP May 2019]

Answer: The decision to offer the division for sale on 1st April, 2018 means that from that date the division has been classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division will be measured at the lower of their existing carrying amounts and their fair value less cost to sell. Here the division shall be measured at their existing carrying amount ie Rs. 30,60,000 since it is less than the fair value less cost to sell Rs. 32,00,000.

The increase in expected selling price will not be accounted for since earlier there was no impairment to division held for sale.

The assets of the division need to be presented separately from other assets in the balance sheet. Their major classes should be separately disclosed either on the face of the balance sheet or in the notes.

The Property, Plant and Equipment shall not be depreciated after 1st April, 2018 so its carrying value at 30th June, 2018 will be Rs. 20,00,000 only. The inventories of the division will be shown at Rs. 9,00,000.

The division will be regarded as discontinued operation for the quarter ended 30th June, 2018. It represents a separate line of business and is held for sale at the year end.

The Statement of Profit and Loss should disclose, as a single amount, the post-tax profit or loss of the division on classification as held for sale.

Further, as per Ind AS 33, EPS will also be disclosed separately for the discontinued operation.

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Employee Benefits (IND AS 19)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1. Sunderam Pvt. Ltd. has a headcount of 100 employees in 2010-11. As per the employee policy, the employees are entitled for 30 annual leaves out of which 10 may be carried forward to the next current year, 10 sick leaves out of which 2 may be carried forward as paid leave. At March 31, 2011, the average unused entitlement is 5 days per employee for privilege leave and 1 for sick leave. On an average, it is found that the number of such employees who would be claiming annual leaves would be 30 and 10 employees who would claim sick leaves. Compute the liability to be recognised as sick pay and privilege leave by the entity in 2010-11.

Ans: The entity will recognise liability in the books equal to 150 (30 x 5) days of annual leave and 10 (10 x 1) days of sick leave.

Q 2 Laxmi Mills is a profit making entity and has reported Rs. 200 crore in the financial year 20X1-20X2. According to its profit–sharing plan, it distributes and pays 5% as its portion of profit to its employees if they complete 1 year with the organisation. As under these kinds of plans, 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 turnover in the organisation, the estimated pay-out would be around 4.5%. Compute the liability and expense of the company under this plan.

Ans: The company shall make a provision for liability and recognise the same amount as an expense of the amount of Rs. 9 crores in 20X1-20X2 (4.5% of Rs. 200 crores).

Q 3 Paras Pvt. Ltd. does not have sufficient information to about a defined benefit plan and thus accounts for the plan as if it were defined contribution plan. In this kind of plan, there is a contractual agreement between Paras Pvt. Ltd. and its participants to share the deficit amongst all. This kind of funding valuation shows a deficit of Rs. 500 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next 10 years. The entity's total contributions under the contract are Rs. 30 million.

Ans: As per Ind AS 19, Paras Pvt. Ltd. should recognise a liability for the contributions adjusted for the time value of money and an equal expense in profit or loss.

Q 4. 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?

Ans: 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. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.3% of final salary, multiplied by the number of years of service up to the end of the reporting period. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

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Q 5. A plan pays a benefit of Rs. 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?

Ans: 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 Rs. 140 is attributed to each subsequent year.

Q 6. 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. Compute the benefit attributed for last 20 years, 10 and 20 years and within 10 years?

Ans: 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 attributes 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% of the present value of the expected medical costs (50% divided by twenty).

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.

Q 7. Cisca Pvt. Ltd. has a headcount of around 1,000 employees in the organisation in 2010-11. As per the company policy, the employees are given 35 days of privilege leave (PL), 15 days of sick leave (SL) and 10 days of casual leave. Out of the total PL and sick leave, 10 and 5 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 as PL and 5 as SL. Also the company has been incurring profits since 2009. It has decided in 2010-11 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 2010-11 is Rs. 2,000 crores.

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

The company has paid Rs. 20 crores to its employees in 2010-11.

What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Cisca Pvt. Ltd?

Ans:

(i) Cisca Pvt. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 200 employees and 10 days of PL for remaining 800 employees and 2 days of SL for 200 employees

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and 5 days of SL for remaining 800 employees in its books as an unused entitlement that has accumulated in 2010-11.

(ii) Cisca Pvt. Ltd. will recognise Rs. 70 crores (2,000 x 3.5%) as a liability and expense it books of account.

(iii) 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:

(a) Under Ind AS 19, the amount of Rs. 80 crores may be recognised as a liability (accrued expense), after deducting any contribution already paid (100-20). However, if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense); and

(b) Also, Rs. 80 crores will be recognised as an expense in this case study which will be disclosed as an expense in the statement of profit or loss.

It can also be seen that the contributions are payable within 12 months from the end of the year in which the employees render the related service, they will not be discounted. However, where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate.

QUESTIONS FROM RTP/MTP/EXAMS

Q 8: 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, 2017, the actuaries advised that the present value of the defined benefit obligation was Rs. 6,00,00,000. On the same date, the fair value of the assets of the defined benefit plan was Rs. 5,20,00,000. On 1st April, 2017, the annual market yield on government bonds was 5%. During the year ended 31st March, 2018, A Ltd. made contributions of Rs. 70,00,000 into the plan and the plan paid out benefits of Rs. 42,00,000 to retired members. Both these payments were made on 31st March, 2018.

The actuaries advised that the current service cost for the year ended 31st March, 2018 was Rs. 62,00,000. On 28th February, 2018, 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 Rs. 15,00,000 from that date.

During the year ended 31st March, 2018, 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 Rs. 80,00,000. Before 31st March, 2018, A Ltd. made payments of Rs. 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, 2018, the actuaries advised that the present value of the defined benefit obligation was Rs. 6,80,00,000. On the same date, the fair value of the assets of the defined benefit plan were Rs. 5,60,00,000.

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Examine and present how the above event would be reported in the financial statements of A Ltd. for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Ans: All figures are Rs. in ’000.

On 31st March, 2018, A Ltd. will report a net pension liability in the statement of financial position. The amount of the liability will be 12,000 (68,000 – 56,000).

For the year ended 31st March, 2018, A Ltd. will report the current service cost as an operating cost in the statement of profit or loss. The amount reported will be 6,200. The same treatment applies to the past service cost of 1,500.

For the year ended 31st March, 2018, A Ltd. will report a finance cost in profit or loss based on the net pension liability at the start of the year of 8,000 (60,000 – 52,000). The amount of the finance cost will be 400 (8,000 x 5%).

The redundancy programme represents the partial settlement of the curtailment of a defined benefit obligation. The gain on settlement of 500 (8,000 – 7,500) will be reported in the statement of profit or loss.

Other movements in the net pension liability will be reported as remeasurement gains or losses in other comprehensive income.

For the year ended 31st March, 2018, the remeasurement loss will be 3,400 (Refer W. N.).

Working Note:

Remeasurement of gain or loss

	Rs. in ’000
Liability at the start of the year (60,000 – 52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400
Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 – 56,000)	12,000

Q 9. ABC Limited operates a defined benefit plan which provides to the employees covered under the plan a pension benefit which is equal to 0.75% final salary for each year of completed service. An employee needs to complete minimum of five years’ service for becoming eligible to the benefit. On 1st April, 2015, the entity improves the pension benefit to 1% of final salary for each year of service, including prior years. The present value of the defined benefit obligation is therefore, increased by Rs. 80 million. Given below is the composition of this amount:

Employees with more than 5 years’ of service at 1st April, 2015	Rs. 60 million
Employees with less than 5 years’ of service at 1st April, 2015	Rs. 20 million

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The employees in the second category have completed average 2 and half years of service. Hence, they need to complete another two and half year of service until vesting.

Comment on the treatment of Rs. 80 million of the defined benefit obligation in the financial statements both as per AS 15 and Ind AS 19. **[RTP may 2019]**

Ans: Under AS 15, a past service cost of Rs. 60 million needs to be recognized immediately, as those benefits are already vested. The remaining Rs. 20 million cost is recognized on a straight line basis over the vesting period, i.e., period to two and half years commencing from 1st April, 2015.

Under Ind AS 19, the entire past service cost of Rs. 80 million needs to be recognized and charged in profit or loss immediately. ABC Ltd. cannot defer any part of this cost.

Q 10: A defined benefit plan has the following characteristics: (Amount in Rs.)

Present value of the obligation	1,100
Fair value of plan assets	(1,260)
Negative amount determined under paragraph	(160)
Present value of available future refunds and reductions in future contributions	90

Comment on the measurement of plan assets

Ans: The amount determined Net liability may be negative (an asset). An enterprise should measure the resulting asset at the lower of:

(a) the amount of surplus determined; and

(b) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits should be determined using the discount rate.

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

Since in the given case Rs. 90 is less than Rs. 160. Therefore, the enterprise recognises an asset of Rs. 90 and discloses that the limit reduced the carrying amount of the asset by Rs. 70

Q 11 A lump-sum benefit is payable on termination of service and equal to 1 per cent of final salary for each year of service. The salary in year 1 is Rs. 10,000 and is assumed to increase at 7 per cent (compound) each year. The discount rate used is 10 per cent per year. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the entity at an earlier or later date.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation?

Ans: Final annual salary = Rs. 10,000 salary in year 1 × $(1 + 0.07)^4$=13,108

Projected Benefit = (1% × 13,108)x 5 =Rs. 131.08 x 5 = 655.40

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Projected unit Benefit = 655.40/5 = Rs. 131.08

The current service cost is the present value of benefit attributed to the current year:

Year 1—Rs. 131.08 × $1/(1.1)^4$= Rs. 131.08 × 0.683013 = Rs. 89.53

Year 2— Rs. 131.08 × $1/(1.1)^3$= Rs. 131.08 × 0.751315 = Rs. 98.48

Year 3— Rs. 131.08 × $1/(1.1)^2$= Rs. 131.08 × 0.826446 = Rs. 108.33

Year 4— Rs. 131.08 × $1/(1.1)^1$= Rs. 131.08 × 0.909091= Rs. 119.16

Year 5— Rs. 131.08 × $1/(1.1)^0$= Rs. 131.08 × 1 = Rs. 131.08.

Calculation of closing obligation for DBP

Year	1	2	3	4	5
Benefit attributed to:					
– prior years	–	131.08	262.16	393.24	524.32
– current year (1% × final salary)	131.08	131.08	131.08	131.08	131.08
– current and prior years	131.08	262.16	393.24	524.32	655.40
Closing obligation					
Opening obligation	–	89.53	196.96	324.99	476.65
Interest at 10%	–	8.95	19.70	32.50	47.67
Current service cost	89.53	98.48	108.33	119.16	131.08
Closing obligation	89.53	196.96	324.99	476.65	655.40

Q 12: An employee Roshan has joined a company XYZ Ltd. in the year 2013. The annual emoluments of Roshan as decided is Rs. 14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshan is expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.

(P.V factor for 8% - 0.735, 0.794, 0.857, 0.926, 1)

Ans: Calculation of Defined Benefit Obligation

Expected last drawn salary = Rs. 14,90,210 x 110% x 110% x 110% x 110% x 110% = Rs. 24,00,000

Defined Benefit Obligation (DBO) = Rs. 24,00,000 x 25% x 5 = Rs. 30,00,000

Amount of Rs. 6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

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Year	Equal apportioned amount of DBO [i.e. Rs.30,00,000/5years]	Discounting @ 8% PV factor	Current service cost (Present Value)
a	b	c	d = b x c
1	6,00,000	0.735 (4 Years)	4,41,000
2	6,00,000	0.794 (3 Years)	4,76,400
3	6,00,000	0.857 (2 Years)	5,14,200
4	6,00,000	0.926 (1 Year)	5,55,600
5	6,00,000	(0 Year)	6,00,000

Calculation of Interest Cost to be charged per year

Year	Opening balance	Interest cost	Current service cost	Closing balance
a	**b**	**c = b x 8%**	**d**	**e = b + c + d**
1	0	0	4,41,000	4,41,000
2	4,41,000	35,280	4,76,400	9,52,680
3	9,52,680	76,214	5,14,200	15,43,094
4	15,43,094	1,23,447	5,55,600	22,22,141
5	22,22,141	1,77,859*	6,00,000	30,00,000

*Due to approximations used in calculation, this figure is adjusted accordingly.

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ANALYSIS OF FINANCIAL STATEMENTS

CASE STUDIES BASED ON IND AS

Case Study 1

On April 1, 20X1, Pluto Ltd. has advance a loan for Rs. 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. Rs. 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. Rs. 40,000 (Rs. 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. **[MTP May 2019]**

Solution: The above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on Financial Instruments' and Ind AS 19 'Employee Benefits'.

Para 11 (c) (i) of Ind AS 32 'Financial Instruments : Presentation' states that:

"A financial asset is any asset that is: (c) a contractual right: (i) to receive cash or….."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 states that:

"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or reduction of income unless it qualifies for recognition as some other type of asset".

Further, paragraph 5.2.1 of Ind AS 109 states that:

"After initial recognition, an entity shall measure a financial asset at:

(a) amortised cost;

(b) fair value through other comprehensive income; or

(c) fair value through profit or loss.

Further, paragraph 5.4.1 of Ind AS 109 states that:

"Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset"

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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 Rs. 10 lakhs being the amount disbursed and Rs. 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 Rs. 8,54,712.

b) Employee Benefit Expense

Loan Amount – Fair Value of the loan = Rs. 10,00,000 – Rs. 8,54,712 = Rs. 1,45,288

Rs. 1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.

Amortisation table:

Year	Opening balance of Staff Advance (a)	Interest (10%) (b)= (a x 10%)	Repayment (c)	Closing balance of Staff Advance (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	5,38,201	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

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Current Assets	
Financial Assets	
(i) Loans (7,00,183 - 5,38,201)	1,61,982

Case Study 3

Pluto Ltd. has purchased a manufacturing plant for Rs. 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 Rs. 4 lakhs and Rs. 3.5 lakhs respectively.

The accountant has performed the following working: INR

Carrying amount on initial classification as held for sale	
Purchase Price of Plant	6,00,000
Less: Accumulated dep (6,00,000/ 10 Years)* 2.5 years	(1,50,000)
	4,50,000
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: The above treatment needs to be examined in the light of the provisions given in Ind AS 16 'Property, Plant and Equipment' and Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'.

Para 6 of Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' states that:

"An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use".

Paragraph 7 of Ind AS 105 states that:

"For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable. Thus, an asset (or disposal group) cannot be

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classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future".

Further, paragraph 8 of Ind AS 105 states that:

"For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."

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	6,00,000
Less: Accumulated depreciation (6,00,000/ 10 Years)* 3 Years	(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 4

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 Rs. 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at Rs. 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount

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of Rs. 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of Rs. 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 alongwith working for the same.

Solution: The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

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

Further, paragraph 6 of Ind AS 2 defines:

"Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that:

"Inventories shall be measured at the lower of cost and net realisable value".

Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.

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Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of Rs. 8 Lakhs calculated below:

	INR' lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Case Study 5

On April 1, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for Rs. 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 6

Neptune Ltd. issued 15,000, 12% convertible debentures for Rs. 15 lakhs of Rs. 100 each at face value on 1st April 20X1 which will be converted into equity instruments on 31st March 20X6. Similar debentures without conversion right carry interest rate of 15%.

The CFO of the company has advised to recognise the 12% debentures in the balance sheet equivalent to the amount of face value of debentures issued i.e. Rs 15 lakhs. The interest expense for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs. 1,80,000 (Rs 15 lakhs x 12%).

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Required: Analyse whether the above accounting treatment advised by CFO is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

Solution: The above treatment needs to be analysed from the purview of provisions given in Ind AS 32, Ind AS 107 and Ind AS 109 on 'Financial Instruments'.

The terms of a financial instrument may be structured such that it contains both equity and liability components (i.e. by substance, the instrument is neither a liability nor an equity instrument in entirety).

Para 11 of Ind AS 32 'Financial Instruments : Presentation' states that:

"A financial liability is any liability that is: (a) a contractual obligation: (i) to deliver cash or .....

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities".

Paragraph 28 of Ind AS 32 states that:

"The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15."

Further, paragraph 32 of Ind AS 32 which deals with separating the liability and equity components, states that:"The issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 provides the guidance to determine the fair value of liability:

The fair value of the liability component on initial recognition is the present value of the contractual stream of future cash flows discounted at the market rate of interest that would have been applied to an instrument of comparable credit quality with substantially the same cash flows, on the same terms, but without the conversion option.

Further, paragraph 4.2.1 of Ind AS 109 provides that:

The financial liability component will be subsequently measured depending on its classification either as a financial liability at FVTPL, or as a Financial liability measured at amortised cost (using the effective interest rate method).

As per the facts of the case study given in the question, the liability component is measured at amortised cost using the effective interest rate method.

The equity component will not be required to remeasured.

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The CFO of the Neptune Ltd. has advised to recognise 12% debenture in the balance sheet equivalent to the amount of face value of debentures issued i.e. Rs 15 lakhs without separating into the liability and equity component and Rs. 1,80,000 as interest expense 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 32, 107 and 109.

Accordingly, the 12% debentures initially need to be separated between the liability and equity component using the guidance given under Ind AS 32. The liability component shall be initially measured at the fair value and subsequently at the amortised cost. The interest expense is calculated by using the effective interest method. It may be noted that equity component will not be remeasured.

a) Calculation of Financial liability INR

Year	Cash outflow	Discounting Factor (15%)	Present Value
1	1,80,000	0.870	1,56,600
2	1,80,000	0.756	1,36,080
3	1,80,000	0.658	1,18,440
4	1,80,000	0.572	1,02,960
5	1,80,000	0.497	89,460
Total			6,03,540

b) Separating the liability and equity components

Equity component = Fair value of the instrument as whole – Financial liability

= Rs. 15,00,000 – Rs. 6,03,540 = Rs. 8,96,460

The following journal entry is required to pass on the initial recognition of the instrument:

		Rs.	Rs.
Bank Account	Dr.	15,00,000	
To Financial Liability			6,03,540
To Equity			8,96,460

c) Amortisation table INR

Year	Opening balance of liability (a)	Interest (15%) (b)=(a) x 15%	Repayment (c)	Closing balance of liability (d) = (a +b -c)
1	6,03,540	90,531	1,80,000	5,14,071
2	5,14,071	77,111	1,80,000	4,11,182
3	4,11,182	61,677	1,80,000	2,92,859
4	2,92,859	43,929	1,80,000	1,56,788
5	1,56,788	23,212 (b.f.)	1,80,000	Nil

Balance Sheet extracts showing the presentation of compounded financial instrument as at 31st March 20X2

Ind AS compliant Division II of Schedule III needs to be referred for presentation requirement in Balance Sheet on Ind AS. INR

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Equity and Liabilities	
Equity	
Other Equity	
Equity component of compound financial instrument	*8,96,460*
Liabilities	
Non-Current liabilities	
Financial Liabilities	
(i) Borrowings (5,14,071 – 1,02,889)	4,11,182
Current liabilities	
Financial Liabilities	
(i) Borrowings (5,14,071 – 4,11,182)	1,02,889

The Equity component of compound financial instrument needs to be shown as a separate column in Statement of Changes in Equity as per Ind AS compliant Schedule III.

Questions based on Ind AS

1. The company had spent Rs. 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1-20X2, but proved to be a failure.

   Required: Analyse, how you will deal with this amount in the accounts of the company for the year ended 31stMarch, 20X2 with reference to Accounting Standards:

Ans: In the given case, the company spent Rs. 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to IND AS 38 'Intangible Assets', the company should charge the total amount of Rs. 45 lakhs as an expense in the profit and loss account.

2. A company with a turnover of Rs. 250 crores and an annual advertising budget of Rs. 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs. 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of Rs. 2 crore incurred on extensive special initial advertisement campaign for the new product.

   Required: Evaluate the correctness of the procedure adopted by the company?

Ans: According to IND AS 38 'Intangible Assets', expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.

3. Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for Rs. 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of

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financial year 20X1-20X2 the carrying amount was Rs. 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch Rs. 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of Rs. 54 crore per annum and has a carrying amount of Rs. 3.46 crore. All such machines put together could fetch a sum of Rs. 4.44 crore if disposed.

Required: Discuss the applicability of Impairment loss.

Ans: As per provisions of IND AS 36 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

4. On 1st January 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March 20X2, that there was a 75% probability they would have to pay damages of Rs. 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of Rs. 12 lakhs to the customer on 15th May 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May 20X2.

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.

Ans: 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'.

Para 10 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' defines:

"Provision is a liability of uncertain timing or amount.

Liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".

Further, paragraph 14 of Ind AS 37, states:

"A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

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(c) a reliable estimate can be made of the amount of the obligation".

Further, paragraph 36 of Ind AS 37, states:

"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period".

Further, paragraph 3 of Ind AS 10 'Events after the Reporting Period' defines:

"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 8 of Ind AS 10 states that:

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

The Accountant of Sun Ltd. has not recognised the provision and accordingly not adjusted the amounts recognised in its financial statements to reflect adjusting events after the reporting period is not correct and nor in accordance with provision of Ind AS 37 and Ind AS 10.

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 Rs. 7.5 lakhs (Rs. 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 Rs. 12 lakhs and accordingly be recognised as a current liability.

5. Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April 20X1, the company has received a government grant for Rs. 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for Rs. 2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

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.

Ans: As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.

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The above facts need to be examined in the light of the provisions given in Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' and Ind AS 41 'Agriculture'.

Para 2(d) of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' states:

"This Standard does not deal with government grants covered by Ind AS 41, Agriculture".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"This Standard shall be applied to account for the government grants covered by paragraphs 34 and 35 when they relate to agricultural activity".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"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 Rs. 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

Liabilities	INR
Non-Current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

6. Mercury Ltd. has sold goods to Mars Ltd. at a consideration of Rs. 10 lakhs, the receipt of which receivable in three equal installments of Rs. 3,33,333 over a two year period (receipts on 1st April 20X1, 31st March 20X2 and 31st March 20X3).

The company is offering a discount of 5 % (i.e. Rs. 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at Rs. 10 Lakhs and hence, the management has recognised the revenue from sale of goods for Rs. 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

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.

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Ans. The above treatment needs to be examined in the light of the provisions given in Ind AS 115 : Revenue from Contract with customer

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price).

The Transaction (cash price equivalent) of the sale of goods is calculated as follows:

INR

Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333
End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		**9,50,000**

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		INR	INR
Cash	Dr.		3,33,333
Trade Receivable	Dr.		6,16,667
To Sale		9,50,000	
Recognition of interest expense and receipt of second installment			
Cash	Dr.		3,33,333
To Interest Income		32,999	
To Trade Receivable		3,00,334	
Recognition of interest expense and payment of final installment			
Cash	Dr.		3,33,334
To Interest Income (Balancing figure)		17,000	
To Trade Receivable		3,16,333	

Balance Sheet and Profit and Loss extracts showing the presentation for the year ended as at for the year ending 31st March 20X2 and 31st March 20X3

Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet and Profit and Loss on Ind AS.

Balance Sheet (extracts) as at 31st March 20X2 and 31st March 20X3 INR

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	As at Mar 31, 20X2	As at Mar 31, 20X3
Assets		
Current Assets		
Financial Assets		
Trade Receivable	3,16,333	XXX

Statement of Profit and Loss (extracts) for the year ended 31st March 20X2 and 31st March 20X3

	As at Mar 31, 20X2	As at Mar 31, 20X3
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	32,999	17,000

7. Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

(a) One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period. Mr. Y own 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

(b) The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. Elucidate how all these treatments comply with the relevant Ind AS.

(c) In the year to March, 2018, ABC Ltd. spent considerable amount on designing a new product. ABC Ltd. spent the six months from April, 2017 to September, 2017 researching into the feasibility of the product. Mr. X charged these research costs to profit or loss. From October, 2017, A Ltd. was confident that the product would be commercially successful and A Ltd. is fully committed to finance its future development. A Ltd. spent remaining part of the year in developing the product, which is expected to start from selling in the next few months. These development costs have been recognised as intangible assets in the Balance Sheet. State whether the treatment done by Mr. X is correct when all these research and development costs are design costs. Justify your answer with reference to relevant Ind AS.

Provide answers to the queries raised by the managing director Mr. Y as per Ind AS.

[RTP Nov 2018]

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Ans. Ongoing through the queries raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

(a) Related parties are generally characterised by the presence of control or influence between the two parties.

Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

(b) The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class. Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.

According to Ind AS 16, all assets having a finite useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.

Properties which are held for investment purposes are not accounted for under Ind AS 16, but under Ind AS 40 'Investment Property'. As per Ind AS 40, investment properties should be accounted for under a cost model. ABC Ltd. had applied the cost model and thus our investment properties are treated differently from the owner occupied property which is annually to fair value.

(c) As per Ind AS 38 'Intangible Assets', the treatment of expenditure on intangible items depends on how it arose. Internal expenditure on intangible items incurred during research phase cannot be recognised as an asset. Once it can be demonstrated that a development project is likely to be technically feasible, commercially viable, overall profitable and can be adequately resourced, then future expenditure on the project can be recognised as an intangible asset. The difference in the treatment of expenditure upto 30th September, 2017

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and expenditure after that date is due to the recognition phase ie. research or development phase.

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INTEGRATED REPORTING

TEST YOUR KNOWLEDGE

Theoretical Questions

Q 1. State the categories defined in the International IR Framework for capitals. Comment whether an organisation has to follow these categories rigidly.

Ans: Various categories of capital are:

- Financial
- Manufactured
- Intellectual
- Human
- Social and Relationship
- Natural

Organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the above lines of the capitals.

Q 2 Can a Not-for Profit organisation do the Integrated Reporting as per the Framework?

Ans: The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

Q 3 Can an Integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports?

Ans: An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

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Leases (IND AS 17)

TEST YOUR KNOWLEDGE

Q 1 Moon & Sun legal consultants Limited has signed an agreement with a client for rendering consultancy services on monthly basis for 15 days per month for 2 years at a fees of Rs 1 million per annum. Is this agreement tantamount to a lease?

Ans: For an agreement considered to be lease, below four conditions should be there:

(i) Agreement between two parties should be there

(ii) Consideration in Payment or series of payments

(iii) Agreed period of time

(i) Right to use of an asset In this case all of the conditions except right to use an asset is fulfilled.

This agreement is for the use of services. Hence it is not covered within the purview of Ind AS 17.

Q 2 Calculate minimum lease payments for A Ltd. who took an asset on a 5 years lease from B Ltd. using the following information:

Payments over the lease term	Rs. 1,000 per month
Contingent rent	Rs. 20,000
Cost for services given by B Ltd.	Rs. 40,000
Taxes to be reimbursed to B Ltd.	Rs. 15,000
Residual value guaranteed by A Ltd.	Rs. 5,000
Fair value of asset after 5 years	Rs. 6,000

Also, A Ltd. has an option to purchase the asset after a period of 5 years at Rs. 2,000. It is reasonably certain that A Ltd. will exercise the option.

Required Calculation Minimum Lease Payments.

Ans:

Particulars	Amount (Rs.)
Payments over the lease term (1,000 x 12 x 5)	60,000
Contingent rent	-
Cost for services given by B Ltd.	-
Taxes to be reimbursed to B Ltd.	-
Residual value guaranteed by A Ltd.	5,000
Payment made for option to purchase the asset	2,000
Minimum lease payments for A Ltd.	67,000

Q 3 On 1 April 2017, Jupiter ltd began to lease a property on a 20-year lease. Jupiter ltd paid a lease premium of Rs. 30,00,000 on 1 April 2017. The terms of the lease required Jupiter ltd to

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make annual payments of Rs. 500,000 in arrears, the first of which was made on 31 March 2018.

On 1 April 2017 the fair values of the leasehold interests in the leased property were as follows:

– Land Rs. 30,00,000.

– Buildings Rs. 45,00,000.

There is no opportunity to extend the lease term beyond 31 March 2037. On 1 April 2017, the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9·2%. The present value of 20 payments of Rs. 1 in arrears at a discount rate of 9·2% is Rs. 9.

Required: Explain the accounting treatment for the above property lease and produce appropriate extracts from the financial statements of Jupiter ltd for the year ended 31 March 2018.

Ans:

Statement of Profit and Loss	Rs. ’000
Operating lease rental	(260)
Amortisation of asset leased on finance lease	(225)
Finance cost relating to finance leases	(248·4)
Balance Sheet	**Rs. ’000**
Property, plant and equipment	4,275
Prepaid operating lease rentals:	
In non-current assets	1,080
In current assets	60
Lease liability:	
In non-current liabilities	(2,592·1)
In current liabilities	(56·3)

Explanation and supporting calculations:

Separate decisions are made for the land and buildings elements of the lease.

1) The land lease is an operating lease because land has an indefinite useful economic life and the lease term is 20 years.

   The lease premium and annual rentals are apportioned 40% (3/7·5) to the land element.

   Therefore the premium for the land element is Rs. 12,00,000 (Rs. 30,00,000 X 40%) and the annual rentals for the land element Rs. 200,000 (Rs. 500,000 X 40%). This makes the total lease payments Rs. 52,00,000 (Rs. 12,00,000 + 20 X Rs. 200,000).

   The rental expense for the current period is Rs. 2,60,000 (Rs. 52,00,000 X 1/20).

   The amount paid in the current period re: the land element is Rs. 14,00,000 (Rs. 12,00,000 + Rs. 200,000). Therefore there is a prepayment of Rs. 1,140,000 (Rs. 14,00,000 – Rs. 2,60,000) at the year end.

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In the next 19 periods, the rental expense will be Rs. 260,000 and the rental payment will be Rs. 200,000. Therefore Rs. 60,000 of the rental prepayment will reverse in each period. This means that Rs. 60,000 of the prepayment will be a current asset, and the balance a non-current asset.

2) The buildings element of the lease will be a finance lease because the lease term is for substantially all of the useful life of the buildings.

The premium apportioned to the buildings element is Rs. 18,00,000 (Rs. 30,00,000 X 60%) and the annual rental apportioned to the buildings is Rs. 300,000 (Rs. 500,000 X 60%).

The initial carrying value of the leased asset in PPE is Rs. 45,00,000 (Rs. 18,00,000 + Rs. 300,000 X 9).

Therefore the annual depreciation charge is Rs. 2,25,000 (Rs. 45,00,000 X 1/20) and the closing PPE (Rs. 45,00,000 – Rs. 2,25,000).

The finance cost in respect of the finance lease and the closing non-current liability is shown in the working below.

The closing current liability is Rs. 56,300 (Rs. 26,48,400 – Rs. 25,92,100).

Lease liability profile – working

Year ended 31 March	Bal b/f Rs.'000	Finance Cost @9.2% Rs.'000	Lease rental payment Rs.'000	Bal c/f Rs.'000
2018	*2,700	248·4	(300)	2,648·4
2019	2,648·4	243·7	(300)	2,592·1

* = Net of lease premium of Rs. 18,00,000 (Rs. 45,00,000 – Rs. 18,00,000 = Rs. 27,00,000).

Q 4 On 1 April 20X1, Mercury Ltd leased a machine from Pluto Ltd on a three-year lease. The expected future economic life of the machine on 1 April 20X1 was eight years. If the machine breaks down, then under the terms of the lease, Pluto Ltd would be required to repair the machine or provide a replacement. Pluto Ltd agreed to allow Mercury Ltd to use the machine for the first six months of the lease without the payment of any rental as an incentive to Mercury Ltd to sign the lease agreement. After this initial period, lease rentals of Rs. 2,10,000 were payable six-monthly in arrears, the first payment falling due on 31 March 20X2.

Required: Explain the treatment required in accordance of Ind AS 17 in the financial statements of Mercury Ltd for the year ended 31 March 20X2.

Ans: Under the principles of Ind AS 17 – Leases – the lease of the machine is an operating lease because the risks and rewards of ownership of the machine remain with Pluto Ltd. The lease is for only three years of the eight-year life and Pluto ltd is responsible for breakdowns, etc.

Therefore Mercury ltd will recognise lease rentals as an expense in the statement of profit or loss. Ind AS 17 states that this shall normally be done on a straight-line basis.

The total lease rentals payable over the whole lease term are Rs. 1,050,000 (Rs. 210,000 x 5). Therefore the charge for the current year is Rs. 350,000 (Rs. 1,050,000 x 1/3).

The difference between the charge for the period (Rs. 350,000) and the rent actually paid (Rs. 210,000) will be shown as a liability in the statement of financial position at 31 March 20X2.

This amount will be Rs. 140,000. Rs. 70,000 (2 x Rs. 210,000 – Rs. 350,000) of this liability will be current and Rs. 70,000 non-current.

Q 5 On 1 April 20X1 Venus Ltd entered into two leasing contracts:

The first contract was a contract to lease manufacturing machine (M1) for a two-year period. The estimated useful economic live of the M1 at the start of the lease was five years. It was the responsibility of the lessor to repair and insure the M1. The lease contract stated that Venus Ltd should pay a deposit of Rs. 6,00,000 at the start of the lease followed by monthly payments of Rs. 2,00,000 in arrears.

The second contract was to lease another manufacturing machine (M2). The lease was for a four-year period, which was the estimated useful economic life of the machines. Venus Ltd is required to repair and insure the M2, which has no estimated residual value at the end of the lease. The lease rentals were set at Rs. 10,000 every six months, payable in advance. The rate of interest implicit in this lease was 5% per six-monthly period and the present value of the minimum lease payments was very close to the fair value of the assets at the inception of the lease, which was estimated at Rs. 70,000.

Show the necessary treatment in the financial statement for the year ended 31st March 20X2 of Venus Ltd in accordance of Ind AS 17.

Ans: **Lease of machine M1**

The first lease is for two years while the life of the manufacturing machine (M1) is five years, so this is an operating lease. Therefore the operating lease rentals should be charged to profit and loss account on a straight line basis per annum is Rs. 27,00,000 (6,00,000 + 24 x 2,00,000)/2

Lease of machine M2

The second lease is a finance lease as the lease period is equal to the economic life of the machines and the present value of minimum lease payment is close to the fair value of the assets.

An asset and liability is recognised at Rs. 70,000 being the present value of minimum lease payment is recognised.

Lease Liability

Period ended	Bal b/f	Payment	Bal in period	Interest (5%)	Bal c/f
30 September 20X1	70,000	(10,000)	60,000	3,000	63,000
31 March 20X2	63,000	(10,000)	53,000	2,650	55,650
31 September 20X2	55,650	(10,000)	45,650	2,283	47,933
Closing Liability:					55,650
Current liability (55,650-17,717)					37,933
Non-Current liability (20,000-2,283)					17,717

The total finance cost for the period is Rs. 5,650 (3,000 + 2,650)

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Q 6 On 1st April 20X1 Earth ltd sold a property it owned for Rs. 90 lakh and leased it back on a 10-year operating lease for rentals of Rs. 8 lakh per annum, payable on 31st March in arrears. The carrying value of the property in the financial statements of Earth ltd at 1st April was Rs. 55 lakh and its market value on that date was Rs. 70 lakh.

Required: Compute the amounts that will be shown in the financial statement for the year ended 31st March 20X2 in respect of the sale and leaseback.

Ans: Since the lease is an operating lease the property will be removed from the financial statements. A profit on sale of Rs. 15 lakh (Rs. 70 lakh – Rs. 55 lakh) will be shown as other income in the statement of profit and loss. The rental expense of Rs. 8 lakh will be shown as an operating cost in the statement of profit and loss.

The difference of Rs. 20 lakh between the disposal proceeds (Rs. 90 lakh) and the market value of the asset (Rs. 70 lakh) will be shown as deferred income and released to the statement of profit and loss over the lease term of 10 years.

Therefore, Rs. 2 lakh (Rs. 20 lakh x 1/10) will be credited to the statement of profit and loss in the year ended 31st March 20X2, probably as a reduction in operating costs. The remaining deferred income balance of Rs. 18 lakh (Rs. 20 lakh – Rs. 2 lakh) will be included as a liability in the balance sheet. Rs. 2 lakh of this will be a current liability and Rs. 16 lakh (Rs. 18 lakh – Rs. 2 lakh) will be non-current.

Q 7 The below facts are given for the Earth Heavy Movers Limited:

1. The lease is non-cancellable and is initiated on 1 April 20X1 for equipment with an expected useful life of five years.
2. Three payments are due to the lessor of the amount of 51,000 per year beginning 31 March 20X2. Included in the lease payments is a sum of 1,000, to be paid annually by the lessee for insurance.
3. The lessee guarantees a 10,000 residual value on 31 March 20X4 to the lessor.
4. Irrespective of the 10,000 residual value guarantee, the leased asset is expected to have only a 1,000 residual value to the lessee at the end of the lease term.
5. The Lessee company depreciates similar equipment that it owns on a straight-line basis.
6. The Fair value of the equipment at 1 April 20X1 is 1,32,000.
7. The Lessor's implicit rate is 10%. This fact is known to the lessee company.

Requirements: As per provision of Ind AS 17: Leases,

1. How should lessee's company classify and record the lease transaction at its inception on 1 April 20X1 (indicate journal entries)?
2. What are the journal entries the lessee is required to make to record the lease payments and the interest, insurance and depreciation expenses on 31 March 20X2 through 31 March 20X4?

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3. What entry should the lessee make on 31 March 20X4 to record the guaranteed residual value payment (assuming an estimated residual value of 1,000) and to clear the lease related accounts from the lessee's books?

4. What would be the Current and Non Current classification in the books of Lessee in year 1? **[May 2018]**

Ans:

1. The Lessee company should record the asset as a finance lease as the risk and reward is being transferred and inspite of the fact the estimated residual value of the asset will be 1,000 still Lessee is guaranteed lessor residual value of Rs. 10,000. Further the lease payments substantially covers the fair value of leased asset as per calculation given below.

2. Calculation of Present value of Minimum Lease Payments (MLP)

PV of MLP is calculated as per implicit rate of return of 10%

Year	Discount Factor	Minimum Lease payments (see note below)	Present Value of MLP
Annual Lease Rentals			
31 March 20X2	0.909	50,000	45,450
31 March 20X3	0.826	50,000	41,300
31 March 20X4	0.751	50,000	37,550
Guaranteed Residual Value			
31 March 20X4	0.751	10,000	7,510
Total			1,31,810

Note : The Contingent rent, taxes, Insurance, Maintenance expenses etc if paid by the lessee to the lessor, then it does not form part of the Minimum lease payments and it will be expensed when incurred. Hence in the above case, for calculation of Present value of Minimum Lease payments only lease rental of Rs. 50,000 has been considered.

At the time of Initial Recognition, the Lessee will recognise the Leasehold asset at lower of below :

Present value of MLP 1,31,810

Fair Value of Leased Asset 1,32,000

Hence, Lease hold asset will be recognised at 1,31,810

Accounting Entry for Recognition would be :

Leasehold Equipment Dr. 1,31,810

To Leasehold Obligation 1,31,810

Lease rentals should be splitted between Principal portion of leasehold obligation and finance costs. Same is computed in the below table :

Year	Payments	Finance Costs @ 10%	Reduction in Liability	Closing obligation
1 April 20X1				1,31,810

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31 March 20X2	50,000	13,181	36,819	94,991
31 March 20X3	50,000	9,499	40,501	54,499
31 March 20X4	50,000	5,501	44,499	10,000

Entries at the time of Subsequent measurement at the reporting date:

Particulars	31 March 20X2		31 March 20X3		31 March 20X4	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Insurance Expenses		1,000		1,000		1,000
Leasehold obligation		36,819		40,501		44,499
Interest Expenses		13,181		9,499		5,501
Depreciation		43,619		43,619		43,619
Cash		51,000		51,000		51,000
Accumulated Depreciation		43,619		43,619		43,619
	94,619	94,619	94,619	94,619	94,619	94,619

3. Entries at the End of Lease period

Leasehold Obligation Account Dr.	10,000	
Accumulated Depreciation Account Dr.	1,30,810	
To Cash Account		9,000
To Leasehold Equipment Account		1,31,810

4. The Current and Non Current Classification at the end of year 1 in the books of Lessee is as follows:

Particulars	Amount
Non Current Asset	
Leasehold Asset	
- Gross Block	1,31,810
- Accumulated Depreciation	(43,619)
Non Current Liability	
Leasehold Obligation (payable after 12 months)	54,499
Current Liability	
Leasehold Obligation (payable within 12 months)	40,501

Q 8 A Ltd. leases an asset to B Ltd. for its entire economic life and leases the same asset back under the same terms and conditions as the original lease. A Ltd. and B Ltd. have a legally enforceable right to set off the amounts owing to one another, and an intention to settle these amounts on a net basis. In this case, it should be accounted for as a single transaction. Whether the arrangement, in substances, involves a lease under Ind AS 17?

Ans: No. The terms and conditions and period of each of the leases are the same. Therefore, the risks and rewards incident to ownership of the underlying asset are the same as before the arrangement. Further, the amounts owing are offset against one another, and so there is no retained credit risk. The substance of the arrangement is that no transaction has occurred.

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Q 9 A Ltd. prepares its financial statements for the period ending on 31st March each year. The financial statements for the year ended 2017-2018 is under preparation. The following events are relevant to these financial statements:

On 1st April, 2016, A Ltd. purchased an asset for Rs. 20,00,000. The estimated useful life of the asset was 10 years, with an estimated residual value of zero. A Ltd. immediately leased the asset to B Ltd. The lease term was 10 years and the annual rental, payable in advance by B Ltd., was Rs. 27,87,000. A Ltd. incurred direct costs of Rs. 2,00,000 in arranging the lease. The lease contained no early termination clauses and responsibility for repairs and maintenance of the asset rest with B Ltd. for the duration of the lease. The annual rate of interest implicit in the lease is 8%. At an annual discount rate of 8% the present value of Rs. 1 receivable at the start of years 1–10 is Rs. 7·247.

Examine and show how the above event would be reported in the financial statements of A Ltd.. for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Ans: All numbers in Rs. in 000.

The lease of the asset by A Ltd. to B Ltd. would be regarded as a finance lease because the risks and rewards of ownership have been transferred to B Ltd. Evidence of this includes the lease is for the whole of the life of the asset and B Ltd. being responsible for repairs and maintenance.

As per para 36 of Ind AS 17, since the lease is a finance lease and A Ltd. is the lessor, A Ltd. will recognise a financial asset ie. as a receivable at an amount equal to the 'net investment in finance leases'. The amount recognised will be the present value of the minimum lease payments which will be 20,197.39 ie. 2,787 x 7.247.

The impact of the lease on the financial statements for the year ended 31st March, 2018 can best be seen by preparing a profile of the net investment in the lease for the first three years of the lease and shown below:

Year to 31st March	Opening Balance	Finance income	Rental	Closing Balance
2017	20,197.39	1,615.79	(2,787)	19,026.18
2018	18,806	1,522.09	(2,787)	17,761.27
2019	17,301	1,420.90	(2,787)	16,395.17

During the year ended 31st March, 2018, A Ltd. will recognise income from finance leases of 1,522.09.

The net investment on 31st March, 2018 will be 17,761.27.

Of the closing net investment of 17,761.27, current asset will be shown for 2,787 and 14,974.27 as a non-current asset.

Q 10 UK Ltd. has installed Wind Turbine Equipment at Rajasthan to generate electricity for which it has entered into a Power Purchase Agreement (PPA) with the State Government. The terms of the PPA are as follows:

- The PPA is for an initial period of 3 years, renewable at mutual terms and conditions. The Management estimates the useful life of such project around 20 years.

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- The price per unit is fixed for a period of one year and is renewed every year as per the State Government policy.
- The Company's Management is of the view that the power generated by the project will be completely sold to the State Government and not to any third party. However, there is no such restriction prescribed in the PPA.
- Currently the Company has classified the Wind Turbine Equipment as part of the Property, Plant & Equipment and is charging depreciation on the same.

For the above PPA, which condition, as per the applicable Ind AS, is not relevant in determining whether an arrangement is or contains a lease?

(A) Use of Specific Assets;

(B) Right to Operate the assets;

(C) Right to control the Physical access;

(D) Price is contractually fixed by the purchaser;

UK Ltd. also wants you to give your suggestion on the accounting of the above arrangement under applicable Ind AS.

Ans: As per paragraph 6 of Appendix C to Ind AS 17, "Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

(a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and

(b) the arrangement conveys a right to use the asset."

In the present case, the PPA with the State Government can be fulfilled by the use of the Wind Turbine Equipment which is a specific asset. Accordingly, condition (a) above is satisfied.

With respect to condition (b), paragraph 9 of Appendix C to Ind AS 17 provides as below:

"An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:

(a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.

(c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of

output nor equal to the current market price per unit of output as of the time of delivery of the output."

Accounting of the PPA with the State Government under applicable Ind AS:

Continuing the rationale to the above, in the present case, criteria (c) above is fulfilled since:

- The entire output of Wind Turbine Equipment is estimated to be consumed by the purchaser i.e. the State Government
- The price paid by the State Government includes an element of revision in price every year which makes the price for the output variable.

Accordingly, the PPA with the State Government contains an embedded lease arrangement.

Further to determine whether the lease arrangement is an operating lease or a finance lease, paragraph 10 of Ind AS 17 provides certain examples (that individually or in combination would normally lead to a lease being classified as a finance lease) which can be analysed as below:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term - Not fulfilled, as the ownership is not transferred to the State Government.

(b) the lessee has the option to purchase the asset after completion of the agreement - Not fulfilled, as the State Government doesn't have an option to purchase the Wind Turbine Equipment after the completion of PPA.

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred - Not fulfilled, as the PPA is for 3 years whereas the useful life of the Wind Turbine Equipment project is 20 years.

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset – Cannot be determined since the price per unit is not fixed for the entire tenure of the PPA. Definition of the 'inception of the lease' (given in para 4 of Ind AS 17) inter alia states that in the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined. This implies that the given PPA is not a finance lease.

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications - Not fulfilled, as the asset is not specialised in nature.

Conclusion:

Based on the evaluation above, PPA with the State Government shall be accounted by UL Ltd. as "Property, plant and equipment under an operating lease arrangement".

Q 11 ABC Ltd. has entered into an operating lease agreement for 5 year, for taking a building on lease for Rs. 5,00,000 p.a. As per the agreement the lessor will charge escalation in the lease @ 20% p.a. However, the general inflation in the country expected for the aforesaid period is around 7% p.a.

Examine whether the lease payment will be straight lined or not as per Ind AS 17 in the book of ABC Ltd.? If yes, should the entire 20% p.a. escalation in lease rent be straight-lined over a period of 5 years or only the difference which exceeds the expected inflation rate will be straight-lined?

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Ans: As per paragraph 33 of Ind AS 17, lease payments shall be straight-lined over the period of lease unless

Either

another systematic basis is more representative of the time pattern of the user's benefit even if the payments to the lessors are not on that basis

or

the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then lease payments shall be straight-lined.

Judgement would be required to be made as per the facts and circumstances of each case to determine whether the payments to the lessor are structured to increase in line with expected general inflation. Therefore, it is required to evaluate the lease agreement to ascertain the real intention and attributes of escalation in lease payments, i.e., whether the intention of such escalation is to compensate for expected general inflation or any other factors.

It is not necessary that the rate of the escalation of lease payments should exactly be equal to the expected general inflation. If the actual increase or decrease in the rate of inflation is not materially different as compared to the expected rate of inflation under the lease agreement, it is not required to straight-line the lease payments. However, the purpose of such escalation should only be to compensate the expected general inflation rate.

In the given case, the increase of 20% p.a. in lease rentals does not appear to have any link with general inflation which is expected to be 7%. Accordingly, the entire lease payments should be straight-lined since the increase is not a compensation for inflation.

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REVENUE FROM CONTRACT WITH CUSTOMERS (IND AS 115)

Illustration 1

New way limited decides to enter a new market that is currently experiencing economic difficulty and expects that in future economy will improve. New way enters into an arrangement with a customer in the new region for networking products for promised consideration of Rs. 1,250,000. At contract inception, New way expects that it may not be able to collect the full amount from the customer.

Determine how New way will recognise this transaction?

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

In making this assessment, New way considers whether the customer has the ability and intent to pay the estimated transaction price, which may be an amount less than the contract price.

Illustration 2

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

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

Illustration 3

Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases.

Would these contracts be combined?

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

Illustration 4

An entity promises to sell 120 products to a customer for Rs. 120,000 (Rs. 1,000 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer at a price of Rs. 950 per product which is the standalone selling price for such additional products at the time of placing this additional order . The additional 30 products were not included in the initial contract. It is

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assumed that additional products are contracted for a price that reflects the stand-alone selling price.

Determine the accounting for the modified contract?

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

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

Illustration 5

On 1 April, 20X1, KLC Ltd. enters into a contract with Mr. K to provide

- A machine for Rs. 2.5 million
- One year of maintenance services for Rs. 55,000 per month

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

Determine the effect of change in the contract?

Solution: The next six months of services are distinct from the services provided in the first six months before modification in contract,

Therefore, KLC Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is Rs. 270,000, which is the sum of

- The consideration promised by the customer (including amounts already received from the customer) that was included in the estimate of the transaction price and had not yet been recognized as revenue. This amount is zero.
- The consideration promised as part of the contract modification ie Rs. 270,000.

Illustration 6

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

Based on its experience, Growth Ltd determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges Rs. 150 per hour.

After incurring 100 hours of time, Growth Ltd and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of Rs. 100 per hour.

Determine how contract modification will be accounted as per Ind AS 115?

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

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Particulars	Hours	Rate (Rs.)	Amount (Rs.)
Initial contract amount	200	150	30,000
Modification in contract	50	100	5,000
Contract amount after modification	250	140*	35,000
Revenue to be recognised	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*35,000 / 250 = 140

Illustration 7

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

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

Solution

Determining whether a good or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition. In order to determine how many performance obligations are present in the contract, the company applies the guidance above. While the customer may be able to benefit from each promised good or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation.

This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

Illustration 8

An entity provides broadband services to its customers along with voice call service.

Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.

Are the performance obligations under the contract distinct?

Solution: Entity promises to customer to provide

- Broadband Service
- Voice Call services

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- Modem

Entity's promise to provide goods and services is distinct

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

For broadband and voice call services –

- Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependant or interrelated. Also the customer can benefit on its own from the services received.

For sale of modem –

- Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.

Based on the evaluation we can say that there are three separate performance obligation: -

- Broadband Service
- Voice Call services
- Modem

Illustration 9

An entity enters into a contract to build a power plant for a customer. The entity will be responsible for the overall management of the project including services to be prov ided like engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

Determine how many performance obligations does the entity have?

Solution: Based on the discussion above it needs to be determined that the promised goods and services are capable of being distinct as per the principles of Ind AS 115. That is, whether the customer can benefit from the goods and services either on their own or together with other readily available resources. This is evidenced by the fact that the entity, or competitors of the entity, regularly sells many of these goods and services separately to other customers. In addition, the customer could generate economic benefit from the individual goods and services by using, consuming, selling or holding those goods or services.

However, the goods and services are not distinct within the context of the contract. That is, the entity's promise to transfer individual goods and services in the contract are not separately identifiable from other promises in the contract. This is evidenced by the fact that the entity provides a significant service of putting together the various inputs or goods and services into the power plant or the output for which the customer has contracted.

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Since both the criteria has not met, the goods and services are not distinct. The entity accounts for all of the goods and services in the contract as a single performance obligation.

Illustration 10

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

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

Illustration 11:

Entity A, a specialty construction firm, enters into a contract with Entity B to design and construct a multi-level shopping centre with a customer car parking facility located in sub-levels underneath the shopping centre. Entity B solicited bids from multiple firms on both phases of the project — design and construction.

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

Determine how many performance obligations does the entity A have?

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

Illustration 12

An entity, a software developer, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the license, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by

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other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

Determine how many performance obligations does the entity have?

Solution: The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the software is delivered before the other goods and services and remains functional without the updates and the technical support. Thus, the entity concludes that the customer can benefit from each of the goods and services either on their own or together with the other goods and services that are readily available.

The entity also considers the factors of Ind AS 115 and determines that the promise to transfer each good and service to the customer is separately identifiable from each of the other promises. In particular, the entity observes that the installation service does not sign ificantly modify or customise the software itself and, as such, the software and the installation service are separate outputs promised by the entity instead of inputs used to produce a combined output.

On the basis of this assessment, the entity identifies four performance obligations in the contract for the following goods or services:

- The software license
- An installation service
- Software updates
- Technical support

Illustration 13 : Significant customisation

The promised goods and services are the same as in the above Illustration, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

Determine how many performance obligations does the entity have?

Solution: The entity assesses the goods and services promised to the customer to determine which goods and services are distinct. The entity observes that the terms of the contract result in a promise to provide a significant service of integrating the licensed software into the existing software system by performing a customised installation service as specified in the contract. In other words, the entity is using the license and the customised installation service as inputs to produce the combined output (i.e. a functional and integrated software system) specified in the contract. In addition, the software is significantly modified and customised by the service. Although the customised installation service can be provided by other entities, the entity determines that within the context of the contract, the promise to transfer the license is not separately identifiable from the customised installation service and, therefore, the criterion on the basis of the factors is not met. Thus, the software license and the customised installation service are not distinct.

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The entity concludes that the software updates and technical support are distinct from the other promises in the contract. This is because the customer can benefit from the updates and technical support either on their own or together with the other goods and services that a re readily available and because the promise to transfer the software updates and the technical support to the customer are separately identifiable from each of the other promises.

On the basis of this assessment, the entity identifies three performance obligations in the contract for the following goods or services:

a) customised installation service (that includes the software license);

b) software updates; and

c) technical support.

Illustration 14

An entity enters into a contract for the sale of Product A for Rs. 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to Rs. 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs. 500 of additional products.

Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price?

Solution: Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs. 500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is Rs. 120 (Rs. 500 average purchase price of additional products × 30% incremental discount × 80% likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the Rs. 1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	Rs. 1000
Discount voucher	Rs. 120
Total	Rs. 1120

Performance obligations	Allocated transaction price (to nearest Rs.10)
Product A (Rs. 1000 ÷ Rs. 1120 × Rs. 1000)	Rs. 890
Discount voucher(Rs. 120 ÷ Rs. 1120 × Rs. 1000)	Rs. 110

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Total Rs. 1000

The entity allocates Rs. 890 to Product A and recognises revenue for Product A when control transfers. The entity allocates Rs. 110 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

Illustration 15

A cable company provides television services for a fixed rate fee of Rs. 800 per month for a period of 3 years. Cable services is satisfied overtime because customer consumes and receives benefit from services as it is provided i.e. customer generally benefits each day that they have access to cable service.

Determine how many performance obligations does the cable company have?

Solution: Cable company determines that each increment of its services e.g. day or month, is a distinct performance obligation because customer benefits from that period of services on its own. Additionally, each increment of service is separately identifiable from those preceding and following it i.e. one service period does not significantly affect, modify or customise another. Therefore, it can be concluded that its contract with customer is a single performance obligation to provide three years of cable service because each of the distinct increments of service is satisfied over time. Also, cable company uses the same measure of progress to recognise revenue on its cable television service regardless of the contract's time period.

Illustration 16

Manufacturer M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's stores. Retailer A is obligated to pay Manufacturer M Rs. 20 per dress when the dress is sold to an end customer.

During the consignment period, Manufacturer M has the contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacturer M is also required to accept the return of the inventory. State when the control is transferred.

Solution: Manufacturer M determines that control has not been transferred to Retailer A on delivery, for the following reasons:

(a) Retailer A does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;

(b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and

(c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when Retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses.

Manufacturer M recognises revenue as the dresses are sold to the end customer.

Illustration 17

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An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public. The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticket purchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers. The entity sells the tickets and collects the consideration from customers when the tickets are purchased; therefore, there is no credit risk.

The entity also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent.

Solution: To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise. The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is c hanged or cancelled. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:

(a) the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.

(b) the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets for more than the entity's cost.

(c) the entity has discretion in setting the sales prices for tickets to its customers.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange for the tickets transferred.

Illustration 18

Customer buy a new data connection from the telecom entity. It pays one-time registration and activation fees at the time of purchase of new connection.

The customer will be charged based on the usage of the data services of the connection on monthly basis.

Are the performance obligations under the contract distinct?

Solution: By selling a new connection, the entity promises to supply data services to customer. Customer will not be able to benefit from just buying a data card and data services from third party. The activity of registering and activating connection is not a service to customer and therefore does not represent satisfaction of performance obligation.

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Entity's obligation is to provide data service and hence activation is not a separate performance obligation.

Illustration 19 – Estimating variable consideration

XYZ Limited enters into a contract with a customer to build a sophisticated machinery. The promise to transfer the asset is a performance obligation that is satisfied over time. The promised consideration is Rs. 2.5 crores, but that amount will be reduced or increased depending on the timing of completion of the asset. Specifically, for each day after 31 March 20X1 that the asset is incomplete, the promised consideration is reduced by Rs. 1 lakh. For each day before 31 March 20X1 that the asset is complete, the promised consideration increases by Rs. 1 lakh.

In addition, upon completion of the asset, a third party will inspect the asset and assign a rating based on metrics that are defined in the contract. If the asset receives a specified rating, the entity will be entitled to an incentive bonus of Rs. 15 lakhs.

Determine the transaction price.

Solution

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

a) the entity decides to use the expected value method to estimate the variable consideration associated with the daily penalty or incentive (i.e. Rs. 2.5 crores, plus or minus Rs. 1 lakh per day). This is because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled.

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

Illustration 20 – Estimating variable consideration

AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.

Construction is scheduled to be completed by the end of the 36 th month for an agreed-upon price of Rs. 25 crores.

The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)

- 10 percent bonus if completed by the 32nd month (40% likelihood)

- 5 percent bonus if completed by the 34th month (15% likelihood)

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of Rs. 2 crores if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.

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Determine the transaction price.

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

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

Bonus %	Amount of bonus (Rs. in crores)	Probability	Probability-weighted amount (Rs. in crores)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

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

Illustration 21– Volume discount incentive

HT Limited enters into a contract with a customer on 1 April 20X1 to sell Product X for Rs. 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to Rs. 900 per unit. Consequently, the consideration in the contract is variable.

For the first quarter ended 30 June 20X1, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs. 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).

Further, in May 20X1, the customer acquires another company and in the second quarter ended 30 September 20X1 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100 unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to Rs. 900.

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Determine the amount of revenue to be recognise by HT Ltd. for the quarter ended 30 June 20X1 and 30 September 20X1.

Solution

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

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

Illustration 22 – Measurement of variable consideration

An entity has a fixed fee contract for Rs. 1 million to develop a product that meets specified performance criteria. Estimated cost to complete the contract is Rs. 950,000. The entity will transfer control of the product over five years, and the entity uses the cost -to-cost input method

to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (kg)	Award % of fixed fee	Incentive fee
951 or greater	0%	—
701–950	10%	Rs. 100,000
700 or less	25%	Rs. 250,000

The entity has extensive experience creating products that meet the specific performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10 percent incentive and two that will achieve the 25 percent incentive. In this case, the entity determined that it has 95 percent confidence that it will achieve the 10 percent incentive and 20 percent confidence that it will achieve the 25 percent incentive.

Based on this analysis, the entity believes 10 percent to be the most likely amount when estimating the transaction price. Therefore, the entity includes only the 10 percent award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 95 percent confidence in achieving the 10 percent award.

The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criterion. Therefore, the entity revises its estimate of variable consideration to include the entire 25 percent incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when including the entire variable consideration in the transaction price.

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

Year Rs.

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1	50,000
2	1,75,000
3	4,00,000
4	2,75,000
5	50,000

Solution

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

		Year 1	Year 2	Year 3	Year 4	Year 5
Fixed consideration	A				1,000,000	
Estimated costs to complete*	B				950,000	
Total estimated variable consideration	C	100,000	100,000	100,000	250,000	250,000
Fixed revenue	D=A x H/B	52,632	184,211	421,053	289,474	52,632
Variable revenue	E=C x H/B	5,263	18,421	42,105	72,368	13,158
Cumulative revenue adjustment	F(see below)	—	—	—	99,370	—
Total revenue	G=D+E+F	57,895	202,632	463,158	461,212	65,790
Costs	H	50,000	175,000	400,000	275,000	50,000
Operating profit	I=G–H	7,895	27,632	63,158	186,212	15,790
Margin (rounded off)	J=I/G	14%	14%	14%	40%	24%

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

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

Calculation of cumulative catch-up adjustment:

Updated variable consideration	L		250,000
Percent complete in Year 4: (rounded off)	M=N/O		95%
Cumulative costs through Year 4	N	900,000	
Estimated costs to complete	O	950,000	
Cumulative variable revenue through Year 4:	P		138,130

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Cumulative catch-up adjustment F=L x M–P 99,370

Illustration 23 – Management fees subject to the constraint

On 1 April 20X1, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. At 31 March 20X2, the client's assets under management are Rs. 100 crores. In addition, the entity receives a performance- based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

Analyse the revenue to be recognised on 31 March, 20X2

Solution: The entity accounts for the services as a single performance obligation because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress—that is, a time-based measure of progress).

The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception—the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the incentive fee in the transaction price.

At 31 March 20X2, the client's assets under management are Rs. 100 crores. Therefore, the resulting quarterly management fee and the transaction price is Rs. 2 crores.

At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters.

Consequently, the entity recognises Rs. 2 crores as revenue for the quarter ended 31 March 20X2.

Illustration 24 – Right of return

An entity enters into 1,000 contracts with customers. Each contract includes the sale of one

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product for Rs. 50 (1,000 total products × Rs. 50 = Rs. 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is Rs. 30.

The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see paragraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

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

Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the said contracts.

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

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

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

(a) revenue of Rs. 48,500 (Rs. 50 × 970 products not expected to be returned);

(b) a refund liability of Rs. 1,500 (Rs. 50 refund × 30 products expected to be returned); and

(c) an asset of Rs. 900 (Rs. 30 × 30 products for its right to recover products from customers on settling the refund liability).

Illustration 25 – Financing component: significant or insignificant?

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

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component because of an advance payment received in excess of a year before the transfer of control of the product.

State whether company needs to make any adjustment in determining the transaction price.

What if the advance payment was larger and received further in advance, such that the entity concluded that Rs. 1,400,000 represented the financing component based on an analysis of the facts and circumstances.

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

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

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

Illustration 26 – Accounting for significant financing component

NKT Limited sells a product to a customer for Rs. 121,000 that is payable 24 months after delivery. The customer obtains control of the product at contract inception. The contract permits the customer to return the product within 90 days. The product is new and the entity has no relevant historical evidence of product returns or other available market evidence.

The cash selling price of the product is Rs. 100,000 which represents the amount that the customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception. The entity's cost of the product is Rs. 80,000. The contract includes an implicit interest rate of 10 per cent (i.e. the interest rate that over 24 months discounts the promised consideration of Rs. 121,000 to the cash selling price of Rs. 100,000). Analyse the above transaction with respect to its financing component.

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

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

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

Illustration 27 – Determining the discount rate

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VT Limited enters into a contract with a customer to sell equipment. Control of the equipment transfers to the customer when the contract is signed.The price stated in the contract is Rs. 1 crore plus a 10% contractual rate of interest, payable in 60 monthly instalments of Rs. 212,470. Determine the discounting rate and the transaction price when

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

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction ie 14%.

Solution:

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

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

The market terms of the financing mean that the cash selling price of the equipment is Rs. 1 crore. This amount is recognised as revenue and as a loan receivable when control of the equipment transfers to the customer. The entity accounts for the receivable in accordance with Ind AS 109.

Case B—Contractual discount rate does not reflect the rate in a separate financing transaction

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

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

Illustration 28– Advance payment and assessment of discount rate

ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

Payment of Rs. 5,000 in two years when the customer obtains control of the asset or Payment of Rs. 4,000 when the contract is signed. The customer elects to pay Rs. 4,000 when the contract is signed.

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ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.

Pass journal entries showing how the entity would account for the significant financing component.

Solution: Journal Entries showing accounting for the significant financing component:

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

Cash Dr. Rs. 4,000

To Contract liability Rs. 4,000

(b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration and accretes the contract liability by recognising interest on Rs. 4,000 at 6% for two years:

Interest expense Dr. Rs. 494*

To Contract liability Rs. 494

* Rs. 494 = Rs. 4,000 contract liability × (6% interest per year for two years).

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

Contract liability Dr. Rs. 4,494

To Revenue Rs. 4,494

Illustration 29– Withheld payments on a long-term contract

ABC Limited enters into a contract for the construction of a power plant that includes scheduled milestone payments for the performance by ABC Limited throughout the contract term of three years. The performance obligation will be satisfied over time and the milestone payments are scheduled to coincide with the expected performance by ABC Limited. The contract provides that a specified percentage of each milestone payment is to be withheld as retention money by the customer throughout the arrangement and paid to the entity only when the building is complete.

Analyse whether the contract contains any financing component.

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

Illustration 30– Advance payment

XYZ Limited, a personal computer (PC) manufacturer, enters into a contract with a customer to provide global PC support and repair coverage for three years along with its PC. The customer purchases this support service at the time of buying the product. Consideration for the service is an additional Rs. 3,000. Customers electing to buy this service must pay for it upfront (i.e. a monthly payment option is not available).

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

Solution: To determine whether there is a significant financing component in the contract, the entity considers the nature of the service being offered and the purpose of the payment terms. The entity charges a single upfront amount, not with the primary purpose of obtaining financing from the customer but, instead, to maximise profitability, taking into consideration the risks associated with providing the service. Specifically, if customers could pay monthly, they would be less likely to renew and the population of customers that continue to use the support service in the later years may become smaller and less diverse over time (i.e. customers that choose to renew historically are those that make greater use of the service, thereby increasing the entity's costs). In addition, customers tend to use services more if they pay monthly rather than making an upfront payment. Finally, the entity would incur higher administration costs such as the costs related to administering renewals and collection of monthly payments.

In assessing whether or not the contract contains a significant financing component, XYZ Limited determines that the payment terms were structured primarily for reasons other than the provision of finance to the entity. XYZ Limited charges a single upfront amount for the services because other payment terms (such as a monthly payment plan) would affect the nature of the risks it assumes to provide the service and may make it uneconomical to provide the service. As a result of its analysis, XYZ Limited concludes that there is not a significant financing component.

Illustration 31– Advance payment

A computer hardware vendor enters into a three-year arrangement with a customer to provide support services. For customers with low credit ratings, the vendor requires the customer to pay for the entire arrangement in advance of the provision of service. Other customers pay over time.

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

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

Illustration 32 – Sales based royalty

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

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

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

Illustration 33 – Payment in arrears

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

Based on the terms of the contract, the contractor determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control to the customer. The customer agrees to provide the contractor monthly progress payments, with the final 25 percent payment (holdback payment) due upon contract completion. As a result of the holdback payment, there is a gap between when control transfers and when consideration is received, creating a financing component.

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

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

Illustration 34– Payment in arrears

Company Z is a developer and manufacturer of defence systems that is primarily a Tier-II supplier of parts and integrated systems to original equipment manufacturers (OEMs) in the commercial markets. Company Z enters into a contract with Company X for the development and delivery of 5,000 highly technical, specialized missiles for use in one of Company X's platforms.

As a part of the contract, Company X has agreed to pay Company Z for their cost plus an award fee up to Rs. 100 crores. The consideration will be paid by the customer related to costs incurred near the time Company Z incurs such costs. However, the Rs. 100 crores award fee is awarded upon successful completion of the development and test fire of a missile to occur in 16 months from the time the contract is executed.

The contract specifies Company Z will earn up to Rs. 100 crores based on Company X's assessment of Company Z's ability to develop and manufacture a missile that achieves multiple factors, including final weight, velocity, and accuracy. Partial award fees may be awarded based on a pre-determined scale based on their success.

Assume Company Z has assessed the contract under Ind AS 115 and determined the award fee represents variable consideration. Based on their assessment, Company Z has estimated a total of Rs. 80 crores in the transaction price related to the variable consideration pursuant to guidance within Ind AS 115. Further, the entity has concluded it should recognize revenue over time for a single performance obligation using a cost-to-cost input method.

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

Solution: Company Z will transfer control over time beginning shortly after the contract is executed, but will not receive the cash consideration related to the award fee component from Company X for more than one year in the future. Hence, Company Z should assess whether the award fee represents a significant financing component.

The intention of the parties in negotiating the award fee due upon completion of the test fire, and based on the results of that test fire, was to provide incentive to Company Z to produce high functioning missiles that achieved successful scoring from Company X. Therefore, it was determined the contract does not contain a significant financing component, and Company Z should not adjust the transaction price.

As per Ind AS 115.63, as a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between:

(a) when the entity transfers a promised good or service to a customer and

(b) when the customer pays for that good or service

will be one year or less.

Illustration 35– Applying practical expedient

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

Based on the terms of the contract, Company H determines that it transfers control over time, and recognizes revenue based on an input method best reflecting the transfer of control t o Company C.

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

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

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

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

Illustration 36– Entitlement to non-cash consideration

An entity enters into a contract with a customer to provide a weekly service for one year. The contract is signed on 1st April 20X1 and work begins immediately. The

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entity concludes that the service is a single performance obligation. This is because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress — that is, a time-based measure of progress).

In exchange for the service, the customer promises its 100 equity shares per week of service (a total of 5,200 shares for the contract). The terms in the contract require that the shares must be paid upon the successful completion of each week of service.

How should the entity decide the transaction price?

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

- If the fair value of the non-cash consideration promised by a customer varies for reasons other than only the form of the consideration (for example, the fair value could vary because of the entity's performance), the entity is required to apply the guidance on variable consideration and the constraint when determining the transaction price.

Illustration 37– Fair value of non-cash consideration varies for reasons other than the form of the consideration

RT Limited enters into a contract to build an office building for AT Limited over an 18-month period. AT Limited agrees to pay the construction entity Rs. 350 crores for the project. RT Limited will receive a bonus of 10 lakhs equity shares of AT Limited if it completes construction of the office building within one year. Assume a fair value of Rs. 100 per share at contract inception.

Determine the transaction price.

Solution: The ultimate value of any shares the entity might receive could change for two reasons:

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

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

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

As a result, if the entity earns the bonus, its revenue would be Rs. 350 crores plus 10 lakhs equity shares at Rs. 100 per share for total consideration of Rs. 360 crores.

Illustration 38– Customer-provided goods or services

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MS Limited is a manufacturer of cars. It has a supplier of steering systems – SK Limited. MS Limited places an order of 10,000 steering systems on SK Limited.It also agrees to pay Rs. 25,000 per steering system and contributes tooling to be used in SK's production process.

The tooling has a fair value of Rs. 2 crores at contract inception. SK Limited determines that each steering system represents a single performance obligation and that control of the steering system transfers to MS Limited upon delivery.

SK Limited may use the tooling for other projects and determines that it obtains control of the tooling. Determine the transaction price?

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

Illustration 39– Consideration payable to a customer

An entity that manufactures consumer goods enters into a one-year contract to sell goods to a customer that is a large global chain of retail stores. The customer commits to buy at least Rs. 15 crores of products during the year. The contract also requires the entity to make a non - refundable payment of Rs. 1.5 crores to the customer at the inception of the contract. The Rs. 1.5 crores payment will compensate the customer for the changes it needs to make to its shelving to accommodate the entity's products. The entity does not obtain control of any rights to the customer's shelves.

Determine the transaction price.

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

The entity applies the requirements in paragraph 72 of Ind AS 115 and concludes that the consideration payable is accounted for as a reduction in the transaction price when the entity recognises revenue for the transfer of the goods. Consequently, as the entity transfers goods to the customer, the entity reduces the transaction price for each good by 10 per cent [(Rs. 1.5 crores ÷ Rs. 15 crores) x 100]. Therefore, in the first month in which the entity transfers goods to the customer, the entity recognises revenue of Rs. 1.125 crores (Rs. 1.25 crores invoiced amount less Rs. 0.125 crore of consideration payable to the customer).

Illustration 40– Allocation methodology

An entity enters into a contract with a customer to sell Products A, B and C in exchange for Rs. 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand -alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin

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approach for Product C. In making those estimates, the entity maximises the use of observable inputs.

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

Product	Stand-alone selling price	Method
	Rs.	
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach
Product C	7,500	Expected cost plus a margin approach
Total	15,000	

Determine the transaction price allocated to each product.

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

Product	Allocated transaction price (to nearest Rs.100)	
	Rs.	
Product A	3,300	(Rs. 5,000 ÷ Rs. 15,000 × Rs. 10,000)
Product B	1,700	(Rs. 2,500 ÷ Rs. 15,000 × Rs. 10,000)
Product C	5,000	(Rs. 7,500 ÷ Rs. 15,000 × Rs. 10,000)
Total	10,000	

Illustration 41– Allocating a discount

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

Product	Stand-alone selling price
	Rs.
Product X	50,000
Product Y	25,000
Product Z	45,000
Total	1,20,000

In addition, the entity regularly sells Products Y and Z together for Rs. 50,000.

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

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The entity enters into a contract with a customer to sell Products X, Y and Z in exchange for Rs. 100,000. The entity will satisfy the performance obligations for each of the products at different points in time; or Product Y and Z at same point of time. Determine the allocation of transaction price to Product Y and Z.

Case B—Residual approach is appropriate

The entity enters into a contract with a customer to sell Products X, Y and Z as described in Case A. The contract also includes a promise to transfer Product Alpha. Total consideration in the contract is Rs. 130,000. The stand-alone selling price for Product Alpha is highly variable because the entity sells Product Alpha to different customers for a broad range of amounts (Rs. 15,000 – Rs. 45,000). Determine the stand-alone selling price of Products, X, Y, Z and Alpha using the residual approach.

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs. 1,05,000 instead of Rs. 130,000.

Solution

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

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

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

If the entity transfers control of Products Y and Z at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate Rs. 50,000 of the transaction price to the single performance obligation and recognise revenue of Rs. 50,000 when Products Y and Z simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Products Y and Z at different points in time, then the allocated amount of Rs. 50,000 is individually allocated to the promises to transfer Product Y (stand-alone selling price of Rs. 25,000) and Product Z (stand-alone selling price of Rs. 45,000) as follows:

Product	Allocated transaction price	
	Rs.	
Product Y	17,857	(Rs. 25,000 ÷ Rs. 70,000 total stand-alone selling price × Rs. 50,000)
Product Z	32,143	(Rs. 45,000 ÷ Rs. 70,000 total stand-alone selling price × Rs. 50,000)
Total	50,000	

Case B—Residual approach is appropriate

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

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

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

Product	Stand-alone selling price	Method
	Rs.	
Product X	50,000	Directly observable
Products Y and Z	50,000	Directly observable with discount
Product Alpha	30,000	Residual approach
Total	130,000	

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

Case C—Residual approach is inappropriate

The same facts as in Case B apply to Case C except the transaction price is Rs. 105,000 instead of Rs. 130,000. Consequently, the application of the residual approach would result in a stand-alone selling price of Rs. 5,000 for Product Alpha (Rs. 105,000 transaction price less Rs. 100,000 allocated to Products X, Y and Z).

The entity concludes that Rs. 5,000 would not faithfully depict the amount of consideration to which the entity expects to be entitled in exchange for satisfying its performance obligation to transfer Product Alpha, because Rs. 5,000 does not approximate the stand-alone selling price of Product Alpha, which ranges from Rs. 15,000 – Rs. 45,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Alpha using another suitable method. The entity allocates the transaction price of Rs. 1,05,000 to Products X, Y, Z and Alpha using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

Illustration 42– Allocation of variable consideration

An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. The stand-alone selling prices of Licences A and B are Rs. 1,600,000 and Rs. 2,000,000, respectively. The entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation

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The price stated in the contract for Licence A is a fixed amount of Rs. 1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variable consideration) to be Rs. 2,000,000. Allocate the transaction price.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence A is a fixed amount of Rs. 600,000 and for Licence B the consideration is five per cent of the customer's future sales of products that use Licence B. The entity's estimate of the sales-based royalties (ie the variable consideration) is Rs. 3,000,000. Allocate the transaction price and determine the revenue to be recognised for each licence and the contract liability, if any.

Solution

Case A—Variable consideration allocated entirely to one performance obligation

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

(a) the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B).

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

The entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognise revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. Therefore, the entity recognises revenue for the sales-based royalty when those subsequent sales occur.

When Licence A is transferred, the entity recognises as revenue the Rs. 1,600,000 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

To allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirely to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variable consideration entirely to Licence B would be inconsistent with the principle for allocating the

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transaction price. Allocating Rs. 600,000 to Licence A and Rs. 3,000,000 to Licence B does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences A and B of Rs. 1,600,000 and Rs. 2,000,000, respectively. Consequently, the entity applies the general allocation requirements of Ind AS 115.

The entity allocates the transaction price of Rs. 600,000 to Licences A and B on the basis of relative stand-alone selling prices of Rs. 1,600,000 and Rs. 2,000,000, respectively. The entity also allocates the consideration related to the sales-based royalty on a relative stand-alone selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognises as revenue Rs. 333,333 [(Rs. 2,000,000 ÷ Rs. 3,600,000) × Rs. 600,000] allocated to Licence B. When Licence A is transferred, the entity recognises as revenue Rs. 266,667 [(Rs. 1,600,000 ÷ Rs. 3,600,000) × Rs. 600,000] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is Rs. 400,000. Consequently, the entity recognises as revenue Rs. 222,222 (Rs. 2,000,000 ÷ Rs. 3,600,000 × Rs. 400,000) allocated to Licence B (which has been transferred to the customer and is therefore a satisfied performance obligation). The entity recognises a contract liability for the Rs. 177,778 (Rs. 1,600,000 ÷ Rs. 3,600,000 × Rs. 400,000) allocated to Licence A. This is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

Illustration 43– Allocating a change in transaction price

On 1 April 20X0, a consultant enters into an arrangement to provide due diligence, valuation, and software implementation services to a customer for Rs. 2 crores. The consultant can earn Rs. 20 lakhs bonus if it completes the software implementation by 30 September 20X0 or Rs. 10 lakhs bonus if it completes the software implementation by 31 December 20X0.

The due diligence, valuation, and software implementation services are distinct and therefore are accounted for as separate performance obligations. The consultant allocates the transaction price, disregarding the potential bonus, on a relative stand-alone selling price basis as follows:

• Due diligence – Rs. 80 lakhs

• Valuation – Rs. 20 lakhs

• Software implementation – Rs. 1 crore

At contract inception, the consultant believes it will complete the software implementation by 30 January 20X1. After considering the factors in Ind AS 115, the consultant cannot conclude that a significant reversal in the cumulative amount of revenue recognized would not occur when the uncertainty is resolved since the consultant lacks experience in completing similar projects. As a result, the consultant does not include the amount of the early completion bonus in its estimated transaction price at contract inception.

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

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

Determine the transaction price.

Solution: On 1 July 20X0, the consultant allocates the bonus of Rs. 20 lakhs to the software implementation performance obligation, for total consideration of Rs. 1.2 crores allocated to that performance obligation, and adjusts the cumulative revenue to date for the software implementation services to Rs. 72 lakhs (60 percent of Rs. 1.2 crores).

Illustration 44

Minitek Ltd. is a payroll processing company. Minitek Ltd. enters into a contract to provide monthly payroll processing services to ABC limited for one year. Determine how entity will recognise the revenue?

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

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

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

For certain performance obligations, an entity may not be able to readily identify whether a customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs. In such cases, a performance obligation is satisfied over time if an entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date if that other entity were to fulfil the remaining performance obligation to the customer.

In making such determination, an entity shall make both of the following assumptions:

(a) disregard potential contractual restrictions or practical limitations that otherwise would prevent the entity from transferring the remaining performance obligation to another entity; and

(b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any work in progress.

Illustration 45

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T&L Limited ('T&L') is a logistics company that provides inland and sea transportation services. A customer – Horizon Limited ('Horizon') enters into a contract with T&L for transportation of its goods from India to Srilanka through sea. The voyage is expected to take 20 days Mumbai to Colombo. T&L is responsible for shipping the goods from Mumbai port to Colombo port.

Whether T&L's performance obligation is met over period of time?Solution: T&L has a single performance to ship the goods from one port to another. The following factors are critical for assessing how services performed by T&L are consumed by the customer –

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

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

Illustration 46

AFS Ltd. is a risk advisory firm and enters into a contract with a company – WBC Ltd to provide audit services that results in AFS issuing an audit opinion to the Company. The professional opinion relates to facts and circumstances that are specific to the company. If the Company was to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the Company to compensate the risk advisory fir m for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

Whether risk advisory firm's performance obligation is met over period of time?

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

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

  Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: This is service contract and no asset created, over which customer acquires control.
- Criterion (c) – no alternate use to entity and right to seek payment:
  - The services provided by AFS are specific to the company – WBC and do not have any alternate use to AFS

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- Further, AFS has a right to enforce payment if contract was early terminated, for reasons other than AFS's failure to perform. And the profit margin approximates what entity otherwise earns.

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

Illustration 47

Space Ltd. enters into an arrangement with a government agency for construction of a space satellite. Although Space Ltd is in this business for building such satellites for various customers across the world, however the specifications for each satellite may vary based on technology that is incorporated in the satellite. In the event of termination, Company has right to enforce payment for work completed to date.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

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

- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the satellite is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
- Criterion (c) – no alternate use to entity and right to seek payment:

The asset is being specifically created for the customer. The asset is customised to customer's requirements, such that any diversion for a different customer will require significant work. Therefore, the asset has practical limitation in being put to alternate use.

Further, Space Ltd. has a right to enforce payment if contract was early terminated, for reasons other than Space Ltd.'s failure to perform.

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

Illustration 48

ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

Solution: The Company shall evaluate conditions laid in para 35 of Ind AS 115 as follows:

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- Criterion (a) – whether the customer simultaneously receives and consumes the benefits: Customer can benefit only when the asset is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.
- Criterion (b) – An asset created that customer controls: Per provided facts, the customer does not acquire control of the asset as its created.
- Criterion (c) – no alternate use to entity and right to seek payment:
  - The customer has specific right over the asset and company does not have right to divert it for any alternate use. In other words, there is contractual restriction to use the asset for any alternate purpose.
  - In the event of early termination, Company has a right to retain any payments made by the customer. However, such payments need not necessarily compensate the selling price of the partially constructed asset, if the customer was to stop making payments.

Therefore, Company does not have a legally enforceable right to payment for work completed to date and the criterion under para 35 is not. Thus, revenue cannot be recognised over a period of time.

Illustration 49: Measuring progress on straight line basis

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month. The entity's promise to the customer is to provide a service of making the health clubs available for the customer to use as and when the customer wishes.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time. If yes, how should an entity measure its progress of service provided?

Solution: The entity shall determine if revenue should be recognised over a period of time by evaluating the conditions laid in para 35 of Ind AS 115.

- Applying the first criterion of para 35 to establish if the customer simultaneously receives and consumes the benefits, as the entity provides service – The health club provides access to services uniformly through the year. The extent to which the customer uses the health clubs does not affect the amount of the remaining goods and services to which the customer is entitled. The customer therefore simultaneously receives and consumes the benefits of the entity's performance as it performs by making the health clubs available.
- Consequently, the entity's performance obligation is satisfied over time
- Once the pattern of satisfying performance obligation is defined, the Company then determines how progress should be measured. The services are uniformly provided to the customer through the year. Therefore, the best measure of progress is to recognise revenue on a straight line basis over the year.

Illustration 50: Uninstalled materials

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On 01 January 20X1, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

Particulars		Amount (Rs.)
Transaction price		5,000,000
Expected costs:		
(a)	Elevators	1,500,000
(b)	Other costs	2,500,000
Total		4,000,000

The entity purchases the elevators and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of 500,000 by March 31, 20 X1.

How will the Company recognize revenue, if performance obligation is met over a period of time?

Solution: Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation

(b) The cost of elevators is substantial to the overall project and are incurred well in advance.

(c) Upon delivery at site, customer acquires control of such elevators.

(d) And there is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

- The measure of progress should be made based on percentage of costs incurred relative to the total budgeted costs.
- The cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars Amount		(Rs.)
Transaction price		5,000,000
Costs incurred:		
(a)	Cost of elevators	1,500,000
(b)	Other costs	500,000

Measure of progress:500,000 / 2,500,000 = 20%

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Revenue to be recognised:

(a) For costs incurred (other than elevators) Total attributable revenue = 3,500,000

% of work completed = 20% Revenue to be recognised = 700,000

(b) Revenue for elevators1,500,000 (equal to costs incurred)

Total revenue to be recognised1,500,000 + 700,000 = 2,200,000

Therefore, for the year ended 31 March 20X1, the Company shall recognize revenue of Rs. 2,200,000 on the project.

Illustration 51

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for Rs. 1 million. The contract includes a call option that gives the entity the right to repurchase the asset for Rs. 1.1 million on or before December 31, 20X1.

How would the entity account for this transaction?

Solution: In the above case, where the entity has a right to call back the goods upto a certain date –

- The customer cannot be said to have acquired control, owing to the repurchase r ight with the seller entity
- Since the original selling price (Rs. 1 million) is lower than the repurchase price (Rs. 1.1 million), this is construed to be a financing arrangement and accounted as follows:
  (a) Amount received shall be recognized as 'liability'
  (b) Difference between sale price and repurchase price to be recognised as 'finance cost' and recognised over the repurchase term.

Illustration 52

An entity enters into a contract with a customer for the sale of a tangible asset on 1 January 20X1 for Rs. 1,000,000. The contract includes a put option that gives the customer the right to sell the asset for Rs. 900,000 on or before December 31, 20X1. The market price for such goods is expected to be Rs. 750,000

How would the entity account for this transaction?

Solution: In the above case, where the entity has an obligation to buy back the goods upto a certain date –

- The entity shall evaluate if the customer has a significant economic incentive to return the goods. Since the repurchase price is significantly higher than market price, therefore, customer has a significant economic incentive to return the goods. There are no other factors which entity may affect this assessment.
- Therefore, company determines that 'control' of goods is not transferred to the customer till 31 December 20X1, ie, till the put option expires.
- Against payment of Rs. 1,000,000; the customer only has a right to use the asset and put it back to the entity for Rs. 900,000. Therefore, this will be accounted as a lease

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transaction in which difference between original selling price (ie, Rs. 1,000,000) and repurchase price (ie, Rs. 900,000) shall be recognized as lease income over the period of lease.

- At the end of repurchase term, ie, 31 December 20X1, if the customer does not exercise such right, then the control of goods would be passed to the customer at that time and revenue shall be recognized for sale of goods for repurchase price (ie, Rs. 900,000).

Illustration 53

An entity enters into a contract with a customer on 1 April 20 X1 for the sale of a machine and spare parts. The manufacturing lead time for the machine and spare parts is two years.

Upon completion of manufacturing, the entity demonstrates that the machine and spare parts meet the agreed-upon specifications in the contract. The promises to transfer the machine and spare parts are distinct and result in two performance obligations that each will be satisfied at a point in time. On 31 March 20X3, the customer pays for the machine and spare parts, but only takes physical possession of the machine. Although the customer inspects and accepts the spare parts, the customer requests that the spare parts be stored at the entity's warehouse because of its close proximity to the customer's factory. The customer has legal title to the spare parts and the parts can be identified as belonging to the customer. Furthermore, the entity stores the spare parts in a separate section of its warehouse and the parts are ready for immediate shipment at the customer's request. The entity expects to hold the spare parts for two to four years and the entity does not have the ability to use the spare parts or direct them to another customer.

How will the Company recognise revenue for sale of machine and spare parts? Is there any other performance obligation attached to this sale of goods?

Solution: In the facts provided above, the entity has made sale of two goods – machine and space parts, whose control is transferred at a point in time. Additionally, company agrees to hold the spare parts for the customer for a period of 2-4 years, which is a separate performance obligation. Therefore, total transaction price shall be divided amongst 3 performance obligations –

(i) Sale of machinery

(ii) Sale of spare parts

(iii) Custodial services for storing spare parts.

Recognition of revenue for each of the three performance obligations shall occur as follows:

- **Sale of machinery:** Machine has been sold to the customer and physical possession as well as legal title passed to the customer on 31 March 20 X3. Accordingly, revenue for sale of machinery shall be recognised on 31 March 20X3.

- **Sale of spare parts:** The customer has made payment for the spare parts and legal title has been passed to specifically identified goods, but such spares continue to be physically held by the entity. In this regard, the company shall evaluate if revenue can be recognized on bill-n-hold basis if all below criteria are met:

  a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);

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The customer has specifically requested for entity to store goods in their warehouse, owing to close proximity to customer's factory.

b) the product must be identified separately as belonging to the customer;

The spare parts have been specifically identified and inspected by the customer.

c) the product currently must be ready for physical transfer to the customer; and

The spares are identifiedand segregated, therefore, read for delivery.

d) the entity cannot have the ability to use the product or to direct it to another customer

Spares have been segregated and cannot be redirected to any other customer.

Therefore, all conditions of bill-and-hold are met and hence, company can recognize revenue for sale of spare parts on 31 March 20X3.

- **Custodial services:** Such services shall be given for a period of 2 to 4 years from 31 March 20X3. Where services are given uniformly and customer receives & consumes benefits simultaneously, revenue for such service shall be recognized on a straight line basis over a period of time.

Illustration 54

Customer outsources its information technology data centre Term = 5 years plus two 1-yr renewal options

Average customer relationship is 7 years

Entity spends Rs. 400,000 designing and building the technology platform needed to accommodate out-sourcing contract:

Design services	Rs. 50,000
Hardware	Rs. 140,000
Software	Rs. 100,000
Migration and testing of data centre	Rs. 110,000
TOTAL	Rs. 400,000

How should such costs be treated?

Solution

Design services	Rs. 50,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
Hardware	Rs. 140,000	Account for asset under Ind AS 16
Software	Rs. 100,000	Account for asset under Ind AS 38
Migration and testing of data centre	Rs. 110,000	Assess under Ind AS 115. Any resulting asset would be amortised over 7 years (i.e. include renewals)
TOTAL	**Rs. 400,000**	

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Illustration 55: Amortisation

An entity enters into a service contract with a customer and incurs incremental costs to obtain the contract and costs to fulfil the contract. These costs are capitalised as assets in accordance with Ind AS 115. The initial term of the contract is five years but it can be renewed for subsequent one-year periods up to a maximum of 10 years. The average contract term for similar contracts entered into by entity is seven years.

Determine appropriate method of amortisation?

Solution: The most appropriate amortisation period is likely to be seven years (i.e. the initial term of five years plus two anticipated one year renewals) because that is the period over which the entity expects to provide services under the contract to which the capitalised costs relate.

Illustration 56

A Ltd. is in the business of the infrastructure and has two divisions under the same; (I) Toll Roads and (II) Wind Power. The brief details of these business and underlying project details are as follows:

I. Bhilwara-Jabalpur Toll Project - The Company has commenced the construction of the project in the current year and has incurred total expenses aggregating to Rs. 50 crores as on 31st December, 20X1. Under IGAAP, the Company has 'recorded such expenses as Intangible Assets in the books of account. The brief details of the Concession Agreement are as follows:

- Total Expenses estimated to be incurred on the project Rs. 100 crores;
- Fair Value of the construction services is Rs. 110 crores;
- Total Cash Flow guaranteed by the Government under the concession agreement is Rs. 200 crores;
- Finance revenue over the period of operation phase is Rs. 15 crores:
- Other income relates to the services provided during the operation phase.

II. Kolhapur- Nagpur Expressway - The Company has also entered into another concession agreement with Government of Maharashtra in the current year. The construction cost for the said project will be Rs. 110 crores. The fair value of such construction cost is approximately Rs. 200 crores. The said concession agreement is Toll based project and the Company needs to collect the toll from the users of the expressway. Under IGAAP, UK Ltd. has recorded the expenses incurred on the said project as an Intangible Asset.

Required

(i) What would be the classification of Bhilwara-Jabalpur Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

(ii) What would be the classification of Kolhapur-Nagpur Expressway Toll Project as per applicable Ind AS? Give brief reasoning for your choice.

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(iii) Also, suggest suitable accounting treatment for preparation of financial statements as per Ind AS for the above 2 projects.

Solution

(i) Here the operator has a contractual right to receive cash from the grantor. The grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator. Hence, operator recognizes a financial asset to the extent it has a contractual right to receive cash.

(ii) Here the operator has a contractual right to charge users of the public services. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service. Therefore, the operator shall recognise an intangible asset to the extent it receives a right (a licence) to charge users of the public service.

(iii) Accounting treatment for preparation of financial statements

Bhilwara-Jabalpur Toll Project

Journal Entries

	Particulars	Dr. (Rs. in crores)	Cr. (Rs. in crores)
	During construction:		
1	Financial asset A/c Dr.	110	
	To Construction revenue		110
	[To recognise revenue relating to construction services, to be settled in case]		
2	Cost of construction (profit or loss) Dr.	100	
	To Bank A/c (As and when incurred)		100
	[To recognise costs relating to construction services]		
	During the operation phase:		
3	Financial asset Dr.	15	
	To Finance revenue (As and when received or due to receive)		15
	[To recognise interest income under the financial asset model]		
4	Financial asset Dr.	75	
	To Revenue [(200-110) – 15]		75
	[To recognise revenue relating to the operation phase]		
5	Bank A/c Dr.	200	
	To Financial asset		200
	[To recognise cash received from the grantor]		

Kolhapur-Nagpur Expressway -Intangible asset Journal Entries

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	Particulars	Dr. (Rs. in crores)	Cr. (Rs. in crores)
1	During construction: Cost of construction (profit or loss) Dr. To Bank A/c (As and when incurred) [To recognise costs relating to construction services]	110	110
2	Intangible asset Dr. To Revenue [To recognise revenue relating to construction services provided for non-cash consideration]	200	200
3	During the operation phase: Amortisation expense Dr. To Intangible asset (accumulated amortisation) [To recognise amortisation expense relating to the operation phase over the period of operation]	200	200
4	Bank A/c Dr. To Revenue [To recognise revenue relating to the operation phase]	?	?

Note: Amount in entry 4 is kept blank as no information in this regard is given in the question.

TEST YOUR KNOWLEDGE

Question 1:

Q TV released an advertisement in Deshabandhu, a vernacular daily. Instead of paying for the same, Q TV allowed Deshabandhu a free advertisement spot, which was duly utilised by Deshabandu. How revenue for these nonmonetary transactions in the area of advertising will be recognised and measured?

Answer: Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

In industries with homogenous products, it is common for entities in the same line of business to exchange products in order to sell them to customers or potential customers other than parties to exchange. The current scenario, on the contrary, will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services because both of the entities deal in different mode of media, i.e., one is print media and another is electronic media and both parties are acting as customers and suppliers for each other.

Further, in the current scenario, it seems it is for consumption by the said parties and hence it does not fall under paragraph 5(d). It may also be noted that, even if it was to facilitate sales to customers or potential customers, it would not be scoped out since the parties are not in the same line of business.

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As per paragraph 47 of Ind AS 115, "An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both".

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

In accordance with the above, QTV and Deshabandhu should measure the revenue promised in the form of non-cash consideration as per the above referred principles of Ind AS 115.

Question 2:

A Ltd. a telecommunication company, entered into an agreement with B Ltd. which is engaged in generation and supply of power. The agreement provided that A Ltd. will provide 1,00,000 minutes of talk time to employees of B Ltd. in exchange for getting power equivalent to 20,000 units. A Ltd. normally charges Re.0.50 per minute and B Ltd. Charges Rs. 2.5 per unit. How should revenue be measured in this case?

Answer: Paragraph 5(d) of Ind AS 115 excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

However, the current scenario will be covered under Ind AS 115 since the same is exchange of dissimilar goods or services.

As per paragraph 47 of Ind AS 115, "an entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both".

Paragraph 66 of Ind AS 115 provides that to determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of noncash consideration) at fair value.

On the basis of the above, revenue recognised by A Ltd. will be the consideration in the form of power units that it expects to be entitled for talktime sold, i.e. Rs. 50,000 (20,000 units x Rs.2.5). The revenue recognised by B Ltd. will be the consideration in the form of talk time that it expects to be entitled for the power units sold, i.e., Rs. 50,000 (1,00,000 minutes x Re. 0.50).

Question 3:

Company X enters into an agreement on January 1, 20 X1 with a customer for renovation of hospital and install new air-conditioners for total consideration of Rs. 50,00,000. The promised renovation service, including the installation of new air-conditioners is a single performance obligation satisfied over time. Total expected costs are Rs. 40,00,000 including Rs. 10,00,000 for the airconditioners.

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Company X determines that it acts as a principal in accordance with paragraphs B34-B38 of Ind AS 115 because it obtains control of the air conditioners before they are transferred to the customer. The customer obtains control of the air conditioners when they are delivered to the hospital premises.

Company X uses an input method based on costs incurred to measure its progress towards complete satisfaction of the performance obligation.

As at March 31, 20X1, other costs incurred excluding the air conditioners are Rs.6,00,000.

Whether Company X should include cost of the air conditioners in measure of its progress of performance obligation? How should revenue be recognised for the year ended March 20X1?

Answer: Paragraph B19 of Ind AS 115 inter alia, states that, "an entity shall exclude from an input method the effects of any inputs that, in accordance with the objective of measuring progress in paragraph 39, do not depict the entity's performance in transferring control of goods or services to the customer".

In accordance with the above, Company X assesses whether the costs incurred to procure the air conditioners are proportionate to the entity's progress in satisfying the performance obligation. The costs incurred to procure the air conditioners (Rs.10,00,000) are significant relative to the total costs to completely satisfy the performance obligation (Rs.40,00,000). Also, Company X is not involved in manufacturing or designing the air conditioners.

Company X concludes that including the costs to procure the air conditioners in the measure of progress would overstate the extent of the entity's performance. Consequently, in accordance with paragraph B19 of Ind AS 115, the entity adjusts its measure of progress to exclude the costs to procure the air conditioners from the measure of costs incurred and from the transaction price. The entity recognises revenue for the transfer of the air conditioners at an amount equal to the costs to procure the air conditioners (i.e., at a zero margin).

Company X assesses that as at March 20X1, the performance is 20 per cent complete (i.e., Rs. 6,00,000/Rs. 30,00,000). Consequently, Company X recognises the following-

As at March 31, 20X1

	Amount in Rs.
Revenue	18,00,000
Cost of goods sold	16,00,000
Profit	2,00,000

Revenue recognised is calculated as (20 per cent × Rs. 40,00,000) + Rs. 10,00,000.

(Rs. 40,00,000 = Rs. 50,00,000 transaction price – Rs. 10,00,000 costs of air conditioners.)

Cost of goods sold is Rs. 6,00,000 of costs incurred + Rs. 10,00,000 costs of air conditioners.

Question 4

How is 'Revenue' different from 'Income'? What is the distinction between 'Income' and 'Equity'?

Answer: Appendix A of Ind AS 115, Revenue from Contracts with Customers, defines 'Revenue' as income arising in the course of an entity's ordinary activities. Income is defined in the Appendix A of

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Ind AS 115 as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Thus, 'Income' is a wider term as 'Revenue' is income that arises in the course of ordinary activities of an entity, whereas Income encompasses revenue as well as gains which may not arise in the ordinary course of business.

Example: In case of a manufacturer of cement, the income from sale of cement is revenue. However, if the same entity sells its surplus land, the profit on sale of land is a gain and not revenue. However, its total income would comprise revenue from sale of cement as well as gain on sale of land.

It may be noted that changes in equity that relate to contributions from or distributions to owners are excluded from the definition of income and expenses. Paragraph 109 of Ind AS 1, Presentation of Financial Statements, provides that "Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period".

Accordingly, changes in total equity arise due to the following two reasons:

(i) transactions with owners (like equity contributions, dividends etc.); and

(ii) income/expense generated by the entity.

Question 5

Does Ind AS 115 apply to real estate developers?

Answer: Ind AS 18, Revenue, required that for real estate developers, revenue should be accounted for as per the 'Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable)'. However, pursuant to Ind AS 115 becoming effective, the said guidance note has been withdrawn and there is no scope exclusion for real estate developers in the standard.

Accordingly, the real estate developers will be required to apply Ind AS 115 for recognition of revenue from contracts with customers including determining whether the developer satisfies performance obligation and recognises revenue over time or at a point in time.

Question 6

Whether revenue from extraction of mineral ores be accounted for as per Ind AS 115?

Answer: Ind AS 18 specifically scoped out revenue from the extraction of mineral ores. However, Ind AS 115 does not scope out revenue from the extraction of mineral ore, if it arises as a result of a contract with a customer.

Therefore, revenue from extraction of mineral ores will be covered under the scope of Ind AS 115 if the same is pursuant to a contract with the customer.

Question 7

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A Company is registered as an Export Oriented Unit (EOU) and exports all its manufactured products. As per the Foreign Trade Policy in India, Merchandise Exports from India Scheme ("MEIS"), the Company is eligible to claim 2% of its FOB value of exports as export incentives in the form of scrips w.e.f 1st April, 2015 which could be used for payment of custom duty against imports or could be sold in open market. Can the MEIS Incentive be treated as revenue?

Answer: In the given case, the export incentive is in the nature of government grant and does not fall within the scope of Ind AS 115, as it is not revenue arising from contract with customer. Such export incentives are benefits given by the government to incentivise companies to export more products.

In accordance with above, while recognising the income arising from MEIS scheme, the Company should apply the provisions of Ind AS 20 and not Ind AS 115.

The presentation of such incentives shalll be made in accordance with the relevant provisions of Ind AS 20 and Schedule III to the Companies Act, 2013

Question 8

Cybernet Ltd. provides internet-based advertising services to publishing companies. It purchases advertisement space on various websites from a selection of publishers as per the following scenarios:

(i) It pre-purchases the advertisement space from the publishers before it finds advertisers for that space.

(ii) It provides the service of matching the advertisers with the publishers. In each of the above cases, which party will be identified as the customer?

Answer:

(i) In Scenario 1, (it is assumed that the Cybernet Ltd. is acting as a principal in accordance with Ind AS 115), according to paragraph 6 above, where Cybernet Ltd. pre-purchases advertisement space on various websites from a selection of publishers, the companies (i.e., advertiser) to whom it will provide the advertising space will be identified as its customers.

(ii) In Scenario 2, (it is assumed that the Cybernet Ltd. is acting as an agent of the publisher in accordance with Ind AS 115) Cybernet Ltd., does not provide any ad-targeting services or purchase the advertising space from the publishers before it finds advertisers for that space. It only provides the service of matching the ad placement for advertisers with the publishers. Accordingly, the publisher to whom Cybernet Ltd. is providing services will be identified as its customer.

Question 9

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

Answer: Paragraph 5(d) of Ind AS 115 states that this standard shall not apply to nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that

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agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

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

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

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

Question 10

Entities A Ltd. and B Ltd. are both engaged in the extraction and supply of natural gas to different parts of India. A Ltd. is located in western India while B Ltd. is located in Southern part of India. A Ltd. contracts to supply natural gas to a large corporate customer, XL Ltd., located in the South-eastern region of India, who is engaged in supply of natural gas to homes. B Ltd. On the other hand contracts to supply natural gas to YS Ltd. which is located closer to A Ltd.

Consequently, A Ltd. purchases from B Ltd. to supply natural gas to YS Ltd. and B Ltd. purchases from A Ltd. to supply natural gas to XL Ltd. The price of natural gas for this transaction would be based on actual delivery date of gas by either party. Further, the parties would do a monthly calculation of supplies and receipts of gas and do a net settlement based on the prices calculated as above. In the said industry, price varies based on different product categories and also varies based on point of sale. How will this situation be treated under Ind AS 115?

Answer: In the above case, entities A Ltd. & B Ltd. operate in the same line of business and agree to supply the same units of natural gas to each other's customers due to ease of supplying in geographically closer areas.

However, they calculate the price based on date of delivery and do a net settlement every month and hence, the contracts have commercial substance. Thus, the above stated situation does fall within the scope of Ind AS 115, even though the timing of transfer of goods or services may be different. Hence, A Ltd. Will book revenue from sale of goods to B Ltd. and also book revenue from sale of goods to XL Ltd. A Ltd. will also recognise purchase of good from B Ltd.

Similarly, B Ltd. will also record relevant corresponding accounting entries. A Ltd. and B Ltd. will also be required to give disclosures in accordance with Ind AS 115.

Identifying the Contract

Question 11

Company A has a customer P which is undergoing restructuring due to issues related to liquidity. Company A has decided not to do any further business with P. P has informed Company A that it will get Letter of Credit from a nationalised bank against which the Company A can despatch goods. Company A has manufactured the goods exclusively for P, but the Letter of Credit has not yet been arranged because it is in process. When should Company A recognise the revenue?

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Answer: As per paragraph 9(e) of Ind AS 115, requires that for a revenue to be recognised it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In the given case, as the customer has liquidity issues, the collection is not considered to be probable. Accordingly, till the time the Letter of Credit is arranged from a nationalised bank in favour of Company A, criterion as mentioned in paragraph 9(e) is not met. However, in case the

Company A is able to demonstrate through any other mechanism that the above criteria would be fulfilled in its favour, then it may recognise the revenue in accordance with the principles of Ind AS 115 assuming all other conditions as stated in paragraph 9 are met.

Furthermore, in accordance with paragraph 14 of Ind AS 115, if a contract with a customer does not meet the criteria in paragraph 9, an entity shall continue to assess the contract to determine whether the criteria of paragraph 9 are subsequently met (or requirements of paragraph 15 are met). Hence, the company shall reassess whether the criteria under paragraph 9 are subsequently met.

Question 12

An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for Rs.20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry. P Ltd. pays a non-refundable deposit of Rs.1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. Can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the machinery. The cost of the machinery for G Ltd. is Rs.12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognise revenue from sale of machinery to P Ltd. In accordance with paragraph 9 of Ind AS 115?

Answer: Paragraph 9(e) above, requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

(a) P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);

(b) P Ltd. lacks other income or assets that could be used to repay the balance consideration; and

(c) P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

Further, paragraphs 15 and 16 of Ind AS 115, state as follows: " When a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer,

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the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

(a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

An entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met (see paragraph 14).

Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer."

In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of Rs.1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has received substantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. Will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred.

Further, G Ltd. will continue to assess the contract in accordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

Question 13

Company A, a manufacturer of specialised construction equipment enters into a contract with Customer B to manufacture and deliver a customised boom lift for Rs.95,000. The total cost to Company A of designing, manufacturing and delivering the boom lift is estimated to be Rs.70,000. Two days later, Company A enters into another contract with Customer B to deliver four boom lift tyres that Customer B will use on the customised boom lift in the future after the original tyres deteriorate. The contract price per tyre is Rs.800, however, the cost of each tyre is estimated at Rs.900. Whether these two contracts should be treated as a single contract?

Answer: In the given case, Company A enters into two contracts with the same party at about the same time, i.e. within two days. In addition, the contracts should satisfy one or more of the criteria in paragraph 17 of Ind AS 115 for the contracts to be combined.

In the given case, criterion (a) of paragraph 17 for combining contracts is met because the two contracts are negotiated as a bundle with one business objective. The relationship between the consideration in the contracts (i.e., the price interdependence) is such that if those contracts were not combined, the amount of consideration allocated to the performance obligations in each contract might not faithfully depict the value of the goods or services transferred to the customer.

In other words, Company A would have incurred a loss of Rs.400 [(Rs.900 – Rs.800) x 4 = Rs.400] on the second contract, if it was not combined with the first contract. Considering that the contracts

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were entered into at about the same time, it seems that two contracts are negotiated as a package with a single commercial objective, i.e. the tyres have not been sold at a loss instead the consideration of Rs.95,000 stated for the boom lift includes a part of consideration for the tyres as well. Therefore, Company A should combine the two contracts for revenue recognition.

Contract Modifications

Question 14

Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for Rs.4,50,000 (Rs.1,50,000 per year). The standalone selling price for one year of service at inception of the contract is Rs.1,50,000 per year. AB Ltd. accounts for the contract as a series of distinct services. At the beginning of the third year, the parties agree to modify the contract as follows:

(i) the fee for the third year is reduced to Rs.1,20,000; and

(ii) CD Ltd. agrees to extend the contract for another three years for Rs.3,00,000 (Rs.1,00,000 per year).

The standalone selling price for one year of service at the time of modification is Rs.1,20,000. How should AB Ltd. account for the modification?

Answer: In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

AB Ltd. should reallocate the remaining consideration to all of the remaining services to be provided (i.e. the obligations remaining from the original contract and the new obligations). AB Ltd. will recognise a total of Rs.4,20,000 (Rs.1,20,000 + Rs.3,00,000) over the remaining four-year service period (one year remaining under the original contract plus three additional years) or Rs.1,05,000 per year.

Question 15

Bob Ltd., a construction company, enters into a contract on 15th April, 2017 to construct a commercial building for Lee Ltd. on the land owned by Lee Ltd. for a consideration of Rs.20,00,000. The expected cost of construction is Rs.14,00,000. As per the agreed terms, if the building is completed within 24 months, i.e. 14th April, 2019, then the Bob Ltd. is entitled for a performance bonus of Rs.4,00,000.

As at year ended March 2018, Bob Ltd. has satisfied 60 per cent of its performance obligation on the basis of costs incurred to date. In June 2018, Bob Ltd. and Lee Ltd. agreed to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by Rs.3,00,000 and Rs.2,40,000 respectively.

In addition, the allowable time for achieving the performance bonus of Rs.4,00,000 is extended by 6 months (i.e. from 24 months to 30 months) viz. 14th October 2019 from the original contract inception date. How should Bob Ltd. account for this contract modification?

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Answer: It is assumed that Bob Ltd. accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with paragraph 35(b) of Ind AS 115 because the customer, Lee Ltd. Controls the building during construction.

Year 1

At the inception of the contract, for Bob Ltd:

Amount in	Rs.
Transaction Price	20,00,000
Expected costs	14,00,000
Expected profit (30%)	6,00,000

In accordance with the above, in the given case, at contract inception Bob Ltd. will exclude the performance bonus of Rs.4,00,000 from the transaction price because it cannot be concluded that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur as the completion of the building is highly susceptible to factors outside the entity's influence, including weather and regulatory approvals.

As at the year end, March 2018, Bob Ltd. will reassess the variable consideration (i.e. performance bonus) and if it is concluded that the amount is still uncertain in accordance with paragraphs 56–58 of Ind AS 115, then the cumulative revenue and costs recognised for the year ended March 2018 will be as follows:

Amount in	Rs.
Revenue	12,00,000
Costs	8,40,000
Gross profit	3,60,000

Year 2

In June 2018, Bob Ltd. and Lee Ltd. agreed to modify the contract by changing the floor plan of the building. As a result, the fixed consideration and expected costs increase by Rs.3,00,000 and Rs.2,40,000 respectively.

Now, total potential consideration after the modification is Rs.27,00,000 (Rs.23,00,000 fixed consideration + Rs.4,00,000 performance bonus).

At the date of the modification, on the basis of its experience and the remaining work to be performed, which is primarily inside the building and not subject to weather conditions, if Bob Ltd. concludes that it is highly probable that including the performance bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with paragraph 56 of Ind AS 115 and includes Rs.4,00,000 in the transaction price.

In assessing the contract modification, the Bob Ltd. evaluates paragraph 27(b) of Ind AS 115 and if it concludes that the remaining goods and service to be provided using the modified contract are not distinct from the goods and services transferred on or before the date of contract modification, i.e., the contract remains a single performance obligation, then Bob Ltd. Will account for the contract modification, as if it were part of the original contract (in accordance with paragraph 21(b) of Ind AS 115).

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Bob Ltd. will update its measure of progress and estimates that it has satisfied 51.2 per cent of its performance obligation (Rs.8,40,000 actual costs incurred ÷ Rs.16,40,000 total expected costs).

Bob Ltd. will recognise additional revenue of Rs.1,82,400 [(51.2 per cent complete × Rs.27,00,000 modified transaction price) – Rs.12,00,000 revenue recognised to date] at the date of the modification as a cumulative catch-up adjustment.

Question 16

Royal Silks, a textile chain operates a customer loyalty programme. It grants programme members loyalty points when they purchase textiles for a specified amount. Programme members can redeem the points for further purchase of textiles. The points have no expiry date. In one period, the entity grants 10,000 points. Management estimates the fair value of textiles for which each loyalty point can be redeemed as Rs. 125. This amount takes into account an estimate of the discount that management expects would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management expects only 8,000 of these points to be redeemed. At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e. half of those expected to be redeemed. In the second year, management revises its expectations. It now expects 9,000 points to be redeemed altogether. During the second year, 4,100 points are redeemed. In the third year, a further 900 points are redeemed, i.e. that no more points will be redeemed after the third year.

How would the Royal Silks account for the customer loyalty programme?

Answer: The fair value of textiles for which each loyalty point can be redeemed as Rs. 125. Since management expects that only 8,000 points to be reimbursed, the revenue that should be deferred is of Rs. 10,00,000 (8,000 x 125).

Year 1

At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e., half of those expected to be redeemed. The entity recognises revenue of (4,000 points / 8,000 points) x Rs.10,00,000 = Rs. 5,00,000.

Year 2

During the second year, 4,100 points are redeemed, bringing the total number redeemed to 4,000 + 4,100 = 8,100 points. The cumulative revenue that the entity recognises is (8,100 points / 9,000 points) × Rs. 10,00,000 = Rs. 9,00,000. The entity has recognised revenue of Rs. 5,00,000 in the first year, so it recognises Rs. 4,00,000 in the second year.

Year 3

In the third year, a further nine hundred points are redeemed, taking the total number of points redeemed to 8,100 + 900 = 9,000. Management continues to expect that only 9,000 points will ever be redeemed, i.e., that no more points will be redeemed after the third year. So the cumulative revenue to date is (9,000 points / 9,000 points) × Rs. 10,00,000 = Rs. 10,00,000. The entity has already recognised Rs. 9,00,000 of revenue (Rs. 5,00,000 in the first year and Rs. 4,00,000 in the second year). So it recognises the remaining Rs. 1,00,000 in the third year. All of the revenue initially deferred has now been recognised.

Question 17

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PQR Ltd. participated in a customer loyalty programme operated by a third party XYZ Ltd. Under the programme, members earn points for purchases made in PQR's stores.

The members can redeem the accumulated award points for goods supplied by the third party. PQR Ltd. has granted points to its members on making purchases from its stores. However, the obligation to supply the redeemed goods lies with XYZ Ltd. At the end of 31st March, 20X7, PQR Ltd. X has granted award points with an estimated fair value of INR 40,000 and owes XYZ Ltd. INR 34,000 i.e. goods redeemed were of INR 34,000.

What should be the classification of the expense (INR 34,000) for providing free third party goods assuming that PQR Ltd. is collecting the consideration on its own account; whether it should be

- classified as changes in inventories of finished goods, stock in trade and WIP or
- classified as marketing expense or
- reduced from revenue?

Answer: IND AS 115 states inter-alia that if the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards."

Accordingly, since PQR Ltd. is acting as a principal, it shall recognise the revenue at gross amount and the expense of providing free third party goods will be included in the cost of goods sold.

Therefore, PQR Ltd. shall recognise the revenue of INR 40,000 and INR 34,000 shall be charged to the Statement of Profit and Loss as cost of goods sold.

Question 18

KK Ltd. runs a departmental store which awards 10 points for every purchase of Rs. 500 which can be discounted by the customers for further shopping with the same merchant. Each point is redeemable on any future purchases of KK Ltd.'s products within 3 years . Value of each point is Rs. 0.50. During the accounting period 2017-2018, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted (to be redeemed till 31st March, 2020). The management expects only 80% of the remaining will be discounted in future.

The Company has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

(a) How should the recognition be done for the sale of goods worth Rs. 10,00,000 on a particular day?

(b) How should the redemption transaction be recorded in the year 2017-2018? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is Rs. 5,000 lakhs.

(c) How much of the deferred revenue should be recognised at the year-end (2017- 2018) because of the estimation that only 80% of the outstanding points will be redeemed?

(d) In the next year 2018-2019, 60% of the outstanding points were discounted Balance 40% of the outstanding points of 2017-2018 still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 2018-2019 and what will be the amount of balance deferred revenue?

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(e) How much revenue will the merchant recognized in the year 2019-2020, if 3,00,000 points are redeemed in the year 2019-2020? **[RTP May 2019]**

Answer:

(a) Points earned on Rs. 10,00,000 @ 10 points on every Rs. 500 = [(10,00,000/500) x 10]

= 20,000 points.

Value of points = 20,000 points x Rs. 0.5 each point = Rs. 10,000

Revenue recognized for sale of goods Rs. 9,90,099

[10,00,000 x (10,00,000/10,10,000)]

Revenue for points deferred Rs. 9,901

[10,00,000 x (10,000/10,10,000)]

Journal Entry

Bank A/c	Dr.	10,00,000	
To Sales A/c			9,90,099
To Liability under Customer Loyalty programme			9,901

(b) Points earned on Rs. 50,00,00,000 @ 10 points on every Rs. 500 = [(50,00,00,000/500) x 10] = 1,00,00,000 points.

Value of points = 1,00,00,000 points x Rs. 0.5 each point = Rs. 50,00,000

Revenue recognized for sale of goods = Rs. 49,50,49,505

[50,00,00,000 x (50,00,00,000 / 50,50,00,000)]

Revenue for points = Rs. 49,50,495 [50,00,00,000x (50,00,000 / 50,50,00,000)]

Journal Entries in the year 2017-18

Bank A/c	Dr.	50,00,00,000	
To Sales A/c			49,50,49,505
To Liability under Customer Loyalty programme			49,50,495
(On sale of Goods)			
Liability under Customer Loyalty programme	Dr.	42,11,002	
To Sales A/c			42,11,002
(On redemption of (100 lakhs -18 lakhs) points)			

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year 18,00,000 x 80%

= 14,40,000 points

Total expected points to be redeemed in 2018-2019 and 2019-2020 = [(1,00,00,000 - 18,00,000) + 14,40,000] = 96,40,000

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Revenue to be recognised with respect to discounted point = 49,50,495 x (82,00,000/96,40,000) = 42,11,002

(c) Revenue to be deferred with respect to undiscounted point in 2017-2018= 49,50,495 – 42,11,002 = 7,39,493

(d) In 2018-2019, KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 60% = 10,80,000 points

Total points discounted till date = 82,00,000 + 10,80,000 = 92,80,000 points

Revenue to be recognized in the year 2018-2019 = [{49,50,495 x (92,80,000 / 96,40,000)} - 42,11,002] = Rs. 5,54,620.

Journal Entry in the year 2018-2019

Liability under Customer Loyalty programme	Dr.	5,54,620	
To Sales A/c			5,54,620
(On redemption of further 10,80,000 points)			

The Liability under Customer Loyalty programme at the end of the year 2018 -2019 will be Rs. 7,39,493 – 5,54,620 = 1,84,873.

(e) In the year 2019-2020, the merchant will recognized the balance revenue of Rs. 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Journal Entry in the year 2019-2020

Liability under Customer Loyalty programme	Dr.	1,84,873	
To Sales A/c			1,84,873
(On redemption of further 10,80,000 points)			

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