CHIRANJEEV JAIN CLASSES

FOR CA - FINAL COURSE

QUESTION BANK

FOR

FINANCIAL REPORTING

As per the latest syllabus of Final issued by Board of Studies of ICAI

"IT'S TIME TO BE BUSY BECAUSE TODAY WILL BE YESTERDAY VERY SOON"

PAPER: 1

FINANCIAL REPORTING

QUESTION BANK
VOLUME – I

COMPILED BY

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[B.COM (H); FCA; DISA; MBA(F)]

OUR GREATEST WEAKNESS LIES IN GIVING UP. THE MOST CERTAIN WAY TO SUCCEED IS ALWAYS TO TRY JUST ONE MORE TIME.

REMEMBER

“IN ORDER TO SUCCEED, WE MUST FIRST BELIEVE THAT WE CAN”

Dedicated to
My Father Sri Mool Chand Jain
and
My Mother Smt. Sarala Devi Jain

Think Beyond 90+ IN CA FINAL - Financial Reporting

STOP Memorizing Without Understanding the CONCEPTS

Its Time To Learn Accounts Conceptually

GUIDE TO A BETTER STUDENT LIFE

Don't compare yourself with others'. You are Unique.

Don't have negative thoughts of things you cannot control. Instead invest your energy in the positive present moment.

Don't overdo; keep your limits.

Don't take yourself so seriously; no one else does.

Don't waste your precious energy on gossip.

Dream more while you are awake.

Envy is a waste of time. You already have all you need.

Forget issues of the past. That will ruin your present task.

Life is too short to waste time.

No one is in charge of your happiness except you.

Realize that life is a school and you are here to learn.

Problems are simply part of the curriculum that appear and fade away.

Smile and laugh more.

You don't have to win every event.

Do the right things at right time

However good or bad a situation is, it will change.

No matter how you feel, get up, dress up and show up.

The best is yet to come.

No matter how many people believe or don't believe in you, you must be the ultimate believer in yourself!"

Brilliant people do not make mistakes, But Mistakes make people brilliants!!!

"You can't have a goal without determination, because without the determination the goal will die."

"Do not pray for an easy life, pray for the strength to endure a difficult one."

"CHALLENGES ARE WHAT MAKE LIFE INTERESTING AND OVERCOMING THEM IS WHAT MAKES LIFE MEANINGFUL.

PREFACE

Financial Reporting is Paper 1 in Chartered Accountancy – Final Course. It is rightly so because Accounting is the language of business and without understanding accounting terminology, it is not possible to understand business and commerce. It is, therefore, essential for all CA students to possess knowledge of Financial Reporting concepts and practices.

The approach of the book is examination-oriented problems from ICAI Study Resource and solutions have also been included in all chapters as per ICAI Suggested solution. Examples and Illustration (mostly selected from ICAI Study Modules) have been included in the book to understands the IND AS concepts.

Recent question from ICAI RTP, MTP and Exam papers with answers have been included to help the students.

Practical Question from Other Sources are also included in some of the chapters for better understanding of the concepts. Solutions for some of these questions may not be provided for which students may refer our class notes.

Considering the importance of the question bank and its practical implications, care has been taken to solve almost all the problems for the benefit of the students.

We are sure the book will prove extremely useful to CA Final students.

We are Thankful to all my students to have faith on me.

Suggestions from all readers would be highly appreciated and acknowledged.

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“CA IS NOT HARD” IF U “WORK HARD”

NUMBER OF EXAMPLES & QUESTIONS COVERED

No	Chapter Name	Examples/ Illustrations	Questions
1	Framework for Preparation and Presentation of Financial Statement	16	8
2	IND AS – Introduction	-	-
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29	Business Combination (IND AS 103)	69	31
30	Earnings Per Share (IND AS 33)	-	22
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32	FAIR VALUE MEASUREMENT (IND AS 113)	16	8
33	CORPORATE SOCIAL RESPONSIBILITY	-	14
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35	INTEGRATED REPORTING	-	4
	Total	370	1024

CA Final - Paper 1 Financial Reporting

ABC & TREND ANALYSIS

Category	Chapter	May-18	Nov-18	May-19	Nov-19	Nov-20	Jan-21	Jul-21	Total
A	*Consolidated Financial Statement*	25	16	27		10	20	16	114
A	*Financial instruments*	16	20	12	14	6	19	19	106
A	*Revenue from Contact with Customers*	4	10	5	12	18	12	12	73
A	*ANALYSIS OF FINANCIAL STATEMENTS*	10	8	16	12	12		8	66
A	*Business Combination (IND AS 103)*	10	4	8	28	8		5	63
A	*Shares based Payment (IND AS 102)*	10	8	5	8	5	12	5	53
	Total (A)	**75**	**66**	**73**	**74**	**59**	**63**	**65**	**475**
B	*Impairment of Assets*		15	4		8		6	33
B	*Leases (IND AS 116)*	12				8	6	4	30
B	*Property, Plant and Equipment*		8		8		5		21
B	*Agriculture (IND AS 41)*				4		4	9	17
B	*Earnings Per Share (IND AS 33)*					8		8	16
B	*Employee Benefits (IND AS 19)*			8		6			14
B	*The Effects of Changes in Foreign Exchange Rates (Ind AS 21)*			5	4			5	14
B	*Non-current Assets Held for Sale and Discontinued Operations*				10				10
B	*Accounting for Income Tax*					6	4		10
B	*FIRST-TIME ADOPTION OF IND AS*							6	6
	Total (B)	**12**	**23**	**17**	**26**	**36**	**19**	**38**	**171**
C	*CORPORATE SOCIAL RESPONSIBILITY*	8	4			5	6	6	29
C	*Operating Segments (IND AS 108)*	10				6	4	8	28
C	*Interim Financial Reporting (IND AS 34)*		5	4		6		5	20
C	*Events occurring after the Balance Sheet Date*				8		8		16
C	*Intangible Assets (IND AS 38)*			5			10		15
C	*Presentation of Financial Statements*			4			5	4	13
C	*Statement of Cash Flows (IND AS 7)*					8	5		13
C	*FAIR VALUE MEASUREMENT*		5		8				13
C	*Government Grant (IND AS 20)*		5	4					9
C	*Valuation of Inventories (IND AS 2)*	4				4			8
C	*Borrowing Costs (IND AS 23)*				8				8
C	*INTEGRATED REPORTING*						6		6
C	*Framework for Preparation and Presentation of Financial Statement*			5					5
C	*Provisions, Contingent Liabilities and Contingent Assets (IND AS 37)*		4						4
C	*IND AS – Introduction*								0
C	*Schedule III of Companies Act*								0
C	*Accounting Policies, Changes in Accounting Estimates and Errors*								0
C	*Investment Property (IND AS 40)*								0
C	*Related Party Disclosures*								0
	Total (C)	**22**	**23**	**22**	**24**	**29**	**44**	**23**	**187**
	Portions Deleted	15	12	12					
	Total (A+ B+C)	**124**	**124**	**124**	**124**	**124**	**126**	**126**	

CHAPTER 1

FRAMEWORK FOR PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

SCOPE:

The Framework deals with:

(a) the objective of financial statements;

(b) the qualitative characteristics that determine the usefulness of information provided in financial statements;

(c) definition, recognition and measurement of the elements from which financial statements are constructed; and

(d) concepts of capital and capital maintenance

IMPORTANT FACTS-ABOUT "FRAMEWORK"

The framework provides a road map and approach which eventually will be considered as broad lines within which generally all accounting standards will be applied. However, following facts are worth to be noted:

- Since Framework is not an Indian Accounting Standard and hence does not define standards for any particular measurement or disclosure issue
- Existing standards might have some areas which contradicts (very rare in practice) with such Framework, then, requirement of the Indian Accounting Standards will prevail
- All the future Indian Accounting Standards or other pronouncement will be guided by the framework resulting in minimal conflicts
- Based on the experiences, the Framework will change to harmonise the Indian Accounting Standards across the industries.

USERS AND THEIR INFORMATION NEEDS

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. These needs include the following:

(a) **Investors:** The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

(b) **Employees:** Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

(c) **Lenders:** Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

(d) **Suppliers and other trade creditors:** Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due.

(e) **Customers:** Customers have an interest in information about the continuance of an enterprise especially when they have a long-term involvement with, or are dependent on, the enterprise.

(f) **Governments and their agencies:** Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

(e) **Public:** Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the number of people they employ and their patronage of local suppliers.

THE OBJECTIVE OF FINANCIAL STATEMENTS

The objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions

- Information about financial position i.e. balance sheet, statement of profit and loss, cash flows and related notes-
  - **Balance Sheet** comprises information about the economic resources controlled by the entity and its capacity in the past to modify these resources is useful in predicting the ability of the entity to generate cash and cash equivalents in the future. The balance sheet provides overall strength and capacity of a business at any point of time.
  - **Income Statement** comprises information about the performance of an entity, in particular its profitability, is required in order to assess potential changes in the economic resources that it is likely to control in the future.
  - **Cash flow Statements** will be useful in order to assess its investing, financing and operating activities during the reporting period. This information is useful in providing the user with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows,
  - The information that are being captured in balance sheet, statement of profit and loss, cash flows will have certain explanatory notes/ information, which are being reflected in the notes to accounts. The requirement of what to disclose specifically has been defined in different Accounting Standards, however there is nothing which precludes to make

any additional information that might be useful for the user of such Financial Statements.

- Provide useful information to USER of the Financial Statement only reflects a financial information-
  - ♦ The information that reflects from the Financial Statements are purely based on financial information e.g. related to the monetary aspects of such transactions
  - ♦ Users of the Financial Statements might need to evaluate such other non- financial information which might be useful for them to analyze which normally will not be available in the Financial Statements.
- To know about the management style of working and their objectives going forward.

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

1. Accrual Basis

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

2. Consistency:

It is assumed that accounting policies are consistent from one period to another.

3 Going Concern

The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

QUALITATIVE CHARACTERISTICS OF THE FINANCIAL STATEMENTS

Qualitative characteristics are the attributes that make the information provided in the financial statements useful to the users. The four principal qualitative characteristics are:

(a) **Understandability:** An essential quality of the information provided in the financial statement is that it is readily understandable by the users. For this purpose, users are deemed to have reasonable knowledge of business and economic activities.

Example 1
An Oil & Gas Company maintaining well and exploration services has defined recognition of assets related to such exploration in the Financial Statements. It is expected that the user of such financial statement would know about the exploration activities and it is not expected to mention the meaning of these terms which otherwise is expected to be known by a person who uses such financial statements. However, if there is any change or any term which is specific to

the entity, then the same should be properly explained e.g. any special contract and its related accounted treatment.

(b) **Relevance:** To be useful, information must be relevant to the decision making needs of all the users. Information has the quality of relevance when it influences the economic decisions of users by helping them to evaluate past, present or future events or confirming, or correcting their past evaluations. The relevance of information is affected by its ***materiality.***

Example 2

1. A default by a customer who owes INR 1,000 to a Company having net assets of worth INR 10 million is not relevant to the decision making needs of users of the financial statements. However, if the amount of default is, say, INR 2 million, the information becomes relevant to the users as it may affect their view regarding the financial performance and position of the company.
2. A fire has been broken out at the end of the period but before issue of financial statements, could be relevant for the user to know about the estimated impact on future performance of the business even though the assessment of such loss was not possible to calculate, at the time of approving of such financials.

3. Materiality

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

4. Reliability

The information which is relevant for the user of the financial statement but not reliable would eventually mislead the financial statements presentation and may influence the decision taken by the user of such financial statements. Information should be relevant and reliable as it is expected to have an error free and unbiased impact on the presentation of the financial statements.

Faithful Representation

It means that, unless the recognition criteria of any element of financial statement i.e. assets, liabilities, income or expenses etc. is fulfilled/met, there should not be any recognition of such elements in order to be faithful to the users who actually rely on information reflecting from the financial statements.

Example 3

1. If there is a revenue which is to be recognized as per the relevant accounting standard but if the amount can’t be ascertained then if an entity still does so, it will be unfaithful representation of the information.
2. There could be a recoverability of debtors in which management provides a written communication to ensure about expectation of recovery in full, however, the chances are

remote then this would be treated as unfaithful representation of debtor's amount in the financial statements.

Substance over Form

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form.

Neutrality

The information contained in the financial statements should be free from any bias i.e. neutral and there should not be any kind of influence which makes the information undesirable or undisclosed. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

Often certain estimates are being required to be made by the preparer of the financial statements which may or may not be 100% correct. However, one should use its prudence which is without any biasness and best possible action to reach to the conclusion in such cases. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Example 4

Receivables recoveries are being assessed based on some estimation by the management and to arrive to such estimation for provision for bad debts, there must be a prudent action which is required to identify the recoverability of the debtors. The prudence could be used by meeting personally with the debtors, reviewing correspondences with the debtors, visiting the business premises to ensure the health of debtor's business before it is concluded for making any provision.

Completeness

The financial statements should be prepared to ensure that it covers all the transactions that has be done during the period and control must be establish to ensure its completeness of transactions without having any left out entries/ transactions which purposely/ by error are recorded in next period or not recorded at all. It may be due to wrong classification of nature of the transactions as well.

Example 5

Some direct costs booked into general overheads, has overstated the Gross Margin, which otherwise should have been booked as direct costs. There should be some check and balances to ensure that all elements reflected in the financial statements are complete in all aspects.

4 Comparability

Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.

Example 6

There are certain expenses that have been grouped under cost of sales in the previous year, whereas, in the current year, the amount has been shown under other general expenses without regrouping the previous year numbers which eventually distort the comparison of amounts of cost of sales & general expenses on yearly basis.

Users wish to compare the financial position, performance and cash flows of an entity over time, it is important that the financial statements show corresponding information for the preceding periods. Information which is necessary to provide details relating to any change in accounting policy should be clearly mentioned with impact of such change for the current and previous period.

CONSTRAINTS ON RELEVANT AND RELIABLE INFORMATION

1 Timeliness

It is one of the common objective to provide useful and reliable financial reports to the user but it should never be at the cost of time. If there are certain situations where the relevant inputs are taking too much of time to retrieve, then it will not serve a meaningful purpose by justifying a time that has been spent on the same. However, time constraint should not preclude the management to get rid with reliable inputs as required to be presented to ensure faithful representation.

2 Cost and its Benefit Comparison

At the same time, if information requires too much efforts in terms of utilization of resources and efforts comparing to its benefit to the user of such financial statements, then the same should be analyze carefully by the management for consideration.

Undue efforts and cost will fade its utility and will not make any sense to user of such financial statements.

Example

There is an additional verification (as part of normal policy to be applied to all debtors) which has been requested by the management for some small debtor which are totally immaterial. The verification was intended by visiting customer business place which are far from the Company Head office and would take at least 2 working day to complete the process with a significant amount of expense on travel. The management should perform such procedure by using some other alternative procedure to avoid cost which will not make any sense to substantiate an immaterial customer balance.

3 Balance between Qualitative Characteristic

There should be a balance between the qualitative information provided in financial statements and its objective. Over information will not serve any purpose and hence, a balance between the qualitative information and its objective should be made.

Elements of Financial Statements:

The elements that are directly related to the measurement of financial position, which is shown in the statement of financial position (sometimes called the balance sheet), are assets, liabilities and equity.

The elements that are directly related to the measurement of performance, which is shown in the statement of profit and loss, are income and expenses. Income and expenses are defined with reference to changes in assets and liabilities.

The financial position of an entity is the relationship of its assets, liabilities and equity as of a specific date as presented in the statement of financial position. These are defined as follows:

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

(b) **A 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.

(c) **Equity** is the residual interest in the assets of the entity after deducting all its liabilities.

Assets:

An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise. The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. For example, an asset may be:

(a) used in the production of goods or services to be sold by the enterprise;

(b) exchanged for other assets;

(c) used to settle a liability; or

(d) distributed to the owners of the enterprise

Example: Control over Asset (substance over form)

Due to some legal constraints in the country, Entity A holds some assets on behalf of Company B which are being used/ directed by the Company B itself, without any interfere by the Company A. All production benefits will exclusively been used by Company B.

Merely holding an asset as its legal owner will not satisfy recognition criteria for an asset, hence, Asset will be recognized in the books of Company B as all the future economic benefit which is expected to flow to Company B only.

Example: Economic Benefits Flow to the Entity

A Pharma Company incurs some expenditure which is expensed off in order to develop its new drug. The future economic benefits will not expected to flow to the Pharma Company because research phase itself does not establish any rationale to provide any kind of benefit which will flow to the Company at this stage (as per the relevant accounting standards).

Hence all expenditures will not be eligible to recognize as asset unless its benefits are expected to flow to the entity in future.

Example: Results from Past Transactions

An entity expected to purchase some asset in future which will increase profitability for the Company will not satisfy the definition of the Asset. Since the transaction/ expenses incurred should result from past event and not something which belongs to any future course of action, an asset will not be recognized based on any future course of action.

The readers may note the following points.

(a) The resource regarded as asset, need not have a physical substance.

(b) An asset is a resource controlled by the enterprise. This means it is possible to recognise a resource not owned but controlled by the enterprise as an asset, example Leased assets

(c) A resource cannot be recognised as an asset if the control is not sufficient. For this reason specific management or technical talent of an employee cannot be recognised because of insufficient control.

(d) To be considered as asset, it must be probable that the resource generates future economic benefit.

(e) To considered as asset, the resource must have a cost or value that can be measured reliably.

(f) When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognised as expense rather than as asset.

Recognition of Assets: An asset is recognised in the balance sheet when

✓ it is probable that the future economic benefits associated with it will flow to the enterprise and

✓ the asset has a cost or value that can be measured reliably.

Examples—recognition of assets?

Example 7

An entity has developed a formula that it uses to manufacture a unique glue. The glue is the leading adhesive product in the market because of its distinctive mix of chemicals. The special formula is known only by the entity's two owner-managers and hence no competitors have been able to discover and replicate the formula. The formula is not protected by a patent, or by other means. Many competitors have approached the entity to try to purchase the formula.

The formula meets the definition of an asset of the entity because, although the formula is not protected by legal rights, the entity has control over the formula by keeping the formula a secret from its competitors.

However, in accordance with AS 26, internally generated intangible assets are not recognised as assets because it is often difficult to attribute expenditure directly to a particular intangible asset rather than expenditure to develop the business as a whole.

Example 8

An entity has developed a successful brand that allows the entity to charge a premium for its products. The entity continues to spend large amounts of money on maintaining the brand and on developing the brand (eg sponsoring local sports events, sponsoring select cultural events and advertising the brand).

The costs that are incurred in developing the brand are recognised as an expense as they do not satisfy the recognition criteria for an asset—they are recognised as expense because they cannot be distinguished from costs incurred in respect of developing the business as a whole.

Example 9

An entity acquires a competitor's brand in a separate acquisition for ₹ 100,000.The entity uses the brand to charge a premium for the products that it manufactures.

The entity recognises the brand acquired from its competitor as an intangible asset. The ₹ 100,000 incurred to acquire the brand satisfies the recognition criteria for an asset (the probability recognition criterion is always considered as being satisfied for intangible assets that are separately acquired).

Note: amounts that are incurred by the entity for maintaining and improving the brand will be recognised as an expense as incurred (ie expenditures incurred for sponsorships and advertising cannot be separated from costs incurred in respect of the business as a whole.

Liabilities:

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of a resource embodying economic benefits. The following points may be noted:

(a) A liability is a present obligation, i.e. an obligation the existence of which, based on the evidence available on the balance sheet date is considered more probable than not.

(b) It may be noted that certain provisions, e.g. provisions for doubtful debts, provisions for depreciation and provisions for impairment losses, represent diminution in value of assets rather than obligations. These provisions are outside the scope of AS 29 and hence should not be considered as liability.

(c) A liability is recognised when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured.

Settlement of a present obligation may occur in a number of ways, for example, by:

(a) payment of cash;

(b) transfer of other assets;

(c) provision of services;

(d) replacement of that obligation with another obligation; or

(e) conversion of the obligation to equity.

Example: Present Obligation based on Past Events

An Entity has got an information about the requirement to implement new taxation system based on proposed change in legislation in the country. The amount that is expected to outflow from the entity is not based on past events and hence this cannot be treated as present obligation.

Example: Additional Custom Duty Rate Changes

An import has been done in the past on which there is change in additional duty, as announced by the government of that country, which is to be paid in future. Since, the goods have been imported in the past period and new additional custom duty obligation arises because of this past event, hence this will result in a present obligation based on past events and therefore, a liability will be created.

Recognition of Liability: An entity shall recognise a liability in the statement of financial position when:

✓ the entity has an obligation at the end of the reporting period as a result of a past event,

✓ it is probable that the entity will be required to transfer resources embodying economic benefits in settlement, and

✓ the settlement amount can be measured reliably.

Example 10

A Company has sold some goods to Mr. X in the current year and found that there were some defects in the goods supplied. Mr. X has asked for damage/ repair reimbursement from the Company. At the year end, the Company made an assessment using its past experiences in similar kind of condition and made a provision in the books at the year end. Since the Company A has agreed to compensate Mr. X as a matter of custom of the business relationship, it is certain that the economic benefit will out flow from the company because of past event of selling off the goods. Further, the Company was able to estimate the amount of provision which was based on its past experience and hence, a liability has been recognized.

Equity:

Equity is defined as residual interest in the assets of an enterprise after deducting all its liabilities. It is important to avoid mixing up liabilities with equity. Equity is the excess of aggregate assets of an enterprise over its aggregate liabilities. For example, in a corporate entity, sub classifications may include funds contributed by shareholders, retained earnings and gains or losses recognised directly in equity.

The value of equity may change either through contribution from/distribution to equity participants or due to income earned/expenses incurred. The definition of income and expense makes use of this fact.

Income:

Income is increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases of liabilities that result in increases in equity other than those relating to contributions from equity participants.

The definition of income includes revenue and gains.

Revenue is an income that arises in the ordinary course of activities of the enterprise and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.

Gains are income, which may or may not arise in the ordinary course of activity of the enterprise, e.g. profit on disposal of fixed assets.

Recognition of Income: An entity shall recognise income in the income statement when following conditions are satisfied:

- ✓ an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen and
- ✓ It can be measured reliably.

Example 11

A construction company has done some construction activities during the current year and at the end of the year, it was found that the proportionate work that has been done, is not identifiable and there is no history of similar kind of work that had ever been performed by the entity. Hence, if the value of the revenue cannot be estimated reliably, then, no revenue will be recognized in the period. However, it will be recognized when the estimation can be reliably measured in one or more subsequent periods.

Expense:

Expense is defined as decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decrease in equity other than those relating to distributions to equity participants.

The definition of expenses encompasses those expenses that arise in the course of the ordinary activities of the enterprise, as well as losses.

Expenses that arise in the course of the ordinary activities of the enterprise include, for example, cost of goods sold, wages, and depreciation.

Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the enterprise. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses.

Recognition of Expense: An entity shall recognise expenses in the income statement when following conditions are satisfied:

✓ a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen and

✓ it can be measured reliably.

Following are some applications approach relating to the expenses:

- **Matching costs with revenue generated**

  Example

  A Manufacturing Company captures all cost which would have been incurred against the inventory that has been produced during the period. This concept is called Matching concept. However, the expenses will only be recognized in this case when it meets recognition criteria as per the definition.

- **Economic benefit to arise in one or more accounting periods**

  Example

  A maintenance contract has been signed for repairing the tools which are being used under the production process. The contract has been made for 3 years. There are no limits/ reference in the contract which defines the number of tools that can be repaired. However, the maintenance contract amount is to be paid on yearly basis even when there are no repairs of tool. In this situation, there is no other basis to allocate these expenses over the period but to allocate on straight line basis over the period, hence the maintenance expense will be equally spread over the 3 year period irrespective of its actual use in repairing the tools.

- **Immediate recognition of expense**

  Example

  A company has incurred an amount of INR 1,00,000 on a land surfacing and at the later part of the year, it was found that the title of land was not transferred in the name of the Company due to some legal restrictions. Hence, the deal to purchase a land will be cancelled. Now, the amount that has been incurred relating to surfacing the land will have no future economic value and hence there is no allocation of expenses for any future benefits. Hence this cost of INR 1,00,000 will be expensed out immediately in full.

- **Recognition of a liability with an expenses**

  Example

  A Company has sold some product with warranty for next 2 years. The Company has history of making such repairs and based on the estimate, has made a provision for next 2 years. The said recognition of liability will have corresponding expenses over the period of such provision.

MEASUREMENT OF ELEMENTS IN FINANCIAL STATEMENTS:

Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss. The framework recognises four alternative measurement bases for the purpose.

(i) Historical Cost

(ii) Current Cost

(iii) Realisable (Settlement) Value and

(iv) Present Value.

Historical Cost:

Assets are recorded at an amount of cash or cash equivalent paid or the fair value of the asset at the time of acquisition.

Liabilities are recorded at the amount of proceeds received in exchange for the obligation. In some circumstances a liability is recorded at the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business.

Example 12

1) When one Mr. X, a businessman, takes ₹ 10 lacs loan from a bank @ 12% interest p.a., it is to be recorded at the amount of proceeds received in exchange for the obligation. Here the obligation is the (i) Repayment of loan and (ii) Payment of interest at an agreed rate i.e. 12% p.a. Historical cost of the transactions is Proceeds received ie. ₹ 10 lacs.

2) A machine was acquired in exchange of an old vehicle and ₹ 25,000 paid in cash. The book value of the vehicle was ₹ 2 lacs. The fair market value of the vehicle on the date of exchange was ₹ 1.5 lacs. The accounting entry to record the exchange is as below.

		₹	₹
Machinery [₹ 1,50,000 + ₹ 25,000]	Dr.	1,75,000	
Loss on deposal of Car [₹ 2,00,000 - ₹ 1,50,000]	Dr.	50,000	
To Vehicle (carrying amount)			2,00,000
To Cash			25,000

Historical cost of the machine = Fair value of car given on exchange + Cash paid.

Current Cost:

Assets are carried out at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.

Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

Example 13

A machine was acquired for $ 10,000 on deferred payment basis. The rate of exchange on the date of acquisition was ₹ 49/$. The payments are to be made in 5 equal annual instalments together with 10%o interest per year. The current market value of similar machine in India is ₹ 5 lakh.

Machinery	Dr.	5,00,000	
To Deferred Payment Obligation			4,90,000
To Revaluation Reserves (Note 1)			10,000

Current cost of the machine = Current market price = ₹ 5,00,000. By historical cost convention, the machine would have been recorded at ₹ 4,90,000. To settle the deferred payment on current date one must buy dollars at ₹ 49/$. The liability is therefore recognised at ₹ 4,90,000 ($ 10,000 x ₹ 49). Note that the amount of liability recognised is not the present value of future payments. This is because, in current cost convention, liabilities are recognised at undiscounted amount.

Note 1: Paragraph 80 of the conceptual framework provides that revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the Profit & Loss A/c under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves.

Realisable (Settlement) Value:

Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal.

Liabilities are carried at their settlement values, that is, the undiscounted amounts of cash or cash equivalents expected to be required to settle the liabilities in the normal course of business.

Present Value:

Assets are carried at the present value of the future net cash inflows that the item is expected to generate in the normal course of business.

Liabilities are carried at the present value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Present value of an amount A, after n years is the amount P, one has to invest on current date to have A after n years. If the rate if interest is R:

A = P(l+R)n

Or P (Present value of A after n years) = A/(l + R)n

The process of obtaining present value of future cash flow is called discounting. The rate of interest used for discounting is called the discounting rate. The expression [1/(1+R)n], called discounting factor depends on values of R and n.

Example 14

Carrying amount of a machine is ₹ 40,000 (Historical cost less depreciation). The machine is expected to generate ₹ 10,000 net cash inflow. The net realisable value (or net selling price) of the machine on current date is ₹ 35,000. The enterprises required earning rate is 10% per year. The enterprise can either use the machine to earn ₹ 10,000 for 5 years. This is equivalent of receiving present value of ₹ 10,000 for 5 years at discounting rate 10% on current date. The value realised by use of the asset is called value in use. The value in use is the value of asset by present value convention.

Value in use = ₹ 10,000 (0.909 + 0.826 + 0.751 + 0.683 + 0.621) = ₹ 37,900

Net selling price = ₹ 35,000

The company should use the asset to realise ₹ 37,900

The value of the asset is ₹ 37,900, which is called its recoverable value. It is obviously not appropriate to carry any asset at a value higher than its recoverable value.

The asset is currently overstated by ₹ 2,100 (₹ 40,000 - ₹ 37,900).

The overstatement of the asset is called impairment loss. The accounting entries to recognise the impairment loss and to bring down the asset to its recoverable value are suggested below:

Impairment Loss	Dr.	2,100	
To Machinery			2,100
Profit & Loss A/c	Dr.	2,100	
To Impairment Loss			2,100

FINANCIAL CAPITAL MAINTENANCE VS. PHYSICAL CAPITAL MAINTENANCE

A. **Financial Capital maintenance**

Under this concept, a profit is earned only if the financial amount of the net assets at the end of the period exceeds the financial amount of net assets at the beginning of the period, after excluding any distribution to, and contribution from, owners during the period.

B. **Physical Capital maintenance**

Under this concept, a profit is earned only if the physical productive or operating capability of the entity at the end of the period exceeds the physical productive capacity at the beginning of

the period, after excluding any distributions to, and contributions from, owners during the period.

Major differences between Physical Capital & Financial Capital

- The physical capital maintenance concept requires the adoption of the current cost basis as measurement whereas financial capital maintenance concept does not require the use of a particular basis of measurement.
- The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is profit.
- Financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period When the concept of financial capital maintenance is defined in terms of constant purchasing power units, profit represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as profit.
- Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit.

This Framework is applicable to wide variety of financial statements based on the selection of measurement as per relevant accounting standards. The overall objective is to provide the framework so that presentation requirements and principals remains consistent. However, the framework supplements the requirements of various accounting standards and does not intend to override any of such specific guidance available in any accounting standards.

Example 15

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. 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.

Example 16

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.

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.

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.

Example (Physical Capital Maintenance)

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.

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
Less: Capital to be maintained		
Opening capital (At current cost)	15,000	
Introduction (At current cost)	Nil	(15,000)
Retained profit		(3,000)

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	₹
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 ₹ 60,000.

(b) The trader's purchases and sales in 20X1-20X2 amounted to ₹ 4 lakh and ₹ 4.5 lakh respectively.

(c) The cost and net realisable value of inventories on 31.03.20X2 were ₹ 32,000 and ₹ 40,000 respectively.

(d) Employee benefit expenses for the year amounted to ₹ 14,900.

(e) Other asset is written off equally over 4 years.

(f) Trade receivables on 31.03.20X2 is ₹ 25,000, of which ₹ 2,000 is doubtful. Collection of another ₹ 4,000 depends on successful re-installation of certain product supplied to the customer.

(g) Cash balance on 31.03.20X2 is ₹ 37,100 before deduction of interest paid on loan.

(h) There is an early repayment penalty for the loan ₹ 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)
	₹	₹
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) ₹	Case (ii) ₹
Assets		
Non-current assets		
Property, Plant and Equipment	52,000	60,000
Current Asset		
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"?

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

QUESTIONS FROM OTHER SOURCE

Q 7: **History** Ltd. set up a factory on 1st January, 1980 at a cost of ₹ 100 crores financed 50% by debentures, 30% by preference capital and 20% by equity capital. By 31st December, 1989 the debentures were repaid and preference capital redeemed. The net asset value per rupee of equity investment made on 1st Jan. 1980 as on 31-12-1989 was ₹ 8 of which 10% was in fixed assets and the balance 90% was in net working capital.

On 1st January, 1990 the company made a rights issue of equity shares at premium of 50% in the ratio of 1:1; it also made a public issue of equity shares at a premium of 200% to the tune of 80% of equity capital after the rights issue. The entire proceeds of rights and public issue were earmarked for capital expenditure.

On 31st December, 1998 the net asset value of one rupee of equity capital based on the position as on 1-1-1990 was ₹ 41 of which only 1% was in fixed assets and the balance was in net working capital.

You are informed that:

1. Capital expenditure was made only in 1980 and 1990
2. ₹ 1 of 1980 is equal to ₹ 3 of 1990 and ₹ 15 of 1999

History Ltd. asks you to:

1. Prepare Balance Sheets as on 1st January, 1980, 31st December, 1989, 1st January 1990, 31st December, 1998.
2. Work out the retained profit over the period 1st January 1980 to 31st December, 1998 under the concept of physical capital maintenance.

Ans: 1) Balance Sheet as at 1st January, 1980, 31st December, 1989, 1st January 1990, 31st December, 1998.

₹ In Crores

As at	1st January, 1980	31st December, 1989	1st January 1990	31st December, 1998
Assets				
Non-current assets				
Property, Plant and Equipment	100	16	142	29.52
Current Asset				
(Net Working Capital)	-	144	144	2922.48
	100	**160**	**286**	**2952**
Equity and Liabilities				
Equity				
Share Capital	20	20	72	72
Other Equity -				
- Retained Earning	-	140	140	2806

- Securities Premium	-	-	74	74
Non-current liabilities				
- Borrowing	80	-	-	-
Current liabilities	-	-	-	-
	100	**160**	**286**	**2952**

2) Calculation of the retained profit over the period 1st January 1980 to 31st December, 1998 under the concept of physical capital maintenance

		₹ In Crores
Equity as on 31/12/1998		2952
Less: Capital to be maintained at current cost		
Opening Capital as on 1st January, 1980 (20 x 15/1)	300	
Addition capital introduced on 1st January 1990 (126 x 15/3)	630	930
Retained Profit under the concept of physical capital maintenance		2022

Working notes:

Calculation of Fixed assets and working capital as on 31st December, 1989 and 31st December, 1998

As on 31-12-1989

Net asset value per rupee of equity capital made on 1st Jan. 1980	8
Equity Capital as 1st Jan. 1980	20 Crores
Net Assets as on 31-12-1989 (8 x 20)	160 Crores
Fixed Assets (90% of 160)	144 Crores
Working Capital (10% of 160)	16 Crores

As on 31-12-1998

Net asset value per rupee of equity capital made on 1st Jan. 1990	41
Equity Capital as 1st Jan. 1980 (20 +20+32)	72 Crores
Net Assets as on 31-12-1989 (41 x 72)	2952 Crores
Fixed Assets (1% of 2952)	29.52 Crores
Working Capital (99% of 2952)	2922.48 Crores

QUESTIONS FROM RTP/MTP/EXAMS

Q8. Mr. Unique commenced business on 1/04/17 with ₹ 20,000 represented by 5,000 units of the product @ ₹ 4 per unit. During the year 2017-18, he sold 5,000 units @ ₹ 5 per unit. During 2017-18, he withdraw ₹ 4.000.

- 31/03/18: Price of the product @ ₹ 4.60 per unit
- Average price indices: 1/4/17: 100 & 31/3/18: 120

Find out:

a. Financial capital maintenance at Historical Cost

b. Financial capital maintenance at Current Purchasing Power

c. Physical Capital Maintenance **[Exam May 2019]**

Ans: **Financial Capital Maintenance at historical costs**

	₹	₹
Closing capital (₹ 25,000 – ₹ 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At historical cost)	-	
Introduction (At historical cost)	20,000	(20,000)
Retained profit		1,000

Financial Capital Maintenance at current purchasing power

	₹	₹
Closing capital (₹ 25,000 – ₹ 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At closing price) (5,000 x ₹ 4.80)	24,000	
Introduction (At closing price)	Nil	(24,000)
Retained profit		(3,000)

Physical Capital Maintenance

	₹	₹
Closing capital (₹ 25,000 – ₹ 4,000)		21,000
Less: Capital to be maintained		
Opening capital (At current cost) (5,000 x ₹ 4.60)	23,000	
Introduction (At current cost)	Nil	(23,000)
Retained profit		(2,000)

CHAPTER 2

IND AS - INTRODUCTION

INTRODUCTION TO INDIAN ACCOUNTING STANDARD (IND AS)

In the present era of globalisation and liberalisation, the world has become an economic village. The globalisation of the business world, the attendant structures and the regulations, which support it, as well as the development of e-commerce make it imperative to have a single globally accepted financial reporting system. A number of multi-national companies are establishing their businesses in various countries with emerging economies and vice versa. The entities in emerging economies are increasingly accessing the global markets to fulfill their capital needs by getting their securities listed on the stock exchanges outside their country. Capital markets are, thus, becoming integrated consistent with this world-wide trend. More and more Indian companies are being listed on overseas stock exchanges. The use of different accounting frameworks in different countries, which require inconsistent treatment and presentation of the same underlying economic transactions, creates confusion for users of financial statements. This confusion leads to inefficiency in capital markets across the world. Therefore, increasing complexity of business transactions and globalisation of capital markets call for a single set of high quality accounting standards.

High standards of financial reporting underpin the trust investors place in financial and nonfinancial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries to pursue convergence of national accounting standards with IFRS.

International Financial Reporting Standards (IFRS) are considered a "principles-based" set of standards. In fact, they establish broad rules rather than dictating specific treatments. Every major nation is moving toward adopting them to some extent. Large number of authorities requires public companies to use IFRS for stock-exchange listing purposes, and in addition, banks, insurance companies and stock exchanges may use them for their statutorily required reports. So over the next few years, thousands of companies will adopt the international financial reporting standards while preparing their financial statements.

GOVERNMENT OF INDIA - COMMITMENT TO IFRS CONVERGED IND AS

Consistent, comparable and understandable financial reporting is essential to develop a robust economy. With a view to achieve international benchmarks of financial reporting, the Institute of Chartered Accountants of India (ICAI), as a proactive role in accounting, set out to introduce Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS). This endeavour of the ICAI is supported by the Government of India.

Initially Ind AS were expected to be implemented from the year 2011. However, keeping in view the fact that certain issues including tax issues were still to be addressed, the Ministry of Corporate Affairs decided to postpone the date of implementation of Ind AS.

In July 2014, the Finance Minister of India at that time, Shri Arun Jaitelyji, in his Budget Speech, announced an urgency to converge the existing accounting standards with the International Financial Reporting Standards (IFRS) through adoption of the new Indian Accounting Standards (Ind AS) by the Indian companies from the financial year 2015-16 voluntarily and from the financial year 2016-17 on a mandatory basis.

Pursuant to the above announcement, various steps have been taken to facilitate the implementation of IFRS-converged Indian Accounting Standards (Ind AS). Moving in this direction, the Ministry of Corporate Affairs (MCA) has issued the Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 covering the revised roadmap of implementation of Ind AS for companies other than Banking companies, Insurance Companies and NBFCs and Indian Accounting Standards (Ind AS). As per the Notification, Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) shall be implemented on voluntary basis from 1st April, 2015 and mandatorily from 1st April, 2016.

Initially, India decided to adopt Ind AS 115 corresponding to IFRS 15 two years ahead of the world. However, after the same were notified by the MCA, many representations were being received from various organisations, industry associations etc. for deferring the applicability of Ind AS 115. Considering the difficulties being faced by various industries, it was decided to defer the applicability of Ind AS 115 and to bring Ind AS 11 and Ind AS 18 in its place. Further, there were certain amendments that were made in IFRS/IAS issued by the IASB. The Institute of Chartered Accountants of India (ICAI) to keep up the pace with the global developments, revised the notified Ind AS in line with the amendments made in IFRS/IAS issued by the IASB. MCA had notified the amendments to the Ind AS vide notification dated March 30, 2016, as Companies (Indian Accounting Standards) Amendment Rules, 2016.

WHAT ARE INDIAN ACCOUNTING STANDARDS (IND AS)?

Indian Accounting Standards (Ind-AS) are the International Financial Reporting Standards (IFRS) converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).

ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICSI, ICAI, representatives from ASSOCHAM, CII, FICCI, etc. National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

WHAT ARE CARVE OUTS/INS IN IND AS?

The Government of India in consultation with the ICAI decided to converge and not to adopt IFRS issued by the IASB. The decision of convergence rather than adoption was taken after the detailed analysis of IFRS requirements and extensive discussion with various stakeholders.

Accordingly, while formulating IFRS-converged Indian Accounting Standards (Ind AS), efforts have been made to keep these Standards, as far as possible, in line with the corresponding IAS/IFRS and departures have been made where considered absolutely essential. These changes have been made considering various factors, such as

- Various terminology related changes have been made to make it consistent with the terminology used in law, e.g., ‘statement of profit and loss’ in place of ‘statement of comprehensive income’ and ‘balance sheet’ in place of ‘statement of financial position’.

- Removal of options in accounting principles and practices in Ind AS vis-a-vis IFRS, have been made to maintain consistency and comparability of the financial statements to be prepared by following Ind AS. However, these changes will not result into carve outs.
- Certain changes have been made considering the economic environment of the country, which is different as compared to the economic environment presumed to be in existence by IFRS. These differences are due to differences in application of accounting principles and practices and economic conditions prevailing in India. These differences which are in deviation to the accounting principles and practices stated in IFRS, are commonly known as 'Carve-outs'.

  Note: In Ind AS 103 "Business Combination", an additional guidance on "Accounting of Business Combinations of Entities under Common Control" is given which is over and above what is given in IFRS. This is termed as 'Carve-in'.

ROADMAP FOR IMPLEMENTATION OF THE INDIAN ACCOUNTING STANDARDS (IND AS)

For Companies other than banks, NBFCs and Insurance Companies

Phase I 1st April 2015 or thereafter: Voluntary Basis for all companies (with Comparatives)

1st April 2016: Mandatory Basis

(a) Companies listed/in process of listing on Stock Exchanges in India or Outside India having net worth > INR 5 Billion

(b) Unlisted Companies having net worth > INR 5 Billion

(c) Parent, Subsidiary, Associate and J.V. of above

Phase II 1st April 2017: Mandatory Basis

(a) All companies which are listed/or in process of listing inside or outside India on Stock Exchanges not covered in Phase I (other than companies listed on SME Exchanges)

(b) Unlisted companies having net worth INR 5 Billion > INR 2.5 Billion

(c) Parent, Subsidiary, Associate and J.V. of Above

- Companies listed on SME exchange not required to apply Ind AS.
- Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements.
- Companies not covered by the above roadmap shall continue to apply existing Accounting Standards notified in Companies (Accounting Standards) Rules, 2006.

For Scheduled Commercial Banks (Excluding RRBs), Insurers/Insurance Companies and Non-Banking Financial Companies (NBFC's)

Non-Banking Financial Companies (NBFC's)

Phase I: From 1st April, 2018 (with comparatives)

(a) NBFCs (whether listed or unlisted) having net worth 500 crore or more

(b) Holding, Subsidiary, JV and Associate companies of above NBFC other than those already covered under corporate roadmap shall also apply from said date

Phase II: From 1st April, 2019 (with comparatives)

(a) NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than 500 crore

(b) NBFCs that are unlisted having net worth 250 crore or more but less 500 crore

(c) Holding, Subsidiary, JV and Associate companies of above other than those already covered under corporate roadmap shall also apply from said date

- Applicable for both Consolidated and individual Financial Statements
- NBFC having net worth below 250 crore shall not apply Ind AS.
- Adoption of Ind AS is allowed only when required as per the roadmap.
- Voluntary adoption of Ind AS is not allowed.

Scheduled Commercial banks (excluding RRB's)

Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Indian Accounting Standards (Ind AS) from 1 April 2018. RBI vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. from 1 April 2019. However, later on it deferred the Ind AS implementation till further notice RBI through a notification dated 22 March 2019.

Insurers/Insurance companies

The Insurance Regulatory and Development Authority (IRDA) has deferred the date of implementation of Indian Accounting Standard (Ind-AS) for the insurance sector from FY20-21 till further notice.

Clarifications

How to calculate Net Worth?

Net worth for a company is to be calculated in accordance with its SFS as on 31st March 2014 or the first financial audited statements for accounting period which ends after that date. Accordingly, if a company has net worth more than INR 500 crores as of 31st March 2015, then it will be covered in the Phase 1 itself and apply Ind AS from financial year beginning on or after 1st April 2016.

For the purpose of computing the net worth, reference should be made to the definition under the Companies Act, 2013. In accordance with section 2(57) of the Companies Act, 2013, net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

Companies not covered in the roadmap

- Companies whose securities are listed or in the process of listing on SME exchanges. These companies shall continue to comply with the existing accounting standards unless they choose otherwise.
- Companies not covered by the roadmap shall continue to apply the existing accounting standards prescribed in the Annexure to the Companies (Accounting Standards) Rules, 2006.
- Once a company opts to follow the Indian Accounting Standards (Ind AS), it shall be required to follow the Ind AS for all the subsequent financial statements.

Standalone and consolidated financial statements

It is now clear that Ind AS will apply to both consolidated and stand-alone financial statements of a company covered by the roadmap. This is helpful as companies will not have to maintain dual accounting systems.

Foreign operations

It is a relief that an overseas subsidiary, associate or joint venture of an Indian company is not required to prepare its stand-alone financial statements as per the Ind AS, and instead, may continue with its jurisdictional requirements. However, these entities will still have to report their Ind AS adjusted numbers for their Indian parent company to prepare consolidated Ind AS accounts.

DIVISION II OF THE SCHEDULE III TO THE COMPANIES ACT, 2013

The Ministry of Corporate Affairs vide its notification dated 6th April, 2016 notified amendments to Schedule III to the Companies Act, 2013 thereby inserting Division II to Schedule III for preparation of financial statements by those entities who have to comply with Indian Accounting Standards (Ind AS). Now

1. Division I is applicable to a company whose financial statements are required to comply with the current accounting standards
2. Division II is applicable to a company whose financial statements are drawn up in compliance with Ind AS.
3. Division III, which is applicable to Non-Banking Finance Companies whose financial statements are drawn up incompliance with Ind AS.

Points for consideration

- All companies that prepare, either voluntarily or mandatorily, Financial Statements in compliance with the Companies Ind AS Rules, should consider Ind AS Schedule III as well as this Guidance Note.
- The requirements of Ind AS Schedule III however, do not apply to companies as referred to in the proviso to Section 129(1) of the Act, i.e., any insurance or banking company, or any company engaged in the generation or supply of electricity or to any other class of company for which a form of Balance Sheet and Statement of Profit and Loss has been specified in or under

any other Act governing such class of company. Moreover, the requirements of Ind AS Schedule III do not apply to Non-Banking Finance Companies (NBFCs) that adopt Ind AS.

- It may, however, be clarified that for companies engaged in the generation and supply of electricity, neither the Electricity Act, 2003, nor the rules framed there under, prescribe any specific format for presentation of Financial Statements by an electricity company. Section 1(4) of the Act states that the Act will apply to electricity companies, to the extent it is not inconsistent with the provisions of the Electricity Act. Keeping this in view, Ind AS Schedule III as applicable may be followed by such companies till the time any other format is prescribed by the relevant statute.
- Listed entities shall follow guidelines issued by SEBI by way of circulars prescribing formats for publishing financial results (quarterly, half yearly and annual) which is guided by the relevant provisions of the Ind AS and Ind AS Schedule III and may make suitable modifications, as applicable.

❖ Applicability

- ✓ It is applicable to every company to which Ind AS apply in preparation of its financial statements.
- ✓ The provisions of Schedule III also apply when a company is required to prepare consolidated financial statements, in addition to the disclosure requirements specified under Ind AS.
- ✓ Financial Statements include Balance Sheet, Statement of Changes in Equity for the period, Statement of Profit and Loss for the period and Notes. Cash Flow Statement shall be prepared in accordance with the requirements of the relevant Ind AS.
- ✓ The Ind AS Schedule III requires that if the compliance with the requirements of the Act including Ind AS as applicable to the companies, require any change in presentation or disclosure in the Financial Statements, the requirements of Ind AS Schedule III will stand modified accordingly.

❖ Balance Sheet

- ✓ Schedule III provides a format of the balance sheet and sets out the minimum requirements of disclosure on the face of the balance sheet
- ✓ Items presented in the balance sheet are to be classified as current and non-current.
- ✓ Schedule III does not permit companies to avail of the option of presenting assets and liabilities in the order of liquidity, as provided by Ind AS 1, Presentation of Financial Statements.

❖ Statement of Profit and Loss

- ✓ Schedule III provides a format of the statement of profit and loss and sets out the minimum requirements of disclosure on the face of the statement of profit and loss.
- ✓ The statement of profit and loss is to be presented in accordance with the nature of expenses and would include profit or loss for the period and other comprehensive income for the period.

❖ Statement of changes in Equity

✓ This is a new component for preparers of financial statements that have historically prepared financial statements under Indian GAAP.

✓ The Statement of changes in equity would reconcile opening to closing amounts for each component of equity including reserves and surplus and items of other comprehensive income.

✓ The format also includes disclosure of the equity component of compound financial instruments in 'other equity', which is in accordance with Ind AS 32, Financial Instruments: Presentation.

❖ Statement of Cash Flows

✓ The Statement of cash flows would be presented when required in accordance with Ind AS7, Statement of Cash Flows.

❖ Notes

✓ Notes containing information in addition to that which is presented in the financial statements would be provided, including, where required, narrative descriptions or disaggregation of items recognised in the financial statements and information about items that do not qualify for such recognition.

✓ Disclosure under Ind AS (for e.g., fair value measurement reconciliation, fair value hierarchy, risk management and capital management, disclosure of interests in other entities, components of other comprehensive income, reconciliations on first-time adoption of Ind AS, etc.) shall be made in the Notes or by way of additional statement(s) unless required to be disclosed on the face of the Financial Statements.

❖ Compliance with Ind AS and the Companies Act, 2013

✓ In situations where compliance with the requirements of the 2013 Act including Ind AS requires any change in treatment or disclosure (including addition, amendment, substitution or deletion in the head/sub-head or any changes in the financial statements or statements forming part thereof) in the formats given in Schedule III, then Schedule III permits such changes to be made and the requirements of Schedule III would stand modified accordingly.

❖ Conflict of requirements of Ind AS and Schedule III

✓ It further mentions that disclosure requirements specified in Schedule III would be in addition to and not in substitution of the disclosure requirements specified in Ind AS. Companies would be required to make additional disclosures specified in Ind AS either in the notes or by way of additional statement(s) unless required to be disclosed on the face of financial statements. Similarly, all other disclosures as required by the 2013 Act should be made in the notes in addition to the requirements of Schedule III.

✓ This is an important provision, as it clarifies that in situations where an accounting treatment or disclosure in an Ind AS is in conflict with the requirements of Schedule III, companies are required to comply with the relevant Ind AS.

❖ General Instruction

- ✓ Where any Act or Regulation requires specific disclosures to be made in the Financial Statements of a company, the said disclosures shall be made in addition to those required under Ind AS Schedule III.
- ✓ Note 8 to General Instructions for Preparation of Financial Statements in Ind AS Schedule III states that the terms used in the Ind AS Schedule III will carry the meaning as defined by the applicable Ind AS.

  For example, the terms such as 'associate', 'related parties', etc. will have the same meaning as defined in Ind AS notified under the Companies Ind AS Rules.
- ✓ For any terms which are not specifically defined in Ind AS, attention may also be drawn to the Framework for the preparation and presentation of Financial Statements in accordance with Indian Accounting Standards ('Ind AS Framework') issued by ICAI. However, if any term is not defined in the Ind AS Framework, the entity may give consideration to the principles described in Ind AS 8 for the purpose of developing and applying an accounting policy.
- ✓ A General Instruction on 'Materiality' has been included in Note 7 to General Instructions for Preparation of Financial Statements requiring Financial Statements to disclose items that could, individually or collectively, influence the economic decisions that users make on the basis of the Financial Statements. Materiality depends on the size or nature of the item or a combination of both, to be judged based on particular facts and in particular circumstances.
- ✓ Moreover, Ind AS 1 states w.r.t. 'materiality' that an entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.

LIST OF INDIAN ACCOUNTING STANDARDS

Ind AS	Title of Ind AS
101	First Time Adoption of Indian Accounting Standards
102	Share Based Payment
103	Business Combinations
104	Insurance Contracts
105	Non-current Assets Held for Sale and Discontinued Operations
106	Exploration for and Evaluation of Mineral Resources
107	Financial Instruments: Disclosures
108	Operating Segments
109	Financial Instruments
110	Consolidated Financial Statements
111	Joint Arrangements
112	Disclosure of Interests in Other Entities
113	Fair Value Measurement
114	Regulatory Deferral Accounts
115	Revenue from Contracts with Customers

116	Leases
1	Presentation of Financial Statements
2	Inventories
7	Statement of Cash Flows
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events after the Reporting Period
12	Income Taxes
16	Property, Plant and Equipment
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The Effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
27	Separate Financial Statements
28	Investment in Associates and Joint Ventures
29	Financial Reporting in Hyperinflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

NOTES

CHAPTER 3
PRESENTATION OF FINANCIAL STATEMENT (IND AS 1)

QUESTIONS FROM ICAI STUDY MATERIAL

Q 1: In 20X8 entity 'Superb' was acquired by entity 'Happy go lucky'. To align its reporting date with that of its parent. Superb changed the end of its annual reporting period from 31 January to 31 March. Consequently, entity Superb's reporting period for the year ended 31 March 20X8 is 14 months. What disclosure is required by Superb

Ans: On the basis of those facts, the following disclosure is appropriate.

Extract from the notes to entity Superb's 31 March 20X8 financial statements:

Note 1

Basis of preparation and accounting policies

Reporting period

In 20X8, to align the entity's reporting period with that of its parent (Happy Go Luck), the entity changed the end of its reporting period from 31 January to 31 March. Amounts presented for the 20X8 reporting period are for a 14-month period. Comparative figures are for a 14-month period. Consequently, comparative amounts for the statement of comprehensive income, statement of changes in equity, statement of cash flows and related notes are not entirely comparable.

Q 2 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 3 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 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 4: 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 5: An entity has taken a loan facility from a bank that is to be repaid within a period of 9 months from the end of the reporting period. Prior to the end of the reporting period, the entity and the bank enter into an arrangement, whereby the existing outstanding loan will, unconditionally, roll into the new facility which expires after a period of 5 years.

(a) How should such loan be classified in the balance sheet of the entity?

(b) Will the answer be different if the new facility is agreed upon after the end of the reporting period?

(c) Will the answer to (a) be different if the existing facility is from one bank and the new facility is from another bank?

(d) Will the answer to (a) be different if the new facility is not yet tied up with the existing bank, but the entity has the potential to refinance the obligation?

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 6: 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 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 7: 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 8: 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?

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 9: 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 10: Entity A has undertaken various transactions in the financial year ended March 31, 20X1. Identify and present the transactions in the financial statements as per Ind AS 1.

	₹
Remeasurement of defined benefit plans	2,57,000
Current service cost	1,75,000
Changes in revaluation surplus	1,25,000
Gains and losses arising from translating the monetary assets in foreign currency	75,000
Gains and losses arising from translating the financial statements of a foreign operation	65,000
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	1,00,000
Income tax expense	35,000
Share based payments cost	3,35,000

Ans: **Items impacting the Statement of Profit and Loss for the year ended 31st March, 20X1**

	(₹)
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

	(₹)
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 11 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 12 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?

Ans: These should be classified as current.

Q 13 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 14 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 15 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 16 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.

Q 17 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 18 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 19 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 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 ₹ 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 ₹ 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 ₹500,000 starting on 31 March 20X3.

Ans: In its statement of financial position at 31 March 20X3 the entity must present the ₹ 1,20,000 accrued interest and ₹ 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 ₹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.

NEW QUESTIONS IN SM (FOR MAY 20 ATTEMPT)

Q 20: A retail chain acquired a competitor in March, 2011 and accounted for the business combination under Ind AS 103 on a provisional basis in its 31st March, 2011 annual financial statements. The business combination accounting was finalised in 2011-2012 and the provisional fair values were updated. As a result, the 2010-2011 comparatives were adjusted in the 2011-12 annual financial statements. Does the restatement require an opening statement of financial position (that is, an additional statement of financial position) as of 1st April, 2010?

Ans: An additional statement of financial position is not required, because the acquisition had no impact on the entity's financial position at 1st April, 2010.

Q 21: OMN Ltd has a subsidiary MN Ltd. OMN Ltd provides a loan to MN Ltd at 8% interest to be paid annually. The loan is required to be paid whenever demanded back by OMN Ltd.

How should the loan be classified in the financial statements of OMN Ltd? Will it be any different for MN Ltd?

Ans: The demand feature might be primarily a form of protection or a tax-driven feature of the loan. Both parties might expect and intend that the loan will remain outstanding for the foreseeable future. If so, the instrument is, in substance, long-term in nature, and accordingly, OMN Ltd would classify the loan as a non-current asset.

However, OMN Ltd would classify the loan as a current asset if both the parties intend that it will be repaid within 12 months of the reporting period.

MN Ltd would classify the loan as current because it does not have the right to defer repayment for more than 12 months, regardless of the intentions of both the parties.

The classification of the instrument could affect initial recognition and subsequent measurement. This might require the entity's management to exercise judgement, which could require disclosure under judgements and estimates.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q 22 XYZ Limited (the Company') is into the manufacturing of tractor parts and mainly supplying components to the Original Equipment Manufacturers (OEMs). The Company does not have any subsidiary, joint venture or associate company. During the preparation of financial statements for the year ended March 31, 20X1, the accounts department is not sure about the treatment/presentation of below mentioned matters. Accounts department approached you to advice on the following matters.

S. No.	Matters
(i)	There are qualifications in the audit report of the Company with reference to two Ind AS.
(ii)	Is it mandatory to add the word -standalone‖ before each of te components of financial statements?
(iii)	The Company is Indian Company and preparing and presenting its financial statements in ₹. Is it necessary to write in the financial statements that the financial statements has been presented in ₹.
(iv)	The Company is having turnover of ₹ 180 crores. The Company wants to present the absolute figures in the financial statements. Because for tax audit purpose, tax related filings and other internal purposes, Company always need figures in absolute amounts.
(v)	The Company had sales transactions with 10 related party parties during previous year. However, during current year, there are no transactions with 4 related parties out of aforesaid 10 related parties. Hence, Company is of the view that it need not disclose sales transactions with these 4 parties in related party disclosures because with these parties there are no transactions during current year.

Evaluate the above matters with respect to preparation and presentation of general purpose financial statement

Ans:

i. Yes, an entity whose financial statements comply with Ind AS shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with Ind AS unless they comply with all the requirements of Ind AS. (Refer Para 16 of Ind AS 1)

ii. No, but need to disclose in the financial statement that these are individual financial statement of the Company. (Refer Para 51(b) of Ind AS 1)

iii. Yes, Para 51(d) of Ind AS 1 inter alia states that an entity shall display the presentation currency, as defined in Ind AS 21 prominently, and repeat it when necessary for the information presented to be understandable.

iv. Yes, it is mandatory as per the requirements of Division II of Schedule III to Companies Act, 2013).

v. No, as per Para 38 of Ind AS 1, except when Ind AS permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

Q 23. A Company presents financial results for three years (i.e one for current year and two comparative years) internally for the purpose of management information every year in addition to the general purpose financial statements. The aforesaid financial results are presented without furnishing the related notes because these are not required by the management for internal purpose. During current year, management thought why not they should present third year statement of profit and loss also in the general purpose financial statements. I t will save time and will be available easily whenever management needs this in future.

With reference to above background, answer the following:

(i) Can management present the third statement of profit and loss as additional comparative in the general purpose financial statements?

(ii) If management present third statement of profit and loss in the general purpose financial statement as comparative, is it necessary that this statement should be compliant of Ind AS?

(iii) Can management present third statement of profit and loss only as additional comparative in the general purpose financial statements without furnishing other components (like balance sheet, statement of cash flows, statement of change in equity) of financial statements?

Ans:

(i) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

(ii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS.

(iii) Yes, as per Para 38C of Ind AS 1, an entity may present comparative information in addition to the minimum comparative financial statements required by Ind AS, as long as that information is prepared in accordance with Ind AS. This comparative information may consist of one or more statements referred to in paragraph 10 but

need not comprise a complete set of financial statements. When this is the case, the entity shall present related note information for those additional statements.

Q 24 A Company while preparing the financial statements for Financial Year (FY) 20X1 -20X2, erroneously booked excess revenue of ₹ 10 Crore. The total revenue reported in FY 20X1-20X2 was ₹ 80 Crore. However, while preparing the financial statements for 20X2-20X3, it discovered that excess revenue was booked in FY 20X1 -20X2 which it now wants to correct in the financial statements. However, management of the Company is not sure whether it need to present the third balance sheet as additional comparative.

regard to the above background, answer the following:

(a) Is it necessary to provide the third balance sheet at the beginning of the preceding period in this case?

(b) The Company wants to correct the error during FY 20X2 -20X3 by giving impact in the figures of current year only. Is the contention of management correct?

Ans:

a) No, as per Para 40A of Ind AS 1, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:

- it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
- the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period.

b) No, management need to correct the previous year figures to correct the error but need not to furnish third balance sheet at the beginning of preceding period. (Refer Para 40A of Ind AS 1)

Q 25: XYZ Limited (the 'Company') is into construction of turnkey projects and has assessed its operating cycle to be 18 months. The Company has certain trade receivables and payables which are receivable and payable within a period of twelve months from the reporting date, i.e, March 31, 20X2.

In addition to above there are following items/transactions which took place during financial year 20X1-20X2.

S. No.	Items/transactions
(1)	The Company has some trade receivables which are due after 15 months from the date of balance sheet. So the Company expects that the payment will be received within the period of operating cycle.

(2)	The Company has some trade payables which are due for payment after 14 months from the date of balance sheet. These payables fall due within the period of operating cycle. Though the Company does not expect that it will be able to pay these payable within the operating cycle because the nature of business is such that generally projects gets delayed and payments from customers also gets delayed.
(3)	The Company was awarded a contract of ₹ 100 Crore on March 31, 20X2. As per the terms of the contract, the Company made a security deposit of 5% of the contract value with the customer, of ₹ 5 crore on March 31, 20X2. The contract is expected to be completed in 18 months' time. The aforesaid deposit will be refunded back after 6 months from the date of the completion of the contract.
(4)	The Company has also given certain contracts to third parties and have received security deposits from them of ₹ 2 Crore on March 31, 20X2 which are repayable on completion of the contract but if contract is cancelled before the contract term of 18 months, then it becomes payable immediately. However, the Company does not expect the cancellation of the contract.

Considering the above items/transactions answer the following:

(a) The Company wants to present the trade receivable as current despite the fact that these are receivables in 15 months' time. Does the decision of presenting the same as current is correct?

(b) The Company wants to present the trade payables as non-current despite the fact that these are due within the operating cycle of the Company. Does the decision of presenting the same as non-current is correct?

(c) Can the security deposit of ₹ 5 Crore made by the Company with the customers be presented as current?

(d) Can the security deposit of ₹ 2 Crore taken by the Company from contractors be presented as non-current?

Ans:

(a) Yes, but additionally the Company also need to disclose amounts that are receivable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

(b) No, the Company cannot disclose these payables as non-current and the Company also need to disclose amounts that are payable within a period of 12 months and after 12 months from the reporting date. (Refer Para 60 and 61 of Ind AS 1)

(c) No, because the amount will be received after the operating cycle of the Company. (Refer Para 66 of Ind AS 1)

(d) No, because the amount may be required to be paid before completion of the contact in case the contract is cancelled. (Refer Para 69 of Ind AS 1).

QUESTIONS FROM OTHER SOURCE

Q 26. Sumedha Ltd. took a loan from bank for ₹ 10,00,000 to be settled within 5 years in 10 equal half yearly instalments with interest. First instalment is due on 30.09.2013 of ₹ 1,00,000. Determine how the loan will be classified in preparation of Financial Statements of Sumedha Ltd. for the year ended 31st March, 2013 according to IND AS 1.

Ans: In the given case, instalments due on 30.09.2013 and 31.03.2014 will be shown as "current liabilities' as per criteria (c) of definition.

Therefore, in the balance sheet as on 31.3.2013, ₹ 8,00,000 (₹ 1,00,000 x 8 instalments) will be shown as non-current liability' and ₹ 2,00,000 (₹ 1,00,000 x 2 instalments) will be shown as 'Current Liabilities' as current maturities of loan from bank.

Q 27. KAY Ltd. is in the process of finalizing its accounts for year ended 31st March, 2014 and furnishes the following information:

(i) Finished goods normally are held for 30 days before sale.

(ii) Sales realization from Debtors usually takes 60 days from date of credit invoice.

(iii) Raw materials are held in stock to cover one month's production requirements.

(iv) Packing materials, being specifically made for the company and having lead time of 90 days is held in stock for 90 days.

(v) The holding period in respect of unfinished goods is 30 days.

(vi) Being a monopoly KAY Ltd. enjoys a credit period of 12.5 months from its suppliers who sometimes at the end of their credit period opt for conversion of their dues into long term debt of KAY Ltd.

You are required to compute the operating cycle of KAY Ltd. as per Schedule III of Companies Act, 2013. As the suppliers of the company are paid off after a credit period of 12.5 months should this be part of Current Liability? Would your answer be the same if the creditors are settled in 330 days?

Ans: Operating cycle of Kay Ltd. will be computed as under:

Raw material stock holding period + Work-in-progress holding period + Packing Materials holding period+ Finished goods holding period + Debtors collection period

= 1 + 1 + 3 + 1 + 2 = 8 months

There are two situations:

(a) When credit period given by supplier is 12.5 months: The nature of classification of liability is to be seen with reference to the reporting date. Hence all liabilities except those that arise in the last fortnight of the accounting period will be "Current" as this will have to be settled within 12 months of the reporting date. Thus, all liabilities that do not arise in the last fortnight of the accounting period will be "Non-Current".

(b) When credit period given by suppliers is 330 days (i.e. 11 months approx.): If the creditors are settled in 330 days i.e. within 11 months. This satisfies the third condition i.e. it is due to be settled within twelve months after the reporting date and there is no option to defer it. Hence, in the case it will be treated as current liability.

QUESTIONS FROM RTP/MTP/EXAMS

Q28: An entity has the following trial balance line items. How should these items be classified, i.e., current or non-current as per Ind AS 1?

(a) Receivables (viz., receivable under a contract of sale of goods in which an entity deals)

(b) Advance to suppliers

(c) Income tax receivables [other than deferred tax]

(d) Insurance spares

RTP May 2021

Ans: (a) As per paragraph 66(a) of Ind AS 1, an entity shall classify an asset as current when it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.

Paragraph 68 provides the guidance that current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period.

In accordance with above, the receivables that are considered a part of the normal operating cycle will be classified as current asset.

If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

(b) As discussed in point (a) above, advances to suppliers for goods and services would be classified in accordance with normal operating cycle if it is given in relation to the goods or services in which the entity normally deals. If the advances are considered a part the normal operating cycle, it would be classified as a current asset. If the operating cycle exceeds twelve months, then additional disclosure as required by paragraph 61 of Ind AS 1 is required to be given in the notes.

(c) Classification of income tax receivables [other than deferred tax] will be driven by paragraph 66 (c) of Ind AS 1, i.e., based on the expectation of the entity to realise the asset. If the receivable is expected to be realised within twelve months after the reporting period, then it will be classified as current asset else non-current asset.

(d) Para 8 of Ind AS 16 states that items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

Accordingly, the insurance spares that are treated as an item of property, plant and equipment would normally be classified as non-current asset whereas insurance spares that are treated as inventory will be classified as current asset if the entity expects to consume it in its normal operating cycle.

Q29: Entity A had obtained a long-term bank loan during January 2019, which is subject to certain financial covenants. One of such covenants states that during the tenure of the loan, debt equity ratio of 65:35 is to be maintained at all time. In case of breach of this covenant, the loan will be repayable immediately. The loan agreement also states that these covenants will be assessed at the end of each quarter and reported to the bank within a month from the end of each quarter. If the covenants are breached at this time, the loan will be repayable immediately. The entity closes its annual accounts as on 31st March every year.

You are required to show how the loan will be classified as on 31st March 2020, if:

(i) At the financial year end, Entity A determines that it is not in breach of any of the covenants;

(ii) At the quarter ending 31st December 2019, Entity A's debt equity ratio became 75:25 and thus breaches the covenant, however it obtains a waiver from the bank. The terms of the waiver specify that if Entity A rectifies the breach within a period of 12 months from the reporting date then the bank cannot demand repayment immediately on account of the breach during this period. Entity A expects to rectify the breach by raising additional equity capital by means of a rights issue to the existing shareholders and expects that the issue will be fully subscribed;

(iii) Considering the same facts as in (ii) above, except obtaining the waiver clause, what would be your answer? **Exam Paper January 2021 (5 Marks)**

Ans: Para 74 of Ind AS 1 'Presentation of Financial Statements', states that 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.

However, an entity classifies the liability as non-current, if the lender agreed by the end of the reporting period to provide a period of grace ending at least twelve months after the reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

(i) The entity has obtained a long-term loan during January, 2019. Since repayment period of the loan is not mentioned in the question, it is assumed that on 31st March 2020, the repayment period of the loan is more than 12 months. Further, the entity has not breached the covenants specified in the loan; therefore, as at 31st March, 2020, the loan will be classified as 'non-current liability.

(ii) In the second case, though there is a breach of covenant on 31st December, 2019 i.e. before reporting date of 31st March, 2020, yet the bank had agreed to provide a period of grace for twelve months from the reporting period, within which the entity A can rectify the breach and during this period bank cannot demand immediate repayment. Also, entity A has intention to rectify the breach. Thus, entity A w ill classify the liability of bank loan as non-current liability in its books as at 31st March, 2020.

(iii) Since the covenant for the bank loan has been breached during the quarter ended 31st December, 2019 and reported to the bank within one month from the end of the

quarter i.e. by 31st January, 2020, the bank loan becomes repayable immediately. Therefore, it will be presented as current liability in the books of entity A as on 31st March, 2020.

CHAPTER 4
SCHEDULE III OF COMPANIES ACT

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

A Non-Current Assets

I. Property. Plant and Equipment:

(i) Classification shall be given as:

(a) Land

(b) Buildings

(c) Plant and Equipment

(d) Furniture and Fixtures

(e) Vehicles

(f) Office equipment

(g) Bearer Plants

(h) Others (specify nature)

(ii) Assets under lease shall be separately specified under each class of assets

(iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

II. Investment Property:

A reconciliation of the gross and net carrying amounts of each class of property at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

III. Goodwill :

A reconciliation of the gross and net carrying amount of goodwill at the beginning and end of the reporting period showing additions, impairments, disposals and other adjustments.

IV. Other Intangible assets

(i) Classification shall be given as:

(a) Brands or trademarks

(b) Computer software

(c) Mastheads and publishing titles

(d) Mining rights

(e) Copyright, patents, other intellectual property rights, services and operating rights

(f) Recipes, formulae, models, designs and prototypes

(g) Licenses and franchises

(h) Others (specify nature)

(ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses or reversals shall be disclosed separately.

V. Biological Assets other than bearer plants:

A reconciliation of the carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments shall be disclosed separately.

VI. Investment

(i) Investments shall be classified as:

(a) Investments in Equity Instruments;

(b) Investments in Preference Shares;

(c) Investments in Government or trust securities;

(d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) Investments in partnership firms; or

(g) Other investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate that are-

(i) subsidiaries,

(ii) associates,

(iii) joint ventures, or

(iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). Investments in partnership firms along with names of the firms, their partners, total capital and the shares of each partner shall be disclosed separately.

(ii) The following shall also be disclosed:

(a) Aggregate amount of quoted investment and market value thereof:

(b) Aggregate amount of unquoted investment: and

(c) Aggregate amount of impairment in value of investment.

VII. Trade Receivables:

(i) Trade receivables shall be sub-classified as;

a. Trade Receivables considered good - Secured;

b. Trade Receivables considered good - Unsecured;

c. Trade Receivables which have significant increase in Credit Risk; and

d. Trade Receivables - credit impaired

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

VIII. Loans;

(i) Loans shall be classified as-

(a) Security Deposits;

(b) Loans to related parties (giving details thereof); and

(c) Other loans (specify nature).

The above shall also be separately sub-classified as-

(a) Loans Receivables considered good - Secured;

(b) Loans Receivables considered good - Unsecured;

(c) Loans Receivables which have significant increase in Credit Risk; and

(d) Loans Receivables - credit impaired;

(ii) Loans due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

IX. Bank deposits with more than 12 months maturity shall be disclosed under 'Other financial assets';

X. Other non-current asset: Other non-current assets shall be classified as-

(i) Capital Advances; and

(ii) Advances other than capital advances;

(1) Advances other than capital advances shall be classified as:

(a) Security Deposits;

(b) Advances to related parties (giving details thereof; and

(c) Other advances (specify nature).

(2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated, in case advances are of the nature of a financial asset as per relevant Ind AS, these are to be disclosed under other financial assets separately.

(iii) Others (specify nature).

B. Current Assets

I. Inventories:

(i) Inventories shall be classified as-

(a) Raw materials;

(b) Work in-progress;

(c) Finished goods;

(d) Stock-in-trade (in respect of goods acquired for trading);

(e) stores and spares;

(f) Loose tools; and

(g) Others (specify nature).

(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

(iii) Mode of valuation shall be stated.

II. Investment;

(i) Investments shall be classified as-

(a) Investments in Equity instruments;

(b) investment in Preference Shares;

(c) investment in government or trust securities;

(d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) investment in partnership firms; and

(g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate that are-

(i) subsidiaries,

(ii) associates,

(iii) joint ventures, or

(iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid)

(ii) The following shall also be disclosed

(a) Aggregate amount of quoted investments and market value thereof;

(b) Aggregate amount of unquoted investments;

(c) Aggregate amount of impairment in value of investments,

III. Trade Receivables

(i) Trade receivables shall be sub-classified as:

a. Trade Receivables considered good - Secured;

b. Trade Receivables considered good - Unsecured;

c. Trade Receivables which have significant increase in Credit Risk; and

d. Trade Receivables - credit impaired

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or. private companies respectively in which any director is a partner or a director or a member should be separately stated.

IV. Cash and cash equivalents:

Cash and cash equivalents shall be classified as-

a. Balances with Banks (of the nature of cash and cash equivalents);

b. Cheques, drafts on hand;

c. Cash on hand; and

d. Others (specify nature).

V. Loans:

(i) Loans shall be classified as:

(a) Security deposits;

(b) Loans to related parties (giving details thereof); and

(c) others (specify nature).

(ii) The above shall also be sub-classified as-

(a) Loans Receivables considered good - Secured;

(b) Loans Receivables considered good - Unsecured;

(c) Loans Receivables which have significant increase in Credit Risk; and

(d) Loans Receivables - credit impaired;

(iii) Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.

(iv) Loans due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

VI. Other current assets (specify nature):

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories. Other current assets shall be classified as-

(i) Advances other than capital advances

(1) Advances other than capital advances shall be classified as:

(a) Security Deposits;

(b) Advances to related parties (giving details thereof);

(c) Other advances (specify nature)

(2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

(a) Earmarked balances with banks (for example. for unpaid dividend) shall be separately stated.

(b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

C. Equity

I. Equity Share Capital: For each class of equity share capital:

(a) the number and amount of shares authorised;

(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;

(c) par value per Share;

(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;

(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

(g) shares in the company held by each shareholder holding more than five per cent. shares specifying the number of shares held;

(h) shares reserved for issue under options and contracts or commitments for the sale of shares or disinvestment, including the terms and amounts;

(i) for the period of five years immediately preceding the date at which the Balance Sheet is prepared

- aggregate number and class of shares allotted as fully paid up pursuant to contract without payment being received in cash;
- aggregate number and class of shares allotted as fully paid up by way of bonus shares; and
- aggregate number and class of shares bought back;

(j) terms of any securities convertible into equity shares issued along with the earliest date of conversion in descending order starting from the farthest such date;

(k) calls unpaid (showing aggregate value of calls unpaid by directors and officers);

(l) forfeited shares (amount originally paid up).

II. Other Equity:

(i) Other Reserves' shall be classified in the notes as-

(a) Capital Redemption Reserve;

(b) Debenture Redemption Reserve;

(c) Share Options Outstanding Account; and

(d) others- (specify the nature and purpose of each reserve and the amount in respect thereof);

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

(ii) Retained Earnings represents surplus i.e. balance of the relevant column in the Statement of Changes in Equity;

(iii) A reserve specifically represented by earmarked investments shall disclose the fact that it is so represented;

(iv) Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'retained earnings'. Similarly, the balance of 'Other Equity', after adjusting negative balance of retained earnings, if any, shall be shown under the head 'Other Equity' even if the resulting figure is in the negative; and

(v) Under the sub-head 'Other Equity', disclosure shall be made for the nature and amount of each item.

D. Non-Current Liabilities

I. Borrowings:

(i) borrowings shall be classified as-

- (a) Bonds or debentures
- (b) Term loans
  - (i) from banks
  - (ii) from other Parties
- (c) Deferred payment liabilities
- (d) Deposits.
- (e) Loans from related parties
- (f) Long term maturities of finance lease obligations
- (g) Liability component of compound financial instruments
- (h) Other loans (specify nature);

(ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

(iv) bonds or debentures (along with the rate of interest, and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be, where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due;

(v) particulars of any redeemed bonds or debentures which the company has power to reissue shall be disclosed;

(vi) terms of repayment of term loans and other loans shall be stated; and

(vii) period and amount of default as on the balance sheet date in repayment of borrowings and interest shall be specified separately in each case.

II. Provisions: The amounts shall be classified as-

(a) Provision for employee benefits; and

(b) Others (specify nature).

III. Other non-current liabilities;

(a) Advances; and

(b) Others (specify nature).

E. Current Liabilities

I. Borrowings:

(i) Borrowings shall be classified as-

(a) Loans repayable on demand

(I) from banks

(II) from other parties

(b) Loans from related parties

(c) Deposits

(d) Other loans (specify nature);

(ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case;

(iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

(iv) period and amount of default as on the balance sheet date in repayment of borrowings and interest, shall be specified separately in each case.

II. Other Financial Liabilities: Other Financial liabilities shall be classified as-

(a) Current maturities of long-term debt;

(b) Current maturities of finance lease obligations;

(c) Interest accrued;

(d) Unpaid dividends;

(e) Application money received for allotment of securities to the extent refundable and interest accrued thereon;

(f) Unpaid matured deposits and interest accrued thereon;

(g) Unpaid matured debentures and interest accrued thereon; and

(h) Others (specify nature).

'Long term debt is a borrowing having a period of more than twelve months at the time of origination

III. Other current liabilities:

The amounts shall be classified as-

(a) revenue received in advance;

(b) other advances (specify nature); and

(c) others (specify nature);

IV. Provisions: The amounts shall be classified as-

(i) provision for employee benefits; and

(ii) others (specify nature)

F. The presentation of liabilities associated with group of assets classified as held for sale and non-current assets classified as held for sale shall be in accordance with the relevant Indian Accounting Standards (Ind ASs)

G. Contingent Liabilities and Commitments: (to the extent not provided for)

(i) Contingent Liabilities shall be classified as-

(a) claims against the company not acknowledged as debt;

(b) guarantees excluding financial guarantees; and

(c) other money for which the company is contingently liable.

(ii) Commitments shall be classified as-

(a) estimated amount of contracts remaining to be executed on capital account and not provided for;

(b) uncalled liability on shares and other investments partly paid; and

(c) other commitments (specify nature).

H. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and title related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on irredeemable preference shares shall also be disclosed separately.

I. Where in respect of an issue of securities made for a specific purpose the whole or part of amount has not been used for the specific purpose at the Balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

Clarification:

1. Depending upon the turnover of the company, the figures appearing in the Financial Statements shall be rounded off as below:

Turnover	Rounding off
(i) less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof
(ii) one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

2. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.

3. Financial Statements shall disclose all 'material' items, ie, the items if they could. individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.

4. For the purpose of this Schedule, the terms used herein shall have the same meanings assigned to them in Indian Accounting Standards.

5. Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

6. When a company applies an accounting policy retrospectively or makes a restatement of items in the financial statements or when it reclassifies items in its financial statements, the company shall attach to the Balance Sheet, a "Balance Sheet" as at the beginning of the earliest comparative period presented.

7. Share application money pending allotment shall be classified into equity or liability in accordance with relevant Indian Accounting Standards. share application money to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable shall be separately shown under 'Other financial liabilities'.

8. Preference shares including premium received on issue, shall be classified and presented as 'Equity' or 'Liability' in accordance with the requirements of the relevant Indian Accounting Standards. Accordingly, the disclosure and presentation requirements in that regard applicable to the relevant class of equity or liability shall be applicable mutatis mutandis to the preference shares. For instance, plain vanilla redeemable preference shares shall be classified and presented under 'non-current liabilities' as 'borrowings' and the disclosure requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares.

9. Compound financial instruments such as convertible debentures, where split into equity and liability components, as per the requirements of the relevant Indian Accounting Standards, shall be classified and presented under the relevant heads in 'Equity' and 'Liabilities'

10. Regulatory Deferral Account Balances shall be presented in the Balance Sheet in accordance with the relevant Indian Accounting Standards.

GENERAL INSTRUCTIONS FOR PREPARING OF STATEMENT OF PROFIT AND LOSS

1. The provisions of this Part shall apply to the income and expenditure account, in like manner as they apply to a Statement of Profit and Loss,

2. The Statement of Profit and Loss shall include:

   (1) Profit of loss for the Period;

   (2) Other Comprehensive Income for the period

   The sum of (1) and (2) above is "Total Comprehensive Income"

3. Revenue from operations shall disclose separately in the notes

   (a) sale of products (including Excise Duty);

   (b) sale of services; and

   (c) other operating revenues.

4. Finance Costs: Finance costs shall be classified as-

   (a) interest;

   (b) dividend on redeemable preference shares;

   (c) exchange differences regarded as an adjustment to borrowing costs; and

   (d) other borrowing costs (specify nature).

5. Other income: other income shall be classified as-

   (a) interest Income;

   (b) dividend Income; and

   (c) other non-operating income (net of expenses directly attributable to such income)

6. Other Comprehensive Income shall be classified into-

   (A) Items that will not be reclassified to profit or loss

      (i) Changes in revaluation surplus;

      (ii) Re-measurements of the defined benefit plans;

      (iii) Equity Instruments through Other Comprehensive Income;

      (iv) Fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss;

(v) Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and

(vi) Others (specify nature).

(B) Items that will be reclassified to profit or loss;

(i) Exchange differences in translating the financial statements of a foreign operation;

(ii) Debt instruments through Other Comprehensive Income;

(iii) The effective portion of gains and loss on hedging instruments in a cash flow hedge;

(iv) Share of other comprehensive income in Associates and Joint Ventures, to the extent to be classified into profit or loss; and

(v) Others (specify nature)

7. Additional Information: A Company shall disclose by way of notes, additional information regarding aggregate expenditure and income on the following items:

(a) employee Benefits expense (showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) share based payments to employees, (iv) staff welfare expenses).

(b) depreciation and amortisation expense;

(c) **any item of income or expenditure which exceeds one per cent of the revenue from operations or ₹ 10,00,000, whichever is higher, in addition to the consideration of 'materiality 'as specified in clause 7 of the General Instructions for Preparation of Financial Statements of a Company;**

(d) interest Income;

(e) interest Expense

(f) dividend income;

(g) net gain or loss on sale of investments;

(h) net gain or loss on foreign currency transaction and translation (other than considered as finance cost);

(i) payments to the auditor as (a) auditor, (b) for taxation matters, (c) for company law matters, (d) for other services, (e) for reimbursement of expenses;

(j) in case of companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities; and

(k) details of items of exceptional nature;

8. Changes in Regulatory Deferral Account Balances shall be presented in the Statement of Profit and Loss in accordance with the relevant Indian Accounting Standards

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: XYZ Limited is having the following Fixed Deposit Receipts:

	Date of FDR	Maturity Date	Amount (₹)
Axis Bank Limited	01 January, 2014	30 April, 2015	10,00,000
Punjab National Bank	01 January, 2014	30 June, 2014	15,00,000
State Bank o f India	28 February, 2014	30 May, 2014	10,00,000
ICICI Bank	31 January, 2013	31 January, 2015	10,00,000

Prepare 'Notes to accounts' showing the above deposits in accordance with the requirements of Schedule III.

Reporting Date is 31 March 2014

Ans: Notes to Accounts

S. No.	Particulars		Amount in ₹
1.	Non-current assets		
	Financial Assets		
	- Other Financial Assets		
	FDR of Axis Bank Limited		10,00,000
2.	Current assets		
	Financial Assets		
	- Cash and cash equivalents		
	FDR of State Bank of India	10,00,000	
	- Other bank balances		
	FDR of ICICI Bank	10,00,000	
	FDR of Punjab National Bank	15,00,000	35,00,000

Note: The above 'Notes to Accounts' have been prepared on the basis of IND AS 1. It states that in case of bank deposits having maturity of more than 3 months but upto 12 months will be shown as "Other bank balances" under Current Financial assets. As per IND AS 3, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Therefore, even if the remaining maturity of FDR from reporting date is 3 months or less but its original maturity is more than 3 months from the date of acquisition it will be shown under the sub-heading "Other Bank Balances".

It also states that bank deposits having maturity of more than 12 months should be shown as "Other Financial assets" under Non- current Financial assets

Working Notes:

	Amount in ₹	Date of FDR	Maturity date	Maturity months from the reporting date i.e. 31.3.2014
Axis Bank Limited	10,00,000	1.1.2014	30.4.2015	13

Punjab National Bank	15,00,000	1.1.2014	30.6.2014	3
State Bank of India	10,00,000	28.2.2014	30.5.2014	2
ICICI Bank	10,00,000	31.1.2013	31.1.2015	10
	45,00,000			

Q2: A Limited has prepared the following draft balance sheet as on 31st March 20X1:

(₹ in crores)

Particulars	March 31, 20X1	March 31, 20X0
ASSETS		
Cash	250	170
Cash equivalents	70	30
Non-Controlling interest's share of profit for the year	160	150
Dividend declared by A Limited	90	70
Accounts receivable	2,300	1,800
Inventory at cost	1,500	1,650
Inventory at fair value less cost to complete and sell	180	130
Investment property	3,100	3,100
Property, plant and equipment (PPE) at cost	5,200	4,700
Total	12,850	11,800
Particulars	**March 31, 20X1**	**March 31, 20X0**
CLAIMS AGAINST ASSETS		
Long term debt (₹ 500 crores due on 1st January each year)	3,300	3,885
Interest accrued on long term debt (due in less than 12 months)	260	290
Share Capital	1,130	1,050
Retained earnings at the beginning of the year	1,875	1,740
Profit for the year	1,200	830
Non-controlling interest	830	540
Accumulated depreciation on PPE	1,610	1,240
Provision for doubtful receivables	200	65
Trade payables	880	790
Accrued expenses	15	30
Warranty provision (for 12 months from the date of sale)	600	445
Environmental restoration provision (restoration expected in 20X6)	765	640
Provision for accrued leave (due within 12 months)	35	25
Dividend payable	150	230
Total	12,850	11,800

Prepare a balance sheet using current and non-current classification in accordance with Ind AS 1. Assume operating cycle is 12 months.

Ans: **A Limited**

Balance Sheet as at 31st March 20X1 (₹ in crores)

Particulars	March 31, 20X1	March 31, 20X0
ASSETS		
Non-current assets		
(a) Property, plant and equipment *(Refer Note 5)*	3,590	3,460
(b) Investment property	3,100	3,100
Current assets		
(a) Inventory (Refer Note 6)	1,680	1,780
(b) Financial assets		
Trade and other receivables (Refer Note 7)	2,100	1,735
(c) Cash and cash equivalents (Refer Note 8)	320	200
Total assets	**10,790**	**10,275**
EQUITY & LIABILITIES		
Equity attributable to owners of the parent		
Share capital	1,130	1,050
Other Equity *(Refer Note 1)*	2,825	2,350
Non-controlling interests	830	540
Total equity	4,785	3,940
LIABILITIES		
Non-current liabilities		
(a) Financial Liabilities		
Borrowings - Long-term debt *(Refer Note 2)*	2,800	3,385
(b) Provisions		
Long-term provisions (environmental restoration)	765	640
Current liabilities		
(a) Financial Liabilities		
(i) Trade and other payables *(Refer Note 3)*	895	820
(ii) Current portion of long-term debt *(Refer Note 4)*	500	500
(iii) Interest accrued on long-term debt	260	290
(b) Provisions		
(i) Warranty provision	600	445
(ii) Other short-term provisions	35	25
(c) Other current liability		
Dividends payable	150	230
Total liabilities	**6,005**	**6,335**
Total equity and liabilities	**10,790**	**10,275**

Working Notes:

Notes	Particulars	March 31, 20X1	March 31, 20X0
1.	Retained earnings		
	Retained earnings at the beginning of the year	1,875	1,740
	Add: Profit for the year	1,200	830
	Less: Non- controlling interest's share of profit	160	150

	for the year		
	less Dividend declared by A Limited	90	70
		2,825	2,350
2	Long-term debt		
	Long-term debt	3,300	3,885
	less Due on 1st January each year	500	500
		2,800	3,385
3	Trade & other payables		
	Trade payables	880	790
	Add Accrued expenses	15	30
		895	820
4	Current portion of long- term debt		
	Due on 1st January each year	500	500
5	Property, plant and equipment		
	Property, plant and equipment (PPE) at cost	5,200	4,700
	Less: Accumulated (depreciation on PPE	1,610	1,240
		3,590	3,460
6	Inventory		
	Inventory at cost	1,500	1,650
	Add Inventory at fair value Less cost to complete and sell	180	130
		1,680	1,780
7	Trade and other receivables		
	Accounts receivable	2,300	1,800
	Less: Provision for doubtful receivables	200	65
		2,100	1,735
8	Cash and cash equivalents		
	Cash	250	170
	Add: Cash equivalents	70	30
		320	200

QUESTIONS FROM OTHER RESOURCES

Q3: A Ltd has following Balances as on 1/4/2018

	₹ 000
Equity Share Capital (of ₹ 10 each)	2,000
Shares application money pending Allotment	2,000
General Reserve	200
Convertible Preference Share Capital	
- Liability Component	400

- Equity Component	800
Revaluation Surplus	1200
Retained earnings	1,800
Securities Premium	800

Additional information:

(a) During the year 18-19, 40,000 ES of ₹10 each were allotted at a premium of ₹ 40 out of share application money

(b) Purchase of furniture 20,000 on 01/10/17 were wrongly debited to purchase account. Rate of Dep = 10%

(c) During the year, management decided to change method of inventory valuation from FIFO to WAPM due to this opening Stock will reduced by ₹ 40,000

(d) Dividend including CDT paid ₹1,00,000

(e) Total comprehensive income for 18-19

PL = ₹ 10,00,000

OCI = ₹ 2,50,000

(f) OCI consist of following items

(a) Items that will be reclassified to PL

- Changes in FV of debt instrument through OCI ₹ 1,00,000
- Effective portion of cash flow hedge ₹ (70,000)

(b) Items that will not be reclassified to PL

- Revaluation surplus ₹ 1,00,000
- Changes in FV of equity through OCI ₹1,20,000

(g) During the year, amount of additional dep has been transferred from Revaluation Surplus to retained earning = ₹ 80,000

(h) Transfer to general reserve = ₹ 1,00,000

Prepare Statement of Changes in equity

Statement of Shareholders Equity for the year ended 30 June 2014

a) Equity Share Capital

Balance as at 1-4-08	Changes during the year	Balance as at 31-03-09
2,000	400	2,400

b) Other Equity

	Shares Application money pending allotment	Equity Component of CFI	General Reserve	Securities Premium	Retained earnings	Debt Instrument though OCI	Equity Instrument Though OCI	Revaluation surplus	Cash flow hedge reserve	Total
Balance as at 1-4-08	**2,000**	**800**	**200**	**800**	**1,800**	**-**	**-**	**1,200**	**-**	**6,800**
Effect due to changes in accounting policy					(40)					(40)
Effect due to correction of error					19					19
Restated Balance as at 1-4-08	**2,000**	**800**	**200**	**800**	**1,779**	**-**	**-**	**1,200**	**-**	**6,779**
Issue of new shares	(2,000)		-	1,600	-			-		(400)
TCI	-		-		1,000	100	120	100	(70)	1,250
Dividends					(100)					(100)
Transfer from Revaluation surplus	-				80			(80)		-
Transfer to General Reserve	-		100		(100)			-		-
Balance as at 31/03/09	**-**	**800**	**300**	**2,400**	**2,659**	**100**	**120**	**1,220**	**(70)**	**7,529**

Q4: Alumina, Inc. is a company engaged in extraction of Aluminum. The company's CFO has asked you to prepare a statement of changes in equity for the company for the year ended 30 June 2014. Following information is available:

The composition of the company's shareholders equity as at 1 July 2013 was as follows:

	USD in million
Equity Shares, 20 Million authorized shares,	
5 Million issued and outstanding	50
Securities premium	120
Capital reserves	30
Retained earnings	90
Revaluation surplus	15
	305

On 30 August 2014, the company declared and issued 10% bonus shares. Price per share at the date was ₹ 40.

On 1 September 2014, the company issued 1 million new shares for total consideration of ₹ 45 million. The face Value of a equity share is ₹ 10.

Profit for the financial year ended 30 June 2014 amounted to ₹ 50 million and the company paid dividends totaling ₹ 16 million.

The company is required under law to set a side 10% of net income for the period and credit it to capital reserve.

The company reversed upward revaluation of an asset by ₹ 5 million. The revaluation surplus already includes ₹ 7 million of such initial upward revaluation.

Ans: Following is the statement of shareholders equity for Alumina, Inc. for financial year ended 30 June 2014. Each change is explained in the notes below:

Alumina, Inc.

Statement of Shareholders Equity for the year ended 30 June 2014

	Equity Shares	Securities Premium	Capital Reserve	Retained earnings	Revaluation surplus	Total
						USD in million
Balance as at 1-Jul-13	50	120	30	90	15	305
Issue of bonus shares	5	-		(5)	-	-
Issue of new shares	10	35	-	-	-	45
TCI	-	-	-	50	-	50
Transfer to capital reserve	-	-	5	(5)	-	-
Dividends	-	-	-	(16)	-	(16)
Reversal of revaluation	-	-	-	- (5)		(5)
Balance as at 30-Jun-14	65	155	35	114	10	379

CHAPTER 5
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.	Fixed deposit with SBI	12%, 3 years maturity on 1st January 20X4
2.	Fixed deposit with HDFC	10%, original term was for 2 years, but due for maturity on 30th June 20X1
3.	Redeemable Preference shares in ABC ltd	Acquired on 31st January 20X1 and the redemption is due on 30th April 20X1
4.	Cash balances at various banks	All branches of all banks in India
5.	Cash balances at various banks	All international branches of Indian banks
6.	Cash balances at various banks	Branches of foreign banks outside India
7.	Bank overdraft of SBI Fort branch	Temporary overdraft, which is payable on demand
8.	Treasury Bills	90 days maturity

Ans:

Sr. No.	Name of the Security	Decision
1.	Fixed deposit with SBI	Not to be considered – long term
2.	Fixed deposit with HDFC	Exclude as original maturity is not less than 90 days from the date of acquisition
3.	Redeemable Preference shares in ABC Ltd.	Include as due within 90 days from the date of acquisition
4.	Cash balances at various banks	Include
5.	Cash balances at various banks	Include
6.	Cash balances at various banks	Include
7.	Bank overdraft of SBI Fort branch	Include (Assumed as integral part of an entity's cash management)
8.	Treasury Bills	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 Phone 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	Loss due to decrease in market value of the closing stock of old mobile phones	Do not include - Non cash transaction
8	Payment to suppliers of mobile phones	Include – cash outflow related to main operations of business
9	Depreciation on Furniture of sales showrooms	Do not include – non cash item
10	Interest paid on cash credit facility of the bank	Do not include – cost of finance
11	Profit on sale of old computers and printers, in exchange of new laptop and printer	Do not include – non cash item
12	Advance received from customers	Include – Related to operations of busines
13	Sales tax and excise duty paid	Include – related to operations of business

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.

Sr. 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	Operating – in case of financial institutes
4	Loans given to customers	Operating – in case of financial institutes
5	Loans repaid by the	Operating – in case of financial institutes

	customers	
6	Deposits repaid	Operating – in case of financial institutes
7	Commission received	Operating – Main revenue generating activity
8	Lease rentals paid for various branches	Operating – Main expenses of operations
9	Service tax paid	Operating – Main expenses of operations
10	Furniture 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 and cash payment	Investing-for cash payment
14	Provident fund for the paid 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
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 loans and advances given	Investing
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

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	**₹**
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	**₹**	**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	

Note No 1 - Cash Receipts from Sales and debtors	
Particulars	₹
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	₹
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	₹
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	₹
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 ₹ 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 ₹ 10,00,000 by paying ₹ 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 ₹ 10,00,000 should be split between interest income and receipts from investment activity.

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 ₹ 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 ₹ 5,30,000/- during the current year. Out of the above paid tax, ₹ 30,000 is paid for tax on long term capital gains.

Under which activity the above said tax be classified in the cash flow 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 ₹ 30,000 is specifically related with investing activities. ₹ 5,00,000 to be shown under operating activities. ₹ 30,000 to be shown under investing activities.

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

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 ₹ 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 ₹ 4,500). Presuming no other transaction taking place, the entity reported a profit before tax of ₹ 100 on account of exchange gain on the bank balance in foreign currency. 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	(₹)
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 ₹)
	20X2	20X1
Cash	4,000	14,000
Accounts Receivable	25,000	32,500
Prepaid Insurance	5,000	7,000
Inventory	37,000	34,000
Fixed Assets	3,16,000	2,70,000
Accumulated Depreciation	(45,000)	(30,000)
Total Assets	3,42,000	3,27,500
Accounts Payable	18,000	16,000
Wages Payable	4,000	7,000
Debentures	1,73,000	1,60,000
Equity Shares	88,000	84,000
Retained Earnings	59,000	60,500
Total Liabilities & Equity	3,42,000	3,27,500

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 ₹ 2,500.

During 20X2, ABC Ltd. paid ₹ 46,000 in cash to acquire new fixed assets. The accounts payable was used only for inventory. No debt was retired during 20X2.

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

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

	₹ '000		**₹ '000**
Balance on 1.4.20X0	50	Payment to creditors	2,000
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	**₹ '000**	**₹ '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 = ₹ 45. The same on 31.12.2018 was US $ 1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 2017. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7?

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

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q 13: An entity has entered into a factoring arrangement and received money from the factor. Examine the said transaction and state how should it be presented in the statement of cash flows?

Ans: Under factoring arrangement, it needs to be assessed whether the arrangement is recourse or non-recourse.

Recourse factoring:

The cash received is classified as a financing cash inflow as the entity continues to recognize the receivables and the amount received from the factor is indeed a liability, The substance of the arrangement is financing, as the entity retains substantially all of the risk and rewards of the factored receivables.

When the cash is collected by the factor, the liability and the receivables are de-recognized. It is acceptable for this to be disclosed as a non-cash transaction, because the settlement of the liability and the factored receivables does not result in cash flows. The net impact of these transactions on the cash flow statement is to present a cash inflow from financing, but there is no operating cash flow from the original sale to the entity's customers.

Non-recourse factoring:

Where an entity de-recognises the factored receivables and receives cash from the factor, the cash receipt is classified as an operating cash inflow. This is because the entity has received cash in exchange for receivables that arose from its operating activities.

Q 14: The relevant extracts of consolidated financial statements of A Ltd. are provided below:

Consolidated Balance Sheet

	For the year ended (₹ in Lac)	
	31st March 20X2	31st March 20X1
Assets		
Non-Current Assets		
Property, Plant and Equipment	4,750	4,650
Investment in Associate	800	-
Financial Assets	2,150	1,800
Current Assets		
Inventories	1,550	1,900
Trade Receivables	1,250	1,800
Cash and Cash Equivalents	4,650	3,550
Liabilities		
Current Liabilities		
Trade Payables	1,550	3,610

Extracts from Consolidated Statement of Profit and Loss for the year ended 31st March 20X2

Particulars	Amount (₹ in Lac)
Revenue	12,380

Cost of Goods Sold	(9,860)
Gross Profit	2,520
Other Income	300
Operating Expenses	(450)
Other expenses	(540)
Interest expenses	(110)
Share of Profit of Associate	120
Profit before Tax	1,840

The below information is relevant for A Ltd Group.

1. A Ltd had spent ₹ 30 Lac on renovation of a building. A Ltd charged the entire renovation cost to profit and loss account.
2. On 1st April 20X1, A Ltd acquired 100% shares in S Ltd, for cash of ₹ 300 Lac. Fair value of the assets acquired and liabilities assumed under the acquisition are as under:
3.

Property, Plant and Equipment	140 Lac
Inventories	60 Lac
Trade Receivables	30 Lac
Cash and Cash Equivalents	20 Lac
Total Assets	250 Lac
Less: Trade Payables	(50 Lac)
Net Assets on acquisition	200 Lac

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

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

5. A Ltd constructed a machine that is a qualifying asset and incurred construction costs of
6. ₹ 40 Lac that has been charged to other expenses. Of the interest cost of ₹ 110 Lac charged to profit or loss statement, ₹ 10 Lac includes interest cost on specific borrowings that need to be capitalized.

7. Property, plant and equipment was sold at 630 Lac. Gain on disposal is adjusted against operating expenses.

8. A Ltd. purchased 30% interest in an Associate (G Ltd) for cash on 1st April 20X1. The associate reported profit after tax of ₹ 400 Lac and paid a dividend of ₹ 100 Lac for the year.

9. Impairment test was conducted on 31st March 20X2. The following were impaired as under:

   Goodwill impairment loss: ₹ 265 Lac

   Intangible Assets impairment loss ₹900 Lac

10. The goodwill impairment relates to 100% subsidiaries. Assume that interest cost is all paid in cash.

You are required to determine cash generated from operations for group reporting purposes for the year ended 31st March 20X2.

Ans: Extracts of Statement of Cash Flows for the year ended 31 st March 20X2

Cash Flows from Operating Activities		**Amount in ₹ Lacs**
Profit before tax (W.N.1)		1,920
Less: Profit on Sale of PPE (630 - 490)		(140)
Add back: Depreciation		290
Impairment of Goodwill		265
Impairment of Intangible Assets		900
Less: Share of Profits of Associate (400 x 30%)		(120)
Add: Interest expense	[110 – 10]	100
Working Capital Changes (W.N.2):		
Add: Decrease in Trade Receivables		580
Add: Decrease in Inventories		410
Less: Decrease in Trade Payables		(2,110)
Cash generated from operations		**2,095**

Working Notes:

1. Profit before tax **Amount in ₹ Lacs**

Reported profit as per Profit or Loss Statement	1,840
Add back: Renovation costs charged as expense	30
Construction costs charged as expense	40
Borrowing costs to be capitalized	10
Revised Profit before tax	1,920

2. Changes in Trade Receivables **Amount in ₹ Lacs**

Opening Balance	1,800
Add: Receivables of S Ltd.	30
	1,830
Less: Closing Balance	(1,250)
	580

3. Changes in Inventories **Amount in ₹ Lacs**

Opening Balance	1,900
Add: Receivables of S Ltd.	60
	1,960
Less: Closing Balance	(1,550)
	410

4. Changes in Trade Payables **Amount in ₹ Lacs**

Opening Balance	3,610
Add: Receivables of S Ltd.	50
	3,660
Less: Closing Balance	(1,550)
	2,110

Q 15: Entity A (Indian Company) purchased goods for resale from France during January for EUR 10,000 (Exchange rate: 1 EUR = ₹ 70) on a credit period of 4 months. It accounted for the purchase of inventory at ₹ 7,00,000 (10,000 x 70). On 31st March, the exchange rate has changed to 1 EUR = ₹ 65. This would mean an unrealised gain due to exchange fluctuation of ₹ 50,000 (since the payables will be recorded at ₹ 6,50,000 (at closing exchange rate). Assume that the inventory is unsold at that date, how the movement is reported in Cash Flow statements.

Ans: The movement is reported in Cash Flow statements as under:

Profit	₹ 50,000
Less: Increase in Inventory	₹ (7,00,000)
Add: Increase in Payables	₹ 6,50,000
Net Cash flows from operating activities	₹ 0

QUESTIONS FROM OTHER SOURCE

Q 16: Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

	₹ (in lacs)	₹ (in lacs)
Net Profit		60,000
Add: Sale of Investments		70,000
Depreciation on Assets		11,000
Issue of Preference Shares		9,000
Loan raised		4,500
Decrease in Stock		12,000
		1,66,500
Less: Purchase of Fixed Assets	65,000	
Decrease in Creditors	6,000	
Increase in Debtors	8,000	
Exchange gain	8,000	
Profit on sale of investments	12,000	
Redemption of Debenture	5,700	
Dividend paid	1,400	
Interest paid	945	1,07,045
		59,455
Add: Opening cash and cash equivalent		12,341
Closing cash and cash equivalent		71,796

Ans: **Cash Flow Statement**

Cash flows from operating activities		**(₹ in lacs)**
Net profit		60,000
Less: Exchange gain		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
(-) Increase in debtors	(8,000)	
(+) Decrease in stock	12,000	
(-) Decrease in creditors	(6,000)	(2,000)
Net cash from operating activities		**49,000**
Cash flows from investing activities		
Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from Investing activities		**5,000**
Cash flows from financing activities		
Issue of preference shares	9,000	

Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		**5,455**
Net increase in cash & cash equivalents		**59,455**
Add: Opening cash and cash equivalents		**12,341**
Closing cash and cash equivalents		**71,796**

Q 17: Bellhop LLC submits the following information pertaining to year 2011. Using the data, you are required to find the ending cash and bank balances given an opening figure thereof was ₹ 1.55 million by preparing cash flow statement.

	(₹ Millions)
Additional shares issued	6.50
CAPEX (Capital expenditure)	9.90
Proceeds from assets sold	1.60
Dividends declared	0.50
Gain from disposal of assets	(1.20)
Net income	3.30
Increase in Accounts Receivable	1.50
Redemption of 4.5% debentures	2.50
Depreciation & Amortization	0.75

Ans: **Cash Flow Statement of Bellhop LLC for the year ended 31st March, 2011**

	₹ In millions	**₹ In millions**
Cash flows from operating activities		
Net income	3.30	
Add: Depreciation & amortization	0.75	
Loss from disposal of assets	1.20	
Less: Increase in accounts receivables	(1.50)	
Net cash generated from operating activities		**3.75**
Cash flows from investing activities		
Capital expenditure	(9.90)	
Proceeds from sale of fixed assets	1.60	
Net cash used in investing activities		**(8.30)**
Cash flows from financing activities		
Proceeds from issuance of additional shares	6.50	
Dividend declared	(0.50)	
Redemption of 4.5% debentures	(2.50)	
Net cash generated from financing activities		**3.50**
Net decrease in cash		**(1.05)**
Cash at beginning of the period		**1.55**
Cash at end of the period (Balancing figure)		**0.50**

QUESTIONS FROM RTP/MTP/EXAMS

Q 18: Company A acquires 70% of the equity stake in Company B on July 20, 20X1. The consideration paid for this transaction is as below:

(a) Cash consideration of ₹ 15,00,000

(b) 200,000 equity shares having face of ₹ 10 and fair value of ₹ 15 per share.

On the date of acquisition, Company B has cash and cash equivalent balance of ₹ 2,50,000 in its books of account.

On October 10, 20X2, Company A further acquires 10% stake in Company B for cash consideration of ₹ 8,00,000.

Advise how the above transactions will be disclosed/presented in the statement of cash flows as per Ind AS 7. **[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 ₹ 15,00,000 less ₹ 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.

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 19: Z Ltd. has no foreign currency cash flow for the year 2017. It holds some deposit in a bank in the USA. The balances as on 31.12.2017 and 31.12.2018 were US$ 100,000 and US$ 102,000 respectively. The exchange rate on December 31, 2017 was US$1 = ₹ 45. The same on 31.12.2018 was US$1 = ₹ 50. The increase in the balance was on account of interest credited on 31.12.2018. Thus, the deposit was reported at ₹ 45,00,000 in the balance sheet as on December 31, 2017. It was reported at ₹ 51,00,000 in the balance sheet as on 31.12.2018. How these transactions should be presented in cash flow for the year ended 31.12.2018 as per Ind AS 7? **[RTP May 2019]**

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

Cash flows arising from transactions in a foreign currency shall be recorded in Z Ltd.'s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

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

	(₹ in lacs)	
	20X2	**20X1**
ASSETS		
Non-current Assets		
Property, plant and equipment	13,000	12,500
Intangible assets	50	30
Other financial assets	145	170
Deferred tax asset (net)	855	750
Other non-current assets	800	770
Total non-current assets	14,850	14,220
Current assets		
Financial assets		
Investments	2,300	2,500
Cash and cash equivalents	220	460
Other current assets	195	85
Total current assets	2,715	3,045
Total Assets	17,565	17,265

EQUITY AND LIABILITIES		
Equity		
Equity share capital	300	300
Other equity	12,000	8,000
Total equity	12,300	8,300
Liabilities		
Non-current liabilities		
Long-term borrowings	2,000	5,000
Other non-current liabilities	2,740	3,615
Total non-current liabilities	4,740	8,615
Current liabilities		
Financial liabilities		
Trade payables	150	90
Bank Overdraft	75	60
Other current liabilities	300	200
Total current liabilities	525	350
Total liabilities	5,265	8,965
Total Equity and Liabilities	17,565	17,265

Additional Information:

a) Profit after tax for the year ended 31st March, 20X2 - ₹ 4,450 lacs

b) Interim Dividend paid during the year - ₹ 450 lacs

c) Depreciation and amortisation charged in the statement of profit and loss during the current year are as under

(i) Property, Plant and Equipment - ₹ 500 lacs

(ii) Intangible Assets - ₹ 20 lacs

d) During the year ended 31st March, 20X2 two machineries were sold ₹70 lacs. The carrying amount of these machineries as on 31st March, 20X2 is ₹ 60 lacs.

e) Income taxes paid during the year ₹ 105 lacs.

Using the above information of Kuber Limited, construct a statement of cash flows under indirect method. Other non-current/current assets and liabilities are related to operations of Kuber Ltd. and do not contain any element of financing and investing activities.

[RTP Nov 2019]

Ans: Statement of Cash Flows ₹ in lacs

Cash flows from Operating Activities		
Net Profit after Tax	4,450	
Add: Tax Paid	105	
		4,555
Add: Depreciation & Amortisation (500 + 20)	520	
Less: Gain on Sale of Machine (70-60)	(10)	
Less: Increase in Deferred Tax Asset (855-750)	(105)	
Change in operating assets and liabilities	4,960	
Add: Decrease in financial asset (170 - 145)	25	
Less: Increase in other non-current asset (800 - 770)	(30)	
Less: Increase in other current asset (195 - 85)	(110)	
Less: Decrease in other non-current liabilities (3,615 – 2,740)	(875)	
Add: Increase in other current liabilities (300 - 200)	100	
Add: Increase in trade payables (150-90)	60	
		4,130
Less: Income Tax	(105)	
Cash generated from Operating Activities		4,025
Cash flows from Investing Activities		
Sale of Machinery	70	
Purchase of Machinery [13,000-(12,500 – 500-60)]	(1,060)	
Purchase of Intangible Asset [50-(30-20)]	(40)	
Sale of Financial asset - Investment (2,500 – 2,300)	200	
Cash outflow from Investing Activities		(830)
Cash flows from Financing Activities		
Dividend Paid	(450)	
Long term borrowings paid (5,000 – 2,000)	(3,000)	
Cash outflow from Financing Activities		(3,450)
Net Cash outflow from all the activities		(255)
Opening cash and cash equivalents (460 – 60)		400
Closing cash and cash equivalents (220 – 75)		145

Q 21: Entity A acquired a subsidiary, Entity B, during the year. Summarised information from the Consolidated Statement of Profit and Loss and Balance Sheet is provided, together with some supplementary information.

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

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

Other information

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

Particulars	Amount (₹)
Inventories	4,000
Trade receivables	8,000
Cash	2,000
Property, plant and equipment	1,10,000
Trade payables	(32,000)

Long term debt	(36,000)
Goodwill	18,000
Cash consideration paid	**74,000**

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

[RTP May 2020]

Ans: This information will be incorporated into the Consolidated Statement of Cash Flows as follows:

Statement of Cash Flows for the year ended 20X2 (extract)

	Amount (₹)	Amount (₹)
Cash flows from operating activities		
Profit before taxation	70,000	
Adjustments for non-cash items:		
Depreciation	30,000	
Decrease in inventories (W.N. 1)	9,000	
Decrease in trade receivables (W.N. 2)	4,000	
Decrease in trade payables (W.N. 3)	(24,000)	
Interest paid to be included in financing activities	4,000	
Taxation (11,000 + 15,000 – 12,000)	(14,000)	
Net cash generated from operating activities		79,000
Cash flows from investing activities		
Cash paid to acquire subsidiary (74,000 – 2,000)	(72,000)	
Net cash outflow from investing activities		(72,000)
Cash flows from financing activities		
Interest paid	(4,000)	
Net cash outflow from financing activities		(4,000)
Increase in cash and cash equivalents during the year		**3,000**
Cash and cash equivalents at the beginning of the year		**5,000**
Cash and cash equivalents at the end of the year		**8,000**

Working Notes:

1.	**Calculation of change in inventory during the year**	**₹**
	Total inventories of the Group at the end of the year	30,000
	Inventories acquired during the year from subsidiary	(4,000)
		26,000
	Opening inventories	35,000
	Decrease in inventories	9,000

2.	Calculation of change in Trade Receivables during the year	₹
	Total trade receivables of the Group at the end of the year	54,000
	Trade receivables acquired during the year from subsidiary	(8,000)
		46,000
	Opening trade receivables	50,000
	Decrease in trade receivables	4,000

3.	Calculation of change in Trade Payables during the year	₹
	Trade payables at the end of the year	68,000
	Trade payables of the subsidiary assumed during the year	(32,000)
		36,000
	Opening trade payables	60,000
	Decrease in trade payables	24,000

Q 22: During the financial year 2019-2020, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:

- Capital gain tax of ₹ 20 crore on sale of office premises at a sale consideration of ₹ 100 crore.
- Income Tax of ₹ 3 crore on Business profits amounting ₹ 30 crore (assume entire business profit as cash profit).
- Dividend Distribution Tax of ₹ 2 crore on payment of dividend amounting ₹ 20 crore to its shareholders.
- Income tax Refund of ₹ 1.5 crore (Refund on taxes paid in earlier periods for business profits).

You need to determine the net cash flow from operating activities, investing activities and financing activities of Akola Limited as per relevant Ind AS. **[RTP Nov 2020]**

Ans: Para 36 of Ind AS 7 inter alia states that when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, th e total amount of taxes paid is disclosed.

Accordingly, the transactions are analysed as follows:

Particulars	Amount (in crore)	Activity
Sale Consideration	100	Investing Activity
Capital Gain Tax	(20)	Investing Activity
Business profits	30	Operating Activity
Tax on Business profits	(3)	Operating Activity

Dividend Payment	(20)	Financing Activity
Dividend Distribution Tax	(2)	Financing Activity
Income Tax Refund	1.5	Operating Activity
Total Cash flow	**86.5**	

Activity wise	**Amount (in crore)**
Operating Activity	28.5
Investing Activity	80
Financing Activity	(22)
Total	**86.5**

Q 23: A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of ₹ 2,00,000, but there are no trade receivables or trade payables balances as on 1st April, 2017. During the year 2017-2018, the entity entered into the following foreign currency transactions:

1) A Ltd. purchased goods for resale from Europe for €1,00,000 when the exchange rate was €1 = ₹ 50. This balance is still unpaid at 31st March, 2018 when the exchange rate is €1 = ₹ 45. An exchange gain on retranslation of the trade payable of ₹ 5,00,000 is recorded in profit or loss.

2) A Ltd. sold the goods to an American client for $ 1,50,000 when the exchange rate was $1 = ₹ 40. This amount was settled when the exchange rate was $1 = ₹ 42. A further exchange gain regarding the trade receivable is recorded in the statement of profit or loss.

3) A Ltd. also borrowed €2,00,000 under a long-term loan agreement when the exchange rate was €1 = ₹ 50 and immediately converted it to ₹ 50,00,000. The loan was retranslated at 31st March, 2018 @ ₹ 45, with a further exchange gain recorded in the statement of profit or loss.

4) A Ltd. therefore records a cumulative exchange gain of ₹ 18,00,000 (10,00,000 + 3,00,000 + 5,00,000) in arriving at its profit for the year.

5) In addition, A Ltd. records a gross profit of ₹ 10,00,000 (₹ 60,00,000 – ₹ 50,00,000) on the sale of the goods.

6) Ignore taxation.

How cash flows arising from the above transactions would be reported in the statement of cash flows of A Ltd. under indirect method?

Ans: **Statement of cash flows Particulars**

	Amount (₹)
Cash flows from operating activities	
Profit before taxation (10,00,000 + 18,00,000)	28,00,000
Adjustment for unrealised exchange gains/losses:	
Foreign exchange gain on long term loan [€ 2,00,000 x ₹ (50 – 45)]	(10,00,000)
Decrease in trade payables [1,00,000 x ₹ (50 – 45)]	(5,00,000)

Operating Cash flow before working capital changes	13,00,000
Changes in working capital (Due to increase in trade payables)	50,00,000
Net cash inflow from operating activities	63,00,000
Cash inflow from financing activity [€ 2,00,000 x ₹ 50]	1,00,00,000
Net increase in cash and cash equivalents	1,63,00,000
Cash and cash equivalents at the beginning of the period	2,00,000
Cash and cash equivalents at the end of the period	1,65,00,000

Q24: From the following data, identify the nature of activities as per Ind AS 7.

S.no.	Nature of transaction
1	Cash paid to employees
2	Cash paid for development of property costs
3	Borrowings repaid
4	Cash paid to suppliers
5	Loan to Director
6	Bonus shares issued
7	Dividends paid
8	Cash received from trade receivables
9	Proceeds from sale of PPE
10	Depreciation of PPE
11	Advance received from customers
12	Purchased goodwill
13	Payment of promissory notes

Ans:

S. No.	Nature of transaction	Activity as per Ind AS 7
1	Cash paid to employees	Operating activity
2	Cash paid for development costs	Investing activity
3	Borrowings repaid	Financing activity
4	Cash paid to suppliers	Operating activity
5	Loan to Director	Investing activity
6	Bonus shares issued	Non-cash item
7	Dividends paid	Financing activity
8	Cash received from trade receivables	Operating activity
9	Proceeds from sale of PPE	Investing activity

10	Depreciation of PPE	Non-cash item
11	Advance received from customers	Operating activity
12	Purchased goodwill	Investing activity
13	Payment of promissory notes	Financing activity

Q25 Z Ltd. (India) has an overseas branch in USA. It has a bank account having balance of USD 7,000 as on 1st April 2019. During the financial year 2019-2020, Z Ltd. acquired computers for its USA office for USD 280 which was paid on same date. There is no other transaction reported in USA or India.

Exchange rates between INR and USD during the financial year 2019-2020 were:

Date	USD 1 to INR	
1st April 2019	70.00	
30th November 2019	71.00	(Date of purchase of computer)
31st March	2020	
	71.50	
Average for	2019-2020	
	70.50	

Please prepare the extract of Cash Flow Statement for the year ended 31 st March 2020 as per the relevant Ind AS and also show the foreign exchange profitability from these transactions for the financial year 2019-2020? **Exam Paper January 2021 (5 Marks)**

Ans: **In the books of Z Ltd.**

Statement of Cash Flows for the year ended 31st March 2020

	₹	₹
Cash flows from operating activities		
Net Profit (Refer Working Note)	10,360	
Adjustments for non-cash items:		
Foreign Exchange Gain	(10,360)	
Net cash outflow from operating activities		0
Cash flows from investing activities		
Acquisition of Property, Plant and Equipment	(19,880)	
Net cash outflow from Investing activities		(19,880)
Cash flows from financing activities		0

Net change in cash and cash equivalents		(19,880)
Cash and cash equivalents at the beginning of the year i.e. 1st April 2019		4,90,000
Foreign Exchange difference		10,360
Cash and cash equivalents at the end of the year i.e. 31st March 2020		4,80,480

Working Note:

Computation of Foreign Exchange Gain

Bank Account USD	Date	USD	Exchange Rate	₹
Opening balance	1.4.2019	7,000	70.00	4,90,000
Less: Purchase of Computer	30.11.2019	280	71.00	19,880
Closing balance calculated		6,720		4,70,120
Closing balance (at year end spot rate)	31.3.2020	6,720	71.50	4,80,480
Foreign Exchange Gain credited to Profit and Loss account				10,360

NOTES

CHAPTER 6

ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS (IND AS 8)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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?

Ans: 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.

Q2: 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?

Ans: (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.

(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.

Q3: 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

Ans: 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.

Q4: 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 ₹6,500.

2 Beta's accounting records for 20X2 show sales of ₹ 1,04,000, cost of goods sold of ₹86,500 (including ₹ 6,500 for the error in opening inventory), and income taxes of ₹ 5,250.

3. In 20X1, Beta Ltd. reported:

- Sales of ₹ 73,500
- Cost of goods sold of ₹ 53,500
- Profit before income taxes of ₹ 20,000
- Income taxes of ₹ 6,000

- Profit of ₹ 14,000

4. 20X1 opening retained earnings was ₹ 20,000 and closing retained earnings was ₹ 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 ₹ 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.

Ans: **Beta Ltd.**

Extract from the statement of profit and loss (Amount in ₹)

	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 ₹)**

	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 ₹ 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.

Q5: 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	₹ 25,000
Depreciation	₹ 14,000
Net book value	₹11,000

(iii) Prospective depreciation expense for 20X2 (old basis) ₹1,500

(iv) Some results of the engineering survey:

Valuation	₹ 17,000
Estimated residual value	₹ 3,000
Average remaining asset life	7 years

Depreciation expense on existing property, plant and equipment for 20X2 (new basis) ₹ 2,000

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

Ans: 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 ₹ 6,000;
- increase the opening deferred tax provision by ₹ 1,800;
- create a revaluation surplus at the start of the year of ₹ 4,200;
- increase depreciation expense by ₹500; and
- reduce tax expense by ₹ 150.

NEW QUESTIONS IN SM (FOR MAY 20 ATTEMPT)

Q6: Can an entity voluntarily change one or more of its accounting policies?

Ans: A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8. As per para 14 of Ind AS 8, an entity shall change an accounting policy only if the change:

(a) is required by an Ind AS; or

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

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

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

Whether a changed accounting policy results in reliable and more relevant financial information is a matter of assessment in the particular facts and circumstances of each case. In order to ensure that such an assessment is made judiciously (such that a voluntary change in an accounting policy does not effectively become a matter of free choice), paragraph 29 of Ind AS 8 requires an entity making a voluntary change in an accounting policy to disclose, inter alia, "the reasons why applying the new accounting policy provides reliable and more relevant information."

Q7: Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 2011- 12. During the financial year 2012- 13, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity ABC reclassified it from PPE to investment property in the financial year 2012- 13. Should Entity ABC account for the change as a change in accounting policy?

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

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

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

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

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

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

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

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

Q8: Whether change in functional currency of an entity represents a change in accounting policy?

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

As per Ind AS 21, 'functional currency' is the currency of the primary economic environment in which the entity operates.

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

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

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

translation procedures applicable to the new functional currency prospectively from the date of the change.

Q9: An overseas national standard-setting body in due accordance with Ind AS 8. Would it be permissible for the entity to change the said policy to reflect a subsequent amendment in that entity developed one of its accounting policies by considering a pronouncement of an pronouncement?

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

Q10: Whether an entity can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?

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

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

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

Q11: Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

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

Accordingly, a change in cost formula is a change in accounting policy.

Q12: An entity has presented certain material liabilities as non-current in its financial statements for periods upto 31st March, 2011. While preparing annual financial statements for the year ended 31st March, 2012, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 2011). Would this reclassification of liabilities from non- current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

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

In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 2012, the comparative amounts as at 31st

March, 2011 would be restated to reflect the correct classification.

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

Q13: An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March, 2011. While preparing annual financial statements for the year ended 31st March, 2012, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 2011). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet ?

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

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 2012, the comparative amounts for the year ended 31st March, 2011 would be restated to reflect the correct classification.

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

In the given case, the retrospective restatement of relevant items in statement of profit and loss has

no effect on the information in the balance sheet at the beginning of the preceding period (1st April, 2010). Therefore, the entity is not required to present a third balance sheet.

Q14: While preparing the annual financial statements for the year ended 31st March, 2013, an entity discovers that a provision for constructive obligation for payment of bonus to selected employees in corporate office (material in amount) which was required to be recognised in the annual financial statements for the year ended 31st March, 2011 was not recognised due to oversight of facts. The bonus was paid during the financial year ended 31st March, 2012 and was recognised as an expense in the annual financial statements for the said year. Would this situation require retrospective restatement of comparatives considering that the error was material?

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

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

In the given case, expenses for the year ended 31st March, 2011 and liabilities as at 31st March, 2011 were understated because of non-recognition of bonus expense and related provision.

Expenses for the year ended 31st March, 2012, on the other hand, were overstated to the same extent because of recognition of the aforesaid bonus as expense for the year. To correct the above errors in the annual financial statements for theyear ended 31st March, 2013, the entity should:

(a) restate the comparative amounts (i.e., those for the year ended 31st March, 2012) in the statement of profit and loss; and

(b) present a third balance sheet as at the beginning of the preceding period (i.e., as at 1st April, 2011) wherein it should recognise the provision for bonus and restate the retained earnings.

Q15: While preparing interim financial statements for the half-year ended 30th September, 2011, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30th June, 2011. The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no need to correct the error in the interim financial statements considering that the amount is expected to be immaterial from the point of view of the annual financial statements. Whether the management's view is acceptable?

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

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

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

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

Accordingly, the management is required to correct the error in the interim financial statements since it is assessed to be material in relation to interim period data.

Q16: ABC Ltd has an investment property with an original cost of ₹ 1,00,000 which it inadvertently omitted to depreciate in previous financial statements. The property was acquired on 1st April, 2011. How should the error be corrected in the financial statements for the year ended 31st March, 2014, assuming the impact of the same is considered material? The property has a useful life of 10 years and is depreciated using straight line method. Estimated residual value at the end of 10 year is Nil. For simplicity, ignore tax effects.

Ans: The error shall be corrected by retrospectively restating the comparatives. A third balance sheet as at the beginning of the earliest period shall also be presented.

Q17: A company owns several hotels and provides significant ancillary services to occupants of rooms. These hotels are, therefore, treated as owner-occupied properties and classified as property, plant and equipment in accordance with Ind AS 16. The company acquires a new hotel but outsources entire management of the same to an outside agency and remains as a passive investor. The selection and application of an accounting policy for this new hotel in line with Ind AS 40. Is this a change in accounting policy.

Ans: It is not a change in accounting policy simply because the new hotel rooms are also let out for rent. This is because the way in which the new hotel is managed differs in substance from the way other existing hotels have been managed so far.

Q18: An entity has classified as investment property, an owner occupied property previously classified as part of property, plant and equipment where it was measured after initial recognition applying the revaluation model. Ind AS 40 on investment property permits only cost model. The entity now measures this investment property using the cost model. Is this a change in accounting policy.

Ans: This is not a change in accounting policy.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q19: A carpet retail outlet sells and fits carpets to the general public. It recognizes revenue when the carpet is fitted, which on an average is six weeks after the purchase of the carpet.

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

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

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

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

Q20: When is an entity required to present a third balance sheet as at the beginning of the preceding period?

Ans: As per paragraph 40A of Ind AS 1, Presentation of Financial Statements, an entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements required by paragraph 38A of the standard if:

1. it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
2. the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the balance sheet at the beginning of the preceding period

Q21: Is change in the depreciation method for an item of property, plant and equipment a change in accounting policy or a change in accounting estimate?

Ans: As Paragraphs 60 and 61 of Ind AS 16, Property, Plant and Equipment, the depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8.

As per the above, depreciation method for a depreciable asset has to reflect the expected pattern of consumption of future economic benefits embodied in the asset. Determination of depreciation method involves an accounting estimate and thus depreciation method is not a matter of an accounting policy.

Accordingly, Ind AS 16 requires a change in depreciation method to be accounted for as a change in an accounting estimate, i.e., prospectively.

QUESTIONS FROM RTP/MTP/EXAMS

Q22: 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 ₹ 10 million
- 31st March, 2016 - Increase of ₹ 15 million
- 31st March, 2017- Increase of ₹ 20 million

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

Ans: Profit or loss under weighted average valuation are as follows: ₹ in million

	2017	2016 (Restated)
Revenue	324	296
Cost of sales	(168)	(159)

Gross profit	**156**	**137**
Expenses	(83)	(74)
Profit	**73**	**63**

Statement of changes in equity (extract) ₹ 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

Q23: While preparing the financial statements for the year ended 31st March, 20X3, Alpha Limited has observed two issues in the previous year Ind AS financial statements (i.e. 31st March, 20X2) which are as follows:

Issue 1:

The company had presented certain material liabilities as non-current in its financial statements for periods as on 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31 st March, 20X2).

Issue 2:

The company had charged off certain expenses as finance costs in the year ended 31st March, 20X2. While preparing annual financial statements for the year ended 31st March, 20X3, it was discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 20X2).

What is your analysis and recommendation in respect of the issues noted with the previously presented set of financial statements for the year ended 31st March, 20X2? **[RTP May 2020]**

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

subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Accordingly, the stated issues in question are to dealt as under:

Issue 1

In accordance with para 41, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended March 31, 20X3, the comparative amounts as at 31 March 20X2 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period. Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1 April 20X1 in addition to the comparatives for the financial year 20X1-20X2.

Issue 2

In accordance with para 41, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31 March, 20X3, the comparative amounts for the year ended 31 March 20X2 would be restated to reflect the correct classification.

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

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1 April 20X1). Therefore, the entity is not required to present a third balance sheet.

Q24: During the year ended 31st March,20X2, Blue Ocean group changed its accounting policy

for depreciating property, plant and equipment, so as to apply components approach fully, whilst at the same time adopting the revaluation model.

In years before 20X1-20X2, Blue Ocean group's asset records were not sufficiently detailed to apply a components approach fully. At the end of 31st March, 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 20X1-20X2.

The results are shown as under:

Property, plant and equipment at the end of 31st March, 20X1

	₹
Cost	25,000
Depreciation	(14,000)
Net book value	11,000
Depreciation expense for 20X1-20X2 (on old basis)	1,500
Some results of the engineering survey:	
Valuation	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7

However, the survey did not provide a sufficient basis for reliably estimating the cost of those components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

The board of directors 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 20X1-20X2.

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 Blue Ocean group's new policy prospectively from the start of 20X1-20X2.

Blue Ocean group's tax rate is 30 per cent.

Compute the impact of change in accounting policy related to change in carrying amount of Property, Plant & Equipment under revaluation method and impact on taxes based on the basis of information provided. Show the impact of each item affected on financial statements by the analysis of stated issue. **[MTP May 2020]**

Ans: As per Ind AS 8 'Accounting Policies, Accounting Estimates and Errors, prospective application of a change in accounting policy has to be done since retrospective application is not practicable.

Property, plant and equipment at the end of 31st March, 20X2:

₹

As per the engineering survey:

Valuation of PPE	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7
Depreciation expense on existing property, plant and equipment for 20 X 1 – 20 X 2 (new basis) (17,000 – 3,000)/7	2,000

From the start of 20X1-20X2, Blue Ocean group changed its accounting policy for depreciating property, plant and equipment, so as to apply 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 the year 20X1-20X2 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 impact on the financial statements for 20X1-20X2 would be as under:

Particulars	₹
Increase the carrying amount of property, plant and equipment at the start of the year (17,000-11,000)	6,000
Increase the opening deferred tax provision (6,000 x 30%)	1,800
Create a revaluation surplus at the start of the year (6,000 – 1,800)	4,200
Increase depreciation expense by (₹2,000 – ₹1,500)	500
Reduce tax expense on depreciation (30%)	150

Q25: In 20X3-20X4, after the entity's 31 March 20X3 annual financial statements were approved for issue, a latent defect in the composition of a new product manufactured by the entity was discovered (that is, a defect that could not be discovered by reasonable or customary inspection). As a result of the latent defect the entity incurred ₹100,000 in unanticipated costs for fulfilling its warranty obligation in respect of sales made before 31 March 20X3. An additional ₹20,000 was incurred to rectify the latent defect in products sold during 20X3-20X4 before the defect was detected and the production process rectified, ₹5,000 of which relates to items of inventory at 31 March 20X3. The defective inventory was reported at cost ₹ 15,000 in the 20X2-20X3 financial statements when its selling price less costs to complete and sell was estimated at ₹18,000. The accounting estimates made in preparing the 31 March 20X3 financial statements were appropriately made using all reliable information that the entity could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Analyse the above situation in accordance with relevant Ind AS.

RTP May 2021

Ans: Ind AS 8 is applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset. This change in accounting estimate is an outcome of the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Further, the effect of change in an accounting estimate, shall be recognised prospectively by including it in profit or loss in: (a) the period of the change, if the change affects that period only; or (b) the period of the change and future periods, if the change affects both.

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were approved for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

On the basis of above provisions, the given situation would be dealt as follows:

The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approved for issue, so understatement of the warranty provision ₹ 1,00,000 and overstatement of inventory ₹ 2,000 (Note 1) in the 31 March 20X3 financial statements are not a prior period errors.

The effects of the latent defect that relate to the entity's financial position at 31 March 20X3 are changes in accounting estimates.

In preparing its financial statements for 31 March 20X3, the entity made the warranty provision and inventory valuation appropriately using all reliable information that the entity could reasonably be expected to have obtained and had taken into account the same in the preparation and presentation of those financial statements.

Consequently, the additional costs are expensed in calculating profit or loss for 20X3-20X4.

Working Note:

Inventory is measured at the lower of cost (ie ₹ 15,000) and fair value less costs to complete and sell (ie ₹ 18,000 originally estimated minus ₹ 5,000 costs to rectify latent defect) = ₹ 13,000.

NOTES

CHAPTER 7
INTERIM FINANCIAL REPORTING (IND AS 34)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: Company A expects to earn ₹ 15,000 pre-tax profit each quarter and has a corporate tax slab of 20 percent on the first ₹ 20,000 of annual earnings and 40 per cent on all additional earnings. Actual earnings match expectations. Calculate the amount of income tax to be shown in each quarter.

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

Expected Total Income = 15,000 x 4 = ₹ 60,000

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

Q2: ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of ₹ 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

1. Bad debts of ₹ 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.
2. Additional depreciation of ₹ 4,50,000 resulting from the change in the method of depreciation.
3. Exceptional loss of ₹ 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.
4. ₹ 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:

1. The treatment of bad debts is not correct as the expenses incurred during an interim reporting period should be recognised in the same period. Accordingly, ₹ 50,000 should be deducted from ₹ 20,00,000.

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

3. Treatment of exceptional loss is not as per the principles of Ind AS 34, as the entire amount of ₹ 28,000 incurred during the third quarter should be recognized in the same quarter. Hence ₹ 14,000 which was deferred should be deducted from the profits of third quarter only.

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

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

Thus considering the above, the correct net profits to be shown in Interim Financial Report of the third quarter shall be ₹ 14,36,000 (₹ 20,00,000 -₹ 50,000 - ₹ 14,000 - ₹ 5,00,000).

NEW QUESTIONS IN SM (ADDED FOR MAY 21)

Q3: ABC Ltd. presents interim financial report quarterly. On 1.4.20X1, ABC Ltd. has carried forward loss of ₹ 600 lakhs for income-tax purpose for which deferred tax asset has not been recognized. ABC Ltd. earns ₹ 900 lakhs in each quarter ending on 30.6.20X1, 30.9.20X1, 31.12.20X1 and 31.3.20X2 excluding the carried forward loss. Income-tax rate is expected to be 40%. Calculate the amount of tax expense to be reported in each quarter.

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

The estimated payment of the annual tax on earnings for the current year:

₹ 3,000* x 40 / 100 = ₹ 1,200 lakhs.

*(3,600 lakhs - ₹ 600 lakhs) = ₹ 3,000 lakhs

Average annual effective tax rate = (1,200 / 3,600) × 100 = 33.33%

Tax expense to be shown in each quarter = 900 x 33.33% = ₹ 300 lakhs

Q4: Innovative Corporation Private Limited (or "ICPL") is dealing in seasonal product and the sales pattern of the product, quarter wise is as under during the financial year 20X1-20X2:

Qtr. I	Qtr. II	Qtr. III	Qtr. IV
ending 30 June	ending 30 September	ending 31 December	ending 31 March
10%	10%	60%	20%

For the first quarter ending on 30 June, 20X1, ICPL has provided the following information:

Particulars	Amounts (in crore)
Sales	70

Employees benefits expenses	25
Administrative and other expenses	12
Finance cost	4

ICPL while preparing interim financial report for first quarter wants to defer ₹ 16 crores expenditure to third quarter on the argument that third quarter is having more sales therefore third quarter should be debited by more expenditure. Considering the seasonal nature of business and that the expenditures are uniform throughout all quarter

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

Ans: Result of the first quarter ending 30 June

Particulars	**Amounts (in crore)**
Sales	70
Total Revenue (A)	**70**
Less: Employees benefits expenses	(25)
Administrative and other expenses	(12)
Finance cost	(4)
Total Expense (B)	**(41)**
Profit (A-B)	**29**

Note- As per Ind AS 34, the income and expense should be recognized when they are earned and incurred respectively. Seasonal incomes will be recognized when they occur. Therefore, the argument of ICPL is not correct considering the priciples of Ind AS 34.

Q5: Fixed production overheads for the financial year is ₹ 10,000. Normal expected production for the year, after considering planned maintenance and normal breakdown, also considering the future demand of the product is 2,000 MT. It is considered that there are no quarterly / seasonal variations. Therefore, the normal expected production for each quarter is 500 MT and the fixed production overheads for the quarter are ₹ 2,500.

Actual production achieved	**Quantity (In MT)**
First quarter	400
Second quarter	600
Third quarter	500
Fourth quarter	400
Total	**1,900**

Ans: If it is considered that there is no quarterly / seasonal variation, therefore normal expected production for each quarter is 500 MT and fixed production overheads for the quarter are ₹ 2,500 .

Fixed production overhead to be allocated per unit of production in every quarter will be ₹ 5 per MT (Fixed overheads / Normal production).

Q6: Due to decline in market price in second quarter, Happy India Ltd. incurred an inventory loss. The Market price is expected to return to previous levels by the end of the year. At the end of year, the decline had not reversed. When should the loss be reported in interim statement of profit and loss of Happy India Ltd.?

Ans: Loss should be recongised in the second quarter of the year.

QUESTIONS FROM OTHER SOURCES

Q7: 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.

Q8: 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%

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 ₹ 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	**(₹ 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 ₹ 10 crores is not tenable as expenditures are uniform throughout all quarters.

Q9: 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.

Q10: On 30-6-2011, X Limited incurred ₹ 3,00,000 net loss from disposal of a business segment. Also on 31-7-2011, the company paid ₹ 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 ₹ 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 ₹ 80,000 property tax payment relates to the entire 2011 calendar year, only ₹ 40,000 of the payment would be reported as an expense at September 30, 2011, while out of the remaining ₹ 40,000, ₹ 20,000 for Jan. 2011 to March, 2011 would be shown as payment of the outstanding amount of previous year and another ₹ 20,000 related to quarter October, 2011 to December, 2011, would be reported as a prepaid expense.

Q11: An enterprise reports quarterly, estimates an annual income of ₹ 10 lakhs. Assume tax rates on 1st ₹ 5,00,000 at 30% and on the balance income at 40%. The estimated quarterly income are ₹ 75,000, ₹ 2,50,000, ₹ 3,75,000 and ₹ 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	₹10,00,000
Tax expense:	
30% on ₹ 5,00,000	₹ 1,50,000
40% on remaining ₹ 5,00,000	₹2,00,000
	₹3,50,000
Weighted average annual income tax rate = 3,50,000/10,00,000 =	35%
Tax expense to be recognised in each of the quarterly reports	
Quarter I - ₹ 75,000 x 35%	₹ 26,250
Quarter II - ₹ 2,50,000 x 35%	₹ 87,500
Quarter III - ₹ 3,75,000 x 35%	₹ 1,31,250
Quarter IV - ₹ 3,00,000 x 35%	₹ 1,05,000
	₹ 3,50,000

Q 12: Antarbarti Limited reported a Profit Before Tax (PBT) of ₹ 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 ₹ 4 lakhs received during the quarter has been recognized to the extent of ₹ 1 lakh only.

(ii) 80% of sales promotion expenses ₹ 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 ₹ 12 lakhs. The entire amount has been debited in the third quarter, though the share of the third quarter is only ₹ 3 lakhs.

(iv) ₹ 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 ₹ 3 lakhs. Out of this loss ₹ 1 lakh relates to previous quarters.

(vi) Sale of investment in the first quarter resulted in a gain of ₹ 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 inventory valuation is a change in the accounting policy. The change in the method of depreciation is a change in the accounting estimates.

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

	(₹ in lakhs)
Profit before tax (as reported)	4
Add: Dividend income R₹ (4-1) lakhs	3
Add: Extra ordinary gain R ₹ (2-1) lakhs	1
Add: Cumulative loss due to change in the method of inventory valuation	
should be applied retrospectively ₹ (3-2) lakhs	1
Less: Sales promotion expenses (80% of ₹ 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)

Q13: 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 ₹ 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 ₹ 700 lakhs and ₹ 300 lakhs respectively for the first two quarters of Financial year 2013-14 and ·anticipates a net earning of ₹ 800 lakhs in the coming half year ended March 2014 of which ₹ 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 ₹1,800 lakhs less b/f losses ₹ 630 lakhs (90% of 700)] x 33%

= 33% of ₹ 1,170 lakhs = ₹ 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 = ₹ 386.10 lakhs divided by ₹ 1,800 lakhs=21.45%

Tax expense to be recognised in each quarter

		₹ in lakhs
Quarter I -	₹ 700 lakhs x 21.45%	150.15
Quarter II -	₹ 300 lakhs x 21.45%	64.35
Quarter III -	(₹ 100 lakhs) x 21.45%	(21.45)
Quarter IV -	₹ 900 lakhs x 21.45%	193.05

Q14:

Estimated annual income ₹ 1 lakh

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

Assumed Tax Rates:

On Capital Gains	10%
On other income:	
First ₹ 40,000	30%
Balance income	40%

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 ₹ 25,000 and income for 2nd quarter of ₹ 25,000 includes capital gain of ₹ 20,000.

Ans:

Tax Expense:	
On Capital Gains portion of annual income:	
10% of ₹ 20,000	₹ 2,000
On other income: 30% of ₹ 40,000 + 40% of ₹40,000	₹28,000
Total:	₹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 ₹25,000, when income of ₹25,000 for 2nd Quarter includes capital gains of ₹20,000, the tax expense for each quarter will be calculated as below:

	Income	Tax Expense
Quarter I:	₹ 25,000	35% of ₹ 25,000 = ₹ 8,750
Quarter II:	Capital Gains: ₹ 20,000	10% of ₹ 20,000 = ₹ 2,000
	Other: ₹ 5,000	35% of ₹ 5,000 = ₹ 1,750
Quarter III:	₹ 25,000	35% of ₹ 25,000 = ₹ 8,750
Quarter IV:	₹ 25,000	35% of ₹ 25,000 = ₹ 8,750
Total tax expense for the year		₹ 30,000

QUESTIONS FROM RTP/MTP/EXAMS

Q15: An entity reports quarterly, earns ₹ 1,50,000 pre-tax profit in the first quarter but expects to incur losses of ₹ 50,000 in each of the three remaining quarters. The entity operates in a jurisdiction in which its estimated average annual income tax rate is 30%.

The management believes that since the entity has zero income for the year, its income-tax expense for the year will be zero. State whether the management's views are correct. If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34.

Ans. As per para 30 (c) of 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.

Accordingly, the management's contention that since the net income for the year will be zero no income tax expense shall be charged quarterly in the interim financial report, is not correct.

The following table shows the correct income tax expense to be reported each quarter in accordance with Ind AS 34:

Period	Pre-tax earnings (in)	Effective tax rate	Tax expense (in ₹)
First Quarter	1,50,000	30%	45,000
Second Quarter	(50,000)	30%	(15,000)
Third Quarter	(50,000)	30%	(15,000)
Fourth Quarter	(50,000)	30%	(15,000)
Annual	**0**		**0**

Q16: An entity's accounting year ends is 31st December, but its tax year end is 31st March. The entity publishes an interim financial report for each quarter of the year ended 31st December, 2019. The entity's profit before tax is steady at ₹10,000 each quarter, and the estimated effective tax rate is 25% for the year ended 31 st March, 2019 and 30% for the year ended 31st March, 2020.

How the related tax charge would be calculated for the year 2019 and its quarters.

[RTP Nov 2020]

Ans: Table showing computation of tax charge:

	Quarter ending 31st March, 2019	Quarter ending 30th June, 2019	Quarter ending 30th Septemb, 2019	Quarter ending 31st December, 2019	Year ending 31st Decembe, 2019
	₹	₹	₹	₹	₹
Profit before tax	10,000	10,000	10,000	10,000	40,000
Tax charge	(2,500)	(3,000)	(3,000)	(3,000)	(11,500)
	7,500	7,000	7,000	7,000	28,500

Note: As per para B17 of Ind AS 34, since an entity's accounting year is not same as the tax year, more than one tax rate might apply during the accounting year. Accordingly, the entity should apply the effective tax rate for each interim period to the pre-tax result for that period.

Q17 Lal Ltd. provides you the following information for financial year 2019 -2020: Estimated Income for the year ended 31 March 2020:

Gross Annual Income (inclusive of Estimated Capital Gains of ₹ 4,00,000)	₹ 16,50,000
Quarter I	₹ 3,50,000
Quarter II	₹ 4,00,000
Quarter III (including Estimated Capital Gains of ₹ 4,00,000)	₹ 6,00,000
Quarter IV	₹ 3,00,000

Calculate the tax expense for each quarter, assuming that there is no difference between the estimated taxable income and the estimated accounting income.

Exam Paper November 2020 (6 Marks)

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.

If different income tax rates apply to different categories of income (such as capital gains or income earned in particular industries) to the extent practicable, a separate rate is applied to each individual category of interim period pre-tax income.

	₹
Estimated annual income exclusive of estimated capital gain (16,50,000 – 4,00,000) (A)	12,50,000
Tax expense on other income:	
20% on ₹ 2,50,000	50,000
30% on remaining ₹ 10,00,000	3,00,000
(B)	3,50,000

Weighted average annual income tax rate $= \frac{B}{A} = \frac{3,50,000}{12,50,000} = 28\%$

Tax expense to be recognised in each of the quarterly reports :

		₹
Quarter I - ₹ 3,50,000 x 28%		98,000
Quarter II - ₹ 4,00,000 x 28%		1,12,000
Quarter III - ₹ (6,00,000 - 4,00,000) x 28%	56,000	
₹ 4,00,000 x 12%	48,000	1,04,000
Quarter IV - ₹ 3,00,000 x 28%		84,000
		3,98,000

NOTES

CHAPTER 8

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (IND AS 37)

CONCEPTS BASED EXAMPLES

Example 1: Fitting smoke filters in a certain type of factory.

Since, the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

Example 2: Staff retraining as a result of changes in the income tax system

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no obligation because no obligating event (retraining) has taken place.

Conclusion – No provision is recognised.

Example 3: Refurbishment costs – no legislative requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the end of the reporting period, the lining has been in use for three years. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no present obligation.

Conclusion – No provision is recognised.

The cost of replacing the lining is not recognised because, at the end of the reporting period, no obligation to replace the lining exists independently of the company's future actions—even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, i.e., it is depreciated over five years. The re-lining costs then incurred are capitalised with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 4: Refurbishment costs – legislative requirement

An airline is required by law to overhaul its aircraft once every three years. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There is no present obligation.

Conclusion – No provision is recognised.

The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in above example. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions—the entity could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, i.e., an amount equivalent to the expected maintenance costs is depreciated over three years.

Example 5: Contaminated land – legislation virtually certain to be enacted

An entity in the oil industry (having 31 March year-end) causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the entity has been contaminating land in that country for several years. At March 31, 20X1, it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year-end. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of the costs of the clean-up.

Example 6: Contaminated land and constructive obligation

An entity in the oil industry (having 31 March year-end) causes contamination and operates in a country where there is no environmental legislation. However, the entity has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The entity has a record of honouring this published policy. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event- The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of the entity has created a valid expectation on the part of those affected by it that the entity will clean up contamination.

An outflow of resources embodying economic benefits in settlement- Probable.

Conclusion- A provision is recognised for the best estimate of the costs of clean-up.

Example 7: Offshore oilfield

An entity operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. 90% of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and 10% arise through the extraction of oil. At the end of the reporting period, the rig has been constructed but no oil has been extracted. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – The construction of the oil rig creates a legal obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the end of the reporting period, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. The 10% of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Example 8: A Court case

After a wedding in 20X1-20X2, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year to 31 March 20X2 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 March 20X3, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable. It is assumed that a reliable estimate can be made of any outflows expected.

(a) At 31 March 20X2

Present obligation as a result of a past obligating event – On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion – No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) At 31 March 20X3

Present obligation as a result of a past obligating event – On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion – A provision is recognised for the best estimate of the amount to settle the obligation.

Example 9: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e., more likely than not) that there will be some claims under the warranties. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement – Probable for the warranties as a whole.

Conclusion – A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period.

Example 10: Refunds policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement – Probable, a proportion of goods are returned for refund.

Conclusion – A provision is recognised for the best estimate of the costs of refunds.

Example 11: Contingent liabilities

In a lawsuit brought against an entity, a group of people are collectively seeking compensation for damages to their health as a result of contamination to the nearby land believed to be caused by waste from that entity's production process. It is doubtful whether the entity is the source of the contamination because many entities operate in the same area producing similar waste and it is unclear which entity is the source of the leak. The entity denies any wrongdoing because it has taken precautions to avoid such leaks and so it is vigorously defending the case.

However, the entity cannot be certain that it has not caused the leak and the true offender will become known only after extensive testing. The entity's lawyers expect a court ruling in about two years. If the entity loses the case, compensation is likely to be in the range of ₹ 1 lac to ₹ 30 lacs.

On the basis of the facts above it may be uncertain whether the entity has a present obligation—this is the matter being determined by the court.

If taking account of all of the available evidence, it is probable that the entity will successfully defend the court case then the entity has a possible obligation and hence a contingent liability.

If taking account of all of the available evidence, it is probable that the entity will lose the court case then the entity is deemed to have a present obligation, and hence a liability of uncertain timing or amount—a provision.

Examples 12: Contingent assets

1. An entity is taking legal action against its competitor for patent infringement relating to a patent that had been granted to the entity on one of its products. The outcome of the case is uncertain. However, it is probable that the court will order the competitor to pay damages to the entity.

   The entity must disclose the contingent asset in the notes to account because an inflow of economic benefits is probable, but not virtually certain.

2. The facts are the same as in above example. However, in this example, it is virtually certain that the court will order the competitor to pay damages to the entity.

The entity must recognise an asset. It is not a contingent asset because the virtual certainty of receiving benefits removes the contingency.

3. The facts are the same as in above example. However, in this example, it is probable that the court will rule in favour of the competitor (ie it is probable that the entity's case will not be successful).

   An asset must not be recognised. Because an inflow of economic benefits is not probable the contingent asset also is not disclosed.

Example 13: Best Estimate

1. An entity faces a single legal claim, with a 40 per cent likelihood of success with no cost and a 60 percent likelihood of failure with a cost of ₹1 million. Expected value is not valid in this case because the outcome will never be a cost of ₹600,000 (60 percent × ₹1 million); the outcome will either be nil or ₹1 million. Ind AS 37 indicates that the provision may be estimated at the individual most likely outcome. In this example, it is more likely that a cost of ₹1 million will result and, therefore, a provision for ₹1 million should be recognised.

2. An entity is required to replace a major component of an asset under warranty. Each time replacement costs ₹ 1 million. From experience, there is a 30 per cent chance of a single failure, a 50 per cent chance of two failures, and a 20 per cent chance of three failures. The most likely outcome is two failures, costing ₹ 2 million.The expected value is ₹ 1.9 million [(30 per cent x ₹ 1 million) + (50 per cent x ₹ 2 million) + (20 per cent x ₹ 3 million)]. The expected value supports the provision for the most likely outcome of ₹ 2 million.

3. At the end of 20X1, an entity is demonstrably committed to the closure of some facilities, having drawn up a detailed plan and made appropriate announcements. The expected impact of the plan is as follows:

	20X2	20X3
Committed closure costs	₹ 10,00,000	
Gain from sale of property		2,00,000

   The provision required at the end of 20X1 is ₹ 10,00,000 (ignoring discounting). The expected gain on the sale of the property is dealt with separately under the derecognition criteria in Ind AS 16.

Example 14 Executory contracts and onerous contact

1. In case of take and pay contracts, an agreement is entered into between two entities wherein the purchaser is legally obligated to take delivery of goods or accept services offered by seller (and make payment for those goods or services) and if the goods or services are not taken, he is required to pay a specified amount of penalty.

   In case of through put contracts, an agreement is entered into between two entities wherein one entity undertakes to pass (put through) to another entity an agreed minimum amount of material or services during a specified period of time.

   Such types of commitments, the entity has entered into are exempt from the requirements of Ind AS 37, i.e., such contracts are not covered under Ind AS 37 unless they are onerous.

2. **Contract not onerous:** An entity has a contract to purchase one million units of gas at 23p per unit, giving a contract price of ₹ 2,30,000. The current market price for a similar contract is 16p per unit, giving a price of ₹ 1,60,000. The gas will be used to generate electricity, which will be sold at a profit. The economic benefits from the contract include the benefits to the entity of using the gas in its business and, because the electricity will be sold at a profit, the contract is not onerous.

3. **Impairment of assets:** The contract's terms and market prices are the same as in example 29. However, the electricity is sold at a loss, and the entity makes an overall operating loss. All of the gas purchased by the entity is used to generate electricity using dedicated assets. The electricity is sold to a wide range of customers. The entity first considers whether the assets used to generate electricity are impaired. To the extent that there is still a loss after the assets have been written down, a provision for an onerous contract should be recorded.

4. **Sale to third party at below purchase price:** The contract terms and market price are the same as in example 29. However, in this example, the entity sells the gas under contract, which it no longer needs, to a third party for 18p per unit (5p below cost). The entity determines that it would have to pay ₹ 55,000 to exit the purchase contract. The only economic benefit from the purchase contract costing ₹ 2,30,000 are the proceeds from the sales contract, which are ₹ 1,80,000. Therefore, a provision should be made for the onerous element of ₹ 50,000, being the lower of the cost of fulfilling the contract and the penalty cost of cancellation (₹ 55,000).

5. **Contract termination costs**: In the year ended 31 December 20X1, an entity has a contract with a third party supplier. The entity wishes to terminate this contract in 20X2 because it can enter into a cheaper contract with a new supplier, even though it will still have two years to run. It will incur a charge for terminating the contract. Does the entity have to provide in 20X1-20X2 for the contract that it will be exiting in 20X2-20X3? A provision should be recognised only if the contract is onerous. If the goods received under the supply contract are sold at a profit, the contract is not onerous and provision should not be made in 20X1-20X2. The termination cost should be recognised as incurred in 20X2-20X3.

Example 15: Closure of a division – no implementation before end of the reporting period

On March 12, 20X1 the board of an entity decided to close down a division. Before the end of the reporting period (March 31, 20X1) the decision was not communicated to any of those affected and no other steps were taken to implement the decision. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – There has been no obligating event and so there is no obligation.

Conclusion – No provision is recognised.

Example 16: Closure of a division – communication/ implementation before end of the reporting period

On March 12, 20X1 (reporting date), the board of an entity decided to close down a division making a particular product. On March 20, 20X1 a detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and

redundancy notices were sent to the staff of the division. It is assumed that a reliable estimate can be made of any outflows expected.

Present obligation as a result of a past obligating event – The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement – Probable.

Conclusion – A provision is recognised at March 31, 20X1 for the best estimate of the costs of closing the division.

Example 17- Disclosures

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the end of the reporting period, a provision of ₹ 60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed:

A provision of ₹ 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years after the reporting period.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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.

Q2: 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.

Q3: X Ltd. has entered into an agreement with its selling agent Y, in accordance with which X Ltd. has to pay a base percentage of commission on export sales and an additional commission is to be paid if the export incentives are received. As per the accounting policy of X Ltd., it 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.

Q4: X Sugars Ltd. has entered into a sale contract of ₹ 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 ₹ 30,00,000 to Y Chocolates Ltd.

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

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

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

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 ₹ 2,12,50,000 (₹ 2,50,00,000 x 85%) at the end of the financial year 20X1-20X2.

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

Q5: 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 ₹ 100 will result. If a major defect is detected in a product, estimated repair costs of ₹ 400 will result. The entity's experience together with its future expectations indicate that 75 per cent of the goods sold 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 × ₹ 100) + (5% × 1,000 units × ₹ 400) = ₹ 40,000.

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

Q6: X Solar Power Ltd., a power company, has a present obligation to dismantle its plant after 35 years of useful life. X Solar Power Ltd. cannot cancel this obligation or transfer to third party. X Solar Power Ltd. has estimated the total cost of dismantling at ₹ 50,00,000, the present value of which is ₹ 30,00,000. Based on the facts and circumstances, X Solar Power Ltd. considers the risk factor of 5% i.e., the risk that the actual outflows would be more from the expected present value. How should X Solar Power Ltd. account for the obligation?

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

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

Q7: 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.

Q8: 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 ₹ 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: Since the understanding results in an enforceable agreement, the reimbursement of ₹ 9,00,000 (₹ 30,00,000 x 30%) shall be recognised as a reimbursement right and provision will be recognised for ₹ 30,00,000. The reimbursement right shall be treated as a separate asset and shall not be offset with the provision. In the statement of profit and loss, the expense may be presented as ₹ 21,00,000 after offsetting the reimbursement right.

Q9: 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 ₹ 1,00,00,000 may arise in two years. The liability is recognised on a discounted basis. The discount rate at which the liability has been discounted is 10% and it is assumed that discount rate does not change over the period of 2 years. How should X Telecom Ltd. calculate the amount of borrowing cost?

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

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

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

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

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

Q10: 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 ₹ 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 ₹ 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.

Q11: X Metals Ltd. had entered into a non-cancellable contract with Y Ltd. to purchase 10,000 units of raw material at ₹ 50 per unit at a contract price of ₹ 5,00,000. As per the terms of contract, X Metals Ltd. would have to pay ₹ 60,000 to exit the said contract. X Metals Ltd. has discontinued manufacturing the product that would use the said raw material. For that X Metals Ltd. has identified a third party to whom it can sell the said raw material at ₹ 45 per unit.

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

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

Q12: 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 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.

Q13: ~~In 2017, an entity involved in nuclear activities recognises a provision for decommissioning costs of ₹ 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 to ₹ 136 million. Draft the note assuming that discount rate of 2%.~~

~~**Ans:** A provision of ₹ 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 ₹ 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.~~

~~**Q14:** An entity is involved in a dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of ₹ 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 ₹ 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.~~

Q15: X Ltd. is operating in the telecom industry. During the Financial Year 20X1-20X2, the Income Tax authorities sent a scrutiny assessment notice under Section 143(2) of the Income-tax Act, 1961, in respect to return filed under Section 139 of this Act for Previous Year 20X0-20X1 (Assessment Year 20X1-20X2) and initiated assessment proceedings on account of a deduction claimed by the company which in the view of the authorities was inadmissible.

During the financial year 20X1-20X2 itself, the assessment proceedings were completed and the assessing officer did not allow the deduction and raised a demand of ₹ 1,00,00,000 against the company. The company contested such levy and filed an appeal with the Appellate authority. At the end of the financial year 20X1-20X2, the appeal had not been heard. The company is not confident whether that the company would win the appeal. However, the company was advised by its legal counsel that on a similar matter, two appellate authorities of different jurisdictions had given conflicting judgements, one in favour of the assessee and one against the assessee. The legal counsel further stated it had 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 ₹ 1,00,00,000.

Q16: 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. 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.

Q17: 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 OTHER SOURCE

Q18: 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 (₹)
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 ₹ 1,20,000 + 10% of ₹ 2,00,000

= ₹ 36,000 + ₹ 20,000 = ₹ 56,000

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

= ₹ 30,000 + ₹ 42,000 = ₹ 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 ₹ 9,20,000 (₹ 56,000 X 10 + ₹ 72,000 X 5) as contingent liability.

Q19: 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 ₹

19th January, 2011	40,000
29th January, 2012	25,000
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 = ₹ 40,000 x .02 + ₹ 25,000 x .03 = ₹ 800 + ₹ 750 =	₹ 1,550
As at 31st March, 2013 = ₹ 25,000 x .02 + ₹ 90,000 x .03 = ₹ 500 + ₹ 2,700 =	₹ 3,200
Amount debited to Profit and Loss Account for year ended 31st March, 2013	₹
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

Q20: Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 2009-10 financial year. The profit on this transaction is ₹ 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 ₹ 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 ₹ 1.5 crores as per IND AS 37.

Q21: Mini Ltd. took a factory premises on lease on 1.4.07 for ₹ 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 ₹ 66,00,000 (i.e.2,00,000 p.m. for next 33 months). Therefore, provision on account of ₹66,00,000 is to be provided in the accounts for the year ending 31.03.08. Hence auditor is right

Q22: 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 ₹ 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 ₹ 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 ₹ 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 ₹ 1,250 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of ₹ 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 ₹ 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 ₹ 1,250 lakhs is not as per IND AS 37 and also the concept of prudence will not be followed if ₹ 1,250 lakhs is simultaneously recognized as income. ₹ 1,250 lakhs are not the revenue at present but only reimbursement of claim for which an asset is created. However, the accountant incorrect to the extent as that non- recognition of ₹ 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.

Q23: 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	₹ 211.64 lakhs
Total income after adjustments	₹ 228.48 lakhs
Tax thereon	₹ 74.13 lakhs
TDS deducted during the year	₹ 30.45 lakhs
Tax paid for the year	₹ 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 ₹ 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 ₹ 2.39 lakhs deducted by XY LTD., is not traceable. The rectification is lying pending with the Assessing Officer.

Please suggest the treatment of ₹ 2.39 lakhs and ₹ 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 ₹ 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 ₹ 5.13 lakhs (₹ 7.52 lakhs less ₹ 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 disclose it as contingent liability.

Q24: 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’.

Q25: Lucky P Limited has been assessed to Income-tax, in which a demand of ₹ 10 lacs has-been made. The company has gone in appeal. The company has deposited ₹ 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 ₹ 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 ₹10 lacs raised by the Income-tax department. As per the advise by the counsel, the outflow of resources up to ₹ 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 ₹ 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 ₹ 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 ₹ 6 lacs against demand on being pursued by the department but created a provision of ₹ 4 lacs only. Hence it is expecting to get a refund in due course. Till the final settlement of the case, ₹ 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.

QUESTIONS FROM RTP/MTP/EXAMS/GFRS

Q26: 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 ₹ 60 lakhs. The actual termination payments totalling to ₹ 520 lakhs were made in full on 15th May 2018. As per latest estimates made on 15th May 2018, the total relocation cost is ₹ 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 ₹ 430 lakhs. On 15th May 2018, G Ltd. made a payment to the lessor of ₹ 410 lakhs in return for early termination of the lease.

The loss after tax of G Ltd. for the year ended 31st March 2018 was ₹ 400 lakhs. G Ltd. made further operating losses totalling ₹ 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 Ind 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 ₹ 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 ₹ 410 lakhs.

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

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

Q27: 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 defective 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 ₹ 5 crores. This estimate was revised to ₹ 5.2 crores as on 31st March, 2017 and ₹ 5.25 crores as at 15th May, 2017. This case was eventually settled on 1st June, 2017, when the Company paid damages of ₹ 5.3 crores to K.

On 1st December, 2016, QA Ltd. had estimated that it would receive damages of ₹ 3.5 crores from F. This estimate was revised to ₹ 3.6 crores as at 31st March, 2017 and ₹ 3.7 crores as on 15th May, 2017. This case was eventually settled on 1st June, 2017 when F paid ₹ 3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2017, provided ₹ 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.	₹ 5.2 crores	
	To Current Liability A/c		₹ 5.2 crores
(B)	Statement of Profit and Loss A/c Dr.	₹ 5.3 crores	
	To Non-Current Liability A/c		₹ 5.3 crores
(C)	Statement of Profit and Loss A/c Dr.	₹ 5.25 crores	
	To Current Liability A/c		₹ 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 ₹ 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. ₹ 5.2 crore

To Current Liability A/c ₹ 5.2 crore

(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.

Q28: Sun Limited has entered into a binding agreement with Moon Limited to buy a custom-made machine for ₹ 4,00,000. At the end of 2017-18, before delivery of the machine, Sun Limited had to change its method of production. The new method will not require the machine ordered which is to be scrapped after delivery. The expected scrap value is nil. Given that the asset is yet to be delivered, should any liability be recognized for the potential loss? If so, give reasons for the same, the amount of liability as well as the accounting entry. **[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 ₹ 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)			

Q29: A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale, the manufacturer undertakes to remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. As this is the first year that the warranty has been available, there is no data from the firm to indicate whether there will be claim under the warranties. However, industry research suggests that it is likely that such claims will be forthcoming.

Should the manufacturer recognize a provision in accordance with the requirements of Ind AS 37. Why or why not? **[Nov 2019]**

Ans: For a provision to be recognized, Para 14 of Ind AS 37 requires that:

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 required to settle the obligation, and

c) a reliable estimate can be made of the amount of the obligation.

Here, the manufacturer has a present legal obligation. The obligation event is the sale of the product with a warranty.

Ind AS 37 outlines that the future sacrifice of economic benefits is probable when it is more likely than less likely that the future sacrifice of economic benefits will required. The probability that settlement will be required will be determined by considering the class of obligation (warranties) as a whole. In accordance with para 24 of Ind AS 37, it is more likely than less likely that a future sacrifice of economic benefits will be required to settle the class of obligations as a whole.

If a reliable estimate can be made the provision can be measured reliably. Past data can provide reliable measures, even if the data is not firm specific but rather industry based. Ind AS 37 notes that only in extremely rare cases, a reliable measure of a provision cannot be obtained. Difficulty in estimating the amount of a provision under conditions of significant uncertainty does not justify non-recognition of the provision.

Here, the manufacturer should recognize a provision based on the best estimate of the consideration required to settle the present obligation as at the reporting date.

Q30: Assume that the firm has not been operating its warranty for five years, and reliable data exists to suggest the following:

- If minor defects occur in all products sold, repair costs of ₹ 20,00,000 would result.
- If major defects are detected in all products, costs of ₹ 50,00,000 would result.
- The manufacturer's past experience and future expectations indicate that each year 80% of the goods sold will have no defects. 15% of the goods sold will have minor defects, and 5% of the goods sold will have major defects.

Calculate the expected value of the cost of repairs in accordance with the requirements of Ind AS 37, if any. Ignore both income tax and the effect of discounting. **[Nov 2019]**

Ans: The expected value of cost of repairs in accordance with Ind AS 37 is:

(80% x nil) + (15% x ₹ 20,00,000) + (5% x ₹ 50,00,000) = 3,00,000 + 2,50,000 = 5,50,000

Q31: Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required? **[RTP May 2020]**

Ans: Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets" 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".

Paragraph 68 of Ind AS 37 states that "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it".

In the instant case, cost of fulfilling the contract is ₹ 0.5 million (₹ 2.5 million – ₹ 2 million) and cost of exiting from the contract by paying penalty is ₹ 0.25 million.

In accordance with the above reproduced paragraph, it is an onerous contract as cost of meeting the contract exceeds the economic benefits.

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, i.e., at ₹ 0.25 million (lower of ₹ 0.25 million and ₹ 0.5 million).

Q32: An entity engaged in automobile sector has assessed the impact of COVID-19 outbreak on its future viability of business model. Senior Management has identified the need for restructuring some of its business activities and retrenching its employees in many areas. Senior Management is drawing up a plan for the consideration of the Board of Directors in their meeting scheduled in May 2020, which is subsequent to the reporting date of the current financial year i.e. 31 March 2020. Can the entity recognise provisions for restructuring costs in the financial statements of the current year i.e. 2019-2020?

[MTP Nov 2020]

Ans: In accordance with paragraph 72 of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', a constructive obligation to restructure arises only when an entity has detailed formal plan for restructuring identifying the business or part of business concerned; the principal locations affected; the location, function, and approximate number of employees who will be compensated for terminating their services; the expenditures that will be undertaken; and when the plan will be implemented; and 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.

Further, paragraph 75 of Ind AS 37 provides that a management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the end of the reporting period

a) started to implement the restructuring plan; or

b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

In the given case, since COVID-19 pandemic impact started during March 2020, it is likely that the senior management started drawing up the plan for restructuring some of its business activities after the end of the reporting period, i.e., 2019-2020. If that be so, as per Ind AS 37, the management decisions subsequent to reporting date do not give rise to constructive obligation as of reporting date and no provision is required for restructuring costs as at 31 March 2020.

In this regard, paragraph 75 of Ind AS 37 provides that if an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under Ind AS 10, Events after the Reporting Period, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

Q33: Mr. Goel also mentioned that during the year ended 31st March 2017, ABC Ltd. provided consultancy services to a customer regarding the installation of a new production system. The system has caused the customer considerable problems, so the customer has taken legal action against ABC Ltd. for the loss that has arisen as a result of the problems with the system installation. The legal department of the group felt that there is 25% chance to successfully defend the claim. However, at the same time it also felt that 75% chance is that ABC Ltd. may require to pay damages of ₹1.6 million. Mr. Goel believes that ABC Ltd. should not suffer any overall loss because the legal department informed that the company is covered by insurance against such types of losses. Mr. Goel feels that ABC Ltd. will make a claim immediately if the outcome of the case is against the company. According to him no provision shall be made for it because ABC Ltd. is covered by insurance. However, disclosure by way of a note shall be given for it.

Do you agree with the views of Mr. Goel on the legal action taken by the customer and the treatment suggested by him? State your answer with reasons **[GFRS]**

Ans: It is necessary to consider the two parts of the issue separately.

The claim made by the customer needs to be recognised as a liability in the financial statements for the year ended 31 March 2017.

IND AS 37 – Provisions, Contingent Liabilities and Contingent Assets – states that a provision should be made when, at the reporting date:

- An entity has a present obligation arising out of a past event.
- There is a probable outflow of economic benefits.
- A reliable estimate can be made of the outflow.

All three of those conditions are satisfied here, and so a provision is appropriate.

The provision should be measured at the amount the entity would rationally pay to settle the obligation at the reporting date.

Where there is a range of possible outcomes, the individual most likely outcome is often the most appropriate measure to use.

In this case a provision of ₹1·6 million seems appropriate, with a corresponding charge to profit or loss.

The insurance claim against our customer (to whom consultancy is provided) is a contingent asset.

IND AS 37 states that contingent assets should not be recognised until their realisation is virtually certain, but should be disclosed where their realisation is probable.

Accordingly, the contingent asset would be disclosed in 2016 -2017 financial statements. Any credit to profit or loss arises when the claim is settled.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q34: ABC Limited is an automobile component manufacturer. The automobile manufacturer has specified a delivery schedule, non-adherence to which will entail a penalty. As on 31st March, 20X1, the reporting date, the manufacturer has a delivery scheduled for June 20X2. However, the manufacturer is aware that he will not be able to meet the delivery schedule in June 20X2.

Determine whether the entity has a present obligation as at 31st March, 20X1, requiring recognition of provision.

Ans: In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery in June 20X2 and there is no delay as at 31st March, 20X1. Hence, there is no present obligation to pay the penalty in the current year. Therefore, there is no present obligation to recognise the provision.

Q35: ABC Ltd. has an obligation to restore the seabed for the damage it has caused in the past. It has to pay ₹ 10,00,000 cash on 31st March 20X3 relating to this liability. ABC Ltd.'s management considers that 5% is an appropriate discount rate. The time value of money is considered to be material.

Calculate the amount to be provided for at 31st March 20X1 for the costs of restoring the seabed.

Ans: Discounting factor of 5% for 2nd year as on 31st March 20X1 = (1/1.05)2 = 0.907 The present value of the provision as on 31st March 20X1 is = ₹ 10,00,000 x 0.907 = ₹ 9,07,000

The amount of increase in the provision resulting from unwinding of discounting to reflect the passage of time should be included as an element of borrowing cost in determining the profit or loss for the year.

The provision should be initially recognised at ₹ 9,07,000 which is the present value of ₹ 10,00,000 discounted at 5% for two years. At the end of year 1 i.e. 31st March 20X2, the provision increases to ₹ 9,52,350, and the difference of ₹ 45,350 is recognised as borrowing cost. Similarly, for the year ending 31st March 20X3, the provision will increase to 10,00,000 and the increase being recognised as borrowing cost. Consequently, at the end of year 2 the amount of provision will be equal to the amount due, i.e., ₹ 10,00,000.

Note: There may be some difference in amount due to approximation (limiting discounting factor to 3 place decimal), which can be overcome either by full scale calculation or adjustment at the end.

Q36: A company manufacturing and supplying process control equipment is entitled to duty draw back if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 20X1-20X2 the company has exceeded the specified limit of turnover by the end of the reporting period. However, duty drawback can be claimed on filing of application

within the stipulated time or on discretion of the Department if filing of application is late. The application for duty drawback is filed on April 20, 20X2, which is after the stipulated time of 15 days of meeting the turnover condition. Duty drawback has been credited by the Department on June 28, 20X2 and financial statements have been approved by the Board of Directors of the company on July 26, 20X2. What would be the treatment of duty drawback credit as per the given information?

Ans: In the instant case, the condition of exceeding the specified turnover was met at the end of the reporting period and the company was entitled for the duty drawback. However, the application for the same has been filed after the stipulated time. Therefore, credit of duty drawback was discretionary in the hands of the Department. Since the claim was to be accrued only after filing of application, its accrual will be considered in the year 20X2-20X3 only.

Accordingly, the duty drawback credit is a contingent asset as at the end of the reporting period 20X1-20X2, which will be realised when the Department credits the same.

As per para 35 of Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

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

Q37: Entity XYZ entered into a contract to supply 1000 television sets for ₹ 2 million. An increase in the cost of inputs has resulted into an increase in the cost of sales to ₹ 2.5 million. The penalty for non- performance of the contract is expected to be ₹ 0.25 million. Is the contract onerous and how much provision in this regard is required?

Ans: Ind AS 37 "Provisions, Contingent Liabilities and Contingent Assets" 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.

Paragraph 68 of Ind AS 37 states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

In the instant case, cost of fulfilling the contract is ₹ 0.5 million (₹ 2.5 million – ₹ 2 million) and cost of exiting from the contract by paying penalty is ₹ 0.25 million.

In accordance with the above reproduced paragraph, it is an onerous contract as cost of meeting the contract exceeds the economic benefits.

Therefore, the provision should be recognised at the best estimate of the unavoidable cost, which is lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it, i.e., at ₹ 0.25 million (lower of ₹ 0.25 million and ₹ 0.5 million).

Q38: Marico has an obligation to restore environmental damage in the area surrounding its factory. Expert advice indicates that the restoration will be carried out in two distinct phases; the first phase requiring expenditure of ₹ 2 million to remove the contaminated soil from the area and the second phase, commencing three years later from the end of first phase, to replant the area with suitable trees and vegetation. The estimated cost of replanting is ₹ 3.5 million. Marico uses a cost of capital (before taxation) of 10% and the expenditure, when incurred, will attract tax relief at the company's marginal tax rate of 30%. Marico has not recognised any provision for such costs in the past and today's date is 31 March 20X2. The first phase of the clean up will commence in a few months time and will be completed on 31 March 20X3 when the first payment of ₹ 2 million will be made. Phase 2 costs will be paid three years later from the end of first phase. Calculate the amount to be provided at 31 March 20X2 for the restoration costs.

Ans:

Year	Cash Flow	10% Discount factor	Present Value
20X2-20X3	20,00,000	0.909	18,18,000
20X5-20X6	35,00,000	0.683	23,90,500
Provision required at 31 March 20X2			**42,08,500**

The provision is calculated using the pre-tax costs and a pre-tax cost of capital. The fact that the eventual payment will attract tax relief will be reflected in the recognition of a deferred tax asset for the deductible temporary difference (assuming that the recognition criteria for deferred tax assets are met.)

Q39: A manufacturer gives warranties to the purchasers of its goods. Under the terms of the warranty, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale to the purchasers.

On 30 April 20X1, a manufacturing defect was detected in the goods manufactured by the entity between 1 March 20X1 and 30 April 20X1.

At 31 March 20X1 (the entity's reporting date), the entity held approximately one week's sales in inventories.

The entity's financial statements for the year ended 31 March 20X1 have not yet been finalised.

Three separate categories of goods require separate consideration:

Category 1—defective goods sold on or before 31 March 20X1

Category 2—defective goods held on 31 March 20X1

Category 3—defective goods manufactured in 20X1-20X2

State the accounting treatment of the above categories in accordance with relevant Ind AS.

RTP May 2021

Ans: **Category 1—defective goods sold on or before 31 March 20X1**

If customer has the option to purchase warranty separately, the warranty is a distinct service because the entity promises to provide the service to the customer in addition to the product that has the functionality described in the contract. In that case, entity shall account for the promised warranty as a performance obligation and allocate a portion of the transaction price to that performance obligation.

If a customer does not have the option to purchase a warranty separately, an entity shall account for the warranty in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, unless it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. If that is the case, then, the promised service is a performance obligation. Entity shall allocate the transaction price to the product and the service.

If an entity promises both an assurance-type warranty and a service-type warranty but cannot reasonably account for them separately, the entity shall account for both of the warranties together as a single performance obligation.

A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. The entity shall account for such obligations in accordance with Ind AS 37.

Category 2—defective goods held on 31 March 20X1

At 31 March 20X1, the entity did not have a present obligation to make good the unsold defective goods that it held in inventories. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective inventories.

For this category, the detection of the manufacturing defect in April 20X1 is an adjusting event after the end of the reporting period as per Ind AS 10, Events after the End of the Reporting Period. It provides evidence of a manufacturing defect in inventories held at 31 March 20X1.

Category 3—defective goods manufactured in 20X1-20X2

At 31 March 20X1 the entity did not have a present obligation to make good any defective goods that it might manufacture in the future. Accordingly, at 31 March 20X1 the entity should not recognise a provision in respect of the defective goods manufactured in 20X1-20X2.

For this category, the detection of the manufacturing defect in April 20X1 is a non - adjusting event after the end of the reporting period as per Ind AS 10, Events After the End of the Reporting Period.

NOTES

CHAPTER 9
EVENTS AFTER THE REPORTING PERIOD (IND AS 10)

CONCEPTS BASED EXAMPLES

Examples – Adjusting Events

1 A loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

Event occurred – insolvency of customer

Condition existing – provision for doubtful debt

This is an adjusting event after the end of the reporting period.

2 A fraud during the accounting period is detected after the balance sheet date but before the approval of financial statements

Event occurred – Detection of fraud

Condition existing – fraud happened during the accounting period

This is an adjusting event after the end of the reporting period.

3 An entity gives warranties at the time of sale to purchasers of its products. On 31 December 20X5 an entity assessed its warranty obligation to be ₹ 100,000. Immediately before the 31 December 20X5 annual financial statements were authorised for issue, the entity discovered a latent defect in one of its lines of products (ie a defect that was not discoverable by reasonable or customary inspection). As a result of the discovery, the entity reassessed its estimate of its warranty obligation at 31 December 20X5 at ₹ 150,000.

The event occurred —discovery of the latent defect—

The condition existing—the latent defect—existed in products sold before 31 December 20X5.

This is an adjusting event after the end of the reporting period.

4 A Ltd. Agreed in principle to sell a plot of land on 18 March 2012 at a price to be determined by an independent valuer. Pending the agreement for sale and due to non-receipt of valuers report, the sale of land could not be completed up to the accounting year end i.e. 31 March 2012. The Company received the report on 07 April 2012 and the agreement was signed on 10 April 2012. The financial statements were approved by the board on 12 May 2012. Is it an adjusting event?

Event occurred – Signing of the agreement for sale of land

Timing of event – between balance sheet date and date of approval by the board. Hence, it's an event occurring after the balance sheet date

Condition existing – Company agreed in principle to sell the plot of land

Hence, it is an adjusting event and the Company should record sale transaction in books as on 31 March 2012

5 In X Co. Ltd., theft of cash of ₹ 5 lacs by cashier in January 2012 was detected only by May 2012. The accounts of the company were not yet approved by the Board of Directors of the company.

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31 March 2012.

Event occurred – Detection of theft

Timing of event – between balance sheet date and date of approval by the board. Hence, it's an event occurring after the balance sheet date

Condition existing – Theft had occurred during the accounting period

Hence, it is an adjusting event and the Company should adjust the accounts as on 31 March 2012

Example– Non adjusting events

6 A decline in market value of investments between the balance sheet date and the date on which the financial statements are approved.

Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

It is a non-adjusting event. Hence, only disclosure is required.

7 An announcement after balance sheet date but before approval of financial statement, of a formal plan to discontinue an operation does not justify adjustment of financial statement

It is a non-adjusting event. Hence, only disclosure is required.

8 An earthquake destroyed a major warehouse of C Ltd. on 20 April 2012. The last accounting year ended on 31 March 2012 and the accounts were approved on 08 May 2012.

Event occurred – Destruction of major warehouse

Timing of event – between balance sheet date and date of approval by the board

Condition existing – None. The earthquake did not exist on the balance sheet date.

Hence, the destruction of warehouse is a non-adjusting event. The notes to account must disclose the fact of earthquake together with estimate of loss.

9 A company follows April-March as its financial year. Sometimes the company receives cheques dated 31 March or before, after 31 March but before approval of financial statements. It recognizes such cheques by debiting Cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand is shown in the balance sheet as an item of cash and cash equivalents. All the Cheques in hand are presented to bank in the month of April and are also realized in the same month in the normal course after deposit in the bank.

Event occurred – Receipt of cheques

Timing of event – between balance sheet date and date of approval by the board

Condition existing – None. The cheques were received after the balance sheet date

Hence, the collection of cheques is not an adjusting event.

Recognition of cheques in hand is therefore not consistent with the requirements of IND AS 10.

Also, it does not represent material change or commitments affecting financial position and so no disclosure in notes is necessary.

10 On 1 March 2011 an entity's financial statements for the year ended 31 December 2010 were authorised for issue. At 31 December 2010 the entity had significant foreign currency exposures. By 1 March 2011 a significant loss had been incurred on these exposures because of a material weakening of the entity's functional currency against the foreign currencies to which it is exposed.

The event—Deterioration of the exchange rate

The Condition existing – None.

This a non-adjusting event after the end of the reporting period. It is indicative of conditions that arose after the end of the reporting period. The decline in exchange rate does not usually relate to conditions that existed at the end of the reporting period, but reflects circumstances that have arisen subsequently (ie the exchange rate at the end of the reporting period took account of conditions that existed at that date).

11 An entity gives warranties at the time of sale to purchasers of its products. On 31 December 2015 an entity assessed its warranty obligation to be ₹ 100,000. The latent defect was discovered on 31 March 2016, after the 31 December 2015 annual financial statements were authorised for issue. In April 2016 the entity paid ₹ 150,000 to transfer the obligation to an independent third party. Comment

The latent defect is not an event after the end of the reporting period because it was discovered after the 2015 financial statements were authorised for issue.

The ₹ 100,000 obligation for the warranty provision was measured and reported in good faith in the entity's 31 December 2015 annual financial statements. The additional ₹ 50,000 not provided for at 31 December 2015 is a change in accounting estimate. It is recognised as an expense in determining the profit or loss for the three-month period ended 31 March 2016. Thus, it will be included in profit or loss in the 2016 financial statements.

Example - Long Term Loan

12. ABC Ltd., in order to raise funds, has privately placed debentures of ₹ 1 crore, on 1st January, 20X1, issued to PQR Ltd. As per the original terms of agreement, the debentures are to be redeemed on 31st March, 20X9. One of the conditions of the private placement of the debentures was that debt-equity ratio at the end of any reporting year should not exceed 2:1. If this condition is not fulfilled, then, PQR Ltd., has a right to demand immediate redemption of the debentures. On 31st March, 20X6, debt-equity ratio of ABC Ltd., exceeds 2:1. Therefore, PQR Ltd., decides to return the debentures.

Thus, on 31st March, 20X6, the liability of the ABC Ltd., towards PQR Ltd., (which was originally a long-term liability) becomes a current liability, since, it is now a liability on demand. However, ABC Ltd., enters into an agreement with PQR Ltd., on 15th April, 20X6 that PQR Ltd., will not demand the payment immediately. The financial statements are approved by the BOD on 30th April, 20X6.

Now, in such a case, the liability is turning into demand liability on 31st March, 20X6. The agreement that PQR Ltd., will not demand the money immediately is a subsequent event. Even though it is a subsequent event not affecting the condition existing at the balance sheet date, yet because of the specific provisions of Ind AS 10, it has to be given effect in the financial statements for the year 20X5-20X6. Accordingly, though as per original terms the liability would have been otherwise reclassified as a current liability as on 31st March, 20X6, by giving effect to the event after the reporting period due to the specific provisions of Ind AS 10, it would continue to be classified as a non-current liability as on 31st March, 20X6. In other words, the re-classification of debentures as current liability as at 31st March, 20X6 will be adjusted and once again classified as a non-current liability as at that date.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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?

Ans: 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.

Q2: A company has inventory of 100 finished cars on 31st March, 20X2, which are having a cost of ₹ 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 ₹ 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 ₹ 4,00,000 each or should it value at ₹ 3,00,000 each? Ignore estimated costs necessary to make the sale. **[ICAI SM]**

Ans: 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 ₹ 3,00,000 should be considered for the valuation of stock.

Q3: 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?

Ans: 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.

Q4: 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?

Ans: 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

Q5: 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?

Ans: 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.

Q6: 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]**

Ans: 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.

Q7: ABC Ltd. is trading company in Laptops. On 31st March 20X2 company has 50 laptops which were purchased at ₹ 45,000 each. Company has considered the same price for calculation of closing inventory. On 15th April 20X2, advanced version of same series of laptops is introduced in the market. Therefore, the price of the current laptops crashes to ₹ 35,000 each. Company does not want to value the stock as ₹ 35,000 as the event of reduction took place after the 31st March 20X2 and the reduced prices were not applicable as on 31st March 20X2. Comment

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

Q8: 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 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?

Ans: 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.

Q9: What is the date of approval for issue of the financial statements prepared for the reporting period from April 1, 2011 to March 31, 2012, in a situation where following dates are available? Completion of preparation of financial statements May 28, 2012 Board reviews and approves it for issue June 19, 2012

Available to shareholders	July 01, 2012
Annual General Meeting	September 15, 2012
Filed with regulatory authority	October 16, 2012

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

Ans: As per Ind AS 10 the date of approval for issue of financial statements is the date on which the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity. Accordingly, in the instant case, the date of approval is the date on which the financial statements are approved by the Board of Directors of the company, i.e., June 19, 2012.

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

Q10: ABC Ltd. prepared interim financial report for the quarter ending June 30, 2011. The interim financial report was approved for issue by the Board of Directors on July 15, 2011. Whether events occurring between end of the interim financial report and date of approval by Board of Directors, i.e., events between July 1, 2011 and July 15, 2011 that provide evidence of conditions that existed at the end of the interim reporting period shall be adjusted in the interim financial report ending June 30, 2011?

Ans: Paragraph 3 of Ind AS 10, inter alia, defines 'Events after the reporting period' as those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

What is reporting period has not been dealt with in Ind AS 10. Absence of any specific guidance regarding reporting period implies that any term for which reporting is done by preparing financial statements is the reporting period for the purpose of Ind AS 10. Accordingly, financial reporting done for interim period by preparing either complete set of financial statements or by

preparing condensed financial statements will be treated as reporting period for the purpose of Ind AS 10.

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

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

In order to comply with the requirements of Ind AS 10, each interim financial report should be adjusted for the adjusting events occurring between end of the interim financial report and the date of approval by Board of Directors. Therefore, in the instant case, events occurring between July 1, 2011 and July 15, 2011 that provide evidence of conditions that existed at the end of the interim reporting period should be adjusted in the interim financial report ending June 30, 2011.

Q11: The Board of Directors of ABC Ltd. approved the financial statements for the reporting period 2011-12 for issue on June 15, 2012. The management of ABC Ltd. discovered a major fraud and decided to reopen the books of account. The financial statements were subsequently approved by the Board of Directors on June 30, 2012. What is the date of approval for issue as per Ind AS 10 in the given case?

Ans: Date of approval is the date on which the financial statements are approved by the Board of Directors in case of a company, and by the corresponding approving authority in case of any other entity for issue. In the given case, there are two dates of approval by Board of Directors. The financial statements were reopened for further adjustments subsequent to initial approval. The date of approval should be taken as the date on which financial statements are finally approved by the Board of Directors. Therefore, in the given case, the date of approval for issue as per Ind AS 10 should be considered as June 30, 2012.

Q12: While preparing its financial statements for the year ended 31st March, 2011, XYZ Ltd. made a general provision for bad debts @ 5% of its debtors. In the last week of February, 2011 a debtor for ₹ 2 lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. Considering the event of earthquake, XYZ Ltd. made a provision @ 50% of the amount receivable from that debtor apart from the general provision of 5% on remaining debtors. In April, 2011 the debtor became bankrupt. Can XYZ Ltd. provide for the full loss arising out of insolvency of the debtor in the financial statements for the year ended 31st March, 2011?

Would the answer be different if earthquake had taken place after 31st March, 2011, and therefore, XYZ Ltd. did not make any specific provision in context that debtor and made only general provision for bad debts @ 5% on total debtors?

Ans: As per the definition of 'Events after the Reporting Period' and paragraph 8 of Ind AS 10, Events after the Reporting Period, financial statements should be adjusted for events occurring after the reporting period that provide evidence of conditions that existed at the end of the reporting period. In the instant case, the earthquake took place before the end of the reporting period, i.e., in February 2011. Therefore, the condition exists at the end of the reporting date

though the debtor is declared insolvent after the reporting period. Accordingly, full provision for bad debt amounting to ₹ 2 lakhs should be made to cover the loss arising due to the bankruptcy of the debtor in the financial statements for the year ended March 31, 2011. Since provision for bad debts on account of amount due from that particular debtor was made @ 50%, XYZ Ltd should provide for the remaining amount as a consequence of declaration of this debtor as bankrupt.

In case, the earthquake had taken place after the end of the reporting period, i.e., after 31st March, 2011, and XYZ Ltd. had not made any specific provision for the debtor who was declared bankrupt later on, since the earthquake occurred after the end of the reporting period no condition existed at the end of the reporting period. The company had made only general provision for bad debts in the ordinary business course and not to recognise the catastrophic situation of an earthquake. Accordingly, bankruptcy of the debtor in this case is a non-adjusting event.

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

(a) the nature of the event; and

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

If the amount of bad debt is considered to be material, the nature of this non-adjusting event, i.e., event of bankruptcy of the debtor should be disclosed along with the estimated financial effect of the same in the financial statements.

Q13: Company XYZ Ltd. was formed to secure the tenders floated by a telecom company for publication of telephone directories. It bagged the tender for publishing directories for Pune circle for 5 years. It has made a profit in 2011- 2012, 2012-2013, 2013-2014 and 2014-2015. It bid in tenders for publication of directories for other circles – Nagpur, Nashik, Mumbai, Hyderabad but as per the results declared on 23rd April, 2015, 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 2015. The financial statements for the F.Y. 2014-15 have been approved by the Board of Directors on July 10, 2015. Whether it is appropriate to prepare financial statements on going concern basis?

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

An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate 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 2015 and it is confirmed on 23rd April, 2015, 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 2014-15 and thereafter on going concern basis may not be appropriate.

Q14: In the plant of PQR Ltd., there was a fire on 10.05.2011 in which the entire plant was damaged and the loss of ₹ 40,00,000 is estimated. The claim with the insurance company has been filed and a recovery of ₹ 27,00,000 is expected.

The financial statements for the year ending 31.03.2011 were approved by the Board of Directors on 12th June 2011. Show how should it be disclosed? **[RTP Nov 2020]**

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

With regard to going concern basis followed for preparation of financial statements, the company needs to determine whether it is appropriate to prepare the financial statements on going concern basis, since there is only one plant which has been damaged due to fire. If the effect of deterioration in operating results and financial position is so pervasive that management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so, preparation of financial statements for the F.Y.2010-11 on going concern assumption may not be appropriate. In that case, the financial statements may have to be prepared on a basis other than going concern.

However, if the going concern assumption is considered to be appropriate even after the fire, no adjustment is required in the financial statements for the year ending 31.03.2011.

Q15: What would be the treatment for dividends declared to redeemable preference shareholders after the reporting period but before the financial statements are approved for issue for the year 2011-12. Whether Ind AS 10 prescribes any accounting treatment for such dividends?

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

However, Ind AS 10 does not prescribe accounting treatment for dividends declared to redeemable preference shareholders. As per the principles of Ind AS 32, Financial Instruments:

Presentation, a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability. Thus, dividend payments to such preference shares are recognised as expense in the same way as interest on a bond. Since interest will be charged on time basis, the requirements of Ind AS 10 regarding date of declaration of dividend not relevant for its recognition.

Q16: XY Ltd had taken a large-sized civil construction contract, for a public sector undertaking, valued at ₹ 200 Crores. Execution of the project started during 2011-12, and continued in the next financial year also. During the course of execution of the work on May 29, 2012, the company found while raising the foundation work that it had met a rocky surface and cost of contract would go up by an extra ₹50 crore, which would not be recoverable from the Contractee as per the terms of the contract. The Company's financial year ended on 31st March, 2012, and the financial statements were considered and approved by the Board of Directors on 15th June, 2012. How will you treat the above in the financial statements for the year ended 31st March, 2012?

Ans: In the instant case, the execution of work started during the F.Y. 2011-12 and the rocky surface was there at the end of the reporting period, though the existence of rocky surface is confirmed after the end of the reporting period as a result of which it became evident that the cost may escalate by ₹ 50 Crores. In accordance with the definition of 'Events after the Reporting Period', since the rocky surface was there, the condition was existing at the end of the reporting period, therefore, it is an adjusting event. The cost of the project and profit should be accounted for accordingly.

Q17: A Ltd. was required to pay penalty for a breach in the performance of a contract. A Ltd. believed that the penalty was payable at a lower amount than the amount demanded by the other party. A Ltd. created provision for the penalty but also approached the arbitrator with a submission that the case may be dismissed with costs. A Ltd. prepared the financial statements for the year 2011-12, which were approved in July 2012. The arbitrator, in June 2012, awarded the case in favour of A Ltd. As a result of the award of the arbitrator, the provision earlier made by A Ltd. was required to be reduced. The arbitrator also decided that cost of the case should be borne by the other party.

Now, whether A Ltd. is required to re measure its provision and what would be the accounting treatment of the cost that will be recovered by A Ltd., which has already been charged to the Statement of Profit and Loss as an expense for the year 2011-2012 ?

Ans: In the instant case, A Ltd. approached the arbitrator before the end of the reporting period, who decided the award after the end of the reporting period but before approval of the financial statements for issue. Accordingly, the conditions were existing at the end of the reporting date because A Ltd. had approached the arbitrator before the end of the reporting period whose outcome has been confirmed by the award of the arbitrator. Therefore, it is an adjusting event. Accordingly, the measurement of the provision is required to be adjusted for the event occurring after the reporting period. As far as the recovery of the cost by A Ltd. from the other party is concerned, this right to recover was a contingent asset as at the end of the reporting period.

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

On the basis of the above, a contingent asset should be recognised in the financial statements of the period in which the realisation of asset and the related income becomes virtually certain. In the instant case, the recovery of cost became certain when the arbitrator decided the award during F.Y. 2012-13.

Accordingly, the recovery of cost should be recognised in the financial year 2012-13.

Q18: A company manufacturing and supplying process control equipment is entitled to duty drawback if it exceeds its turnover above a specified limit. To claim duty drawback, the company needs to file application within 15 days of meeting the specified turnover. If application is not filed within stipulated time, the Department has discretionary power of giving duty draw back credit. For the year 2011-12, the company has exceeded the specified limit of turnover by the end of the reporting period but the application for duty drawback is filed on April 20, 2012, which is after the stipulated time of 15 days of meeting the turnover condition.

Duty drawback has been credited by the Department on June 28, 2012 and financial statements have been approved by the Board of Directors of the company on July 26, 2012. Whether duty drawback credit should be treated as an adjusting event?

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

As per para 35 of Ind AS 37, contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset.

In accordance with the above, the duty draw back credit which was contingent asset for the F.Y. 2011-12 should be recognised as asset and related income should be recognized in the reporting period in which the change occurs. i.e., in the period in which realisation becomes virtually certain, i.e., F.Y. 2012-13.

Q19: XYZ Ltd. sells goods to its customer with a promise to give discount of 5% on list price of the goods provided that the payments are received from customer within 15 days. XYZ Ltd. sold goods of ₹ 5 lakhs to ABC Ltd. between 17th March, 2012 and 31st March, 2012. ABC Ltd. paid the dues by 15th April, 2012 with respect to sales made between 17th March, 2012 and 31st March, 2012. Financial statements were approved for issue by Board of Directors on 31st May, 2012.

State whether discount will be adjusted from the sales at the end of the reporting period.

Ans: As per Ind AS 115, if the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

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

Q20: Whether the fraud related to 2011-12 discovered after the end of the reporting period but before the date of approval of financial statements for 2013-14 is an adjusting event?

Ans: In the instant case, the fraud is discovered after the end of the reporting period of 2013-14, which related to F.Y. 2011-12. Since the fraud has taken place before the end of the reporting period, the condition was existing which has been confirmed by the detection of the same after the end of the reporting period but before the approval of financial statements. Therefore, it is an adjusting event.

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

Q21: X Ltd. was having investment in form of equity shares in another company as at the end of the reporting period, i.e., 31st March, 2012. After the end of the reporting period but before the approval of the financial statements it has been found that value of investment was fraudulently inflated by committing a computation error. Whether such event should be adjusted in the financial statements for the year 2011-12?

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

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q22: ABC Ltd. received a demand notice on 15th June, 20X2 for an additional amount of ₹ 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same in respect of transactions related to financial year 20X1-20X2. The financial statements for the year 20X1-20X2 are approved on 10th August, 20X2. In July, 20X2, the company has appealed against the demand of ₹ 28,00,000 and the company has expected that the demand would be settled at ₹ 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 20 X1-20X2. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly.

Ans: **Ind AS 10 defines „Events after the Reporting Period" as follows:**

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:

- those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)

In the instant case, the demand notice has been received on 15th June, 20X2, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, condition exists on 31st March, 20X2, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 20X1-20X2, at best estimate of the expenditure to be incurred, i.e., ₹ 15,00,000.

QUESTIONS FROM OTHER SOURCE

Q23: X and Y entered into a proposal on 20.12.2005 which provided for the sale of an asset (book value ₹ 2,50,000) for ₹ 3,70,000 to Y. The sale deed was to be registered and other formalities completed on 15.1.2006. Y has paid an advance money of ₹ 50,000 to X on 20.12.2005. Both X and Y prepare final accounts on December 31 every year and present in April next. How the transaction be shown in the books of X and for the year 2005.

Ans: **Books of X:** In the given case, proposal for deal of immovable property was sent before the closure of the books of accounts. This is a non-adjusting event as only the proposal was sent and no agreement was effected in the month of March i.e. before the balance sheet date.. The amount received as advance shall be shown as a liability in the balance sheet and there should be an disclosure in Notes to Accounts about the proposal to sell.

Books of Y: He has paid an advance of ₹ 50,000 and it should be shown in the balance sheet. There should be a disclosure in the Notes to Accounts for the year 2005, that proposal for purchase of an asset at a price of ₹ 3,70,000 has been entered and an advance of ₹ 50,000 has been paid.

Q24: Cashier of A-One Limited embezzled cash amounting to ₹ 6,00,000 during March, 2012. However same comes to the notice of Company management during April, 2012 only. Financial statement of the company is not yet approved by the Board of Directors of the company. With the help of provisions of IND AS 10 "Events after the Reporting date" decide, whether the embezzlement of cash should be adjusted in the books of accounts for the year ending March,

2012? What will be your reply, if embezzlement of cash comes to the notice of company management only after approval of financial statements by the Boar Directors of the company?

Ans: As per IND AS 10, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

Though the theft, by the cashier ₹ 6,00,000, was detected after the balance sheet date (before approval of financial statements) but it is an additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March, 2012 for recognition of the loss amounting ₹ 6,00,000.

If embezzlement of cash comes to the notice of company management only after approval of financial statements by board of directors of the company, then the treatment will be done as per the provisions of AS 5. This being extra ordinary item should be disclosed in the statement of profit and loss as a part of loss for the year ending March, 2013. The nature and the amount of prior period items should be separately disclosed on the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Q25: There was a government notification in June 2001 increasing the limit of gratuity payment with effect from 24th September 2000. The accounts were approved by the Board of Directors in July 2001. The accounts officer is of the opinion that since the change took place after the balance sheet date, no effect should be given to it in the financial statements for the year ended 31" March 2001. Is his view correct?

Ans: Event occurred – Government notification in June 2001 increasing the limit of gratuity payment with effect from 24th September 2000

Timing of event – between balance sheet date and date of approval by the board. Hence, it's an event occurring after the balance sheet date

Condition existing – Services rendered by employee during the year for which condition existing on balance sheet date to create provision for gratuity.

Therefore it is an adjusting event and hence a provision is required to be made considering the increase in limit of gratuity payment.

Q26: During the year 2012-2013, Raj Ltd. was sued by a competitor for ₹ 15 lakhs for infringement of a trademark. Based on the advice of the company's legal counsel, Raj Ltd. provided for a sum of ₹ 10 lakhs in its financial statements for the year ended 31st March, 2013. On 18th May, 2013, the Court decided in favour of the party alleging infringement of the trademark and ordered Raj Ltd. to pay the aggrieved party a sum of ₹ 14 lakhs. The financial statements were prepared by the company's management on 30th April, 2013, and approved by the board on 30th May, 2013.

Ans: As per IND AS 10, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

In the given case, since Raj Ltd. was sued by a competitor for infringement of a trademark during the year 2012-13 for which the provision was also made by it, the decision of the Court on 18th May, 2013, for payment of the penalty will constitute as an adjusting event because it is an event occurred before approval of the financial statements. Therefore, Raj Ltd. should adjust the provision upward by ₹ 4 lakhs to reflect the award decreed by the Court to be paid by them to its competitor.

Had the judgment of the Court been delivered on 1st June, 2013, it would be considered as post reporting period i.e. event occurred after the approval of the financial statements. In that case, no adjustment in the financial statements of 2012-13 would have been required.

Q27: A Limited Company closed its accounting year on 30.6.2005 and the accounts for that period were considered and approved by the board of directors on 20th August, 2005. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2005 it had met a rocky surface for which it was estimated that there would be an extra cost to the tune of ₹ 80 lakhs. You are required to state with reasons, how the event would he dealt with in the financial statements for the year ended 30. 6.2005.

Ans: In this case the incidence, which was expected to push up cost, became evident after the date of approval of the balance sheet. So that was not any 'event occurring after the balance sheet date'.

Q28: A company follows April-March as its financial year. The company recognizes cheques dated 31 March or before, received from customers after balance sheet date but before approval of financial statement by debiting Cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand is shown in balance sheet as an item of cash and cash equivalents. All Cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. What is treatment under IND AS 10?

Ans: Even if the cheques bear the date 31 March or before, the cheques received after 31 March do not represent any condition existing on 31 March. Thus the collection of cheques after balance sheet date is not an adjusting event. Recognition of cheques in hand is therefore not consistent with requirements of IND AS 10. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting financial position of the enterprise, and so no disclosure of such collections in the notes is necessary.

It should also be noted that, the Framework for Preparation and Presentation of Financial Statement defines assets as resources controlled by an enterprise as a result of past events from which economic benefits are expected to flow to the enterprise. Since the company acquires custody of the cheques after 31 March, it does not have any control over the cheques on 31 March and hence cheques in hand do not qualify to be recognized as asset on 3 1 March.

Q29: A Limited company closes its accounts on 31st March every year. It issued a cheque in favour of one of its customers towards the refund of advance in December, 2004. In April 2005, the customer returned the cheque to the company without presentation to the bank while accounts of the company for that year were being finalized. Since the cheque was cancelled, the reversal entry was passed in the books of account as on 31.3.2005 with a view to disclose the correct balance as on that date, instead of showing the bank balance lower by treating the cheque as "issued but not encashed as on 31.3.2005". Whether the reversal entry passed in the

books of account of the company as on 31.3.2005 was proper since the cheque was cancelled before closing of the accounts for the year.

Ans: According to IND AS 10, "assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date. Assets and liabilities should not be adjusted for but disclosure should be made in the notes to financial statement of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise." Bank balance as on the date of balance sheet should not be adjusted by passing a reversal entry since the event of cancellation of cheque after the balance sheet date did not relate to conditions existing at the balance sheet date. However, if the amount of the cheque is material enough to affect the financial position of the company, its disclosure should be made in the notes to financial statement.

Q30: The financial statement of Constructions Limited for the year ended 31st March, 2008 were considered and approved by the board of directors on 20th May, 2008. The company was engaged in construction work involving ₹10 crores. In the course of execution of work, a portion of factory shed under construction came crashing down on 30th May, 2008. Fortunately, there was no loss of life, but the company will have to rebuild the structure at an additional cost of ₹2 crores which cannot be recovered from the contractee. How should this event be reported?

Ans: IND AS 10 defines 'Events occurring after the Balance Sheet date' as follows:

'Events occurring after the Balance sheet date are those significant events, both favourable and unfavourable that occur between the Balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a Company".

The facts of the case are as under:

a) Financial Statements are prepared for the year ended 31st March, 2008.

b) Board of Directors of the Company approved the said financial statements on 20th May, 2008.

c) Construction crashed down resulted in a loss of ₹2 crores, on 30th May, 2008.

In view of the above definition, the said unfavourable event does not come under the definition of 'events occurring after the balance sheet date'.

Therefore, no adjustment to assets and liabilities need be required. And also, it would not require disclosure in the financial statements.

Q31: Neel Limited has its corporate office in Mumbai and sells its products to stockists all over India. On 31st March, 2013, the company wants to recognize receipt of cheques bearing date 31st March, 2013 or before, as "Cheques in Hand" by reducing "Trade Receivables". The "Cheques in Hand" is shown in the Balance Sheet as an item of cash and cash equivalents. All cheques are presented to the bank in the month of April 2013 and are also realized in the same month in normal course after deposit in the bank. State with reasons, whether each of the following is an adjusting event and how this fact is to be disclosed by the company, with reference to the relevant accounting standard.

(i) Cheques collected by the marketing personnel of the company from the stockists on or before 31st March, 2013.

(ii) Cheques sent by the stockists through courier on or before 31st March, 2013.

Ans: (i) Cheques collected by the marketing personnel of the company is an adjusting event as the marketing personnels are employees of the company and therefore, are representatives of the company. Handing over of cheques by the stockist to the marketing employees discharges the liability of the stockist. Therefore, cheques collected by the marketing personnel of the company on or before 31st March, 2013 require adjustment from the stockists' accounts i.e. from 'Trade Receivables A/c' even though these cheques (dated on or before 31st March, 2013) are presented in the bank in the month of April, 2013 in the normal course. Hence, collection of cheques by the marketing personnel is an adjusting event as per IND AS 10. Such 'cheques in hand' will be shown in the Balance Sheet as 'Cash and Cash equivalents' with a disclosure in the Notes to accounts about the accounting policy followed by the company for such cheques.

(ii) Even if the cheques bear the date 31st March or before and are sent by the stockists through courier on or before 31st March, 2013, it is presumed that the cheques will be received after 31st March. Collection of cheques after 31st March, 2013 does not represent any condition existing on the balance sheet date i.e. 31st March. Thus, the collection of cheques after balance sheet date is not an adjusting event. Cheques that are received after the balance sheet date should be accounted for in the period in which they are received even though the same may be dated 31st March or before as per IND AS 10. Moreover, the collection of cheques after balance sheet date does not represent any material change affecting financial position of the enterprise, so no disclosure in the notes is necessary.

Q32: Pure Oil Ltd. closed the books of accounts on March 31, 2006 for which financial statement was finalized by the Board of Directors on September 04, 2006. During the month of December 2005, company under took the project of lying a pipeline across the country and during May 2006 engineers realized that due to unexpected heavy rain, the total cost of the project will be inflated by ₹ 50 lakhs. How this should be provided for in the balance sheet of 2005-06 accordance to IND AS 10?

Ans: This event occurred after March 31, 2006 but before September 04, 2006 it is event occurring after the balance sheet date. But this event is not affecting financial position on the date of balance sheet therefore, no adjustment to assets and liabilities need be required. And also it would not require disclosure in the financial statements. Since it is a material change affecting the financial position of the enterprise that took place due to the event occurring after the balance sheet date, the fact and financial implications thereof need to be disclosed in the notes.

Q33: An earthquake destroyed a major warehouse of ACO Ltd. on 20.5.2009. The accounting year of the company ended on 31.3.2009. The accounts were approved on 30.6.2009. The loss from earthquake is estimated at ₹30 lakhs. State with reasons whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company?

Ans: IND AS 10 "Events after the Reporting date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-2009.

However, according to the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore then annual accounts would have to be prepared by not following the fundamental accounting assumption of going concern despite the fact that the event has occurred after the balance sheet date.

QUESTIONS FROM RTP/MTP/EXAMS

Q34: 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]**

Ans: 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.

Q35: ABC Ltd. received a demand notice on 15th June, 2017 for an additional amount of ₹ 28,00,000 from the Excise Department on account of higher excise duty levied by the Excise Department compared to the rate at which the company was creating provision and depositing the same. The financial statements for the year 2016-17 are approved on 10th August, 2017. In July, 2017, the company has appealed against the demand of ₹ 28,00,000 and the company has expected that the demand would be settled at ₹ 15,00,000 only. Show how the above event will have a bearing on the financial statements for the year 2016-17. Whether these events are adjusting or non-adjusting events and explain the treatment accordingly.

Ans: In the instant case, the demand notice has been received on 15th June, 2017, which is between the end of the reporting period and the date of approval of financial statements. Therefore, it is an event after the reporting period. This demand for additional amount has been raised because of higher rate of excise duty levied by the Excise Department in respect of goods already manufactured during the reporting period. Accordingly, condition exists on 31st March, 2017, as the goods have been manufactured during the reporting period on which additional excise duty has been levied and this event has been confirmed by the receipt of demand notice. Therefore, it is an adjusting event.

In accordance with the principles of Ind AS 37, the company should make a provision in the financial statements for the year 2016-17, at best estimate of the expenditure to be incurred, i.e., ₹ 15,00,000.

Q36: Discuss with reasons whether these events are in nature of adjusting or non -adjusting and the treatment needed in light of accounting standard Ind AS 10.

(a) Moon Ltd. won an arbitration award on 25th April, 2019 for ₹ 1 crore. From the arbitration proceeding, it was evident that the Company is most likely to win the arbitration award. The directors approved the financial statements for the year ending 31.03.2019 on 1st May, 2019. The management did not consider the effect of the above transaction in Financial Year 2018-2019, as it was favourable to the Company and the award came after the end of the financial year.

(b) Zoom Ltd. has a trading business of Mobile telephones. The Company has purchased 1000 mobiles phones at ₹ 5,000 each on 15th March, 2019. The manufacturers of phone had announced the release of the new version on 1st March, 2019 but had not announced the price. Zoom Ltd. has valued inventory at cost of ₹ 5,000 each at the year ending 31st March, 2019.

Due to arrival of new advance version of Mobile Phone on 8 th April, 2019, the selling prices of the mobile stocks remaining with Company was dropped at ₹ 4,000 each.

The financial statements of the company valued mobile phones @ ₹ 5,000 each and not at the value @ ₹ 4,000 less expenses on sales, as the price reduction in selling price was effected after 31.03.2019.

(c) There as an old due from a debtor amounting to ₹ 15 lakh against whom insolvency proceedings was instituted prior to the financial year ending 31st March, 2019. The debtor was declared insolvent on 15th April, 2019.

(d) Assume that subsequent to the year end and before the financial statements are approved, Company's management announces that it will restructure the operation of the company. Management plans to make significant redundancies and to close a few divisions of company's business; however, there is no formal plan yet. Should management recognise a provision in the books, if the company decides subsequent to end of the accounting year to restructure its operations? **[Exam Nov 2019]**

Ans: As per Ind AS 10, the treatment of stated issues would be as under:

a) **Adjusting event:** It is an adjusting event as it is the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. Even though winning of award is favorable to the company, it should be accounted in its books as receivable since it is an adjusting event.

b) **Adjusting event:** The sale of inventories after the reporting period may give evidence about their net realizable value at the end of the reporting period, hence it is an adjusting event as per Ind AS 10. Zoom Limited should value its inventory at ₹ 40,00,000. Hence, appropriate provision must be made for ₹ 15 lakh.

c) **Adjusting event:** As per Ind AS 10, the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. The bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period.

d) **Non–adjusting event:** Announcing or commencing the implementation of a major restructuring after reporting period is a non-adjusting event as per Ind AS 10. Though this is a non- adjusting event occurred after the reporting period, yet it would result in disclosure of the event in the financial statements, if restructuring is material.

This would not require provision since as per Ind AS 37, decision to restructure was not taken before or on the reporting date. Hence, it does not give rise to a constructive obligation at the end of the reporting period to create a provision.

Q37: H Ltd. constructed a warehouse at a cost of ₹ 10 lakhs in 2015. It first became available for use by H Ltd. on 1st January 2016. On 29th January 2020, H Ltd. discovered that its warehouse was damaged. During early February 2020, an investigation revealed that the damage was due to a structural fault in the construction of the warehouse. The fault became apparent when the warehouse building leaked severely after heavy rainfall in the week ended 27th January 2020. The discovery of the fault is an indication of impairment. So, H Ltd. was required to estimate the recoverable amount of its warehouse at 31st December 2019. This estimate was ₹ 6,00,000. Furthermore, H Ltd. reassessed the useful life of its warehouse at 20 years from the date that it was ready for use. Before discovering the fault, H Ltd. had depreciated the warehouse on the straight -line method to a nil residual value over its estimated 30-year useful life.

Seepage of rain water through the crack in the warehouse caused damage to inventory worth about ₹ 1,00,000 (cost price) and became un-saleable. The entire damaged inventory was on hand as at 31st December, 2019. H Ltd. has not insured against any of the losses.

It accounts for all its property, plant and equipment under the cost model. H Ltd.'s annual financial statements for the year ended 31st December, 2019 were approved for issue by the Board of Directors on 28th February, 2020.

You are required to :

(i) Prepare accounting entries to record the effects of the events after the end of the reporting period in the accounting records of H Ltd. for the year ended 31st December, 2019. Kindly ignore tax impact;

(ii) Discuss disclosure requirement in above case as per relevant Ind AS; and

(iii) Will your answer be different if there was no structural fault and damage to the warehouse had been caused by an event that occurred after 31 st December, 2019?

Exam Paper January 2021 (8 Marks)

Ans: (i) Journal Entries on 31st December 2019

	₹	₹
Depreciation expense A/c (W.N.1) Dr. To Warehouse or Accumulated depreciation A/c (Being additional depreciation expense recognised for the year ended 31st December 2019 arising from the reassessment of the useful life of the warehouse)	19,608	19,608
Impairment loss A/c (W.N.2) Dr. To Warehouse or Accumulated depreciation A/c (Being impairment loss recognised due to discovery of structural fault in the construction of warehouse at 31st December 2019)	2,47,059	2,47,059

(ii) (a) **The damage to warehouse is an adjusting event** (occurred after the end of the year 2019) for the reporting period 2019, since it provides evidence that the structural fault existed at the end of the reporting period. It is an adjusting event, in spite of the fact that fault has been discovered after the reporting date.

The effects of the damage to the warehouse are recognised in the year 2019 reporting period. Prior periods will not be adjusted because those financial statements were prepared in good faith (eg regarding estimate of useful life,

assessment of impairment indicators etc) and had not affected the financials of prior years.

(b) Damage of inventory due to seepage of rainwater ₹ 1,00,000 occurred during the year 2020**. It is a non-adjusting event** after the end of the 2019 reporting period since the inventory was in good condition at 31st December 2019. Hence, no accounting has been done for it in the year 2019.

H Ltd. must disclose the nature of the event (i.e. rain-damage to inventories) and an estimate of the financial effect (i.e. ₹ 1,00,000 loss) in the notes to its 31st December 2019 annual financial statements.

(iii) If the damage to the warehouse had been caused by an event that occurred after 31st December 2019 and was not due to structural fault, **then it would be considered as a non-adjusting event** after the end of the reporting period 2019 as the warehouse would have been in a good condition at 31st December 2019.

Working Notes:

1. Calculation of additional depreciation to be charged in the year 2019

Original depreciation as per SLM already charged during the year 2019

= ₹ 10,00,000/ 30 years = ₹ 33,333.

Carrying value at the end of 2018 = 10,00,000 – (₹ 33,333 x 3 years) = ₹ 9,00,000

Revised depreciation = 9,00,000 / 17 years = ₹ 52,941

Additional depreciation to be recognised in the books in the year 2019

= ₹ 52,941 – ₹ 33,333 = ₹ 19,608

2. Calculation of impairment loss in the year 2019

Carrying value after charging depreciation for the year 2019 = ₹ 9,00,000 – ₹ 52,941 = ₹ 8,47,059

Recoverable value of the warehouse = ₹ 6,00,000

Impairment loss = Carrying value - Recoverable value = ₹ 8,47,059 - ₹ 6,00,000 = ₹ 2,47,059

CHAPTER 10
VALUATION OF INVENTORIES (IND AS 2)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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.

Q2: 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.

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.

Q3: 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 (₹)	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 ₹ 80 per unit and ₹ 50 per unit respectively, by product is sold @ ₹ 25 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000, ₹ 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**		**₹**
	Selling price of by-product BP (1,600 units x R₹ 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**		
		₹	₹
	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
	Sales price per unit (b)	₹ 80	₹ 50
	Sales value (a x b)	₹ 5,00,000	₹2,50,000
	Ratio of allocation	2	1
	Joint cost of ₹ 3,04,000 allocated in the ratio of 2:1 (c)	₹ 2,02,667	₹ 1,01,333
	Cost per unit [c/a]	₹ 32.43	₹ 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	₹ 32.43	₹ 20.27
	Value of closing stock	₹ 25,944	₹4,054

Q4: 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.

Q5: UA Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to

be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ₹ 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 ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Q6: 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) ₹ 85 lakhs

Solar power panel (finished products) ₹ 55 lakhs

Sundry Debtor (solar power panel) ₹ 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 ₹ 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 ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

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 ₹ 65 lakhs shall be made in the books against the debtors amount.

Q7: 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

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q8: ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was ₹ 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of ₹ 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of ₹ 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

Ans:

	₹
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	5,000
Cost of inventory	12,05,000

Note: The intention to take settlement discount is irrelevant.

Q9: A business plans for production overheads of ₹ 10,00,000 per annum. The normal level of production is 1,00,000 units per annum.

Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were ₹ 126.

Calculate the per unit cost and amount of overhead to be expensed during the year

Ans:

Calculation of cost per unit:	₹
Other costs	126
Production overhead (10,00,000/1,00,000 units)	10
Unit cost	136

Overhead to be expensed:	₹
Total production overhead	10,00,000
The amount absorbed into inventory is (75,000 x 10)	(7,50,000)
The amount not absorbed into inventory	2,50,000

₹ 2,50,000 that has not been included in inventory is expensed during the year i.e. recognised in the statement of profit and loss.

Q10: ABC Ltd. manufactures control units for air conditioning systems.

Each control unit requires the following:

1 component X at a cost of ₹ 1,205 each 1 component Y at a cost of ₹ 800 each

Sundry raw materials at a cost of ₹ 150 each The company faces the following monthly expenses:

Factory rent ₹ 16,500 Energy cost ₹ 7,500

Selling and administrative costs ₹ 10,000

Each unit takes two hours to assemble. Production workers are paid ₹ 300 per hour.

Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.

Determine the cost of inventory.

Ans:

The cost of a single control unit :	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	150
	2,155
Labour (2 hours x 300)	600
Production overhead [(16,500 + 7,500/1,000 hours) x 2 hours]	48
	2,803

Note: The selling and administrative costs are not part of the cost of inventory.

Q11: A dealer has purchased 1,000 cars costing ₹ 2,80,000 each on deferred payment basis as ₹ 25,000 per month per car to be paid in 12 equal instalments.

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

Ans:

	₹
Deferred payment price (25,000 x 12)	3,00,000

Less: Cash price	2,80,000
Interest expense	20,000

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

Q12: ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of ₹ 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was ₹ 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of ₹ 15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value and inventory write-down (loss) amount.

Ans: The net realisable value is the expected sale price ₹ 40, less cost incurred to bring the goods to its saleable condition ie ₹ 15.

Thus, NRV of envelopes pack = ₹ 40 – ₹ 15 = ₹ 25 per pack.

Q13: At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of ₹ 10 per unit. The current market price is ₹ 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at ₹ 11 per unit, which cannot be settled net. Estimated incremental selling cost is ₹ 1 per unit.

Determine Net Realisable Value (NRV) of the inventory of Company P

Ans: While performing NRV test, the NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (i.e. 11-1).

NRV of the remaining 40 units is ₹ 7 per unit (i.e. 8-1).

Therefore, Company P will write down those remaining 40 units by ₹ 120 (i.e. 40 x 3). Total cost of inventory would be

Goods to be sold to Company Q	60 units x ₹ 10	₹ 600
Remaining goods	40 unit x ₹ 7	₹ 280
		₹ 880

Q14: A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

	Cost	Estimated Sales price	Selling costs
Inventory item A1	8,000	7,800	500

Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150

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

Ans: The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	6,000
Value of Inventory				**43,300**

Q15:

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date.

Ans: Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead 75,000 x 10,200 15,000	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing inventory:

Finished Goods (1,200 x 20)	₹ 24,000
Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

Q16: Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

- Cost of purchases (based on vendors' invoices) 5,00,000
- Trade discounts on purchases 10,000
- Import duties 200
- Freight and insurance on purchases 250
- Other handling costs relating to imports 100
- Salaries of accounting department 15,000
- Brokerage commission payable to indenting agents for arranging imports 300
- Sales commission payable to sales agents 150
- After-sales warranty costs 600

Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Ans: Items (a), (b), (c), (d), (e), and (g) are permitted to be included in the cost of inventory since these elements contribute to cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition, as per Ind AS 2

Statement showing cost of inventory

	₹
Cost of purchases (based on vendors' invoices)	5,00,000
Trade discounts on purchases	(10,000)
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Brokerage commission payable to indenting agents for arranging imports	300
Cost of inventory under Ind AS 2	4,90,850

Note: Salaries of accounting department, sales commission, and after-sales warranty costs are not considered as part of cost of inventory under Ind AS 2.

QUESTIONS FROM OTHER SOURCE

Q17: In a production process, normal waste is 5% of input. 5,000 MT of input were put in process resulting in a wastage of 300 MT. Cost MT of input is ₹ 1,000. The entire quantity of waste is on stock at the year end. Suggest accounting treatment of abnormal Loss. **[May 2008]**

Ans: As per IND AS 2(Revised), abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 250 MT and abnormal waste is 50 MT. The cost of 250 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste will be charged in the profit and loss statement and will be calculated as under:

Particulars	Unit (MT)	Cost per MT	Total
Purchase Price	5000	1000	50,00,000
Less: Normal Loss	250	---	---
	4750	1052.632	50,00,000
Abnormal Loss	50	1052.632	52,632

Q18: An enterprise ordered 13,000 Kg. of certain material at ₹ 90 per unit. The purchase price includes GST ₹ 5 per Kg., in respect of which full CENVAT credit is admissible. Freight incurred amounted to ₹ 80,600. Normal transit loss is 4%. The enterprise actually received 12,400 Kg and consumed 10,000 Kg. Calculate the cost of inventory.

Ans: **Normal cost per Kg.**

Purchase price (13,000 Kg. x ₹ 90)	11,70,000
Less: CENVAT Credit (13,000 Kg. x ₹ 5)	65,000
	11,05,000
Add: Freight	80,600
A. Total material cost	11,85,600
B. Number units normally received = 96% of 13,000 Kg.	Kg. 12,480
C. Normal cost per Kg. (A/B)	95

Allocation of material cost

	Kg.	₹/Kg.	₹
Materials consumed	10,000	95	9,50,000
Cost of inventory	2,400	95	2,28,000
Abnormal loss	80	95	7,600
Total material cost	12,480	95	11,85,600

Q19: From the following information, calculate the historical cost of inventories using adjusted selling price method:

₹

Sales during the year	2,00,000
Cost of purchases	2,00,000
Opening stock	Nil
Closing stock at selling price	50,000

Ans: Calculation of gross margin of profit:

Sales	2,00,000
Add: Closing inventory (at selling price)	50,000
Selling price of goods available for sale:	2,50,000
Less : Cost of goods available for sale	2,00,000
Gross margin	50,000
Rate of gross margin = [50,000/2,50,000] ×100=	20%
Cost of closing stock = 50,000 less 20% of ₹ 50,000 =	₹ 40,000

Q20: On 31st March 2013 a business firm finds that cost of a partly finished unit on that date is ₹ 530. The unit can be finished in 2013-14 by an additional expenditure of ₹ 310. The finished unit can be sold for ₹ 750 subject to payment of 4% brokerage on selling price.

The firm seeks your advice regarding:-

(i) the amount at which the unfinished unit should be valued as at 31st March, 2013 for preparation of final accounts and

(ii) the desirability or otherwise of producing the finished unit.

Ans: Valuation of unfinished unit

Net selling price	750
Less: Estimated cost of completion	(310)
	440
Less: Brokerage (4% of 750)	30
Net Realisable Value	410
Cost of inventory	530
Value of inventory (Lower of cost and net realisable value)	410

Incremental cost ₹ 310 (cost to complete) is less than incremental revenue ₹ 720 (₹ 750- ₹ 30). The enterprise will therefore decide to finish the unit for sale at ₹ 750.

Note: The above answer is given on the assumption that partly finished unit cannot be sold in semi-finished form and its NRV is zero without processing it further.

Q21: A Ltd. uses a single raw material that converts that into finish product. During the current period the cost of production and sales are as follows:

Raw material 3 units at ₹ 8 each	₹ 24.00
Cost of conversion	₹ 26.00
Selling Price	₹ 75.00

On the balance sheet date there is a steep fall in the price of product to ₹ 45/- because of competition and a steep fall in material price. Currently materials can be purchased at ₹ 4 per unit. On the balance sheet date there are 1,00,000 units of raw material in stock purchased on 31.3.2004 at cost of ₹ 5 per unit. You are required to value inventory as on the balance date.

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 cost 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.

In the given case,

Cost price of finished goods in which Raw material costing ₹ 5 will be incorporated is calculated as under:

Raw material 3 units at ₹ 5 each	₹ 15.00
Cost of conversion	₹ 26.00
Cost Price of Finished product	₹ 41.00

On balance sheet date finished products are expected to be sold at ₹ 45.00 which is more than its cost price. Since, the cost of finished products is fully realizable hence no need to write down the raw material to ₹ 4 i.e., raw material will be valued at ₹ 5.

Therefore, the stock of Raw material will be valued at ₹ 5,00,000

Q22: A company has entered into a firm contract for supply of 1000 units of a certain product for ₹ 690 each. The product is being manufactured by the company in one of its factories and the cost incurred till the balance sheet date is ₹ 460 per unit. The company expects that it will have to incur another ₹ 650 per unit to complete the manufacture and a further sum of ₹ 125 per unit for delivering the product to the location of the customer. How would you value the above item for balance sheet purposes?

Ans: As per IND AS 2, on 'Valuation of inventories', inventories should be valued at lower of cost and net realizable value. In the present case, the net realizable value is a negative figure per unit (₹ 690- ₹ 650 -₹ 125). The company should make a provision for the -ve realizable value of ₹ 85,000 besides reducing the value of relevant stock to Nil. The note explaining the reasons for the -ve value as referred to earlier would also be necessary.

Q23: A raw material costing ₹ 150 has net realisable value (which can be the replacement cost) ₹ 130. The finished goods for which this raw material is used has other cost to incur ₹ 60. At what price raw material should be valued if finished goods has a net realisable value (i) ₹ 210 or above (ii) less than ₹ 190 and (iii) ₹ 200.

Ans:

(i) The raw material price has declined to ₹ 130 but the cost of finished goods ₹ 210 including raw material cost ₹ 150 is fully realizable hence no need to write down inventory to ₹ 130 i.e. raw material will be valued at ₹ 150,

(ii) If the net realizable value of finished goods say ₹ 190 or less, is less than its cost of ₹ 210 then raw material should be valued at ₹ 130.

(iii) Although wordings of IND AS 2 does not say so clearly but if finished goods can be sold at ₹ 10 less than its expected total cost, then raw material can be valued at ₹ 140 i.e. ₹ 10 less than its cost. That is, it need not be written down to ₹130. This is in view of the purpose of writing down to net realizable in IND AS 2. According to IND AS 2, the practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of the amount that can be realized from its use since it is held for the purpose of that use. Hence the entire cost of ₹ 150 is not recovered by use in finished production. Only ₹ 140 is recoverable by use in production i.e. (₹ 140+60=200). Hence, the stock of raw materials should be valued at ₹ 140.

Q24: Raw materials inventory of a company includes certain material purchased at ₹ 100 per kg. The price of the material is on decline and replacement cost of the inventory at the year end is ₹ 75 per kg. It is possible to convert the material into finished product at conversion cost of ₹ 125. Decide whether to make the product or not to make the product, if selling price is (i) ₹ 175 and (ii) ₹ 225. Also find out the value of inventory in each case.

Ans: As per IND AS 2 'Valuation of 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 realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

(i) When selling price is ₹ 175

Incremental Profit = ₹ 175 - ₹ 125 = ₹ 50

Current price of the material = ₹ 75

Therefore, it is better not to make the product. Raw material inventory would be valued at net realisable value i.e. ₹ 75 because the selling price of the finished product is less than ₹ 225 (100+125) per kg.

(ii) When selling price is ₹ 225

Incremental Profit = ₹ 225 - ₹ 125 = ₹ 100

Current price of the raw material = ₹ 75.

Therefore, it is better to make the product. Raw material inventory would be valued at ₹ 100 per kg because the selling price of the finished product is not less than ₹ 225.

Note: Abnormal losses are recognised as separate expense

Q25: The closing inventory at cost of a company amounted to ₹ 2,84,700. The following items were included at cost in the total:

(a) 400 coats, which had cost ₹ 80 each and normally sold for ₹ 150 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(b) 800 skirts, which had cost ₹ 20 each. These too were found to be defective. Remedial work in April cost ₹ 5 per skirt, and selling expenses for the batch totaled ₹ 800. They were sold for ₹ 28 each.

What should the inventory value be according to IND AS 2after considering the above items?

Ans: Valuation of Closing Stock

Particulars	**₹**	**₹**
Closing Stock at cost		2,84,700
Less :Cost of 400 coats (400 x 80)	32,000	
Less: Net Realisable Value (400 x 75) – 5%	28,500	3,500
Value of Closing Stock		2,81,200

Provision for repairing cost Of ₹ 4,000 (800 x 5) to be incurred in future should be created as per IND AS 29

Q26: Calculate the value of raw materials and closing stock based on the following information:

Raw material X

Closing balance	500 units
	₹ per unit
Cost price including GST	200
GST (Credit is receivable on the GST paid)	10
Freight inward	20
Unloading charges	10
Replacement cost	150

Finished goods Y

Closing Balance	1200 units
	₹ per unit
Material consumed	220
Direct labour	60
Direct overhead	40

Total Fixed overhead for the year was ₹ 2,00,000 on normal capacity of 20,000 units.

Calculate the value of the closing stock, when

(i) Net Realizable Value of the Finished Goods Y is ₹ 400.

(ii) Net Realizable Value of the Finished Goods Y is ₹ 300.

Ans: Working Notes:

Raw Material X	**₹**
Cost Price	200
Less: GST Credit	(10)
	190
Add: Freight Inward	20
Unloading charges	10
Cost	220
Finished goods Y	**₹**
Materials consumed	220
Direct Labour	60
Direct overhead	40
Fixed overheads (₹ 2,00,000/20,000 units)	10
Cost	330

Situation (i)

When Net Realisable Value of the Finished Goods Y is ₹ 400

NRV is greater than the cost of Finished Goods Y i.e. ₹ 330

Hence, Raw Material and Finished Goods are to be valued at cost

Value of Closing Stock:

	Qty	**Rate**	**Amount (₹)**
Raw Material X	500	220	1,10,000
Finished Goods Y	1,200	330	3,96,000
Total Cost of Closing Stock			5,06,000

Situation (ii)

When Net Realisable Value of the Finished Goods Y is ₹ 300

NRV is less than the cost of Finished Goods Y i.e. ₹ 330

Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV since NRV is less than the cost

Value of Closing Stock:

	Qty	**Rate**	**Amount (₹)**
Raw Material X	500	150	75,000
Finished Goods Y	1,200	300	3,60,000
Total Cost of Closing Stock			4,35,000

Note: It has been considered that Raw Material X is used for the production of Finished Goods Y.

Q27: Mr. Mehul gives the following information relating to items forming part of inventory as on 31-3-2015. His factory produces Product X using Raw material A.

(i) 600 units of Raw material A (purchased @ ₹ 120). Replacement cost of raw material A as on 31-3-2015 is ₹ 90 per unit.

(ii) 500 units of partly finished goods in the process of producing X and cost incurred till date ₹ 260 per unit. These units can be finished next year by incurring additional cost of ₹ 60 per unit.

(iii) 1500 units of finished Product X and total cost incurred ₹ 320 per unit.

Expected selling price of Product X is ₹ 300 per unit.

Determine how each item of inventory will be valued as on 31-3-2015. Also calculate the value of total inventory as on 31-3-2015.

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 cost 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. In the given case, selling price of product X is ₹ 300 and total cost per unit for production is ₹ 320.

Hence the valuation will be done as under:

(i) 600 units of raw material will be written down to replacement cost as market value of finished product is less than its cost, hence valued at ₹ 90 per unit.

(ii) 500 units of partly finished goods will be valued at 240 per unit i.e. lower of cost ₹ 320 (₹ 260 + additional cost ₹ 60) or Net estimated selling price ₹ 240 (Estimated selling price ₹ 300 per unit less additional cost of ₹ 60).

(iii) 1500 units of finished product X will be valued at NRV of ₹ 300 per unit since it is lower than cost ₹ 320 of product X

Valuation of Total Inventory as on 31.03.2015:

Units	Cost (₹)	NRV/Replacement Cost	Value = (cost or NRV)Lower	units x value
Raw material A	600	120	90	54,000
Partly finished goods	500	260	240	1,20,000
Finished goods X	1,500	320	300	4,50,000
Value of Inventory				6,24,000

Q28:

Particulars		Kg.	₹
Opening Stock:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Stock:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing stock as on that date.

Ans: Calculation of cost for closing stock

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead (75,000 x 10,200) / 15,000	51,000
Cost of Production	2,29,500
Cost of closing stock per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing stock will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing stock:

Finished Goods (1,200 x 20)	₹ 24,000	
Raw Materials (900 x 9.50)	₹ 8,550	₹ 32,550

QUESTIONS FROM RTP/MTP/EXAMS

Q29: 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 ₹ 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is ₹ 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to ₹ 8 million. The estimated selling expense required to make the sales would ₹ 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 ₹ 11 million and estimated selling expenses are same ₹ 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 ₹ 10 million and net realisable value would be ₹ 7.5 million (i.e. Expected selling price ₹ 8 million- estimated selling expenses ₹ 0.5 million). Accordingly, inventory shall be measured at ₹ 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹ 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 ₹ 1 million and net realisable value would be ₹ 10. 5 million (i.e. expected selling price ₹ 11 million – estimated selling expense ₹ 0.5 million). Accordingly, inventory would be recorded at ₹ 10 million and inventory write down carried out in previous year for ₹ 2.5 million shall be reversed.

Q30: On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re- packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

The accountant of Jupiter Ltd. treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

	₹ lakhs
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 ₹ 8 lakhs calculated below:

	₹' lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Q31: XYZ 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 ₹ 30,00,000, Fixed overhead, therefore based on normal capacity is ₹ 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 ₹ 30,00,000, therefore, overheads on actual basis is ₹ 4 per unit (30,00,000 / 7,50,000).

Hence, by valuing inventory at ₹ 4 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 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) ₹ 22,50,000 and balance ₹ 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 ₹ 30,00,000, therefore, overheads on actual basis is ₹ 2 (30,00,000 / 15,00,000).

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

Q32: The following is relevant information for an entity :

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

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

[RTP May 2020]

Ans: Hours taken to produce 1 unit = 6,500 hours / 6,500 units = 1 hour per unit.

Fixed production overhead absorption rate:

= Fixed production overhead / labour hours for normal capacity

= ₹ 1,500 / 7,500 = ₹ 0.2 per hour

Management should allocate fixed overhead costs to units produced at a rate of ₹ 0.2 per hour.

Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x1 hour x ₹ 0.2 = ₹ 1,300.

The remaining fixed overhead incurred during the year of ₹ 200 (₹ 1500 – ₹ 1300) that remains unallocated is recognised as an expense.

The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.

Variable production overhead absorption rate:

= Variable production overhead/actual hours for current period

= ₹ 2,600 / 6,500 hours = ₹ 0.4 per hour

Management should allocate variable overhead costs to units produced at a rate of ₹ 0.4 per hour.

The above rate results in the allocation of all variable overheads to units produced during the year.

Closing inventory = Opening inventory + Units produced during year – Units sold during year

= 2,500 + 6,500 – 6,700 = 2,300 units

As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognised as part of cost of inventory:

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (₹ 0.2 + ₹ 0.4) = ₹ 1,380

The remaining ₹ 2,720 [(₹ 1,500 + ₹ 2,600) – ₹ 1,380] is recognised as an expense in the income statement as follows:

	₹
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ₹ 0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	2,720

Q33: A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:

Material = ₹ 200 per unit;

Labour = ₹ 100 per unit;

Variable manufacturing overhead = ₹ 100 per unit;

Fixed factory production overhead =₹ 1,00,00,000;

Fixed factory selling overhead = ₹ 50,00,000;

Variable factory selling overhead = ₹ 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead? **[RTP Nov 2020]**

Ans: Calculation of Inventory value per unit as per Ind AS 2:

Particulars	***Value per unit (₹)***
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)	100
	500

Fixed overheads are absorbed based on normally capacity level, i.e.; 1 ,00,000 units, rather than on the basis of actual production, i.e.; 50,000 units. Therefore, fixed manufacturing overhead on 50,000 units, will be absorbed as inventory value. The remaining fixed manufacturing overhead ₹ 50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.

Note: Selling costs are excluded from the cost of inventories and recognised as expense in the period in which they are incurred.

Q34: On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer. Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of ₹ 3,000 recovered from the sale of the scrapped output = ₹ 21,000;
- labour = ₹ 11,000; and
- depreciation of plant used to perform the modifications = ₹ 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000;
- labour = ₹ 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

RTP May 2021

Ans: Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	–	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	–	Recognised as an expense in profit or loss
Total cost of inventories	6,82,000	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

Q35. State the major changes in Ind AS 2 vis-a-vis AS 2 in respect of the following namely:

(I) Machinery Spares

(II) Subsequent assessment of Net Realisable value

(III) Cost Formulae

MTP May 2021

Ans: The major changes in Ind AS 2 vis-à-vis AS 2 with respect to following are as follows:

(i) **Machinery Spares:** AS 2 explains that inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with AS 10. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.

(ii) **Subsequent Assessment of Net Realisable Value (NRV):** Ind AS 2 provides detailed guidance in case of subsequent assessment of net realisable value. It also deals with the reversal of the write-down of inventories to net realisable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements. AS 2 does not deal with such reversal.

(iii) **Cost Formulae:** AS 2 specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition whereas Ind AS 2 does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.

NOTES

CHAPTER 11
PROPERTY, PLANT AND EQUIPMENT (IND AS 16)

CONCEPTS BASED EXAMPLES

Example – Capitalising the cost of "Remodelling" a Supermarket

1. Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of remodelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the remodelling cost will be capitalized or not.

   The expenditure in remodelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of remodelling can be measured reliably, therefore, it should be capitalised.

Example – measurement at initial recognition

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

Particulars	**INR,000 (cost incurred)**	**INR,000** (As per Ind AS 16)
Site preparation costs	150	150
Direct Material	2,000	2,000
Direct Labour cost, including ₹ 10,000 incurred during an industrial strike	1,160	1,150
Testing of various processes in factory	200	200
Consultancy fees for installation of equipment	300	300
Relocation of staff to new factory	450	-
General overheads	550	-
Estimated Costs to dismantle (at present value)	200	200
Total Cost to be Capitalised as per Ind AS 16		4,000

Example – cost when payment is deferred

3 An entity acquired a plant for ₹ 20,00,000 on two-years' interest-free credit. An appropriate discount rate is 10 per cent per year.

The cost of the plant is ₹ 16,52,893 (ie the present value of the future payment).

Calculation: ₹ 2,000,000 future payment x $1/(1.1)^2$.

Note: The unwinding of the discount results in interest expense recognised in profit or loss respectively of ₹ 1,65,289 and ₹ 1,81,818 in the first and second 12-month period after the sale. Furthermore, two years after the sale, the liability of ₹ 20,00,000 (ie ₹ 16,52,893 + ₹ 1,65,289 + ₹ 1,81,818) is derecognised upon settlement of the debt.

Example – Cost of PPE acquired in exchange:

4. Entity A exchanges surplus land with a book value of ₹ 10,00,000 for cash of ₹ 20,00,000 and plant and machinery valued at ₹ 25,00,000. What will be the measurement cost of the assets received?

Since the transaction has commercial substance. The plant and machinery would be recorded at ₹ 25,00,000, which is equivalent to the fair value of the land of ₹ 45,00,000 less the cash received of ₹20,00,000.

5 Entity A exchanges car X with a book value of ₹ 13,00,000 and a fair value of ₹ 13,25,000 for cash of ₹ 15,000 and car Y which has a fair value of ₹ 13,10,000. The transaction lacks commercial substance as the company's cash flows are not expected to change as a result of the exchange. It is in the same position as it was before the transaction. What will be the measurement cost of the assets received?

The entity recognises the assets received at the book value of car X. Therefore, it recognises cash of ₹ 15,000 and car Y as PPE with a carrying value of ₹ 12,85,000.

Example – replacement parts

6 An entity that manufactures agricultural chemicals is required to have the protective lining of its chemical processing plant inspected for corrosion at six-month intervals. If an inspection reveals damage to the lining the entity is required to replace the lining immediately. Experience has shown that linings require replacement, on average, every four years. The entity depreciates linings on the straight line basis over their estimated four-year useful life to a nil residual value. The other parts of the plant are depreciated on the straight-line basis over their estimated 20-year useful life.

During the current reporting period an inspection revealed that a three-year-old lining with a carrying amount of ₹ 100,000(1) was damaged. The lining was immediately replaced at a cost of ₹ 420,000.

To recognise the replacement lining the entity must record ₹ 420,000 as an asset—property, plant and equipment. The new lining (asset) will be recognised as an expense (depreciation) in profit or loss evenly over its estimated four-year useful life.

During the current reporting period (ie when the old lining was removed), the entity must record an expense in profit or loss of ₹ 100,000 for the derecognition of the damaged lining.

Example – inspections that are a condition of operating an asset

7 A shipping company is required by law to bring all ships into dry dock every five years for a major inspection and overhaul. Overhaul expenditure might at first sight seem to be a repair to

the ships but it is actually a cost incurred in getting the ship back into a seaworthy condition. As such the costs must be capitalised.

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

The depreciation charge for the first five years of the assets life will be as follows:

	Overhaul component (million)	**Ship (other than overhaul component) (million)**
Cost	5	15
Years	5	20
Depreciation per year	1	0.75

Total accumulated depreciation for the first five years will be ₹ 8.75, and the carrying amount of the ship at the end of year 5 will be ₹ 11.25 million.

The actual overhaul costs incurred at the end of year 5 are ₹ 6 million. This amount will now be capitalised into the costs of the ship, to give a carrying amount of ₹ 17.25 million.

The depreciation charge for years 6 to 10 will be as follows:

	Overhaul component	**Ship (other than overhaul component)**
Cost	6	11.25
Years	5	15
Depreciation per year	1.2	0.75

Annual depreciation for years 6 to 10 will now be ₹ 1.95 million. This process will be continued for years 11 to 15 and years 16 to 20. By the end of year 20, the capital cost of ₹ 20 million will have been depreciated plus the actual overhaul costs incurred at years 5, 10 and 15.

Example - Revaluation on a class by class basis

8 Entity A is a large manufacturing group. It owns a 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. Entity A's management want to apply the revaluation model as per IND AS 16 to the subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. State whether this is acceptable under IND AS 16 or not with reasons?

Entity A's management can apply the revaluation model only to 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.

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.

Example – depreciation charge allocated to the cost of an asset

9 On 1 January 20X1 an entity acquired a machine for ₹ 1,200,000. Management estimates the machine has a 10-year useful life (measured from the date of acquisition) and a nil residual value. Furthermore, management judges that the straight-line method reflects the pattern in which the entity expects to consume the machine's future economic benefits.

In 20X1 the machine was used to produce inventory for eight months. Thereafter, the machine was used to manufacture components of a new item of plant being constructed by the entity. The new plant will be used by the entity to manufacture a new product line.

Depreciation for the year is ₹ 120,000 (calculation: ₹ 1,200,000 ÷ 10 years). In 20X1 the entity must allocate ₹ 80,000 (ie 8/12 months x ₹ 120,000) to the cost of inventories manufactured in 20X1 and ₹ 40,000 to the cost of the new plant undergoing construction (ie 4/12 months x ₹ 120,000).

Example – impairment

10 Entity A carried plant and machinery in its books at ₹ 2,00,000. These were destroyed in a fire. The assets were insured 'New for old' and were replaced by the insurance company with new machines that cost ₹ 20,00,000. The machines were acquired by the insurance company and the company did not receive the ₹ 20,00,000 as cash compensation. State, how Entity A should account for the same?

Entity A should account for a loss in the Statement of Profit and Loss on de-recognition of the carrying value of plant and machinery in accordance with IND AS 16.

Entity A should separately recognise a receivable and a gain in the income statement resulting from the insurance proceeds once receipt is virtually certain. The receivable should be measured at the fair value of assets that will be provided by the insurer.

11 On 1 November 20X5 an entity sold an owner-occupied building with a carrying amount of ₹ 20,00,000 for ₹ 35,00,000. The estate agent retained 10 per cent of the proceeds from the sale as a selling commission. Legal fees in respect of the sale were ₹10,000.

On 1 November 20X5 the entity must recognise a gain on the disposal of the building of ₹ 11,40,000 in profit or loss.

Calculation:

Selling price	₹ 35,00,000
Less Agent's commission	₹ 3,50,000
Less Legal fees	₹ 10,000
Net disposal proceeds.	₹ 31,40,000

Less Carrying amount	₹ 20,00,000
Gain on disposal of building	₹ 11,40,000

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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 ₹ 5,00,000 to install machinery in the new location.
2. Rent of ₹ 15,00,000
3. Removal costs of ₹ 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.

Q2: 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.

Q3: 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.

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.

Q4: MS Ltd. has acquired a heavy machinery at a cost of ₹ 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 ₹ 45,00,000. The discount rate is assumed to be 5%.

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 — ₹ 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, ₹ 45,00,000 discounted back six years amounts to ₹ 33,57,900 [₹ 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 ₹ 13,43,160 would be derecognised from the books of account, (i.e., Original Cost ₹ 33,57,900 as reduced by accumulated depreciation for past 6 years ₹ 20,14,740, assuming depreciation is charged on straight-line basis.)

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

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

Q5: On 1st April 20X1, an item of property is offered for sale at ₹ 10 million, with payment terms being three equal installments of ₹ 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. ₹0.5 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:

	(INR)	(INR)
On 1st April 20X1		
Property, Plant and Equipment Dr.	95,00,000	
To Cash		33,33,333
To Accounts Payable		61,66,667
(Initial recognition of property)		
On 31st March 20X2		
Interest Expense Dr.	3,30,533	
Accounts payable Dr.	30,02,800	
To Cash		33,33,333
(Recognition of interest expense and payment of second installment)		
On 31st March 20X3		
Interest Expense Dr.	1,69,467	
Accounts payable Dr.	31,63,867	
To Cash		33,33,334
(Recognition of interest expense and payment of final installment)		

Q6: Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of ₹ 10 million. The fair value of such asset is ₹ 15 million. It exchanges the land and building for a private jet, which has a fair value of ₹ 18 million, and pays additional ₹ 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 ₹ 18 million (its fair value) and should recognise a profit on disposal of the land and building of ₹ 5 million, calculated as follow:

		(₹ 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

Q7: Jupiter Ltd. has an item of plant with an initial cost of ₹ 100,000. At the date of revaluation accumulated depreciation amounted to ₹ 55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000. Find out the entries to be passed for revelation of PPE?

Ans: Method – I:

Accumulated depreciation	Dr.	55,000	
To Asset -Cost			55,000
Asset - Cost	Dr.	20,000	
To Revaluation reserve			20,000

The net result is that the asset has a carrying amount of ₹ 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

Q8: 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.

Q9: An item of PPE was purchased for ₹ 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 ₹ 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

In the profit or loss for 20X3-20X4, a depreciation expense of ₹ 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

Q10: An asset which cost ₹ 10,000 was estimated to have a useful life of 10 years and residual value ₹ 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

Q11: An entity acquired an asset 3 years ago at a cost of ₹ 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	₹ 500,000

Year 2	₹ 450,000
Year 3	₹ 405,000
Year 4 to Year 11 (36,45,000 /8)	₹ 455,625 p.a.

Note: In the given question reassessment is the done at the end of year 3 for the remaining useful life, hence depreciation is reassessed from 4th year.

Q12: On 1 January 20X1 an entity acquired an item of machinery for ₹ 500,000. Management estimated the useful life of the machine as 20 years and its residual value as nil. Furthermore, management believed that the straight-line method reflects the pattern in which it expects to consume the machine's future economic benefits.

At the entity's 31 December 20X5 financial year-end management's assessments of the machine changed. It now estimates the useful life of the machine as 25 years (measured from the date of acquisition) and its residual value as ₹ 100,000.

Management continues to believe that the straight-line method reflects the pattern in which it expects to consume the machine's future economic benefits.

How must the entity account for the revised assessment of the machine in the year ended 31 December 20X5?

Ans:

Debit Profit or loss (depreciation expense)	₹ 14,286
Credit Accumulated depreciation	₹ 14,286

To record depreciation expense for the year ended 31 December 20X5.

(a) Original annual depreciation = ₹ 500,000 ÷ 20 years = ₹ 25,000

(b) Carrying amount at 1 January 20X5 (ie 31 December 20X4) = ₹500,000 cost less (4 years × ₹ 25,000 annual depreciation) = ₹ 400,000

(c) depreciation expense for the year ended 31 December 20X5 = (₹ 400,000 less ₹ 100,000 residual value) ÷ 21 years' remaining useful life at the beginning of the current reporting period = ₹14,286

Q13: A property costing ₹ 10,00,000 is bought in 2016. Its estimated total physical life is 50 years. However, the company considers it likely that it will sell the property after 20 years.

The estimated residual value in 20 years' time, based on 2016 prices, is:

Case (a) ₹ 10,00,000

Case (b) ₹ 9,00,000.

Calculate the amount of depreciation.

Ans: Case (a)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will equal the cost.

There is, therefore, no depreciable amount and depreciation is correctly zero.

Case (b)

The company considers that the residual value, based on prices prevailing at the balance sheet date, will be ₹ 9,00,000 and the depreciable amount is, therefore, ₹ 1,00,000.

Annual depreciation (on a straight line basis) will be ₹ 5,000 [{10,00,000 – 9,00,000} ÷ 20].

Q14: On 1 January 20X1 an entity acquired a machine for ₹ 500,000. Management estimated the machine's residual value as nil. Furthermore, management believed that the diminishing balance method computed at the rate of 8 per cent per year reflects the pattern in which the entity expects to consume the machine's future economic benefits.

At the entity's 31 December 20X5 financial year-end its assessment of the machine changed. Management now estimates that the straight-line method of depreciation, at the rate of 6 per cent per year, better reflects the pattern in which the entity expects to consume the machine's remaining future economic benefits.

How must the entity account for the revised assessment of its machine for the year ended 31 December 20X5?

Ans: Debit Profit or loss (depreciation expense) ₹ 21,492

Credit Accumulated depreciation ₹ 21,492

To record depreciation expense for the year ended 31 December 20X5.

(a) Carrying amount at31/12/20X1 = ₹ 500,000 cost x 92% (ie 8% depreciation per year) = ₹ 460,000

Carrying amount at 31/12/20X2 = ₹ 460,000 x 92% = ₹ 423,200.

carrying amount at 31/12/20X3 = ₹ 423,200 x 92% = ₹ 389,344.

Carrying amount at 31/12/20X4. = ₹ 389,344 x 92% = ₹ 358,196

(a) depreciation expense for the year ended 31 December 20X5

= ₹ 358,196x 6% = ₹ 21,492

Q15: On April 1, 20X1, XYZ Ltd. acquired a machine under the following terms:

	₹
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:

	₹
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 ₹ 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 ₹ 3,60,000 (₹ 72,00,000 x 5%) is to be shown as other income in the profit or loss.

Q16: 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 ₹ 25,00,000 on building the wall and present value of estimated cost to dismantle the wall is ₹ 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., ₹ 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).

Q17: X Limited started construction on a building for its own use on April 1, 20X0. The following costs are incurred:

	₹
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 ₹ 1,00,000 had been spoiled and therefore wasted and a further ₹ 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 ₹ 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 ₹ 40,00,000 on April 1, 20X0 for construction of the building. 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.

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	Nil
Total to be capitalized	45,78,000

*Period for Construction of building is not a substantial period (i.e. 9 months), borrowing cost are not eligible for capitalisation.

Q18: XYZ Ltd. purchased an asset on January 1, 20X0, for ₹ 1,00,000 and the asset had an estimated useful life of ten years and a residual value of ₹ nil. The company has charged depreciation using the straight-line method at ₹ 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 1, 20X4, when the asset's net book value is ₹ 60,000. The company should amend the annual provision for depreciation to charge the unamortised cost (namely, ₹ 60,000) over the revised remaining life of four years. Consequently, it should charge depreciation for the next four years at ₹ 15,000 per annum.

Q19: On 1 April 20X1, Sun ltd purchased some land for ₹ 10 million (including legal costs of ₹ 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 – ₹ 3,00,000.
- Purchase of materials for the construction – ₹ 6·08 million in total.
- Employment costs of the construction workers – ₹ 2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – ₹ 1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹ 50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period – ₹ 50,000.
- Costs of relocating employees to work at the new factory – ₹ 300,000.
- Costs of the opening ceremony on 31 January 20X1 – ₹ 150,000.

The factory was completed on 30 November 20X1 (which is considered as substantial period of time as per Ind AS 23) 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 ₹ 20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of ₹ 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 ₹ 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 ₹ 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**

Description	Included in P.P.E. ₹'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	612.50	Capitalise the interest cost incurred in a seven-month period (purchase of land would not trigger off capitalisation since land is not a qualifying asset. Infact, the construction started from 1st May, 2011)
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	19,912.50	
Computation of accumulated depreciation		
Total depreciable amount	9,912.50	All of the net finance cost of 512.50 (612.50 – 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:	49.56	9,912.50 x 30% x 1/20 x 4/12
Depreciation of roof component	57.82	9,912.50 x 70% x 1/40 x 4/12
Total depreciation	107.38	
Computation of carrying amount	19,805.12	19,912.50 – 107.38

Q20: 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)	₹25,00,000
2.	Initial delivery and handling costs	₹2,00,000
3.	Cost of site preparation	₹6,00,000

4.	Consultants used for advice on the acquisition of the plant	₹7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	₹2,00,000
6.	Estimated dismantling costs to be incurred after 7 years	₹3,00,000
7.	Operating losses before commercial production	₹4,00,000

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

1.	Cost of the plant	₹ 25,00,000
2.	Initial delivery and handling costs	₹ 2,00,000
3.	Cost of site preparation	₹ 6,00,000
4.	Consultants' fees	₹ 7,00,000
5.	Estimated dismantling costs to be incurred after 7 years	₹ 3,00,000
		₹ 43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹ 2,00,000 and operating losses before commercial production amounting to ₹ 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.

Q21: B Ltd. owns an asset with an original cost of ₹ 2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹ 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 ₹ 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 ₹ 56,000 at the end of year 8 [₹ 2,00,000 – ₹ 1,44,000] i.e. Accumulated Depreciation.

Accumulated depreciation is calculated as

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

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

Accumulated depreciation = 18,000 × No. of years (8) = ₹ 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 ₹ 46,000. (56,000 – 10,000)

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

Q22: X Ltd. has a machine which got damaged due to fire as on January 31, 20X1. The carrying amount of machine was ₹ 1,00,000 on that date. X Ltd. sold the damaged asset as scrap for ₹ 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 ₹ 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:

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 ₹ 90,000. (i.e., carrying amount of ₹ 1,00,000 – realised amount of ₹ 10,000)

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

Q23: 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 ₹ 1,20,000 which included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on March 31. On March, 2027 value of the decommissioning liability has decreased by ₹ 8,000. The discount rate has not yet changed.

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

Ans: On March 31, 2027, the plant is 10 years old. Accumulated depreciation is ₹ 30,000 (₹ 120,000 × 10/years). Because of the unwinding of discount (5 per cent) over the 10 years, the decommissioning liability has increased from ₹ 10,000 to ₹ 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 ₹ 8,000. Accordingly, the entity adjusts the decommissioning liability from ₹ 16,300 to ₹ 8,300. On this date, the entity makes the following journal entry to reflect the change:

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

Following this adjustment, the carrying amount of the asset is ₹ 82,000 (₹ 1,20,000 – ₹ 8,000 – ₹ 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 ₹ 2,733 (₹ 82,000 ÷ 30). The next year's finance cost for the unwinding of the discount will be ₹ 415 (₹ Ccs\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.

Q24: 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 ₹ 1,20,000.; This included an amount for decommissioning costs of ₹ 10,000, which represented ₹ 70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on March 31. Assume that a market-based discounted cash flow valuation of ₹ 1,15,000 is obtained at March 31, 20X4. This valuation is after deduction of an allowance of ₹ 11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On March 31, 20X5, the entity estimates that, as a result of technological advances, the present value of the decommissioning liability has decreased by ₹ 5,000. The entity decides that a full valuation of the asset is needed at March 31, 20X5, in order to ensure that the carrying amount does not differ materially from fair value. The asset is now valued at ₹ 1,07,000, which is net of an allowance for the reduced decommissioning obligation.

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

Ans: At March 31, 20X4:

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

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

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

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

		₹	₹
Decommissioning liability	Dr.	5,000	

To Revaluation surplus			5,000

As at March 31, 20X5, the entity revalued its asset at ₹ 1,07,000, which is net of an allowance of ₹ 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 ₹ 1,14,200. The following additional journal entry is needed:

Notes:

		₹	₹
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 ₹ 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) ₹ 1,26,600, less cumulative depreciation ₹ 3,420, less new valuation (before allowance for decommissioning costs) ₹ 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) ₹ 10,600 at March 31, 20X4, plus depreciation expense of ₹ 3,420 and discount expense of ₹ 600 = ₹ 14,620.

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

Q25: A Ltd. has an item of property, plant and equipment with an initial cost of ₹ 1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹ 55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹ 65,000.

Pass Journal Entries with regard to Revaluation?

Ans: The entries to be passed would be:

		₹	₹
Accumulated depreciation	Dr.	55,000	
To Asset A/c			55,000
(Being elimination of accumulated depreciation against the cost of the asset)			
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 ₹ 65,000 [1,00,000 – 55,000 + 20,000.]

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q26: H Limited purchased an item of PPE costing ₹ 100 million which has useful life of 10 years. The entity has a contractual decommissioning and site restoration obligation, estimated at ₹ 5 million to be incurred at the end of 10th year. The current market based discount rate is 8%.

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

Determine the carrying value of an item of PPE and decommissioning liability at each year end when

a) There is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate

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

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

Ans: The present value of such decommissioning and site restoration obligation at the end of 10th year is ₹ 2.32 million [being 5 / (1.08)10]. H Limited will recognise the present value of decommissioning liability of ₹ 2.32 million as an addition to cost of PPE and will also recognize a corresponding decommissioning liability. Further, the entity will recognise the unwinding of discount as finance charge.

a) The following table shows the relevant computations, if there is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate:

Year	Opening Amount of PPE	Depreciation Charge (on SLM) for 10 Years	Carrying Amount of PPE at the end of the year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
1	102.32	10.23	92.08	2.32	0.19	2.50
2	92.08	10.23	81.85	2.50	0.20	2.70
3	81.85	10.23	71.62	2.70	0.22	2.92
4	71.62	10.23	61.39	2.92	0.23	3.15
5	61.39	10.23	51.16	3.15	0.25	3.40
6	51.16	10.23	40.93	3.40	0.27	3.68
7	40.93	10.23	30.69	3.68	0.29	3.97
8	30.69	10.23	20.46	3.97	0.32	4.29
9	20.46	10.23	10.23	4.29	0.34	4.63
10	10.23	10.23	-	4.63	0.37	5.00
Total		**102.32**			**2.68**	

b) The changes to the estimate of expected decommissioning obligation:

- The present value of the decommissioning liability at the end of Year 4 works out to be ₹ 5.04 million [being 8 / (1.08)6].
- As against this, the carrying amount of decommissioning liability at the end of Year 4 is ₹ 3.15 million (as computed above).
- The changes in the decommissioning liability of ₹ 1.89 million (being ₹ 5.04 million less ₹ 3.15 million) shall be added to the cost of the asset in the current period and the related provision for decommissioning liability is also adjusted.
- The journal entry will be:

  PPE Dr. ₹ 1.89 million

  To Provision for decommissioning liability ₹ 1.89 million

The following table shows the calculations for years 5 - 10:

Year	Opening Amount of PPE	Depreciation Charge SLM – 10 Years	Carrying Amount of PPE at end of the year	Opening Decommissioning Liability	Unwinding of Interest @8%	Closing Decommissioning Liability
5	63.28	10.55	52.73	5.04	0.40	5.44
6	52.73	10.55	42.19	5.44	0.44	5.88
7	42.19	10.55	31.64	5.88	0.47	6.35
8	31.64	10.55	21.09	6.35	0.51	6.86

9	21.09	10.55	10.55	6.86	0.55	7.41
10	10.55	10.55	-	7.41	0.59	8.00
Total		**63.28**			**2.96**	

Note that in the above table:

- Opening amount of PPE at the beginning of Year 5 is computed as ₹ 63.28 million (being carrying amount of ₹ 61.39 million at the end of Year 4 plus increase of ₹ 1.89 million arising due to increase in the present value of the decommissioning liability at the end of Year 4).
- The revised carrying amount of PPE (at ₹ 63.28 million) at the beginning of Year 5 will be depreciated over the balance 6 years of the useful life).
- Opening decommissioning liability at the beginning of Year 5 is computed as ₹ 5.04 million (being carrying amount of ₹ 3.15 million at the end of Year 4 plus increase of ₹ 1.89 million).
- Since the entity has adjusted the increase in the decommissioning liability against the carrying amount of PPE, it needs to evaluate whether the new carrying amount (in this case, ₹ 63.28 million) is recoverable. If not, it will give rise to impairment loss, to be accounted for under Ind AS 36.

Q27: 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 Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:-

The notes to the financial statements state 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. How should the finance controller respond to the query from the managing director?

Ans: Ongoing through the query raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

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.

QUESTIONS FROM OTHER SOURCE

Q28: J Ltd. purchased machinery from K Ltd. on 30.09.2005. The price was ₹ 370.44 lakhs after charging 8% GST and giving a trade discount of 2% on the quoted price. Transport charges were 0.25% on the quoted price and installation charges come to 1% on the quoted price.

A loan of ₹ 300 lakhs was taken from the bank on which interest at 15% per annum was to be paid. Expenditure incurred on the trial run was Materials ₹ 35,000, Wages ₹ 25,000 and Overheads ₹ 15,000. Machinery was ready for use on 1.12.2005. However, it was actually put to use only on 1.5.2006.

Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 1.12.2005to 1.5.2006. The entire loan amount remained unpaid on 1.5.2006.

Ans:

		(₹ in Lakhs)
Quoted price (refer to working note)		350.00
Less: 2% Trade Discount		7.00
		343.00
Add: 8% GST (8% × ₹ 343 lakhs)		27.44
		370.44
Transport charges (0.25% × ₹ 350 lakhs) (approx.)		0.88
Installation charges (1% × ₹ 350 lakhs)		3.50
Financing cost (15% on ₹300 Lakhs) for the period 30.9.2005 to 1.12.2005		7.50
Trial Run Expenses		
Material	0.35	
Wages	0.25	

Overheads	0.15	0.75
Total cost		383.07

Interest on loan for the period 1.12.2005 to 1.05.2006 is ₹ 300 lakhs X 15% X 5/12= ₹18.75 lakhs

This expenditure will be charged to Profit and Loss Account It has been assumed that no other expenses are incurred on the machine during this period.

Working Note:

Let the quoted price 'X'

Less: Trade Discount 0.02X.

Actual Price = 0.98X.

GST @8% = 1.08 × 0.98X; X= ₹ 350 lakhs

Q29: Value Ltd. acquired a plant on 1.4.2004 for ₹ 100 lakhs. The company charges straight line depreciation on the basis of estimated useful life of the asset as 10 years and scrap value at the end as 2.5% of the cost. At the beginning of the 5th year, the asset was revalued upward by 40% of the written down value and the revaluation profit was transferred to Revaluation Reserve. While charging depreciation after revaluation, estimated remaining useful life was assumed to be 6 years and scrap realisation was expected to be 2.5% of the revalued figure. No additional depreciation was adjusted from Revaluation Reserve account to retained earning. At the beginning of the 8th year the company found the asset useless and accordingly, decided to retire it. On the date of retirement the estimated fair value less cost to sell of the asset is ₹ 3,80,000. Ascertain the loss on retirement of the asset to be charged to the Statement of Profit and Loss.

Ans: **Table showing computation of net loss on retirement of a revalued asset of Value Ltd.**

Particulars	₹
Original cost	1,00,00,000
Less: SLM depreciation up to 4th year [{1,00,00,000 - 2,50,000}/ 10] x 4	(39,00,000)
Net book value at the end of 4th year or at the beginning of 5th year	61,00,000
Add: Revaluation profit (credited to Revaluation Reserve)	24,40,000
Revised carrying amount	85,40,000
Revised residual value (2.5% of 85,40,000) =	₹ 2,13,500
Less: Depreciation for 5th, 6th and 7th years	
[{85,40,000-2,13,500}/6 years] x 3 years	(41,63,250)
Net book value at the end of 7th year or at the beginning of 8th year	43,76,750
Net realizable value on date of retirement	(3,80,000)
Loss on retirement of plant Charged to statement of profit and loss	39,96,750

Q30: Amna Ltd. contracted with a supplier to purchase a specific machinery to be installed in Department A in two months time. Special foundations were required for the plant, which were to be prepared within this supply lead time. The cost of site preparation and laying foundations were ₹ 47,290. These activities were supervised by a technician during the entire period, who is

employed for this purpose of ₹ 15,000 per month. The Technician's services were given to Department A by Department B, which billed the services at ₹ 16,500 per month after adding 10% profit margin.

The machine was purchased at ₹ 52,78,000. Sales Tax was charged at 4% on the invoice ₹ 18,590 transportation charges were incurred to bring the machine to the factory. An Architect was engaged at a fee of ₹ 10,000 to supervise machinery installation at the factory premises. Also, payment under the invoice was due in 3 months. However, the Company made the payment in 2nd month. The company operates on Bank Overdraft@ 11%.

Ascertain the amount at which the asset should be capitalized under IND AS 16.

Ans: Calculation of Cost of Fixed Asset (i.e. Machine)

Particulars		₹
Purchase Price	Given	52,78,000
Add: Sales Tax at 4%	₹ 52,78,000 x 4%	2,11,120
Site Preparation Cost	Given	47,290
Technician's Salary	Specific/Attributable overheads	
	for 2 months (See Note)	30,000
Initial Delivery Cost	Transportation	18,590
Professional Fees for Installation	Architect's Fees	10,000
Total Cost of Asset		55,95,000

Note:

(i) Interest on Bank Overdraft for earlier payment of invoice is not relevant under AS 10. It may be noted that overdraft facility is generally used for working capital purpose.

(ii) Internally booked profits should be eliminated in arriving at the cost of Fixed Assets.

(iii) In the absence of information about excise, CENVAT credit has been ignored.

(iv) It has been assumed that the purchase price of ₹ 52,78,000 excludes amount of sales tax.

Q31: M/s. Versatile Limited purchased machinery for 4,80,000 (inclusive of GST of 40,000). Iput credit is available for 50% of the GST paid. The company incurred the following other expenses for installation.

	₹
Cost of preparation of site for installation	21,000
Total labour charges	66,000
(200 out of the total of 600 men hours worked, were spent for installation of the machinery)	
Spare parts and tools consumed in installation	6,000
Total salary of supervisor	24,000
(time spent for installation was 25% of the total time worked.)	

Total administrative expenses	32,000
(1/10 relates to the plant installation)	
Test run and experimental production expenses	23,000
Consultancy changes to architect for plant set up	9,000
Depreciation on assets used for the installation	12,000

The machine was ready for use on 15-1-2015 but was used from 1-2-2015. Due to this delay further expenses of ₹ 19,000 were incurred. Calculate the value at which the plant should be capitalized in the books of M/s. Versatile Limited.

Ans: **Calculation of Cost of Fixed Asset (i.e. Machine)**

Particulars		₹
Purchase Price	Given	4,80,000
Add:		
Site Preparation Cost	Given	21,000
Labour charges	(66,000/600x200)	22,000
Spare parts	Given	6,000
Supervisor's Salary	25% of ₹ 24,000	6,000
Administrative costs	1/10 of ₹ 32,000	3,200
Test run and experimental production charges	Given	23,000
Architect Fees for set up	Given	9,000
Depreciation on assets used for installation	Given	12,000
Total Cost of Asset		5,82,200
Less: GST credit receivable	50% of ₹ 40,000	20,000
		5,62,200

Note: Expenses of ₹ 19,000 from 15.1.2015 to 1.2.2015 to be charged to profit and loss A/c as plant were ready for production on 15.1.2015.

Q32: Comptech Ltd. having office at Chennai, acquired a sophisticated three dimensional (3D) computer printer having all-inclusive MRP (Maximum Retail Price) of ₹ 50 lakhs from a supplier located at New Delhi. The terms of the purchase were as under:

(i) The supplier would buy back the existing unit with Comptech that has carrying amount of ₹ 10.20 lakhs. Prevailing GST rate is 2%.

(ii) The supplier would give a special discount of 10% on MRP to Comptech considering their long standing relationship.

(iii) A cash payment of ₹ 38.25 lakhs would be made by Comptech Ltd. to the supplier.

(iv) Accessories required to operate the machine costing ₹ 7.60 lakhs (inclusive of all taxes) will be purchased by Comptech.

(v) The supplier will deliver free of cost certain heavy duty cables etc. having MRP of ₹ 5.75 lakhs, that are required to run the machine.

(vi) Transit insurance cost will be borne by Comptech @ 2% of MRP.

(vii) Freight and other incidentals amounting to ₹ 2.30 lakhs is borne by Comptech.

You are required to arrive at the cost of the new asset and show the profit/(loss) incurred by Comptech on the buyback arrangement and also draft the Journal Entries to record the above transaction.

Ans: As per IND AS 16 'Accounting for Fixed Assets', when a fixed asset is acquired in part exchange for another asset, the cost of the asset acquired should be recorded either at fair market value or at the net book value of the asset given up, adjusted for any balancing payment. In the given question the FMV of the new machine is its MRP net of special concession given to the buyer.

1.	**Calculation of Cost of New Asset**				**₹ in lakhs**
	MRP of Printer				50
	Less: Special Discount 10% of MRP				5
					45
	Add: Accessories				7.6
	Add: Transit Insurance Cost (2% of 50 lakh)				1
	Add: Freight and other incidental amount				2.30
					55.9
2.	**Calculation of Profit /Loss incurred on buy-back arrangement**				**₹ in lakhs**
	Discounted price of new machine				45.00
	Less: Cash portion thereof				38.25
	FMV of old machine				6.75*
	Less: Book Value thereof				10.20
	Loss on Buy back				3.45
	*This includes GST of 2%. Thus the GST will be 6.75 x 2/102 = 0.13 lakh				
3.		**Journal Entries**			
	1.	3D Computer Printer A/c	Dr.	49.15	
		To Cash A/c			49.15
		(Being the expenses incurred for purchase of 3D computer – cash payment 38.25 + accessory 7.6 + insurance 1 and freight 2.3)			
	2.	3D Computer Printer A/c	Dr.	6.75	
		Loss on buy back of old machine A/c	Dr.	3.45	
		To Old Machine A/c			10.20
		(Being the transfer of FMV of ₹ 6.75 lakhs of old machine to new printer under buy-back scheme and recognition of loss on buy back)			
		Note: It is assumed that the cash payment of ₹ 38.25 lakhs is the full and final payment to the supplier for the printer.			

QUESTIONS FROM RTP/MTP/EXAMS

Q33: A Ltd. purchased some Property, Plant and Equipment on 1st April, 20X1, and estimated their useful lives for the purpose of financial statements prepared on the basis of Ind AS: Following

were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 20X1:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	₹ 15,000,000	15 years
Plant and machinery	₹ 10,000,000	10 years
Furniture and fixtures	₹ 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	₹ 1,50,00,000/15 =	₹ 10,00,000
Plant and machinery	₹ 1,00,00,000/10 =	₹ 10,00,000
Furniture and fixtures	₹ 35,00,000/7 =	₹ 5,00,000
Total =		₹ 25,00,000 (A)

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

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

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

= ₹ 26,00,000 – ₹ 25,00,000 = ₹ 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. Accordingly, from 20X4-20X5 onward, excess of ₹ 1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

Q34: On 1st October, 2017, A Ltd. completed the construction of a power generating facility. The total construction cost was ₹ 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 ₹ 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 ₹ 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 ₹ 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).

Q35: 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. 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; Exam Nov 2019]**

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.

Presentation

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

Q36: 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	₹ 200
Accumulated depreciation (straight-line method)	₹ 80
Net carrying amount	₹ 120
Fair value	₹ 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	₹ 250	[(200/120) x 150]
Net carrying amount	₹150	
Accumulated depreciation	₹ 100	(₹ 250 – ₹ 150)

Journal entry

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

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 ₹150 to reflect the fair value and Accumulated depreciation is set at zero.

Journal entry

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

Depreciation

Option (a) –Since the Gross Block has been restated, the depreciation charge will be ₹ 25 per annum (₹ 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 ₹ 25 per annum as per Option A (₹ 150 / 6 years).

Q37: Flywing Airways Ltd is a company which manufactures aircraft parts and engines and sells them to large multinational companies like Boeing and Airbus Industries.

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

Costs relating to the production line are as follows:

Details	**Amount ₹'000**
Costs of the basic materials (list price ₹12.5 million less a 20% trade discount)	10,000
Recoverable goods and services taxes incurred not included in the purchase cost	1,000
Employment costs of the construction staff for the three months to 30 June 20X1	1,200
Other overheads directly related to the construction	900
Payments to external advisors relating to the construction	500
Expected dismantling and restoration costs	2,000

Additional Information

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

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

The production line is expected to have a useful economic life of eight years. At the end of that time Flywing Airways Ltd is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The amount of ₹2 million mentioned above is the amount that is expected to be incurred at the end of the useful life of the production line.

The appropriate rate to use in any discounting calculations is 5%. The present value of Re.1 payable in eight years at a discount rate of 5% is approximately Re.0·68.

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

The Company computes its depreciation charge on a monthly basis. No impairment of the plant had occurred by 31 March 20X2.

Analyze the accounting implications of costs related to production line to be recognized in the balance sheet and profit and loss for the year ended 31 March, 20X2. **[MTP May 2020]**

Ans: Statement showing Cost of production line:

Particulars	Amount ₹'000
Purchase cost	10,000
Goods and services tax – recoverable goods and services tax not included	- 800
Employment costs during the period of getting the production line ready for use (1,200 x 2 months / 3 months)	600
Other overheads – abnormal costs	500
Payment to external advisors – directly attributable cost	1,360
Dismantling costs – recognized at present value where an obligation exists (2,000 x 0.68)	
Total	13,260

Carrying value of production line as on 31st March, 20X2:

Particulars	Amount ₹ '000
Cost of Production line	13,260
Less: Depreciation (W.N.1)	(1,694)
Net carrying value carried to Balance Sheet	11,566

Provision for dismantling cost:

Particulars	Amount ₹ '000
Non-current liabilities	1,360
Add: Finance cost (WN3)	57
Net book value carried to Balance Sheet	1,417

Extract of Statement of Profit & Loss

Particulars	Amount ₹ '000

Depreciation (W.N.1) Finance cost (W.N.2)	1,694 57
Amounts carried to Statement of Profit & Loss	1,751

Extract of Balance Sheet

Particulars	Amount ₹ '000
Assets Non-current assets	
Property, plant and equipment	11,566
Equity and liabilities	
Non-current liabilities	
Other liabilities	
Provision for dismantling cost	1417

1. **Calculation of depreciation charge**

Particulars	Amount ₹ '000
In accordance with Ind AS 16 the asset is split into two depreciable components: Out of the total capitalization amount of 13,260, Depreciation for 3,000 with a useful economic life (UEL) of four years (3,000x ¼ x10/12). This is related to a major overhaul to ensure that it generates economic benefits for the second half of its useful life	625
For balance amount, depreciation for 10,260 with an useful economic life (UEL) of eight years will be : 10,260 x 1/8 x 10/12	1,069
Total (To Statement of Profit & Loss for the year ended 31st March 20X2)	1,694

2. **Finance costs**

Particulars	Amount ₹ '000
Unwinding of discount (Statement of Profit and Loss – finance cost) 1,360 x 5% x 10/12	57
To Statement of Profit & Loss for the year ended 31st March 20X2	57

Q38: Entity X has a warehouse which is closer to factory of Entity Y and vice versa. The factories are located in the same vicinity. Entity X and Entity Y agree to exchange their warehouses. The carrying value of warehouse of Entity X is ₹ 1,00,000 and its fair value is ₹ 1,25,000. It exchanges its warehouse with that of Entity Y, the fair value of which is ₹ 1,20,000. It also receives cash amounting to ₹ 5,000. How should Entity X account for the exchange of warehouses? **[RTP Nov 2020]**

Ans: Paragraph 24 of Ind AS 16, inter alia, provides that when an item of property, plant and equipment is acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Further as per paragraph 25 of Ind AS 16, an entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

In the given case, the transaction lacks commercial substance as the company's cash flows are not expected to significantly change as a result of the exchange because the factories are located in the same vicinity i.e. it is in the same position as it was before the transaction. Hence, Entity X will have to recognise the assets received at the carrying amount of asset given up, i.e., ₹ 1,00,000 being carrying amount of existing warehouse of Entity X and ₹ 5,000 received will be deducted from the cost of property, plant and equipment.

Therefore, the warehouse of Entity Y is recognised as property, plant and equipment with a carrying value of ₹ 95,000 in the books of Entity X.

Q39: An entity has the following items of property, plant and equipment:

- **Property A** — a vacant plot of land on which it intends to construct its new administration headquarters;
- **Property B** — a plot of land that it operates as a landfill site;
- **Property C** — a plot of land on which its existing administration headquarters are built;
- **Property D** — a plot of land on which its direct sales office is built;
- **Properties E1–E10** — ten separate retail outlets and the land on which they are built;
- **Equipment A** — computer systems at its headquarters and direct sales office that are integrated with the point of sale computer systems in the retail outlets;
- **Equipment B** — point of sale computer systems in each of its retail outlets;
- Furniture and fittings in its administrative headquarters and its sales office;
- Shop fixtures and fittings in its retail outlets.

How many classes of property, plant and equipment must the entity disclose? **[RTP May 2021]**

Ans: To answer this question one must make a materiality judgement.

class of assets is defined as a grouping of assets of a similar nature and use in an entity's operations.

The nature of land without a building is different to the nature of land with a building. Consequently, land without a building is a separate class of asset from land and buildings. Furthermore, the nature and use of land operated as a landfill site is different from vacant land. Hence, the entity should disclose Property A separately. The entity must apply judgement to determine whether the entity's retail outlets are sufficiently different in nature and use from its office buildings, and thus constitute a separate class of land and buildings.

The computer equipment is integrated across the organisation and would probably be classified as a single separate class of asset.

Furniture and fittings used for administrative purposes could be sufficiently different to shop fixtures and fittings in retail outlets. Hence, they should be classified in two separate classes of assets.

Q40: On 1st April 2019, an entity purchased an office block (building) for ₹ 50,00,000 and paid a non-refundable property transfer tax and direct legal cost of ₹ 2,50,000 and ₹ 50,000 respectively while acquiring the building.

During 2019, the entity redeveloped the building into two -story building. Expenditures on re-development were:

- ₹ 1,00,000 Building plan approval;
- ₹ 10,00,000 construction costs (including ₹ 60,000 refundable purchase taxes); and
- ₹ 40,000 due to abnormal wastage of material and labour.

When the re-development of the building was completed on 1st October 2019, the entity rents out Ground Floor of the building to its subsidiary under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its products. The entity kept first floor for its own administration and maintenance staff usage. Equal value can be attributed to each floor.

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

Also, discuss how the above building will be shown in Consolidated financial statement of the entity as a group and in its separate financial statements as per relevant Ind AS]

Exam Paper January 2021 (5 Marks)

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 building would be:

Particulars	Amount (₹)

Purchase amount	50,00,000
Non-refundable property tax	2,50,000
Direct legal cost	50,000
	53,00,000
Expenditures on redevelopment:	
Building plan approval	1,00,000
Construction costs (10,00,000 – 60,000)	9,40,000
Total amount to be capitalised at 1st October 2019	63,40,000

Treatment of abnormal wastage of material and labour:

As per Ind AS 16, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. It will be charged to Profit and Loss in the year it is incurred. Hence, abnorm al wastage of ₹ 40,000 will be expensed off in Profit & Loss in the financial year 2019 -2020.

Accounting of property- Building

When the property is used as an administrative centre, it is not an investment property, rather it is an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

When the property (land and/or buildings) is held to earn rentals or for capital appreciation (or both), it is an Investment property. Ind AS 40 prescribes the cost model for accounting of such investment property.

Since equal value can be attributed to each floor, Ground Floor of the building will be considered as Investment Property and accounted as per Ind AS 40 and First Floor would be considered as Property, Plant and Equipment and accounted as per Ind AS 16.

Cost of each floor = ₹ 63,40,000 / 2 = ₹ 31,70,000

As on 1st October 2019, the carrying value of building vis-à-vis its classification would be as follows:

(i) **In Separate Financial Statements:** The Ground Floor of the building will be classified as investment property for ₹ 31,70,000, as it is property held to earn rentals. While First Floor of the building will be classified as item of property, plant and equipment for ₹ 31,70,000.

(ii) **In Consolidated Financial Statements:** The consolidated financial statements present the parent and its subsidiary as a single entity. The consolidated entity uses the building for the supply of goods. Therefore, the leased-out property to a subsidiary does not qualify as investment property in the consolidated financial statements. Hence, the whole building will be classified as an item of Property, Plant and Equipment for ₹ 63,40,000.

NOTES

CHAPTER 12
INTANGIBLE ASSETS (IND AS 38)

CONCEPTS BASED EXAMPLES

Example: Identifiability

1. Sun Ltd has an expertise in consulting business. In past years, company has gained a market share for its services of 30 percent and considers recognising it as an intangible asset. Is the action by company is justified?

Market share does not meet the definition of intangible assets as is not identifiable i.e. It is neither separable and nor arised from contractual or legal rights.

Example: Control

2. An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset.

For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

An entity may have a portfolio of customers or a market share and expect that, because of its efforts in building customer relationships and loyalty, the customers will continue to trade with the entity. However, in the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (e.g. portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets. In the absence of legal rights to protect customer relationships, exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination) provide evidence that the entity is nonetheless able to control the expected future economic benefits flowing from the customer relationships. Because such exchange transactions also provide evidence that the customer relationships are separable, those customer relationships meet the definition of an intangible asset.

Examples – general recognition criteria

3. An entity developed a formula that it uses to manufacture a unique glue. The glue is the leading adhesive product in the market because of its distinctive mix of chemicals. The special formula is known only by the entity's two owner-managers and hence no competitors have been able to discover and replicate the formula. The formula is not protected by a patent, or by other means. Many competitors have approached the entity to try to purchase the formula

The formula meets the definition of an intangible asset of the entity. It is identifiable because it is capable of being separated from the entity and sold (ie it is separable). It is non-monetary because it is neither currency held nor an asset receivable in a fixed or determinable amount of money. It meets the definition of an asset of the entity because, although the formula is not protected by legal rights, the entity has control over the formula by keeping the formula a secret from its competitors.

However, in accordance with IND AS 38, internally generated intangible assets are not recognised as assets if the cost of the asset cannot be measured reliably.

4. An entity developed a successful brand that allows the entity to charge a premium for its products. The entity continues to spend large amounts on maintaining the brand and on developing the brand further (eg sponsoring local sports events, sponsoring select cultural events and advertising the brand).

The costs incurred in developing the brand do not satisfy the recognition criteria as per IND AS 38. The expenditures incurred for sponsorships and advertising are not recognised as an intangible asset. They cannot be distinguished from costs incurred in respect of developing the business as a whole. The costs are recognised as an expense as they are incurred.

5. An entity acquires a competitor's brand in a separate acquisition for ₹ 100,000.The entity uses the brand to charge a premium for the products that it manufactures.

The entity recognises the brand acquired from its competitor as an intangible asset. The ₹ 100,000 incurred to acquire the brand satisfies the recognition criteria in IND AS 38.

Note: the probability recognition criterion in IND AS 38 is always considered as being satisfied for intangible assets that are separately acquired.

Note: amounts incurred by the entity for maintaining and improving the brand will be recognised as an expense as incurred (ie expenditures incurred for sponsorships and advertising cannot be separated from costs incurred in respect of the business as a whole.

6. A bakery manufactures rye bread that is very popular with its customers using a recipe that it found in a famous cookbook that is in the public domain. Although the cookbook's publication is protected by copyright, there is no limitation on the use of the recipe. Many of the bakery's competitors produce rye bread.

The recipe does not meet the definition of an asset of the bakery because the bakery does not have control over the recipe. The bakery is unable to restrict the access of others to the benefits from using the recipe because the recipe is available to the public.

Example: Separate Acquisition

7. Jupiter Ltd acquires new energy efficient technology that will significantly reduce its energy costs for manufacturing.

	Costs incurred include	Cost to be capitalised as per Ind AS 38
Cost of new solar technology	10,00,000	10,00,000
Trade discount provided	(1,00,000)	(1,00,000)

Training course for staff in new technology	50,000	-
Initial testing of new technology	35,000	35,000
Losses incurred while other parts of plant shut down during testing and training	25,000	-
Total	10,10,000	9,35,000

Examples – measurement of intangible assets acquired in an exchange of assets

8. On 1 January 20X1 an entity received landing rights at a local airport in exchange for 1 kg of gold, when gold was trading at ₹ 3,000 per gm. Give accounting treatment.

The landing rights received (the intangible asset acquired in the exchange transaction) must be measured at ₹ 30,00,000 (their fair value) on initial recognition. Because there is an active market for gold, the fair value of the landing rights received is most easily determined by reference to the fair value of the gold given up in the exchange transaction (ie 1000 gm × ₹ 3,000 per gm).

9. On 1 January 20X1 an entity received landing rights at a local airport in exchange for 90,000 litres of aviation fuel and ₹ 10,000 cash. Aviation fuel costs ₹ 1 per litre. Give accounting treatment.

The landing rights received (the intangible asset acquired in the exchange transaction) must be measured at ₹ 100,000 (their fair value) on initial recognition. The fair value of the landing rights is determined by reference to the fair values of the aviation fuel ₹ 90,000 (ie 90,000 litres × ₹ 1 per litre) plus ₹ 10,000 cash given up in the exchange transaction.

Examples – Past expenses

10. The Board of Directors of Fair Brother Ltd. seek your advice in the finalisation of financial statements for the year ended 30-6-1999. On review of financial statements, it is noticed that Research and development cost of ₹ 15 lakhs which was charged to profit and loss account a few years before is written back to profit and loss account of the current year. Advise the company on changes to be effected in the draft financial statements. Give reasons in support of your advice.

Research and development cost written off in the earlier period should not be written back and take credit for in the profit and loss account of the current period as per IND AS 38 – 'Intangible Assets'. Research and development costs previously written off are not reinstated because they were incurred at time when the technical and commercial feasibility of the project was too uncertain to establish a relationship with future benefits and they were, therefore, proper charges to those past periods. IND AS 38 makes it clear that even when uncertainties cease to exist, the costs to written off cannot be restated.

Example: Amortisation period & method

11. A direct-mail marketing company acquires a customer list and expects that it will be able to derive benefit from the information on the list for at least one year, but no more than three years.

The customer list would be amortised over management's best estimate of its useful life, say 18 months. Although the direct-mail marketing company may intend to add customer names and other information to the list in the future, the expected benefits of the acquired customer list relate only to the customers on that list at the date it was acquired. The customer list also would be reviewed for impairment in accordance with Ind AS 36, Impairment of Assets, by assessing at the end of each reporting period whether there is any indication that the customer list may be impaired.

12. The product protected by the patented technology is expected to be a source of net cash inflows for at least 15 years. The entity has a commitment from a third party to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and the entity intends to sell the patent in five years.

The patent would be amortised over its five-year useful life to the entity, with a residual value equal to the present value of 60 per cent of the patent's fair value at the date it was acquired. It may be noted that the estimated useful life has to be considered with reference to the entity only though the total life of the patent is much higher i.e., 15 years. The patent would also be reviewed for impairment in accordance with Ind AS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

13. An analysis of consumer habits and market trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.

It needs to be noted that although the remaining legal life of the patent is 50 years, however the useful life from the entity's perspective is only 30 years. The copyright would be amortised over its 30-years estimated useful life. The copyright also would be reviewed for impairment in accordance with Ind AS 36 by assessing at the end of each reporting period whether there is any indication that it may be impaired.

14. The broadcasting licence is renewable every 10 years if the entity provides at least an average level of service to its customers and complies with the relevant legislative requirements. The licence may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. The acquiring entity intends to renew the licence indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the licence renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the licence is expected to contribute to the entity's net cash inflows indefinitely.

The broadcasting licence would be treated as having an indefinite useful life because it is expected to contribute to the entity's net cash inflows indefinitely. Therefore, the licence would not be amortised until its useful life is determined to be finite. The licence would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

15. The licensing authority subsequently decides that it will no longer renew broadcasting licences, but rather will auction the licences. At the time the licensing authority's decision is made, the entity's broadcasting licence has three years until it expires. The entity expects that the licence will continue to contribute to net cash inflows until the licence expires.

Because the broadcasting licence can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired licence would be amortised over its remaining three-year useful life and immediately tested for impairment in accordance with Ind AS 36.

16. The route authority may be renewed every five years, and the acquiring entity intends to comply with the applicable rules and regulations surrounding renewal. Route authority renewals are routinely granted at a minimal cost and historically have been renewed when the airline has complied with the applicable rules and regulations. The acquiring entity expects to provide service indefinitely between the two cities from its hub airports and expects that the related supporting infrastructure (airport gates, slots, and terminal facility leases) will remain in place at those airports for as long as it has the route authority. An analysis of demand and cash flows supports those assumptions.

Because the facts and circumstances support the acquiring entity's ability to continue providing air service indefinitely between the two cities, the intangible asset related to the route authority is treated as having an indefinite useful life. Therefore, the route authority would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

17. The trademark has a remaining legal life of five years but is renewable every 10 years at little cost. The acquiring entity intends to renew the trademark continuously and evidence supports its ability to do so. An analysis of (1) product life cycle studies, (2) market, competitive and environmental trends, and (3) brand extension opportunities provides evidence that the trademarked product will generate net cash inflows for the acquiring entity for an indefinite period.

The trademark would be treated as having an indefinite useful life because it is expected to contribute to net cash inflows indefinitely. Though the remaining legal life is five years, the possibility that it can be renewed every ten years and the entity's intention to renew the same leads to the conclusion that the trademark has an indefinite useful life. Therefore, the trademark would not be amortised until its useful life is determined to be finite. It would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

18. The trademark was regarded as having an indefinite useful life when it was acquired because the trademarked product was expected to generate net cash inflows indefinitely. However, unexpected competition has recently entered the market and will reduce future sales of the product. Management estimates that net cash inflows generated by the product will be 20 per cent less for the foreseeable future. However, management expects that the product will continue to generate net cash inflows indefinitely at those reduced amounts.

As a result of the projected decrease in future net cash inflows, the entity determines that the estimated recoverable amount of the trademark is less than its carrying amount, and an impairment loss is recognised. Because it is still regarded as having an indefinite useful life, the trademark would continue not to be amortised but would be tested for impairment in accordance with Ind AS 36 annually and whenever there is an indication that it may be impaired.

19. At the time of the business combination the acquiree had been producing the line of products for 35 years with many new models developed under the trademark. At the acquisition date the acquirer expected to continue producing the line, and an analysis of various economic factors indicated there was no limit to the period the trademark would contribute to net cash inflows. Consequently, the trademark was not amortised by the acquirer. However, management has recently decided that production of the product line will be discontinued over the next four years.

Because the useful life of the acquired trademark is no longer regarded as indefinite, the carrying amount of the trademark would be tested for impairment in accordance with Ind AS 36 and amortised over its remaining four-year useful life.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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.

Q2: 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 ₹ 800,000 for advertisements before 31 March 20X1. ₹ 700,000 of this sum relates to advertisements shown before 31 March 20X1 and ₹ 100,000 to advertisements shown in April 20X1. Since 31 March 20X1, The Company has paid for further advertisements costing ₹ 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, ₹700,000 would be recognised as an expense and ₹ 100,000 as a pre-payment in the year ended 31 March 20X1. The ₹ 400,000 cost of advertisements paid for since 31 March 20X1 would be charged as expenses in the year ended 31 March 20X2.

Q3: 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 ₹ 4.8 Lakh. The finance director had authorised this campaign on the basis that it would create ₹ 8 lakh of additional profits over the next three years.

2. A new product was developed during the year. The expenditure totalled ₹ 3 lakh of which ₹ 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 ₹ 1.4 lakh.

3. Staff participated in a training programme which cost the company ₹ 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 ₹ 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 ₹ 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.

Q4: Venus India Private Ltd acquired a software for its internal use costing ₹ 10,00,000. The amount payable for the software was ₹ 600,000 immediately and ₹ 400,000 in one year time. The other expenditure incurred were:-

Purchase tax : ₹ 1,00,000

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

Legal fees: ₹ 87,000

Consultancy fees for implementation : ₹ 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 (₹ 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

Q5: Sun Ltd acquired a software from Earth Ltd. in exchange for a telecommunication license. The telecommunication license is carried at ₹ 5,00,000 in the books of Sun Ltd. The Software is carried at ₹ 10,000 in the books of the Earth Ltd which is not the fair value.

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

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

2) Fair Value of Software is not measureable. However similar Telecommunication license is transacted by another company at ₹ 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 500 Cr. Telecommunication license 500 Cr. Profit on Exchange Nil	Dr. Telecommunication license 520 Cr. Software 10 Cr. Profit on Exchange 510
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

Q6: Expenditure on a new production process in 20X1-20X2:

	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 ₹ 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 ₹ 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 ₹ 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

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

Expenditure during Development Phase will be capitalised	₹ 900

(Recoverable amount is higher being ₹ 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.	₹ 5,000

Q7: Saturn Ltd. acquired an intangible asset on 31st March 20X1 for ₹ 1,00,000. The asset was revalued at ₹ 1,20,000 on 31st March 20X2and ₹ 85,000 on 31st March 20X3.

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

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

Jupiter Ltd.

₹ 15,000 revaluation decrease on 31st March 20X2 should be recognised as an expense in the Statement of Profit and loss. ₹ 15,000 out of the ₹ 20,000 increase on 31st March 20X3 should

be recognised as income. The remaining ₹ 5,000 should be credited to revaluation reserve and recognised in other comprehensive income.

Q8: 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 ₹ 10,00,00,000 for the use of know-how for a period of 5 years. X Limited estimates the production of fertiliser as follows:

Year (in metric tons)	
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

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

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

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 ₹ 10,00,00,000 = ₹ 1,11,11,111.

At the end of 2nd year, as per revised estimate the total number of units to be produced in future are 3,70,000 MT (ie 65,000 + 85,000 + 1,05,000 + 1,15,000).

The amortisation for second year will be 65,000 / 3,70,000 on (10,00,00,000 – 1,11,11,111) ie 1,56,15,615 and so on for remaining years unless the estimates are again revised.

Q9: X Ltd. purchased a patent right on April 1, 20X1, for ₹ 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 ₹ 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 ₹ 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	₹ 3,00,000
Less: amortisation	(₹ 60,000)
Net Value	₹ 2,40,000

Value as on March 31, 20X1

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

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

Value as on March 31, 20X4

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

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

Q10: 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 ₹ 10,00,00,000 and fair value of net asset acquired is ₹ 8,50,00,000. The above purchase consideration includes:

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

(b) ₹ 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 ₹ 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, ₹ 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 ₹ 1,00,00,000 (₹ 1,50,00,000 – ₹ 50,00,000).

Alternatively, Goodwill can be calculated as under

Purchase Consideration	₹10,00,00,000
Less: Fair Value of Net assets acquired including 'Non-compete Fee'	

(₹ 8,50,00,000 + ₹ 50,00,000)	₹9,00,00,000
Value of goodwill	₹1,00,00,000

Q11: X Ltd. purchased a franchise from a restaurant chain at a cost of ₹ 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.

Q12: 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.

Q13: 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.

Q14: 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.

Q15: X Ltd. purchased a standardised finance software at a list price of ₹ 30,00,000 and paid ₹ 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 ₹ 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 ₹ 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 (₹)
List price	30,00,000
Less: trade discount (5%)	(1,50,000)
	28,50,000
Non-refundable purchase tax	50,000
Customisation cost	7,00,000
Total cost	36,00,000

The maintenance contract of ₹ 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

Q16: X Limited in a business combination, purchased the net assets of Y Limited for ₹ 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 ₹)**
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 ₹ 1,50,000, ₹ 30,000 and ₹ 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 (₹)
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 = ₹ 4,00,000 – ₹ (1,50,000 + 70,000 + 30,000 + 1,30,000 – 50,000)= ₹ 70,000.

Q17: X Ltd. acquired Y Ltd. on April 30, 20X1. The purchase consideration is ₹ 50,00,000. The fair value of the tangible assets is ₹ 45,00,000. The company estimates the fair value of "in-process research projects" at ₹ 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) ₹ 5,00,000 – as research expenses

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

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

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

Ans: X Ltd. should initially recognise the acquired "in house research project'' at its fair value i.e., ₹ 10,00,000. Research cost of ₹ 5,00,000 and cost of ₹ 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 ₹ 17,00,000 (₹ 10,00,000 + ₹ 7,00,000).

Q18: 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 ₹ 20,00,000 and ₹ 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 ₹ 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 ₹ 18,00,000, in case (b) it is measured at ₹ 20,00,000 (18,00,000 + 2,00,000).

Q19: X Garments Ltd. spent ₹ 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 ₹ 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.

Q20: An entity is developing a new production process. During 20X1-20X2, expenditure incurred was ₹ 1,000, of which ₹ 900 was incurred before March 1, 20X2 and ₹ 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 ₹ 500.

During 20X2-20X3, expenditure incurred is ₹ 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 ₹ 1,900.

Ans: At the end of the financial year 20X2, the production process is recognised as an intangible asset at a cost of ₹ 100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X2). ₹ 900 expenditure incurred before March 1, 20X2 is 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 ₹ 2,100 (₹ 100 expenditure recognised at the end of 20X2 plus ₹ 2,000 expenditure recognised in 20X3). The entity recognises an impairment loss of ₹ 200 to adjust the carrying amount of the process before impairment loss (₹ 2,100) to its recoverable amount (₹ 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

Q21: 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 ₹ 2,00,000 towards salaries of the program designers.

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

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

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

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

(f) Cost of producing product masters for training material is ₹ 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 ₹ 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 ₹ 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, ₹ 9,00,000 (salary cost of ₹ 2,00,000, program design cost of ₹ 5,00,000 and coding and technical feasibility cost of ₹ 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 ₹ 70,000 would be expensed off.

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

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

Q22: X Ltd. has started developing a new production process in financial year 20X1-20X2. Total expenditure incurred till September 30, 20X3, was ₹ 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 ₹ 1,00,00,000, ₹ 70,00,000 were incurred during 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 ₹ 70,00,000 and ₹ 30,00,000 which was already recognised as an expenses in first quarter should not be capitalised.

Q23: 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 ₹ 1,00,00,000 and accumulated amortisation is ₹ 40,00,000. The intangible assets are revalued at ₹ 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 ₹ 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 ₹ 2,50,00,000 gross and ₹ 1,00,00,000 on amortisation.

Q24: 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 ₹ 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 ₹ 3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent ₹ 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 ₹ 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 ₹ 5,00,00,000.

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

5. It has also commenced developing another drug 'Drug B'. It has incurred ₹ 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 ₹ 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.

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

3. The advertisement expenses of ₹ 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 ₹ 5,00,00,000

   Development cost ₹ 5,00,00,000

   Total cost ₹ 10,00,00,000

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

Q25: On 31st March 20X1, Earth India Ltd paid ₹ 50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd's net assets had a fair value of ₹ 30,00,000. In addition Sun Ltd also held the following rights:

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

Sole distribution rights to an electronic product. Future cash flows from which are estimated to be ₹ 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 OTHER SOURCE

Q26: Dharma Record Ltd acquires copyrights to the original recordings of a famous singer. The agreement with the singer allows the company to record and rerecord the singer for a period of five years. During the initial six-month period of the agreement, the singer is very sick and consequently cannot record. The studio time that was blocked by the company had to be paid even during the period the singer could not sing.

These costs were incurred by the company:

(a) Legal cost of acquiring the copyrights ₹ 10,00,000

(b) Operational loss (studio time lost, etc.) during start-up period ₹ 2,00,000

(c) Massive advertising campaign to launch the artist ₹ 1,00,000.

Which of the above items is a cost that can be capitalized as an intangible asset?

Ans: (a) The legal cost of acquiring the copyright can be capitalized.

(b) "Operational costs" during the start-up period are not allowed to be capitalized.

(c) Massive advertising campaign to launch the artist is not allowed to be capitalized.

Q27: M Ltd. launched a project for producing product A in Nov. 2008. The company incurred ₹ 30 lakhs towards Research and Development expenses upto 31st March, 2010. Due to unfavourable market conditions the management feels that it is not possible to manufacture and sold the product in the market for next so many years. The management hence wants to defer the expenditure write off to future years. Advise the company as per the applicable IND AS.

Ans: As per IND AS 38 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of IND AS 38. Therefore, the management cannot defer the expenditure write off to future years and the company is required to expense the entire amount of ₹ 30 lakhs in the Profit and Loss account of the year ended 31st March, 2010.

Q28: Himalaya Ltd. in the past three years spent ₹ 75,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet IND AS 38 criteria for capitalization. In the current year approval of the concerned Govt. Authority has been received. The Company wishes to capitalize ₹ 75,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views.

Ans: In any case, under either standard, the condition for recognition of a research and development asset has to be fulfilled when the expenditure was incurred. If the recognition conditions are not fulfilled the amount has to be charged to the profit and loss account. Once the amount is charged to the Profit and Loss account, such amount cannot be restated later as a Research and Development Asset when the condition for recognition gets fulfilled. The Company therefore cannot capitalize ₹ 75,00,000 even as a prior period item.

Q29: NDA Corporation is engaged in research on a new process design for its product. It had incurred an expenditure of ₹ 530 lakhs on research upto 31st March, 09. The development of the process began on 1st April, 09 and Development phase expenditure was ₹ 360 lakhs upto 31st March, 10 which meets assets recognition criteria.

From 1st April, 10, the company will implement the new process design which will result in after tax saving of ₹ 80 lakhs per annum for the next five years. The cost of capital of company is 10%. Explain:

(1) Accounting treatment for research expenses.

(2) The cost of internally generated intangible asset as per IND AS 38.

(3) The amount of amortization of the assets. (The present value of annuity factor of ₹ 1 for 5 years @ 10% = 3.7908) **[Nov 2010, Nov 2013]**

Ans:

(i) Research Expenditure - According to IND AS 38 'Intangible Assets', the expenditure on research of new process design for its product ₹ 530 lakhs should be charged to Profit and Loss Account in the year in which it is incurred. It is presumed that the entire expenditure is incurred in the financial year 2008-09. Hence, it should be written off as an expense in that year itself.

(ii) Cost of internally generated intangible asset - The question states that the development phase expenditure amounting ₹ 360 lakhs incurred upto 31st March, 2010 meets asset recognition criteria. As per IND AS 38 for measurement of such internally generated intangible asset, fair value can be estimated by discounting estimated future net cash flows.

Savings (after tax) from implementation of new design for next 5 years : 80 lakhs p.a.

Company's cost of capital 10 %

Annuity factor @ 10% for 5 years 3.7908

Present value of net cash flows (₹ 80 lakhs x 3.7908) 303.26 lakhs

The cost of an internally generated intangible asset would be lower of cost value ₹ 360 lakhs or present value of future net cash flows ₹303.26 lakhs.

Hence, cost of an internally generated intangible asset will be ₹ 303.26 lakhs.

The difference of ₹ 56.74 lakhs (i.e. ₹ 360 lakhs – ₹ 303.26 lakhs) will be amortized by the enterprise for the financial year 2009-10.

(iii) Amortisation - The company can amortise ₹ 303.26 lakhs over a period of five years by charging ₹ 60.65 lakhs per annum from the financial year 2010-11 onwards.

Q30: An Enterprise has incurred expense for purchase of Technical Know-how for manufacturing a Moped. The Enterprise has paid ₹ 5 crores for the use of Know-how for a period of 4 years. The Enterprise estimates the production of mopeds as follows:

Year	No. of Mopeds
1	25,000
2	50,000
3	75,000
4	1,00,000

On going into production, at the end of the 1st year it achieved its targeted production, but considered to revise the estimates for the next 3 years as follows:

Year	No. of Mopeds
1	35,000
2	65,000
3	80,000

(a) How will the Enterprise amortise the Technical Know-how Fees as per IND AS 38.

(b) Whether this amortisation should be directly charged as an expense or should form part of Production Cost of the Mopeds.

Ans: Based on the revised estimate, total sales are 2,05,000, the first year charge should be a proportion of 25,000/2,05,000 on ₹ 5 crores, second year will be 35,000/2,05,000, and so on unless the estimates are again revised. If these estimates cannot be determined reliably it would be preferable to charge them off on a straight line basis, otherwise, as can be seen from the above example, significant amortisation amount is inappropriately postponed to later years.

As already mentioned above, there will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method. In the given case, amortisation expense will be included as cost of inventory.

Q31: Swift Ltd. acquired a patent at a cost of ₹80,00,000 for a period of 5 years and the product lifecycle is also 5 years. The company capitalized the cost and started amortizing the asset at ₹10,00,000 per annum. After two years it was found that the product life-cycle may continue for another 5 years from then. The net cash flows from the product during these 5 years were

expected to be ₹36,00,000, ₹46,00,000, ₹44,00,000, ₹40,00,000 and ₹34,00,000. Find out the amortization cost of the patent for each of the years.

Ans: Swift Limited amortised ₹10,00,000 per annum for the first two years i.e. ₹20,00,000. The remaining carrying cost can be amortized during next 5 years on the basis of net cash flows arising from the sale of the product. The amortisation may be found as follows:

Year	Net cash flows	Amortization Ratio	Amortization Amount
I	-	0.125	10,00,000
II	-	0.125	10,00,000
III	36,00,000	0.180	10,80,000
IV	46,00,000	0.230	13,80,000
V	44,00,000	0.220	13,20,000
VI	40,00,000	0.200	12,00,000
VII	34,00,000	0.170	10,20,000
Total	2,00,00,000	1.000	80,00,000

It may be seen from above that from third year onwards, the balance of carrying amount i.e., ₹ 60,00,000 has been amortized in the ratio of net cash flows arising from the product of Swift Ltd.

Note: The answer has been given on the basis that the patent is renewable and Swift Ltd. got it renewed after expiry of five years.

Q32: Nirman Solutions incurred costs to develop and produce a routine, low risk computer software product, as follows, as on 31st March, 2016:

Completion of detailed program design	₹15,00,000
Costs incurred for coding and testing to establish technological feasibility	₹ 8,00,000
Other coding and testing costs after establishment of technological feasibility	₹ 6,50,000
Cost of producing product masters for training materials	₹ 4,20,000
Duplication of computer software and training materials from Product masters (5000 units)	₹ 2,50,000
Packaging product (2500 units)	₹ 1,50,000

(i) What amount should be capitalized as software cost, subject to amortization of Nirman Solutions as on 31st March, 2016.

(ii) What amount should be reported in Inventory of Nirman Solutions as on 31st March, 2016.

Ans: (i) As per IND AS 38, costs incurred in creating a computer software product should be charged to research and development expense when incurred until technological feasibility has been established for the product. Technological feasibility has been established upon completion of detailed program design or working model. In this case, ₹ 23,00,000 would be recorded as an expense (₹ 15,00,000 for completion of detailed

program design and ₹ 8,00,000 for coding and testing to establish technological feasibility). Cost incurred from the point of technological feasibility until the time when products costs are incurred are capitalized as software cost. In this situation, ₹ 10,70,000 (i.e. ₹ 6,50,000 + ₹ 4,20,000) will be capitalized as the cost of the software.

(ii) The cost of duplication of computer software and training materials from product masters (5,000 units) amounting ₹ 2,50,000 and packaging product (2,500 units) amounting ₹ 1,50,000 should be reported as inventory cost as on 31st March, 2016 i.e. inventory value is total of ₹ 4,00,000.

Q33: On 1 January 20X1 an entity acquired a patent-protected medicine formula for ₹ 500,000. Management estimated the useful life of the intangible asset to be 20 years (which is the remaining period of the patent) and its residual value at nil. Furthermore, management believed that the straight-line method reflects the pattern in which it expects to consume the intangible asset's future economic benefits.

At the entity's 31 December 20X5 financial year-end, new information arose that caused management to reconsider its initial assessment of the amortisation period of the intangible asset. To encourage the development of the local pharmaceutical industry, the government extended the term of all local medical patents. Management now estimates the useful life of the formula to be 25 years (measured from the date of acquisition). Management continues to believe that the straight-line method reflects the pattern in which it expects to consume the asset's future economic benefits. Give treatment as per IND AS.

Ans: To record amortisation expense for the year ended 31 December 20X5.

(a) Annual amortisation upto 31/12/20X4= ₹ 500,000 ÷ 20 years = ₹ 25,000

(b) Carrying amount at 1 January 20X5 (ie 31 December 20X4)

Cost	₹ 500,000
Less: Accumulated amortisation (4 years × ₹ 25,000) =	₹ 100,000
	₹4,00,000

(c) Amortisation expense for the year ended 31 December 20X5

= ₹ 400,000(b) ÷ 21 years' remaining useful life at the beginning of the current reporting period =₹ 19,048

The amortisation expense recognised in the year ended 31 December 20X5 is ₹ 19,048, which will be recorded as follows:

Dr Amortisation expense	₹ 19,048	
Cr Accumulated amortisation		₹19,048

QUESTIONS FROM RTP/MTP/EXAMS

Q34: 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 ₹ 8,00,000 before 31st March, 2018. ₹ 7,00,000 of this sum relates to advertisements shown before 31st March, 2018 and ₹ 1,00,000 to advertisements shown in

April, 2018. Since 31st March, 2018, A Ltd. has paid for further advertisements costing ₹ 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 ₹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.

Examine and justify the treatment of these costs of ₹ 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, ₹ 7,00,000 would be recognised as an expense and ₹ 1,00,000 as a pre-payment in the year ended 31st March 2018.

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

Q35: ABC Pvt. Ltd., recruited a player. As per the terms of the contract, the player is prohibited from playing for any other entity for coming 5 years and have to in the employment with the company and cannot leave the entity without mutual agreement. The price the entity paid to acquire this right is derived from the skills and fame of the said player. The entity uses and develops the player through participation in matches. State whether the cost incurred to obtain the right regarding the player can be recognised as an intangible asset as per Ind AS 38?

[RTP Nov 2020]

Ans: As per Ind AS 38, for an item to be recognised as an intangible asset, it must meet the definition of an intangible asset, i.e., identifiability, control over a resource and existence of future economic benefits and also recognition criteria.

With regard to establishment of control, paragraph 13 of Ind AS 38 states that an entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

Further, paragraph 15 of Ind AS 38 provides that an entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical

talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

Since the right in the instant case is contractual, identifiability criterion is satisfied. Based on the facts provided in the given case, the player is prohibited from playing in other teams by the terms of the contract which legally binds the player to stay with ABC Ltd for 5 years.

Accordingly, in the given case, the company would be able to demonstrate control. Future economic benefits are expected to arise from use of the player in matches. Further, cost of obtaining rights is also reliably measurable. Hence, it can recognise the costs incurred to obtain the right regarding the player as an intangible asset. However, careful assessment of relevant facts and circumstances of each case is required to be made.

Q36: PQR Ltd. is a gaming developer company. Few years back, it developed a new game called 'Cloud9'. This game sold over 10,00,000 copies around the world and was extremely profitable. Due to its popularity, PQR Ltd. released a new game in the 'Cloud9' series every year. The games continue to be the bestseller. Based on Management's expectations, estimates of cash flow projections for the 'cloud9 videogame series' over the next five years have been prepared. Based on these projections, PQR Ltd. believes that cloud9 series brand should be recognised at INR 20,00,000 in its financial statement. PQR Ltd. has also paid INR 10,00,000 to MNC Ltd. to acquire rights of another video game series called the 'Headspace' videogame series. The said series have huge demand in the market.

Discuss the accounting treatment of the above in the financial statements of PQR Ltd.

RTP May 2021

Ans: In order to determine the accounting treatment of 'cloud9 videogame series' and 'Headspace', definition of asset and intangible asset given in Ind AS 38 may be noted:

"An asset is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity."

"An intangible asset is an identifiable non-monetary asset without physical substance."

In accordance with the above, for recognising an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control and existence of future economic benefits.

In order to determine whether 'cloud9 videogame series' meet the aforesaid conditions, following provisions of Ind AS 38 regarding Internally Generated Intangible Assets may be noted:

As per paragraph 63 and 64 of Ind AS 38, internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognised as intangible assets. Expenditure on such items cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognised as intangible assets.

Accordingly, though the cash flow projections suggest that the cloud9 brand will lead to future economic benefits, yet the asset has been internally generated; therefore, the Cloud9 brand cannot be recognised as intangible asset in the financial statements.

In order to determine whether 'Headspace' meet the aforesaid conditions, following provisions of Ind AS 38 regarding 'Separately acquired Intangible Assets' should be analysed.

As per paragraphs 25 and 26 of Ind AS 38, normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

The Headspace game has been purchased for INR 10,00,000 and it is expected to generate future economic benefits to the entity. Since Headspace game is a separately acquired asset and the future benefits are expected to flow to the entity, therefore, an intangible asset should be recognised in respect of the 'Headspace' asset at its cost of INR 10,00,000. After initial recognition, either cost model or revaluation model can be used to measure headspace intangible asset as per guidance given in paragraphs 74-87 of Ind AS 38. In accordance with this, Headspace intangible asset should be carried at its cost/revalued amount (as the case may be) less any accumulated amortisation and any accumulated impairment losses.

Q37: Super Sounds Limited had the following transactions during the Financial Year 2019-2020.

(i) On 1st April 2019, Super Sounds Limited purchased the net assets of Music Limited for ₹ 13,20,000. The fair value of Music Limited's identifiable net assets was ₹ 10,00,000. Super Sounds Limited is of the view that due to popularity of Music Limited's product, the life of goodwill is 10 years.

(ii) On 4th May 2019, Super Sounds Limited purchased a Franchisee to organize musical shows from Armaan TV for ₹ 80,00,000 and at an annual fee of 2% of musical shows revenue. The Franchisee expires after 5 years. Musical shows revenue were ₹ 10,00,000 for financial year 2019-2020. The projected future revenues for financial year 2020-2021 is ₹ 25,00,000 and ₹ 30,00,000 p.a. for remaining 3 years thereafter.

(iii) On 4th July 2019, Super Sounds Limited was granted a Copyright that had been applied for by Music Limited. During financial year 2019-2020, Super Sound Limited incurred ₹ 2,50,000 on legal cost to register the Patent and ₹ 7,00,000 additional cost to successfully prosecute a copyright infringement suit against a competitor.

The life of the Copyright is for 10 years.

Super Sound Limited follows an accounting policy to amortize all intangible on SLM (Straight Line Method) basis or any appropriate basis over a maximum period permitted by relevant Ind AS, taking a full year amortization in the year of acquisition.

You are required to prepare:

(i) A Schedule showing the intangible section in Super Sound Limited Balance Sheet as on 31st March 2020, and

(ii) A Schedule showing the related expenses that would appear in the Statement of Profit and Loss of Super Sound Limited for the year ended 2019-2020.

Exam Paper January 2021 (10 Marks)

Ans: (i) Super Sounds Limited

Balance Sheet (Extract relating to intangible asset) as at 31st March 2020

	Note No.	**₹**
Assets (1) Non- current asset Intangible assets	1	69,45,000

(ii) Super Sounds Limited

Statement of Profit and Loss (Extract)

for the year ended 31st March 2020

	Note No.	**₹**
Revenue from Operations		10,00,000
Total Revenue Expenses:		
Amortization expenses Other expenses	2	16,25,000
Total Expenses	3	7,20,000

Notes to Accounts (Extract)

1. Intangible Assets

		Gross Block (Cost)			Accumulated amortization				Net Block
		Opening Balance	Additions	Closing Balance	Opening Balance	Additions	Closing Balance	Opening Balance	Closing Balance
	₹	₹	₹	₹	₹	₹	₹	₹	₹
1.	Goodwill* (W.N.1)	-	3,20,000	3,20,000	-	-	-	-	3,20,000
2.	Franchise** (W.N.2)	-	80,00,000	80,00,000	-	16,00,000	16,00,000	-	64,00,000
3.	Copyright (W.N.3)	-	2,50,000	2,50,000	-	25,000	25,000	-	2,25,000

		-	85,70,000	85,70,000	-	16,25,000	16,25,000	-	69,45,000

* As per Ind AS 36, irrespective of whether there is any indication of impairment, an entity shall test goodwill acquired in a business combination for impairment annually. This **implies that goodwill is not amortised annually but is subject to annual impairment, if any.**

** As per the information in the question, the limiting factor in the contract for the use is time i.e., 5 years and not the fixed total amount of revenue to be generated. Therefore, an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate and amortisation based on time can only be applied.

2. Amortization expenses

Franchise (W.N.2.)	16,00,000	
Copyright (W.N.3.)	25,000	16,25,000

3. Other Expenses

Legal cost on copyright	7,00,000	
Fee for Franchise (10,00,000 × 2%)	20,000	7,20,000

Working Notes:

		₹
(1)	**Goodwill on acquisition of business**	
	Cash paid for acquiring the business	13,20,000
	Less: Fair value of net assets acquired	(10,00,000)
	Goodwill	**3,20,000**
(2)	**Franchise**	80,00,000
	Less: Amortisation (over 5 years)	(16,00,000)
	Balance to be shown in the balance sheet	**64,00,000**
(3)	**Copyright**	2,50,000
	Less: Amortisation (over 10 years as per SLM)	(25,000)
	Balance to be shown in the balance sheet	**2,25,000**

NOTES

CHAPTER 13

INVESTMENT PROPERTY (IND AS 40)

CONCEPTS BASED EXAMPLES

Example: Property held for more than one purpose

1. Sun Ltd owns a building having 15 floors of which it uses 5 floors for its office; the remaining 10 floors are leased out to tenants under operating leases. According to law company could sell legal title to the 10 floors while retaining legal title to the other 5 floors.

In the given scenario, the remaining 10 floors should be classified as investment property, since they are able to split the title between the floors.

2. Moon ltd uses 35% of the office floor space of the building as its head office. It leases the remaining 65% to tenants, but it is unable to sell the tenant's space or to enter into finance leases related solely to it.

Therefore, the company should not classify the property as an investment property as the 35% of the floor space used by the company is significant.

3. An entity owns a hotel, which includes a health and fitness centre, housed in a separate building that is part of the premises of the entire hotel. The owner operates the hotel and other facilities on the hotel with the exception of the health and fitness centre, which can be sold or leased out under a finance lease. The health and fitness centre will be leased to an independent operator. The entity has no further involvement in the health and fitness centre. In this scenario, management should classify the hotel and other facilities as property, plant and equipment and the health and fitness centre as investment property.

If the health and fitness centre could not be sold or leased out separately on a finance lease, then because the owner-occupied portion is not insignificant, the whole property would be treated as an owner-occupied property.

Example: Investment property acquired through exchange of another asset

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

The Building is acquired with the purpose to earn rentals. Hence, it is a case of Investment Property acquired in exchange for a combination of monetary and non- monetary asset.

Therefore, Journal entry at the time of acquisition is :

Investment Property (Building) (5,00,000 + 2,00,000)	Dr.	7,00,000	
To Cash			2,00,000
To PPE (Property, Plant and Equipment) i.e. Warehouse			5,00,000

Note: When the fair value of both the asset given up and acquired is mentioned, it is presumed that both the fair values are equally evident. In such a case, the fair value of the asset given up is considered as the cost of the asset purchased.

However, if the fair value of property acquired is more clearly evident, then the fair value of the asset acquired is considered. In such a situation, the Journal Entry at the time of acquisition (taking information given in the above example) would be

Investment Property (Building)	Dr.	8,00,000	
To Cash			2,00,000
To PPE (Warehouse)			5,00,000
To Gain on Sale of PPE			1,00,000

Example: Disposal

5. Sun Ltd, an aeronautics company is having a building which is given on an operating lease. The book value of such building in the books is ₹ 2,00,000.

Case -A

Pluto Ltd. offers to buy the building at ₹ 4,00,000.

Bank	Dr	4,00,000
To Investment Property		2,00,000
To Gain on disposal		2,00,000

Case- B

Pluto Ltd. Offers to take the building on lease for 10 years at a lease rental of ₹ 80,000 p.a. The present value of lease payments is ₹ 3,20,000.

Lease Receivable	Dr	3,20,000	
To Investment Property			2,00,000
To Gain on Disposal			1,20,000

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: X Limited owns a building which is used to earn rentals. The building has a carrying amount of ₹ 50,00,000. X Limited recently replaced interior walls of the building and the cost of new interior walls is ₹ 5,00,000. The original walls have a carrying amount of ₹ 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 = ₹ 50,00,000 + ₹ 5,00,000 – ₹ 1,00,000 = ₹ 54,00,000.

Q2: X Limited purchased a building for ₹ 30,00,000 in May 1, 20X1.The purchase price was funded by a loan. Property transfer taxes and direct legal costs of ₹ 1,00,000 and ₹ 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:

₹ 2,00,000 planning permission.

₹ 7,00,000 construction costs (including ₹ 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 = ₹ (30,00,000 +1,00,000 + 20,000 + 2,00,000 + 7,00,000 - 40,000) = 39,80,000.

Q3: X Limited purchased a land worth of ₹ 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 ₹ 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 ₹ 1,00,00,00. If the second payment option is used, ₹ 20,00,000 will be treated as interest expenses over the period of credit i.e., 2 years.

Q4: 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 ₹ 50,000. The present value of the minimum lease payment is ₹ 40,000. At what value, X Limited will recognise its investment property?

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

Investment Property A/c	Dr.	₹ 40,000	
To Finance lease obligation			₹ 40,000.

Q5: Moon Ltd has purchased a building on 1st April 20X1 at a cost of ₹ 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 ₹ 8 million. Moon ltd uses cost model for accounting of its investment property.

Ans:

	(₹ 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)

Q6: On April 1, 20X1 an entity acquired an investment property (building) for ₹ 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 ₹ 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 ₹ 40,00,000.

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

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

= ₹ 1,90,000.

Carrying amount = Cost less accumulated depreciation

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

Q7: X Limited has an investment property (building) which is carried in Balance Sheet on March 31, 20X1 at ₹ 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 ₹ 10,00,000 and its remaining useful life as 20 years and residual value is nil. How should X Limited account for the above investment property as on 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., ₹ 15,00,000. Since recoverable amount of the property as on March 31, 20X1 is ₹ 10 Lakhs, impairment loss ₹ 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.

Q8: 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 ₹ 1,80,00,000.

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

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

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

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

Throughout 20X1-20X2, incurred ₹ 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 = ₹ (1,80,00,000 + 20,00,000 + 5,00,000) = ₹ 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 = ₹ 2,05,00,000 x 5/6 = ₹ 1,70,83,333

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

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

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q9: Netravati Ltd. purchased a commercial office space as an Investment Property, in the Global Trade Centre Commercial Complex, for ₹ 5 crores. However, for purchasing the same, the Company had to obtain membership of the Global Trade Centre Commercial Complex Association by paying ₹ 6,25,000 as a one-time joining fee. Netravati Ltd. wants to write off the one-time joining fees paid as an expense under Membership and Subscription Charges and value the investment property at ₹ 5 crores. Advise.

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

Ans: Cost of Investment Property

As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). Accordingly, on initial recognition, the one-time joining fee of ₹ 6,25,000 should be added to the purchase price. Therefore, the investment property should be measured at ₹ 5,06,25,000 (i.e. cost of the commercial office space + one-time joining fee). Writing off the amount of ₹ 6,25,000 to the P&L is not appropriate.

Use as Administrative Office

If the property is used as an administrative centre, it is not an investment property, but rather an 'owner occupied property'. Hence, Ind AS 16 will be applicable.

Even under Ind AS 16, all direct costs relating to the acquisition of the asset should be added to the purchase price. Hence, cost of the asset under Ind AS 16 would be ₹ 5,06,25,000.

Q10: X Limited purchased a building for ₹ 30,00,000 on 1st May, 20X1 with an intention to earn rentals. The purchase price was funded by a loan, interest on which is payable @ 5%. Property transfer taxes and direct legal costs of ₹ 1,00,000 and ₹ 20,000 respectively were incurred in acquiring the building. X Limited redeveloped the building into retail shops for rent under operating leases to independent third parties. Expenditures on redevelopment were:

a) ₹ 2,00,000 planning permission.

b) ₹ 7,00,000 construction costs (including ₹ 40,000 refundable purchase taxes)

What is the cost of the Building as per Ind AS 40?

Ans: As per Ind AS 40, the cost of a purchased investment property comprises its purchase price and any directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs).

Accordingly, cost of the Building is arrived at as under:

Particulars	**Amount in ₹**	**Total ₹**
Purchase price		30,00,000
Add: Property transfer taxes		1,00,000
Direct legal costs		20,000
Fee for planning permission		2,00,000
Construction costs	7,00,000	
Less: Refundable purchase taxes	40,000	6,60,000
Cost of the Building as per Ind AS 40		**39,80,000**

Note: The building does not qualify the substantial period criteria for redevelopment of property. Hence, borrowing cost of loan fund has not been capitalised.

Q11: X Limited purchased a land worth of ₹ 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 ₹ 1,20,00,000. What should be the cost of the building under both the payment methods?

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

QUESTIONS FROM RTP/MTP/EXAMS/GFRS

Q12: 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 ₹ 2,00,00,000 and immediately began to lease the property to Y Ltd. on an operating lease. Annual rentals were ₹ 20,00,000. On 31st March, 2017, the fair value of the property was ₹ 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 ₹ 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 ₹ 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 ₹ 40,00,000 to complete the project, after which each flat could be sold for ₹ 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 ₹ 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 ₹ 30,00,000 (₹ 29,00,000 – ₹ 26,00,000) would not be recognised for the year ended 31st March, 2018.

As per para 59 of Ind AS 40, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes. When the property ceases to be an investment property, it is transferred into inventory at its then carrying amount of ₹ 2,00,00,000. This becomes the initial 'cost' of the inventory.

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

The additional costs of ₹ 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 ₹ 2,60,00,000.

The total selling price of the flats is expected to be ₹ 5,00,00,000 (10 x ₹ 50,00,000). Since the further costs to develop the flats total ₹ 40,00,000, their net realisable value is ₹ 4,60,00,000 (₹ 5,00,00,000 – ₹ 40,00,000), so the flats will be measured at a cost of ₹ 2,60,00,000.

The flats will be shown in inventory as a current asset

Q13: UK Ltd. has purchased a new head office property for ₹ 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
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 ₹ 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 ₹ 3 crores. The remaining cost of ₹ 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 ₹ 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%)	
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)

Q14: 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'.

Property '1' and '2'

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:

"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.

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.

Q15: Shaurya Limited owns Building A which is specifically used for the purpose of earning rentals. The Company has not been using the building A or any of its facilities for its own use for a long time. The company is also exploring the opportunities to sell the building if it gets the reasonable amount in consideration.

Following information is relevant for Building A for the year ending 31st March, 2020:

Building A was purchased 5 years ago at the cost of ₹10 crore and building life is estimated to be 20 years. The company follows straight line method for depreciation.

During the year, the company has invested in another Building B with the purpose to hold it for capital appreciation. The property was purchased on 1st April, 2019 at the cost of ₹ 2 crore. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

Further, during the year 2019-2020, the company earned / incurred following direct operating expenditure relating to Building A and Building B:

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

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

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of ₹ 50 - ₹ 60. It is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at ₹ 10.50 crore on 31st March, 2020.

What would be the treatment of Building A and Building B in the balance sheet of Shaurya Limited? Provide detailed disclosures and computations in line with relevant Indian accounting standards. Treat it as if you are preparing a separate note or schedule, of the given assets in the balance sheet. **[RTP Nov 2020]**

Ans: Investment property is held to earn rentals or for capital appreciation or both. Ind AS 40 shall be applied in the recognition, measurement and disclosure of investment property. An investment property shall be measured initially at its cost. After initial recognition, an entity shall measure all of its investment properties in accordance with the requirement of Ind AS 16 for cost model.

The measurement and disclosure of Investment property as per Ind AS 40 in the balance sheet would be depicted as follows:

INVESTMENT PROPERTIES:

Particulars	**Period ended 31st March, 2020 (₹in crore)**
Gross Amount:	
Opening balance (A)	10.00
Additions during the year (B)	2.00
Closing balance (C) = (A) + (B)	12.00
Depreciation:	
Opening balance (D)	2.50
Depreciation during the year (E) (0.5 + 0.05)	0.55
Closing balance (F) = (D) + (E)	3.05
Net balance (C) - (F)	8.95

The changes in the carrying value of investment properties for the year ended 31st March, 2020 are as follows:

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	**Period ending 31st March, 2020 (₹in crore)**
Rental income from investment properties (0.75 + 0.25)	1.00
Less: Direct operating expenses generating rental income (5+1+2.5+1.5+2+1)	(0.13)
Profit from investment properties before depreciation and indirect expenses	0.87
Less: Depreciation	(0.55)
Profit from earnings from investment properties before indirect expenses	0.32

Disclosure Note on Investment Properties acquired by the entity

The investment properties consist Property A and Property B. As at 31st March, 2020, the fair value of the properties is ₹10.50 crore. The valuation is performed by independent valuers, who are specialists in valuing investment properties. A valuation model as recommended by International Valuation Standards Committee has been applied. The Company considers factors like management intention, terms of rental agreements, area leased out, life of the assets etc. to determine classification of assets as investment properties.

The Company has no restrictions on the realisability of its investment properties and no contractual obligations to purchase, construct or develop investment properties or for repairs, maintenance and enhancements.

Description of valuation techniques used and key inputs to valuation on investment properties:

Valuation technique	Significant unobservable inputs	Range (Weighted average)
Discounted cash flow (DCF) method	- Estimated rental value per sq. ft. per month - Rent growth per annum - Discount rate	- ₹ 50 to ₹60 - 10% every 3 years - 12% to 13%

Q16: A Ltd. has various other assets, not used for operational activities, e.g., freehold land, townships in different locations, excess of office space rented to ABC, etc. Also, A Ltd. has some land, which are kept vacant as per the government regulations which require that a specified area around the plant should be kept vacant.

The details of these assets are as under:

Property	Details
A Ltd.'s office building (registered office)	A Ltd.'s registered office in Delhi, is a 15 storey building, of which only 3 floors are occupied by A Ltd., whereas remaining floors are given on rent to other companies. These agreements are usually for a period of 3 years. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future.
Flats in Township located in location 1	As regards township in Location I, there are approximately 2,000 flats in the said township. It was built primarily for A Ltd.'s employees, hence, approximately 80% of the flats are allotted to employees and remaining flats are either kept vacant or given on rent to other external parties. A lease agreement is signed between A Ltd. and an individual party for every 12 months being 1 April to 31 March. The lease entered is a cancellable lease (cancellable at the option of any of the parties). Also, besides monthly rent, additional charges are levied by A Ltd. on account of electricity, water, cable connection, etc. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees.
Flats in township	There are 1,000 flats in location 2 township, of which:

located in location 2	• 400 flats are given to employees for their own accommodation. • 350 flats are given on rent to Central Government and State Government for accommodation of their employees. Average lease period being 12 months with cancellable clause in lease agreements. • 250 flats are kept vacant.
Hostel located in location 1	60 rooms in the hostel have been let out to G Ltd., for giving accommodation to their personnel. Lease agreement is prepared for every 11 months and renewable thereafter. Besides the monthly rent amount, some charges are levied towards water, electricity and other amenities, e.g., cable connection, etc.
Land in location 1	In 2017, A Ltd. purchased a plot of land on the outskirts of a major city. The area has mainly low-cost public housing and very limited public transport facilities. The government has plans to develop the area as an industrial park in 5 years' time and the land is expected to greatly appreciate in value if the government proceeds with the plan. A Ltd. has not decided what to do with the property.
Land in location 1	A portion of land has been leased out to C Ltd. for its manufacturing operations. Land has been given on lease on a lease rental of INR 10 Lakhs p.a. with a lease term of 25 years.
Land in location 2	A portion of the land has been given on rent to D Ltd. who has constructed a petrol pump on such land. It has been leased since 1970, for a period of 40 years and renewed for a further period of 40 years.

Determine the classification of properties referred to in (c) above which are not held for operational purposes, with appropriate justification in the financial statements of A Ltd. considering the principles of IND AS. **[GFRS]**

Ans:

Property	**Classification of properties not held for operational purpose**
A Ltd.'s office building (registered office)	Excess portion of office space has been given on lease to earn rental income. Out of 15 storey building, only 3 floors are occupied by A Ltd. Such excess office space was constructed for the purpose of letting it out. According to A Ltd., such excess office space will continue to be let out on lease to external parties and have no plans to occupy it, at least in near future. Further, office space given on rent, although in same building, is separately identifiable from other owner occupied portion and hence can be sold separately (if required). Hence, the excess space will qualify to be an investment property.
Flats in Township located in location 1	Excess flats have been given on lease to earn rental income. According to A Ltd., there is no intention of selling such excess flats or allotting it to its employees. Further, flats given on rent, can be sold separately from flats occupied by A Ltd.'s employees as they are separately identifiable. A Ltd. also charges its lessees on account of ancillary services, i.e., water, electricity, cable connection, etc., but

	the monthly charges in such cases are generally not significant as compared to rental payments. Hence flats given on rent should qualify to be an 'investment property'. With regard to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Flats in township located in location 2	350 flats are given on lease to earn rental income and assuming that management intends to let out these flats on rent in future, such flats should be classified as an 'investment property. With regard to the flats kept vacant, A Ltd. has to evaluate the purpose of holding these flats, i.e., whether these would be kept for earning rentals or will it be allotted to its future employees. In case they are held for earning rentals, it would be classified as an investment property; and if they are held for allotment to future employees, it would form part of property, plant and equipment.
Hostel located in location 1	Rooms in a hostel have been let out to G Ltd. to be used by its personnel. A Ltd. also charges G Ltd. on account of ancillary services, i.e., water, electricity, cable connection, etc., but the monthly charges in such cases are generally not significant as compared to rental payments. Hence, it should be classified as an 'Investment property'.
Land in location 1	Although management has not determined a use for the property after the park's development takes place, yet in the medium-term the land is held for capital appreciation. As per IAS 40, if an entity has not determined that it will use the land either as owner-occupied property or for short term sale in the ordinary course of business, then it will be considered as land held for capital appreciation. Therefore, management should classify the property as an investment property.
Land in location 1	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period of time, it should be classified as 'Investment property'.
Land in location 2	Since the land is held with an intention of giving it on lease and earning capital appreciation over a period of time, it should be classified as 'Investment property'.

Q17: X Ltd owned a land property whose future use was not determined as at 31 March 20X1. How should the property be classified in the books of X Ltd as at 31 March 20X1?

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

(a) How should the land property be classified by X Ltd in its financial statements as at 31 March 20X2?

(b) Will there be a change in the carrying amount of the property resulting from any change in use of the investment property?

(c) Whether the change in classification to, or from, investment properties is a change in accounting policy to be accounted for in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors?

(d) Would your answer to (a) above be different if there were to be a management intention to commence construction of an office building for own use; however, no construction activity was planned by 31 March 20X2?

RTP May 2021

Ans: As per paragraph 8(b) of Ind AS 40, any land held for currently undetermined future use, should be classified as an investment property. Hence, in this case, the land would be regarded as held for capital appreciation. Hence the land property should be classified by X Ltd as investment property in the financial statements as at 31 March 20X1.

As per Para 57 of the Standard, an entity can change the classification of any property to, and from, an investment property when and only when evidenced by a change in use. A change occurs when the property meets or ceases to meet the definition of investment property and there is evidence of the change in use. Mere management's intention for use of the property does not provide evidence of a change in use.

(a) Since X Ltd has commenced construction of office building on it for own use, the property should be reclassified from investment property to owner occupied as at 31 March 20X2.

(b) As per Para 59, transfers between investment property, owner occupied and inventories do not change the carrying amount of the property transferred and they do not change the cost of the property for measurement or disclosure purposes.

(c) No. The change in classification to, or from, investment properties is due to change in use of the property. No retrospective application is required and prior period's financial statements need not be re-stated.

(d) Mere management intentions for use of the property do not evidence change in use. Since X Ltd has no plans to commence construction of the office building during 20X1-20X2, the property should continue to be classified as an investment property by X Ltd in its financial statements as at 31 March 20X2.

NOTES

CHAPTER 14
BORROWING COSTS (IND AS 23)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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.

Q2: 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 (₹)
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 (₹)	Interest (₹)
Long term loan @ 10%	10,00,000	1,00,000
Working capital loan	5,00,000	65,000
	15,00,000	1,65,000

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

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

Q3: Alpha Ltd on 1St April 20X1 borrowed 9% ₹ 30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April 20X1. The loan facility was availed on 1st April 20X1 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory 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

Q4: Beta Ltd had the following loans in place at the end of 31st March 20X2:

(Amounts in ₹ 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: ₹ 500,000 on 1st April 20X1 and ₹ 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)	₹1,85,625

Q5: 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

Q6: 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 ₹ 45 per USD. The exchange rate, as at March 31, 20X4, is ₹ 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 ₹ 48/USD = ₹ 24,000/-

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

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

= USD 10000 x 45 x 11%). = ₹ 49,500

Difference between interest on local currency borrowing and foreign currency borrowing

= ₹ 49,500 - ₹ 24,000 =₹ 25,500

Therefore, out of ₹ 30,000 increase in the liability towards principal amount, only ₹ 25,500 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 49,500 being the aggregate of interest of ₹ 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 ₹ 25,500. Thus, ₹ 49,500 would be considered as the borrowing cost to be accounted for as per IND AS 23 and the remaining ₹ 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.

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 ₹ 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., ₹ 34,500 (₹ 58,500 - ₹ 24,000) is more than the exchange difference of ₹ 30,000. Therefore, in such a case, the total borrowing cost would be ₹ 54,000 (₹ 24,000 + ₹ 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.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q7: A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.

State whether borrowing costs incurred to finance the production of inventories (cheese) that have a long production period, be capitalised?

Ans: Ind AS 23 does not require the capitalisation of borrowing costs for inventories that are manufactured in large quantities on a repetitive basis. However, interest capitalisation is permitted as long as the production cycle takes a 'substantial period of time', as with cheese.

Q8: A company is in the process of developing computer software. The asset has been qualified for recognition purposes. However, the development of computer software will take substantial period of time to complete.

a. Can computer software be termed as a 'qualifying asset' under Ind AS 23?

b. Is management intention considered when assessing whether an asset is a qualifying asset?

Ans:

a) Yes. An intangible asset that takes a substantial period of time to get ready for its intended use or sale is a 'qualifying asset'. This would be the case for an internally generated computer software in the development phase when it takes a 'substantial period of time' to complete.

b) Yes. Management should assess whether an asset, at the date of acquisition, is 'ready for its intended use or sale'. The asset might be a qualifying asset, depending on how management intends to use it. For example, when an acquired asset can only be used in combination with a larger group of fixed assets or was acquired specifically for the

construction of one specific qualifying asset, the assessment of whether the acquired asset is a qualifying asset is made on a combined basis.

Q9: A telecom company has acquired a 3G license. The licence could be sold or licensed to a third party. However, management intends to use it to operate a wireless network. Development of the network starts when the license is acquired.

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

Ans: Yes. The license has been exclusively acquired to operate the wireless network. The fact that the license can be used or licensed to a third party is irrelevant. The acquisition of the license is the first step in a wider investment project (developing the network). It is part of the network investment, which meets the definition of a qualifying asset under Ind AS 23.

Q10: A real estate company has incurred expenses for the acquisition of a permit allowing the construction of a building. It has also acquired equipment that will be used for the construction of various buildings.

Can borrowing costs on the acquisition of the permit and the equipment be capitalised until the construction of the building is complete

Ans: **With respect to Permit**

Yes, since permit is specific to one building. It is the first step in a wider investment project. It is part of the construction cost of the building, which meets the definition of a qualifying asset.

With respect to Equipment

No, since the equipment will be used for other construction projects. It is ready for its 'intended use' at the acquisition date. Hence, it does not meet the definition of a qualifying asset.

Q11: On 1st April, 20X1, A Ltd. took a 8% loan of ₹ 50,00,000 for construction of building A which is repayable after 6 years ie on 31st March 20X7. The construction of building was completed on 31st March 20X3. A Ltd. started constructing a new building B in the year 20X3-20X4, for which he used his existing borrowings. He has outstanding general purpose loan of ₹ 25,00,000, interest on which is payable @ 9% and ₹ 15,00,000, interest on which is payable @ 7%.

Is the specific borrowing transferred to the general borrowings pool once the respective qualifying asset is completed? Why

Ans: Yes. If specific borrowings were not repaid once the relevant qualifying asset was completed, they become general borrowings for as long as they are outstanding.

The borrowing costs that are directly attributable to obtaining qualifying assets are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. If cash was not spent on other qualifying assets, it could be directed to repay this specific loan. Thus, borrowing costs could be avoided (that is, they are directly attributable to other qualifying assets).

- When general borrowings are used for qualifying assets, Ind AS 23 requires that, borrowing costs eligible for capitalisation is calculated by applying a capitalisation rate to the expenditures on qualifying assets.

- The amount of borrowing costs eligible for capitalisation is always limited to the amount of actual borrowing costs incurred during the period.

Q12: In a group with Parent Company "P" there are 3 subsidiaries with following business:

"A" – Real Estate Company

"B" – Construction Company

"C" – Finance Company

- Parent Company has no operating activities of its own but performs management functions for its subsidiaries.
- Financing activities and cash management in the group are coordinated centrally.
- Finance Company is a vehicle used by the group solely for raising finance.
- All entities in the group prepare Ind AS financial statements.

The following information is relevant for the current reporting period 20X1-20X2:

Real Estate Company

- Borrowings of ₹ 10,00,000 with an interest rate of 7% p.a.
- Expenditures on qualifying assets during the period amounted to ₹ 15,40,000.
- All construction works were performed by Construction Company. Amounts invoiced to Real Estate Company included 10% profit margin.

Construction Company

- No borrowings during the period.
- Financed ₹ 10,00,000 of expenditures on qualifying assets using its own cash resources.

Finance Company

- Raised ₹ 20,00,000 at 7% p.a. externally and issued a loan to Parent Company for general corporate purposes at the rate of 8%.

Parent Company

- Used loan from Finance Company to acquire a new subsidiary.
- No qualifying assets apart from those in Real Estate Company and Construction Company.
- Parent Company did not issue any loans to other entities during the period.

What is the amount of borrowing costs eligible for capitalisation in the financial statements of each of the four entities for the current reporting period 20X1-20X2?

Ans: Following is the treatment as per Ind AS 23:

Finance Company

No expenditure on qualifying assets have been incurred, so Finance Company cannot capitalise anything.

Real Estate Company

Total interest costs in the financial statements of Real Estate Company is ₹ 70,000. Expenditures on qualifying assets exceed total borrowings, so the total amount of interest can be capitalised.

Construction Company

No interest expense has been incurred, so Construction Company cannot capitalise anything.

Consolidated financial statements of Parent Company:

Total general borrowings of the group: ₹ 10,00,000 + ₹ 20,00,000 = ₹ 30,00,000

Although Parent Company used proceeds from loan to acquire a subsidiary, this loan cannot be excluded from the pool of general borrowings.

Total interest expenditures for the group = ₹ 30,00,000 x 7% = ₹ 2,10,000

Total expenditures on qualifying assets for the group are added up. Profit margin charged by Construction Company to Real Estate Company is eliminated:

Real Estate Company – ₹ 15,40,000/1.1 = ₹ 14,00,000 Construction Co – ₹ 10,00,000

Total consolidated expenditures on qualifying assets:

₹ (14,00,000 + 10,00,000) = ₹ 24,00,000

Capitalisation rate = 7%

Borrowing costs eligible for capitalisation = ₹ 24,00,000 x 7% = ₹ 1,68,000

Total interest expenditures of the group are higher than borrowing costs eligible for capitalisation calculated based on the actual expenditures incurred on the qualifying assets. Therefore, only ₹ 1,68,000 can be capitalised.

QUESTIONS FROM OTHER SOURCE

Q13: Rainbow Limited borrowed an amount of ₹150 crores on 1.4.2008 for construction of boiler plant @ 11% p.a. The plant is expected to be completed in 4 years. Since the weighted average cost of capital is 13% p.a., the accountant of Rainbow Ltd. capitalized ₹19.50 crores for the accounting period ending on 31.3.2009. Due to surplus fund, out of ₹150 crores, an income of ₹3.50 crores was earned and credited to profit and loss account. Comment on the above treatment of accountant with reference to relevant accounting standard.

Ans: IND AS 23 'Borrowing Costs' states, "to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings." The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. Hence, in the above case,

treatment of accountant of Rainbow Ltd. is incorrect. The amount of borrowing costs capitalized for the financial year 2008-2009 should be calculated as follows:

Actual interest for 2008-2009 (11% of ₹150 crores)	₹16.50 crores
Less: Income on temporary investment from specific borrowings	₹ 3.50 crores
Borrowing costs to be capitalized during year 2008-2009	₹ 13.00 crores

Q14: In May, 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹18 lakh, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to 25 lakh. Can ₹25 lakh be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

Ans: IND AS 23 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2005) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Q15: On 1st April, 2009, Amazing Construction Ltd. obtained a loan of ₹ 32 crores to be utilized as under:

(i) Construction of sealink across two cities: (work was held up totally for a month during the year due to high water levels): ₹ 25 crores

(ii) Purchase of equipments and machineries : ₹ 3 crores

(iii) Working capital: ₹ 2 crores

(iv) Purchase of vehicles: ₹ 50,00,000

(v) Advance for tools/cranes etc.: ₹ 50,00,000

(vi) Purchase of technical know-how: ₹ 1 crores

(vii) Total interest charged by the bank for the year ending 31.03.2010: ₹ 80 lacs

Show the treatment of interest by Amazing Construction Ltd. **[Nov 2010]**

Ans: According to IND AS 23 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per this standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred. The treatment of interest by Amazing Construction Ltd. can be shown as:

		Qualifying Asset	Interest to be capitalized	Interest to be charged to P/L A/c
1	Construction of sea-link	Yes	62,50,000	

			(80,00,000*(25/32	
2	Purchase of equipments and machineries	No		7,50,000 (80,00,000*(3/32)
3	Working capital	No		5,00,000 (80,00,000*(2/32)
4	Purchase of vehicles	No		1,25,000 (80,00,000*(.5/32)
5	Advance for tools, cranes etc.	No		1,25,000 (80,00,000*(.5/32)
6	Purchase of technical know-how	No		2,50,000 (80,00,000*(1/32)
	Total		**62,50,000**	**17,50,000**

Q16: XYZ Ltd., has undertaken a project for expansion of capacity as per the following details:

	Plan	Actual
	₹	₹
April, 2006	2,00,000	2,00,000
May, 2006	2,00,000	3,00,000
June, 2006	10,00,000	–
July, 2006	1,00,000	–
August, 2006	2,00,000	1,00,000
September, 2006	5,00,000	7,00,000

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had ₹ 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over ₹ 10 lakhs from 01-09-2002. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure were incurred on 1st Day of each month. Calculate:

1. Interest to be capitalized.
2. Give reasons wherever necessary.

Assume:

a. Overdraft will be less, if there is no capital expenditure.

b. The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time.

Ans:

Month	Actual Expense on Qualifying Assets	Interest to be capitalized	Remark

April 2002	200,000x3/12x12/100	6,000	April, May, July
May 2002	300,000x2/12x12/100	6,000	May, July
June 2002	-	-	-
July 2002	-	-	-
August 2002	100,000	Nil	-
Sept. 2002	700,000x1/12x12/100	7,000	September
	13,00,000	19,000	

Q17: Faulad Iron and Steel Ltd. is establishing an integrated steel plant consisting of four phases. It is expected that the full plant will be established over several years but Phase I and Phase II of the Plant will be started as soon as they are completed.

Following is the detail of the work done on different phases of the plant during the current year:

	Phase I	Phase II	Phase III	Phase IV
	₹	₹	₹	₹
Cash expenditure	20,00,000	35,00,000	25,00,000	40,00,000
Plants purchased	28,00,000	40,00,000	30,00,000	48,00,000
Total expenditure	48,00,000	75,00,000	55,00,000	88,00,000
Total expenditure of all phases				2,66,00,000
Loan taken @ 16%				**2,40,00,000**

During current year, Phases I and II have become operational. Find out the total amount to be capitalized and to be expensed during the year.

Ans: In this case, the total capital expenditure is ₹ 2,66,00,000 while the loan taken is ₹ 2,40,00,000 only. It appears that the balance amount of ₹ 26,00,000 would have been spent by the company from its own resources on which no interest would have been payable. Interest payable on loan of ₹ 2,40,00,000 @ 16% is ₹ 38,40,000. This interest cost is consisting of two components i.e., interest to be expensed and interest to be capitalized.

As Phases I and II have become operational during the year, the interest in proportion to their cost should be treated as expense of the year and interest in respect of Phases III and IV should be capitalized.

	₹
Total cost of Phases I and II (₹ 48,00,000 + ₹ 75, 00,000)	1,23,00,000
Total Cost of Phases III and IV (₹ 55,00,000 + ₹ 88,00,000)	1,43,00,000
Total cost	2,66,00,000
Total loan	2,40,00,000
Proportionate loan used for Phases I and II	
[2,40,00,000/2,66,00,000]x1,23,00,000	1,10,97,744
Proportionate loan used for Phases III and IV	
[2,40,00,000/2,66,00,000]x1,43,00,000	1,29,02,256
Interest on loan used for Phases I and II @ 16%	17,75,639

Interest on loan used for Phases III and IV @ l6%	20,64,361
Total Interest	38,40,000

Interest amounting ₹ 20,64,361 should be capitalized and added to the cost of Phases III and IV, and ₹ 17,75,639 should be treated as expense of the year.

QUESTIONS FROM RTP/MTP/EXAMS

Q18: An entity constructs a new head office building commencing on 1st September 20X1, which continues till 31st December 20X1 *(and is expected to go beyond a year)*. Directly attributable expenditure at the beginning of the month on this asset are ₹ 100,000 in September 20X1 and ₹ 250,000 in each of the months of October to December 20X1.

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

Calculate the capitalization rate for computation of borrowing cost in accordance with Ind AS 23 'Borrowing Costs'. **[RTP May 2018; Exam Mov 2019]**

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

Weighted average borrowings during period

= (20,00,000 x 4) + (500,000 x 4) +(750,000 x 1) /4 = ₹ 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%

Alternative Solution

Calculation of capitalization rate on borrowings other than specific borrowings

Nature of general borrowings	Period of outstanding balance	Amount of loan (₹)	Rate of interest p.a.	Weighted average amount of interest (₹)
	a	B	c	d = [(b x c) x (a/12)]
9% Debentures	12 months	20,00,000	10%	2,00,000

Bank overdraft	9 months	5,00,000	15%	56,250
	2 months	5,00,000	16%	13,333
	1 month	7,50,000	16%	10,000
		46,00,000		2,79,583

Weighted average cost of borrowings

= {20,00,000 x(12/12)} + {5,00,000 x (11/12)} + {7,50,000 x (1/12)}

= 25,20,833

Capitalisation Rate = (Weighted average amount of interest / Weighted average of general borrowings) x 100

= (2,79,583 / 25,20,833) x 100 = 11.09% p.a.

Q19: On 1st April, 20X1, entity A contracted for the construction of a building for ₹ 22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 20X2, and during the period the following payments were made to the contractor:

Payment date	**Amount (₹ '000)**
1st April, 20X1	200
30th June, 20X1	600
31st December, 20X1	1,200
31st March, 20X2	200
Total	2,200

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

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 20X2 amounted to ₹ 7,00,000. Interest of ₹ 65,000 was incurred on these borrowings during the year, and interest income of ₹ 20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,000,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 20X1 amounted to ₹ 1,500,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS?

Ans: As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

The amount of borrowing costs eligible for capitalization, in cases where the funds are borrowed generally, should be determined based on the expenditure incurred in obtaining a qualifying asset. The costs incurred should first be allocated to the specific borrowings.

Analysis of expenditure:

Date	Expenditure (₹'000)	Amount allocated in general borrowings (₹'000)	Weighted for period outstanding (₹'000)
1st April 20X1	200	0	0
30th June 20X1	600	100*	100×9/12=75
31st Dec 20X1	1,200	1,200	1,200×3/12=300
31st March 20X2	200	200	200×0/12=0
Total	2,200		375

*Specific borrowings of ₹ 7,00,000 fully utilized on 1st April & on 30th June to the extent of ₹ 5,00,000 hence remaining expenditure of ₹ 1,00,000 allocated to general borrowings.

The expenditure rate relating to general borrowings should be the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset.

Capitalisation rate = (10,00,000 x 12.5%) + (15,00,000 x 10%) /10,00,000 + 15,00,000 = 11

Borrowing cost to be capitalized:	**Amount (₹)**
On specific loan	65,000
On General borrowing (3,75,000 × 11%)	41,250
Total	1,06,250
Less interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250

Therefore, the borrowing costs to be capitalized are ₹ 86,250.

Q20: X Ltd. began construction of a new building on 1st January, 2007. It obtained ₹1 lakh special loan to finance the construction of the building on 1st January, 2007 at an interest rate of 10%. The company's other outstanding two non–specific loans were:

₹5,00,000	11%
₹9,00,000	13%

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

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**				
	₹2,00,000 x 12 / 12 =				2,00,000
	₹ 2,50,000 x 9 / 12 =				1,87,500
	₹ 4,50,000 x 6 / 12 =				2,25,000
	₹ 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 ₹)			**Rate of interest**	**Amount of interest (in ₹)**
	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 (₹ 1,00,000 X 10%) =				10,000
	Non-specific borrowings (₹ 5,22,500* X 12.285%) =				64,189
	Amount of interest to be capitalized =				74,189
	*(₹ 6,22,500 – ₹ 1,00,000)				
(iv)	**Total expenses to be capitalized for building**				
	Cost of building ₹(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. (₹)**	**Cr. (₹)**
	31.12.2007	Building account -To Bank account (Being amount of cost of building and borrowing cost thereon capitalized)	Dr.	10,94,189	

Q21: How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹ 2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

RTP May 2021

Ans: Capitalisation Method

As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Capitalisation of Interest

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

Quantum of Borrowing

The value of the bond to Y Ltd. is the transaction price ie ₹ 1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at ₹ 1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Opening Borrowing	Interest expense @ 13.39% to be capitalised	Total	Interest paid	Closing Borrowing
	(1)	(2)	(3)	(4)	(5) = (3) – (4)
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of ₹ 48,753 will be capitalized to the cost of qualifying asset.

NOTES

CHAPTER 15

ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE (IND AS 20)

CONCEPT EXAMPLES

Examples Government assistance

1. Free technical assistance or marketing advice and the provision of guarantees are forms of government assistance to which no value could reasonably be assigned.

2. An example of transactions with government which cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales. The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary.

3. **Assistance in the form of priority bidding status:** A government specifies that entities below a certain size are to be given priority in bidding for a particular type of government contract by mandating a minimum number of such entities to obtain bidding status. Although the entities will benefit from the quota, the value cannot be identified and the effects of the assistance cannot be segregated from the trading activities of the entities.

4. **Assistance in the form of credit facilities at market rates:** Three governments that amongst themselves own just over 50% of the shares in an airline, participate in granting it a revolving credit facility at a market rate of interest. This is not a government grant as loan is provided at market rate of interest which any private market participant might have accepted. However, it is a government assistance as the benefit cannot be distinguished from normal trading activities of the airline.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: Government gives a grant of ₹ 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.

Q2: Government gives a grant of ₹ 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.

Q3: 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 ₹ 10,00,000 to A Limited so that 100 artisans are rehabilitated over a period of 3 years. Government releases ₹ 2,00,000. Examine how the Government grant be realized.

Ans: A Limited will recognise ₹ 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.

Q4: A Limited received from the government a loan of ₹ 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 ₹ 37,38,328.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹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
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 ₹ 12,61,672 (₹ 50,00,000 – ₹ 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

₹ 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)

Q5: 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: ₹ 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. ₹ 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. ₹ 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. ₹ 12,61,672 will be recognised in profit or loss on the same basis as depreciation.

Q6: 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 ₹ 10,000 per acre. The fair value of the land is ₹ 100,000 per acre. Calculate the amount of the Government grant to be recognized by an entity.

Ans: A limited will recognise ₹ 450,000 [(₹ 100,000 – ₹ 10,000) x 5)] as government grant.

Q7: A Limited establishes solar panels to supply solar electricity to its manufacturing plant. The cost of solar panels is ₹ 1,00,00,000 with a useful life of 10 years. The depreciation is provided on straight line method basis. The government gives ₹ 50,00,000 as a subsidy. Examine how the Government grant be realized.

Ans: A Limited will set up ₹ 50,00,000 as deferred income and will credit ₹ 5,00,000 equally to its statement of profit and loss over next 10 years.

Alternatively, A Ltd. may deduct ₹ 50,00,000 from the cost of solar panel of ₹ 1,00,00,000.

Q8: 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 ₹ 1,00,00,000 being acquisition of solar panels as outflow in investing activities. The receipt of ₹ 50,00,000 from government will be shown as inflow under financing activities.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q8: 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.

Ans: 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, as per Ind AS 20, 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�1. 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.

Q9: An entity opens a new factory and receives a government grant of ₹ 15,000 in respect of capital equipment costing ₹ 1,00,000. It depreciates all plant and machinery at 20% per annum on straight-line basis. Show the statement of profit and loss and balance sheet extracts in respect of the grant for first year under both the methods as per Ind AS 20

Ans:

(a) When grant is treated as deferred income

Statement of profit and loss – An extract

	₹
Depreciation (₹ 1,00,000 x 20%)	(20,000)
Government grant credit (W.N.1)	3,000

Balance Sheet - An extract

		₹
Non-current assets		
Property, plant and equipment	1,00,000	
Less: Accumulated depreciation	(1,00,000 x 20%) (20,000)	80,000
		????
Non-current liabilities		
Government grant	[12,000 – 3,000 (current liability)]	9,000
Current liabilities		
Government grant	(15,000 x 20%)	3,000
		????

Working Note:

1. Government grant deferred income account

	₹		₹
To Profit or loss	3,000	By Grant cash received	15,000
(15,000 × 20%)			
To Balance c/f	12,000		
	15,000		15,000

(b) When grant is deducted from cost of the asset

Statement of profit and loss – An extract

	₹
Depreciation [(₹ 1,00,000 – 15,000) x 20%]	(17,000)

Balance Sheet - An extract

		₹
Non-current assets		
Property, plant and equipment	(1,00,000-15,000) 85,000	
Less: Accumulated depreciation	(17,000)	68,000

Q10: A company receives a cash grant of ₹ 30,000 on 31 March 20X1. The grant is towards the cost of training young apprentices. Training programme is expected to last for 18 months starting from 1 April 20X1. Actual costs of the training incurred in 20X1-20X2 was ₹ 50,000 and in 20X2-20X3 ₹ 25,000. State, how this grant should be accounted for?

Ans: At 31st March 20X1 the grant would be recognised as a liability and presented in the balance sheet as a split between current and non-current amounts.

₹ 20,000 [(12 months / 18 months) x 30,000] is current and would be recognised in profit and loss for the year ended 31st March, 20X1. The balance amount of ₹ 10,000 will be shown as non-current.

At the end of year 20X1-20X2, there would be a current balance of 10,000 (being the non-current balance at the end of year 20X1-20X1 reclassified as current) in the balance sheet. This would be recognised in profit in the year 20X2-20X3.

Extracts from the financial statements are as follows:

Balance Sheet (extracts)

	31 March 20X1	31 March 20X2	31 March 20X3
Current liabilities			

Deferred income	20,000	10,000	-
Non-current liabilities			
Deferred income	10,000	-	-

Statement of profit and loss (extracts)

	31 March 20X2	31 March 20X3
Method 1		
Other Income - Government grant received	20,000	10,000
Training costs	(50,000)	(25,000)
Method 2		
Training costs (50,000 – 20,000)	30,000	
Training costs (25,000 – 10,000)		15,000

Q11: A Ltd. has received a grant of ₹ 10,00,00,000 in the year 20X1-20X2 from local government in the form of subsidy for selling goods at lower price to lower income group population in a particular area for two years. A Ltd. had accounted for the grant as income in the year 20X1-20X2. While accounting for the grant in the year 20X1-20X2, A Ltd. was reasonably assured that all the conditions attached to the grant will be complied with. However, in the year 20X5-20X6, it was found that A Ltd. has not complied with the above condition and therefore notice of refund of grant has been served to it. A Ltd. has contested but lost in court in 20X5-20X6 and now grant is fully repayable. How should A Ltd. reflect repayable grant in its financial statements ending 20X5-20X6?

Ans: Note: It is being assumed that the accounting done in previous years was not incorrect and was not in error as per Ind AS 8.

Paragraph 32 of Ind AS 20, states that a Government grant that becomes repayable shall be accounted for as a change in accounting estimate (see Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors).

Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

Repayment of a grant related to an asset shall be recognised by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognised in profit or loss to date in the absence of the grant shall be recognised immediately in profit or loss.

The following journal entries should be passed:

S. No.	Particulars	Nature of Account	Dr./Cr.	Amount (₹ in crores)
(i)	Repayment of Government Grant	Expense (P/L)	Dr.	10

	To Grant repayable (Being recognition of repayment of grant in statement of profit or loss)	Balance sheet (Liability)		10
(ii)	Grant repayable To Bank (Being grant refunded)	Balance sheet (Liability) Balance sheet (Asset)	Dr.	10 10

Assuming that no deferred credit balance exists in the year 20 X5-20X6, therefore repayment recognised in P&L.

It may also be noted that the standard also provides that circumstances giving rise to repayment of a grant related to an asset may require consideration to be given to the possible impairment of the new carrying amount of the asset

Q12: A Ltd. received a government grant of ₹ 10,00,000 to defray expenses for environmental protection. Expected environmental costs to be incurred is ₹ 3,00,000 per annum for the next 5 years. How should A Ltd. present such grant related to income in its financial statements?

Ans: As per paragraph 29 of Ind AS 20, Grants related to income are presented as part of profit or loss, either separately or under a general heading such as „Other income‟; alternatively, they are deducted in reporting the related expense.

In accordance with the above, presentation of grants related to income under both the methods are as follows:

Method 1: Credit in the statement of profit and loss

The entity can recognise the grant as income on a straight line basis i.e., ₹ 2,00,000 per year in the statement of profit and loss either separately or under the head "Other Income".

The supporters of this method consider it inappropriate to present income and expense items on a net basis and that „separation of the grant from the expense facilitates comparison with other expenses not affected by a grant‟.

Method 2: As a deduction in reporting the related expense

Since the grant relates to environmental expenses incurred/to be incurred by the entity, it can present the grant by reducing the grant amount every year from the related expense i.e., environmental expense of ₹ 1,00,000 (i.e., net expense ₹ 3,00,000 – ₹ 2,00,000).

The supporters of this method are of the view that „the expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading‟.

The Standard regards both the methods as acceptable for the presentation of grants related to income. However, method 2 may be more appropriate when the company can relate the grant to a specific expenditure.

The Standard also provides that disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate

QUESTIONS FROM OTHER SOURCE

Q13: ABC Limited purchased a machinery for ₹ 25,00,000 which has estimated useful life of 10 years with the salvage value of ₹ 5,00,000. On purchase of the assets Central Government pays a grant for ₹ 5,00,000. Pass the journal entries with narrations in the books of the company for the first year, treating grant as deferred income.

Ans: Journal Entries in the books of ABC Ltd.

Year	Particulars		Dr. (₹)	Cr. (₹)
1st	Machinery Account	Dr.	25,00,000	
	To Bank Account			25,00,000
	(Being machinery purchased)			
	Bank Account	Dr.	5,00,000	
	To Deferred Government Grant Account			5,00,000
	(Being grant received from the government treated as deferred income)			
	Depreciation Account (25,00,000 – 5,00,000)/10	Dr.	2,00,000	
	To Machinery Account			2,00,000
	(Being depreciation charged on Straight line method)			
	Profit & Loss Account	Dr.	2,00,000	
	To Depreciation Account			2,00,000
	(Being depreciation transferred to P/L Account)			
	Deferred Government Grant Account (5,00,000/10)	Dr.	50,000	
	To Profit & Loss Account			50,000
	(Being proportionate government grant taken to P/L Account)			

Q14: X Ltd. purchased fixed assets for ₹ 10 lakhs for which it got grants from an international agency (which comes within the definition of government as mentioned in IND AS 20) ₹ 8 lakhs. X Ltd. decides to treat the grant as deferred income. Suggest appropriate basis for taking credit of the grant to Profit and Loss A/c. Take life of the assets 10 years. The company followed W.D.V method. Scrap value ₹ 2.5 lakhs.

Ans: Deferred income on account of grant should be taken credit at the proportion by which depreciation is charged.

Calculation of Depreciation and taking Credit of Deferred Grant (Depreciation Rate 12.95% calculated by using the formula of rate of depreciation for RBM)

WDV rate of depreciation = $1 - \sqrt[n]{\frac{\text{Residual value}}{\text{Cost of Asset}}} \times 100$

	Original Cost /W. D.V (₹ in Lakhs)	Depreciation (₹ in Lakhs)	Recovery of Grant (₹ in Lakhs)
t0	10.000	–	–
t1	10.000	1.295	1.381
t2	8.705	1.127	1.202
t3	7.578	0.981	1.046
t4	6.597	0.854	0.912
t5	5.743	0.744	0.794
t6	4.999	0.647	0.690
t7	4.352	0.564	0.602
t8	3.788	0.491	0.524
t9	3.297	0.427	0.455
t10	2.870	0.370	0.394

Q15: Siva Limited received a grant of ₹ 1,500 lakhs during the last accounting year (2009-10) from Government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However during the year 2010-11, it was found that the conditions of the grant were not complied with and the grant had to be refunded to the Government in full. Elucidate the current accounting treatment with reference to the provisions of IND AS-20.

Ans: As per IND AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', Government Grant may, sometimes, become refundable if certain conditions are not fulfilled.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortized deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the given case, the amount of refund of grant of ₹ 1,500 lakhs should be charged to the profit and loss account in the year 2010-2011.

Q16: Yogya Ltd. received a specific grant of ₹ 300 lakhs for acquiring the plant of ₹ 1,500 lakhs during 2009-10 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2012-13, due to noncompliance of conditions laid down for the grant of ₹ 300 lakhs, the company had to refund the grant to the Government. Balance in the deferred income on that date was ₹ 210 lakhs and written down value of plant was ₹ 1,050 lakhs.

What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2012-13 in the Statement of Profit and Loss?

Assume depreciation is charged on assets as per Straight Line Method.

Ans: As per IND AS 20, amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent

the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 300 lakhs and balance in deferred income is ₹ 210 lakhs, therefore, ₹ 90 lakhs shall be charged to the profit and loss account for the year 2012-13. There will be no effect on the cost of the fixed asset and depreciation charge will be same as charged in the earlier years.

Q17: Grant Medicare Ltd. acquired 5 units of Brain Scan Equipment for US$ 5,00,000 in April 2010 incurring ₹ 20,00,000 on sea freight and US$ 12,000 per unit towards transit Insurance, bank charges etc. The purchase was partly funded out of the company's internal accruals and from Government Grant of ₹ 94 Lakhs. The prevailing exchange rate to the US$ was 50. The company estimated the useful life of the equipment at 4 years with an estimated salvage value of 13% (approx). The grant was considered as Deferred Income up to 2012-13 and in April 2013 the company had to return the entire grant received due to non fulfillment of certain conditions. You are required to show the deprecation and the grant that is to be recognized in the Profit & Loss accounts for the period commencing, 2010-11 onwards and also draw up the entry that is passed in April 2013 for the return of the Grant. The Company follows the written down value method for depreciating its assets. **[Nov, 2014]**

Ans: Statement showing annual depreciation and amount of Grant to be recognized in P& L A/c

				(Rupees in Lakhs)
Year	**Value of asset**	**Depr.@40%**	**Closing Value**	**Deferred grant to be Recognized***
2010-11	300.00	120.00	180.00	43.20
2011-12	180.00	72.00	108.00	25.92
2012-13	108.00	43.20	64.80	15.55
2013-14	64.80	25.92	38.88	9.33
Total		261.12	94.00	

*[94 X dep. for the year]/Total Depreciation

The entries for depreciation & recognition of the grant will be as per the above table for the year 2010-11, 2011-12 & 2012-13

The entry for the return of the Grant of ₹ 94 lakhs in April 2013 will be as under:

Deferred Grant Account	Dr.	9.33	
Profit & Loss Account (43.20+25.92+15.55)	Dr.	84.67	
To Bank			94.00

(Being the return of the Grant received in April 2010 due to non-fulfillment of conditions)

Working Note:

1.	**Calculation Revised Book Value of Machine as on 1st April, 2010**	
	Particulars	**(₹ in lakhs)**
	Acquisition of 5 units of brain scan units [US $ 5,00,000 x ₹ 50]	250

	Add: Sea Freight on the above units	20
	Add: Transit insurance, Bank charges etc. paid ($ 12,000 x ₹ 50 x 5)	30
	Total landed cost as on 1st April, 2010	300
2.	**Calculation of WDV rate**	
	WDV rate of depreciation = $1-\sqrt[n]{\frac{\text{Residual value}}{\text{Cost of Asset}}} \times 100$	
	$= 1-\sqrt[4]{\frac{39}{300}} \times 100 = 40\%$	

Q18: ABC Ltd. has received the following grants from the Government of Delhi for its newly started pharmaceutical business:

- ₹ 20 lakhs received for immediate start-up of business without any condition.
- ₹ 50 lakhs received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
  - that drug should be available to the public at 20% cheaper from current market price: and
  - the drugs should be in accordance with quality prescribed by the World Health Organisation [WHO].
- Two acres of land (fair Value: ₹ 10 Lakhs) received for set up plant.
- ₹ 2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis.

How should ABC Ltd. recognise the government grants in its books of accounts?

Ans: ABC Ltd. should recognise the grants in the following manner:

- ₹ 20 lakhs has been received for immediate start-up of business. This should be recognised in Statement of Profit and Loss immediately as there are no conditions attached to the grant.
- ₹ 50 lakhs should be recognised in profit or loss on a systematic basis over the periods which the entity recognises as expense the related costs for which the grants are intended to compensate provided that there is reasonable assurance that ABC Ltd. will comply with the conditions attached to the grant.
- Land should be recognised at fair value of ₹ 10 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income.
- ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs/5] should be credited to profit and loss each year over period of 5 years.

QUESTIONS FROM RTP/MTP/EXAMS

Q19: A Limited received from the government a loan of ₹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 ₹ 74,76,656.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on ₹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 ₹ 25,23,344 (₹ 1,00,00,000 – ₹ 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

₹ 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. ₹ 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

Q20: 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 ₹ 12 lakh and acquired value by Government is ₹ 8 lakhs).

(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 ₹ 25 lakh for immediate start-up of a business without any condition.

(iv) S Ltd. received ₹ 10 lakh for purchase of machinery costing ₹ 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 ₹ 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 ₹ 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) ₹ 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) ₹ 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, ₹ 1,00,000 [₹ 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 ₹ 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 ₹ 1.

Q21: Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of ₹ 1,00,000 each, relating to the following ongoing research and development projects:

The first grant relates to the "Clean river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures.

The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

Suggest the accounting treatment of, if any, for the two grants received and the flood - related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.

[RTP MAY 2020]

Ans: Accounting treatment for:

First Grant

The first grant for 'Clear River Project' involving research into effects of various chemicals waste from the industrial area in Madhya Pradesh, seems to be unconditional as no details regarding its refund has been mentioned. Even though the research has not been started nor any major steps have been completed by Rainbow Limited to commence the research, yet the grant will be recognised immediately in profit or loss for the year ended 31st March, 20X2.

Alternatively, in case, the grant is conditional as to expenditure on research, the grant will be recognised in the books of Rainbow Limited over the year the expenditure is being incurred.

Second Grant

The second grant related to commercial development of a new equipment is a grant related to depreciable asset. As per the information given in the question, the equipment will be available for sale in the market from April, 20X3. Hence, by that time, grant relates to the construction of an asset and should be initially recognised as deferred income.

The deferred income should be recognised as income on a systematic and rational basis over the asset's useful life.

The entity should recognise a liability on the balance sheet for the years ending 31st March, 20X2 and 31st March, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of ₹ 100,000 should be recognised over the asset's useful life to compensate for depreciation costs.

Alternatively, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of ₹ 100,000 against the cost of the equipment as on 1st April, 20X3.

For flood related compensation

Rainbow Limited will be able to submit an application form only after 31 st May, 20X2 ie in the year 20X2-20X3. Although flood happened in September, 20X1 and loss was incurred due to flood related to the year 20X1-20X2, the entity should recognise the income from the government grant in the year when the application form related to it is submitted and approved by the government for compensation.

Since, in the year 20X1-20X2, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited should not recognise the grant income as it has not become receivable as on 31st March,20X2.

Q22: Entity A is awarded a government grant of ₹60,000 receivable over three years (₹40,000 in year 1 and ₹10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining

them for three years. The employees are recruited at a total cost of ₹30,000, and the wage bill for the first year is ₹1,00,000, rising by ₹10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3. [RT

Ans. The income of ₹60,000 should be recognised over the three year period to compensate for the related costs.

Calculation of Grant Income and Deferred Income:

Year	Labour Cost	Grant Income		Deferred Income	
	₹	₹		₹	
1	1,30,000	21,667	60,000 x (130/360)	18,333	(40,000 – 21,667)
2	1,10,000	18,333	60,000 x (110/360)	10,000	(50,000 – 21,667 – 18,333)
3	1,20,000	20,000	60,000 x (120/360)	-	(60,000 – 21,667 – 18,333 – 20,000)
	3,60,000	60,000			

So Grant income to be recognised in Profit & Loss for years 1, 2 and 3 are ₹ 21,667, ₹ 18,333 and ₹ 20,000 respectively.

Amount of grant that has not yet been credited to profit & loss i.e; deferred income is to be reflected in the balance sheet. Hence, deferred income balance as at year end 1, 2 and 3 are ₹ 18,333, ₹ 10,000 and Nil respectively.

NOTES

CHAPTER 16
AGRICULTURE (IND AS 41)

QUESTIONS FROM STUDY MATERIAL

Q1: 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.

Q2: A farmer owned a dairy herd, of three years old cattle as at April 1, 20X1 with a fair value of ₹ 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 ₹ 60 per cattle. The fair value of four year cattle as at March 31, 20X2 is ₹75 per cattle.

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

Ans:

Particulars	**Amount (₹)**
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

Q3: XYZ ltd, on 1 December 20X3, purchased 100 sheep's from a market for ₹ 500,000 with a transaction cost of 2%. Sheep's fair value increased from ₹ 500,000 to ₹ 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 ₹ 4,90,000 (5,00,000-10,000). Expense of ₹ 10,000 would be recognised in profit and loss.

On date of Purchase

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 ₹ 5,88,000 as Biological Asset (6,00,000-12,000) and gain of ₹ 98,000 (5,88,000-4,90,000) would be recognised in profit or loss.

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)

Q4: 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 ₹ 50 Lakhs.

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

-- Received a grant of ₹ 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:

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

-- ₹ 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
	₹	₹	₹
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
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 ₹ 5,500 = ₹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 (₹ 11,00,000 –₹ 10,00,000 = a gain of ₹ 1,00,000) would be recognised in the profit and loss along with the maintenance costs and breeding fee of ₹ 6,00,000 and ₹ 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, ₹ 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 ₹ 1,300 = ₹ 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 ₹ 24 = ₹ 72,000. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q5: XY Ltd. is a farming entity where cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis. On 1 April 20X1, XY Ltd. had a herd of 500 cows which were all three years old.

During the year, some of the cows became sick and on 30 September 20X1, 20 cows died. On 1 October 20X1, XY Ltd. purchased 20 replacement cows at the market for ₹ 21,000 each. These 20 cows were all one year old when they were purchased.

On 31 March 20X2, XY Ltd. had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X2 was ₹ 20 per litre. When selling the milk to distributors, XY Ltd. incurs selling costs of ₹ 1 per litre. These amounts did not change during March 20X2 and are not expected to change during April 20X2.

Information relating to fair value and costs to sell is given below:

Date	Fair value of a dairy cow (aged)				Costs to sell a cow
	1 year	1.5 years	3 years	4 years	
1st April 20X1	20,000	22,000	27,000	25,000	1,000
1st October 20X1	21,000	23,000	28,000	26,000	1,000
31st March 20X2	21,500	23,500	29,000	26,500	1,100

You can assume that fair value of a 3.5 years old cow on 1st October 20X1 is ₹ 27,000.

Pass necessary journal entries of above transactions with respect to cows in the financial statements of XY Ltd. for the year ended 31st March, 20X2? Also show the amount lying in inventory if any.

Ans: Journal Entries on 1st October, 20X1 **(All figures in ₹)**

Particulars		Dr.	Cr.
Loss (on death of 20 cows) (Refer W.N.)	Dr.	5,20,000	
To Biological asset			5,20,000
(Loss booked on death of 20 cows)			
Biological Asset (purchase of 20 new cows) (Refer W.N.)	Dr.	4,00,000	
To Bank			4,00,000

(Initial recognition of 20 new purchased cows at fair value less costs to sell)			

Journal Entries on 31st March, 20X2

Loss on remeasurement of old cows	Dr.	2,88,000	
To Biological asset [(1,30,00,000 – 5,20,000) –1,21,92,000] (Subsequent measurement of cows at fair value less costs to sell) Biological Asset (4,48,000 – 4,00,000)	Dr.	48,000	2,88,000
To Gain on remeasurement of new cows (Subsequent measurement of cows at fair value less costs to sell)			48,000

Inventory (Milk) as at 31st March,20X2 =₹ 19,000 (1,000 x (20 – 1))

Working Note:

Calculation of Biological asset at various dates

Date	Number	Age	Fair Value (₹)	Cost to Sell (₹)	Net (₹)	Biological asset (₹)
1st April 20X1	500	3 years	27,000	1,000	26,000	1,30,00,000
1st October 20X1	(20)	3.5 years	27,000	1,000	26,000	(5,20,000)
1st October 20X1	20	1 year	21,000	1,000	20,000	4,00,000
						1,28,80,000
31st March 20X2	480	4 years	26,500	1,100	25,400	1,21,92,000
	20	1.5 years	23,500	1,100	22,400	4,48,000
						1,26,40,000

Q6: Company X purchased 100 beef cattle at an auction for ₹ 1,00,000 on 30 September 20X1. Subsequent transportation costs were ₹ 1,000 that is similar to the cost X would have to incur to sell the cattle at the auction. Additionally, there would be a 2% selling fee on the market price of the cattle to be incurred by the seller.

On 31 March 20X2, the market value of the cattle in the most relevant market increases to

₹ 1,10,000. Transportation costs of ₹ 1,000 would have to be incurred by the seller to get the cattle to the relevant market. An auctioneer's fee of 2% on the market price of the cattle would be payable by the seller.

On 1 June 20X2, X sold 18 cattle for ₹ 20,000 and incurred transportation charges of ₹ 150. In addition, there was a 2% auctioneer's fee on the market price of the cattle paid by the seller.

On 15 September 20X2, the fair value of the remaining cattle was ₹ 82,820. 42 cattle were slaughtered on that day, with a total slaughter cost of ₹ 4,200. The total market price of the

carcasses on that day was ₹ 48,300, and the expected transportation cost to sell the carcasses is ₹ 420. No other costs are expected.

On 30 September 20X2, the market price of the remaining 40 cattle was ₹ 44,800. The expected transportation cost is ₹ 400. Also, there would be a 2% auctioneer's fee on the market price of the cattle payable by the seller.

Pass Journal entries so as to provide the initial and subsequent measurement for all above transactions. Interim reporting periods are of 30 September and 31 March and the company determines the fair values on these dates for reporting.

Ans: Value of cattle at initial recognition (30 September 20X1) **(All figures are in ₹)**

Biological asset (cattle)	Dr.	97,000*	
Loss on initial recognition	Dr.	4,000	
To Bank (Purchase and cost of transportation)			1,01,000
(Initial recognition of cattle at fair value less costs to sell)			

*Fair value of cattle = 1,00,000 – 1,000 – 2,000 (2% of 1,00,000) = 97,000

Subsequent measurement at 31 March 20X2 **(All figures are in ₹)**

Biological Assets (Cattle)	Dr.	9,800	
To Gain on Sale (Profit & Loss)			9,800
(Subsequent measurement of Cattle at fair value less costs to sell (1,06,800** – 97,000))			

** Fair value of cattle = 1,10,0000 – 1,000 – 2,200 (2% of 1,10,000) = 1,06,800

Sale of cattle on 1 June 20X2 **(All figures are in ₹)**

Biological Assets (Cattle)	Dr.	226	
To Gain on Sale (Profit & Loss)			226
(Subsequent re-measurement of 18 Cattle at fair value less costs to sell just prior to the point at which they are sold [19,450 - {(1,06,800/100) x 18}]			
Cost to Sales	Dr.	19,450	
To Biological Assets (Cattle)			19,450
(Recording a cost of sales figure separately with a corresponding reduction in the value of the biological assets)			
Bank	Dr.	19,450	
Selling expenses (150 + 400)	Dr.	550	

To Revenue (Recognition of revenue from sale of cattle)			20,000

Transfer of Cattle to Inventory on 15 September 20X2 **(All figures are in ₹)**

Inventory (48,300 - 420)	Dr.	47,880	
Loss on remeasurement	Dr.	1,176	
To Biological Asset (Cattle)			44,856#
To Bank (Slaughtering cost)			4,200
(Transfer of cattle to inventory)			

#Note: 44,856 is calculated as the proportion of cattle sold using the fair value (1,06,800+ 226 – 19,450) x 42/82)

Subsequent measurement of cattle at 30 September 20X2 **(All figures are in ₹)**

Loss on remeasurement	Dr.	18,440	
To Biological Asset (Cattle)			18,440
(Subsequent measurement of Cattle at fair value less costs to sell [43,504## – {(1,06,800 + 226 – 19,450)– 44,856}]			

##Fair value of cattle = 44,800 – 400 – 896 (2% of 44,800) = 43,504

QUESTIONS FROM RTP/MTP/EXAMS

Q7: 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 ₹ 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).

Q8: Arun Ltd. is an entity engaged in plantation and farming on a large scale and diversified across India. On 1st April, 2018, the company has received a government grant for ₹ 20 lakh 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 trees for specified period of five years and accordingly it recognizes proportionate grant for ₹ 4 lakh 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:

Evaluate whether the above accounting treatment made by the management is in compliance with the applicable Ind AS. If not, advise the correct treatment. **[NOV 19]**

Ans: Arun Ltd. is engaged in plantation and farming on a large scale. This implies that it has agriculture business. Hence, Ind AS 41 will be applicable.

Further, the government grant has been given subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. This implies that it is a conditional grant.

In the absence of the measurement base of biological asset, it is assumed that “Arun Ltd measures its Biological Asset at fair value less cost to sell”:

As per Ind AS 41, the government grant should be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met ie continuous plantation of eucalyptus tree for coming period of 5 years. In this case, the grant shall not be recognised in profit or loss until the five years have passed. The entity has recognised the grant in profit and loss on proportionate basis, which is incorrect.

However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognises that part in profit or loss as time passes. Accordingly, the entity can recognise the proportionate grant for ₹ 4 lakh in the statement of Profit and Loss based on the terms of the grant.

Alternatively, it may be assumed that Arun Ltd. measures its Biological Asset at its cost less any accumulated depreciation and any accumulated impairment losses (as per para 30 of Ind AS 41):

In such a situation, principles of Ind AS 20 (with respect to conditional grant will apply). According to Ind AS 20, the conditional grant should be recognised in the Statement of Profit and Loss over the periods and in the proportions in which depreciation expense on those assets is recognised. Hence the proportionate recognition of grant ₹ 4 lakh (20 lakh / 5) as income is correct since the entity has reasonable assurance that the entity will comply with the conditions attached to the grant.

Note: In case eucalyptus tree is considered as bearer plant by Arun Ltd., then Ind AS 20 will be applicable and not Ind AS 41.

Q9: Entity A purchased cattle at an auction on 30th June 2019

Purchase price at 30th June 2019	₹ 1,00,000
Costs of transporting the cattle back to the entity's farm	₹ 1,000
Sales price of the cattle at 31st March, 2020	₹ 1,10,000

The company would have to incur similar transportation costs if it were to sell the cattle at auction, in addition to an auctioneer's fee of 2% of sales price.

Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March, 2020. **[RTP Nov 2020]**

Ans: Initial recognition of cattle

	₹
Fair value less costs to sell (₹1,00,000 – ₹1,000 - ₹2,000)	97,000
Cash outflow (₹1,00,000 + ₹1,000 + ₹2,000)	1,03,000
Loss on initial recognition	6,000
Cattle Measurement at year end	
Fair value less costs to sell (₹1,10,000 – 1,000 – (2% x 1,10,000))	1,06,800

At 31st March, 2020, the cattle is measured at fair value of ₹ 1,09,000 less the estimated auctioneer's fee of ₹ 2,200). The estimated transportation costs of getting the cattle to the auction of ₹ 1,000 are deducted from the sales price in determining fair value.

Q10: Analyse whether the following activities fall within the scope of Ind AS 41 with proper reasoning:

- Managing animal-related recreational activities like Zoo
- Fishing in the ocean
- Fish farming
- Development of living organisms such as cells, bacteria and viruses
- Growing of plants to be used in the production of drugs

- Purchase of 25 dogs for security purpose of the company's premises.

RTP May 2021

Ans:

Activity	**Whether in the scope of Ind AS 41?**	**Remarks**
Managing animal-related recreational activities like Zoo	No	Since the primary purpose is to show the animals to public for recreational purposes, there is no management of biological transformation but simply control of the number of animals. Hence it will not fall in the purview of considered in the definition of agricultural activity.
Fishing in the ocean	No	Fishing in ocean is harvesting biological assets from unmanaged sources. There is no management of biological transformation since fish grow naturally in the ocean. Hence, it will not fall in the scope of the definition of agricultural activity.
Fish farming	Yes	Managing the growth of fish and then harvest for sale is agricultural activity within the scope of Ind AS 41 since there is management of biological transformation of biological assets for sale or additional biological assets.
Development of living organisms such as cells, bacteria viruses	Analysis required	The development of living organisms for research purposes does not qualify as agricultural activity, as those organisms are not being developed for sale, or for conversion into agricultural produce or into additional biological assets. Hence, development of such organisms for the said purposes does not fall under the scope of Ind AS 41. However, if the organisms are being developed for sale or use in dairy products, the activity will be considered as agricultural activity under the scope of Ind AS 41.
Growing of plants to be used in the production of	Yes	If an entity grows plants for using it in production of drugs, the activity will be agricultural activity. Hence it will come under the scope of Ind AS 41.

drugs		
Purchase of 25 dogs for security purposes of the company's premises	No	Ind AS 41 is applied to account for the biological assets when they relate to agricultural activity. Guard dogs for security purposes do not qualify as agricultural activity, since they are not being kept for sale, or for conversion into agricultural produce or into additional biological assets. Hence, they are outside the scope of Ind AS 41.

Q11: On 1st November 2019, Crattle Agro Limited purchased 100 goats of special breed from a market for ₹ 10,00,000 with a transaction cost of 2%. Goats fair value decreased from ₹ 10,00,000 to ₹ 9,00,000 as on 31st March 2020. Determine the fair value on the date of purchase and as on financial year ended 31st March 2020. Also pass relevant journal entries on 1st November 2019 and 31st March 2020.

Exam Paper January 2021 (4 Marks)

Ans: The fair value less cost to sell of goats on the date of purchase i.e. on 1st November, 2019, would be ₹ 9,80,000 (10,00,000-20,000). Expense of ₹ 20,000 would be recognised in profit and loss.

On date of Purchase			
Biological Asset	Dr.	9,80,000	
Expense on initial recognition	Dr.	20,000	
To Bank			10,00,000

(Being biological asset purchased)

On 31st March, 2020 goats would be measured at ₹ 8,82,000 as Biological Asset (9,00,000-18,000) and loss of ₹ 98,000 (9,80,000 - 8,82,000) would be recognised in profit or loss.

At the end of reporting period

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

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

Note: It is assumed that the transaction cost is borne by the seller.

NOTES

CHAPTER 17
IMPAIRMENT OF ASSETS (IND AS 36)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: 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. Is Private railway is treated as CGU.

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).

Q2: 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. The entity does not have the option to curtail any one bus route. Identify CGU.

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.

Q3: 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. Identify CGU

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.

Q4: 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 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.

Q5: 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.

Q6: 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 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.

Q7: 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.

Q8: Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of ₹ 36 million excludes the benefit to be derived from a future reorganization, but the second value of ₹ 44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments. Whether the business segment needs to be Impaired?

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 ₹ 4 million because the value-in-use of ₹ 36 million is lower than the carrying value of ₹ 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.

Q9: 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.

Q10: 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 ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 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 fair value less cost to sell and its value in use·. In the given case, recoverable amount will be nil [higher of value in use (nil) and fair value less cost to sell (₹70,000)]. Thus

impairment loss will be calculated as ₹ 6,00,000 [carrying amount (₹6,00,000) – recoverable amount (nil)]. Therefore, asset is to be fully impaired and impairment loss of ₹ 6,00,000 has to be recognized as an expense immediately in the statement of Profit and Loss as per IND AS 36.

- * Fair value less cost to sell 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, FVCS = FV – Cost of disposal = Nil – ₹70,000 = ₹ (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.

Q11: Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 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 ₹ 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 ₹ 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 ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 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.

Q12: 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 ₹ 20,000 lakhs

Useful Life was 8 Years

Residual Value estimated at the end of 8 years ₹ 500 lakhs

Fair value less cost to disposal ₹ 10,000 lakhs.

Calculate Impairment loss and revised depreciation

Ans:

(a) Calculation of Carrying Amount on 31st March, 20X4 (` in lakh)

Particular	Amount
Original Cost on 1st April, 20X1	20,000
Less: Depreciation $\frac{(20000 - 500)3}{8}$	(7,313)
Carrying Amount	12,687

(b) Calculation of Value in Use

Year	Cash Flows	*P.V.*	Amount
20X4-20X5	2,000	.869	1,738
20X5-20X6	3,000	.756	2,268
20X6-20X7	3,000	.658	1,974
20X7-20X8	4,000	.572	2,288
20X8-20X9 (including residual value)	2,500	.497	1,242
Total			**9,510**

(c) Calculation of Recoverable Amount

Particular	Amount
Value in Use	9,510
Fair value less costs of disposal	10,000
Recoverable Amount	10,000

(d) Calculation of Impairment Loss

Carrying Amount – Recoverable Amount 12,687 – 10,000 = 2,687

Calculation of Revised Carrying Amount

Particular	Amount
Carrying Amount	12,687
Less: Impairment Loss	(2,687)
Revised Carrying Amount	10,000

(e) Calculation of Revised Depreciation

(Revised Carrying Amount – Residual Value) / Remaining Life

(10,000 – 500)/ 5 = 1,900

Q13: 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	₹ 45/US $
Expected Exchange rate	
March 31, 20X2	₹ 48/US $
March 31, 20X3	₹ 51/US $
March 31, 20X4	₹ 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			₹ 45/US $
Value in use as on March 31, 20X1			₹ 7,668

Q14: Cash flow is ₹ 100, ₹ 200 or ₹ 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
300	30%	90
Total		220

The expected cash flow is ₹ 220.

Q15: Cash flow of ₹ 1,000 may be received in one year, two years or three years with probabilities of 10%, 60% and 30%, respectively. Calculate expected cash flows assuming applicable discount rate of 5%, 5.25% and 5.5% in year 1, 2 and 3, respectively.

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 ₹ 892.36.

Q16: Calculate expected cash flows in each of the following cases:

(a) the estimated amount falls somewhere between ₹ 50 and ₹ 250, but no amount in the range is more likely than any other amount.

(b) the estimated amount falls somewhere between ₹ 50 and ₹ 250, and the most likely amount is ₹ 100. However, the probabilities attached to each amount are unknown.

(c) the estimated amount will be ₹ 50 (10 per cent probability), ₹ 250 (30 per cent probability), or ₹ 100 (60 per cent probability).

Ans: (a) the estimated expected cash flow is ₹ 150 [(50 + 250)/2].

(b) the estimated expected cash flow is ₹ 133.33 [(50 + 100 + 250)/3].

(c) the estimated expected cash flow is ₹ 140 [(50 × 0.10) + (250 × 0.30) + (100 × 0.60)].

Q17: A Ltd. purchased a machinery of ₹ 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 (₹ 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 : ₹ 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 (₹ in crore)	Present value factor @ 10%	Present value
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 ₹ 75.31 crore (higher of value in use of ₹ 75.31 crore and fair value less costs to sell of ₹ 70 crore). Carrying amount of the machinery is ₹ 80 crore (after providing for one year depreciation @ ₹ 20 crore). Therefore, the impairment loss of ₹ 4.69 crore should be provided in the books.

Q18: Ram ltd. acquired plant on 1-4-1995 for ₹ 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 ₹ 29 lakhs against its book value of ₹ 25 lakhs and credited ₹ 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 ₹ 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

Q19: Great Ltd., acquired a machine on 1st April, 2012 for ₹ 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 ₹ 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 ₹ 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

	(₹ 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 of IND AS 36 "Impairment of Assets"	(0.70)
Impairment Loss to be debited to profit and loss account	0.21

Q20: X Ltd. purchased a fixed asset four years ago for ₹ 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 ₹ 75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, expected disposal costs are ₹ 3 lakhs. What will be the treatment in respect of impairment loss on the basis that the value in use is estimated at ₹ 60 lakhs?

[MTP, May 2019]

Ans: **Treatment of Impairment Loss:** As per IND AS 36 "Impairment of assets", if the recoverable amount 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, Fair Value less cost to sell is ₹ 72 lakhs (₹ 75 lakhs – ₹ 3 lakhs) and value in use is ₹ 60 lakhs.

Therefore, recoverable amount will be ₹ 72 lakhs. Impairment loss will be calculated as ₹ 3 lakhs [₹ 75 lakhs (Carrying Amount after revaluation - Refer Working Note) less ₹ 72 lakhs (Recoverable Amount)].

Thus, impairment loss of 3 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

	(₹ 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

Q21: XYZ Limited has a cash-generating unit 'Plant A' as on April 1, 20X1 having a carrying amount of ₹ 1,000 crores. Plant A was acquired under a business combination and goodwill of ₹ 200 crores were 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 ₹ 600 crores. Calculate the impairment loss on Plant A. Also, prescribe its allocation as per Ind AS 36.

Ans: **(₹ 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 ₹ 600 crores, there is an impairment loss of ₹ 500 crores. The impairment loss of ₹ 500 crores should be allocated to goodwill first, and then to the other identifiable assets, i.e., ₹ 200 crores to goodwill and ₹ 300 crores to identifiable assets of Plant A.

(₹ in crores)

Particulars	Goodwill	Identifiable assets	Total
Impairment loss	(200)	(300)	(500)
Carrying amount after impairment loss	-	600	600

Q22: 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 (₹ in crore)**	**Remaining useful life**
A	500	10
B	750	20
C	1,100	20

ABC Ltd. also has two corporate assets having a remaining useful life of 20 years.

(₹ in crore)

Corporate asset	**Carrying amount**
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 (₹ 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

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 (₹ 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 (₹ 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

Q23: A Ltd. purchased an asset of ₹ 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	₹ 60 lakh
March 31, 20X2	₹ 40 lakh
March 31, 20X3	₹ 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) ₹ 100 lakh

Depreciation (₹ 100 lakh /4 years) ₹ 25 lakh

Carrying amount of the asset (closing balance) ₹ 75 lakh

Recoverable amount (given) ₹ 60 lakh

Therefore, an impairment loss of ₹ 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., ₹ 60 lakh.

As on March 31, 20X2

Carrying amount of the asset (opening balance) ₹ 60 lakh

Depreciation (₹ 60 lakh /3 years) ₹ 20 lakh

Carrying amount of the asset (closing balance) ₹ 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) ₹ 40 lakh

Depreciation (₹ 40 lakh / 2 years) ₹ 20 lakh

Carrying amount of the asset (closing balance) ₹ 20 lakh

Recoverable amount (given) ₹ 28 lakh

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by ₹ 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.

Carrying amount as on March 31, 20X3 had no impairment loss being recognised would have been ₹ 25 lakh. Therefore, the reversal of an impairment loss of ₹ 5 lakh should be done as on March 31, 20X3.

Q24: A company operates a mine in a country where legislation requires that the owner must restore the site on completion of its mining operations. The cost of restoration includes the replacement of the overburden, which must be removed before mining operations commence. A provision for the costs to replace the overburden was recognised as soon as the overburden was removed. The amount provided was recognised as part of the cost of the mine and is being depreciated over the mine's useful life. The carrying amount of the provision for restoration costs is ₹ 500, which is equal to the present value of the restoration costs.

The entity is testing the mine for impairment. The cash-generating unit for the mine is the mine as a whole. The entity has received various offers to buy the mine at a price of around ₹ 800. This price reflects the fact that the buyer will assume the obligation to restore the overburden. Disposal costs for the mine are negligible. The value in use of the mine is approximately ₹ 1,200, excluding restoration costs. The carrying amount of the mine is ₹ 1,000.

Ans: The cash-generating unit's fair value less costs of disposal is ₹ 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 ₹ 700 (₹ 1,200 less ₹ 500). The carrying amount of the cash-generating unit is ₹ 500, which is the carrying amount of the mine (₹ 1,000) less the carrying amount of the provision for restoration costs (₹ 500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

Q25: 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 ₹ 20 million and CGU B for ₹ 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 ₹ 10 million. The recoverable amounts are based on value-in-use of ₹ 18 million for CGU A and ₹ 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			
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 (₹ 1 million) and 20/24 against the other assets (₹ 5 million).

Q26: At the end of 2000 an entity tests a machine for impairment. The machine was bought five years earlier for ₹ 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 ₹ 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 of 14 per cent per year is ₹ 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 ₹ 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	₹ 200,000
Less: Recoverable amount	(₹179,310)
Impairment loss	₹ 20,690
Carrying amount after impairment loss (ie recoverable amount)	₹ 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 ₹ 179,310, so the depreciation charge will be ₹ 17,931 per year (ie ₹ 179,310 ÷ 10 years).

End of 2004

Recoverable amount		₹ 122,072
Carrying amount, before the reversal of the impairment loss recognised at 31/12/04		
Carrying amount as on 01/01/2001	₹1,79,310	
Less: Accumulated depreciation till 2004 (17,931 x 4)	₹71,724	₹ 107,586
Difference		₹ 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 ₹ 120,000, so the annual depreciation charge will be ₹ 20,000 (ie ₹ 120,000 depreciable amount ÷ 6 years remaining useful life).

Q27: On 1st April 20X1, Venus ltd acquired 100% of Saturn ltd for ₹ 4,00,000. The fair value of the net identifiable assets of Saturn ltd was ₹ 3,20,000 and goodwill was ₹ 80,000. Saturn ltd is in coal mining business. On 31st March 20X3 the government has cancelled licenses given to it in few states.

As a result Saturn's ltd revenue is estimated to get reduce by 30%. The adverse change in market place and regulatory conditions is an indicator of impairment. As a result Venus ltd has to estimate the recoverable amount of goodwill and net assets of Saturn ltd on 31st March 20X3.

Venus ltd uses straight line depreciation. The useful life of Saturn's ltd assets is estimated to be 20 years with no residual value. No independent cash inflows can be identified to any individual assets. So the entire operation of Saturn ltd is to be treated as a CGU. Due to the regulatory entangle it is not possible to determine the selling price of Saturn ltd as a CGU. Its value in use is estimated by the management at ₹ 2,12,000.

Suppose by 31st March 20X5 the government reinstates the licenses of Saturn ltd. The management expects a favourable change in net cash flows. This is an indicator that an impairment loss may have reversed. The recoverable amount of Saturn's ltd net asset is re-estimated. The value in use is expected to be ₹ 3,04,000 and Fair Value less Cost to Sell is expected to be ₹ 2,90,000. Calculation of Impairment loss and its Reversal.

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 (₹ 3,68,000 - ₹ 2,12,000) = ₹ 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 ₹ 80,000 and remaining loss of ₹ 76,000 (₹ 1,56,000 – ₹ 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.

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 ₹3,04,000 (higher of fair value less costs of disposal ₹ 2,90,000 and value in use ₹ 3,04,000) the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods ie., ₹ 2,56,000

Impairment loss reversal will be ₹ 68,000 i.e. (₹ 2,56,000 – ₹ 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 ₹ 2,56,000.

From 1st April 20X5 the depreciation charge will be ₹ 16,000 i.e. (₹ 2,56,000/16)

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q28: A Ltd acquires 80% shares of a subsidiary B Ltd. for ₹ 3,200 thousand. At the date of acquisition, B Ltd.'s identifiable net assets is ₹ 3,000 thousand. A elects to measure NCI at proportionate share of net identifiable assets. It recognizes

	₹ in thousand
Purchase Consideration	3,200
NCI (3,000 x 20%)	600
	3,800
Less: Net Assets	(3,000)
Goodwill	800

At the end of next financial year, B Ltd.'s carrying amount is reduced to ₹ 2,700 thousand (excluding goodwill).

Recoverable amount of B Ltd.'s assets is

Case (i) ₹ 2,000 thousand,

Case (ii) ₹ 2,800 thousand

Calculate impairment loss allocable to Parent and NCI in both the cases

Ans: Case (i) **₹ in thousand**

Particulars	**Goodwill**	**Other Asset**	**Total**
Carrying amount	800	2,700	**3,500**
Unrecognised NCI (notional) [(800 / 80%) x 20%]	200	-	**200**
Notional Total	1,000	2,700	**3,700**
Recoverable amount	-	-	**2,000**
Total Impairment loss	-	-	**(1,700)**
Impairment loss recognised in CFS	(800)	(700)	**(1,500)**
Carrying amount after impairment	-	2,000	**2,000**

Impairment loss on:	**Parent**	**NCI**
Goodwill	(800)	-
Other assets	(560)	(140)
Total	**(1,360)**	**(140)**

Case (ii)

Particulars	**Goodwill**	**Other Asset**	**Total**
Carrying amount	800	2,700	**3,500**
Unrecognised NCI (notional) (800 / 80% x 20%)	200	-	**200**
Notional Total	**1,000**	**2,700**	**3,700**

Recoverable amount	-	-	2,800
Total Impairment loss	-	-	**(900)**
Impairment loss recognised in CFS (900 x 80%)	(720)	-	**(720)**
Carrying amount after impairment (800 – 720)	80	2,700	**2,780**

Impairment loss on:	**Parent**	**NCI**
Goodwill	(720)	-
Other assets	-	-
Total	**(720)**	-

It is to be noted that since an entity measures NCI at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to NCI is not recognised in the parent's consolidated financial statements and so the impairment loss on such goodwill not recognised.

Q29: Entity A acquires Entity B for ₹ 50 million, of which ₹ 35 million is the fair value of the identifiable assets acquired and liabilities assumed. The acquisition of B Ltd. is to be integrated into two of Entity A's CGUs with the net assets being allocated as follows:

₹ in million

	CGU 1	**CGU 2**	**Total**
Fair value of acquired identifiable tangible and intangible assets	25	10	35

In addition to the net assets acquired that are assigned to CGU 2, the acquiring entity expects CGU 2 to benefit from certain synergies related to the acquisition (e.g. CGU 2 is expected to realise higher sales of its products because of access to the acquired entity's distribution channels). There is no synergistic goodwill attributable to other CGUs.

Entity A allocated the purchase consideration of the acquired business to CGU 1 and CGU 2 as ₹ 33 million and ₹ 17 million respectively.

Determine the allocation of goodwill to each CGU?

Ans: If goodwill is allocated to the CGUs based on the difference between the purchase consideration and the fair value of net assets acquired ie direct method, the allocation would be as follows:(All figures are ₹ in million, unless otherwise specified)

	CGU 1	**CGU 2**	**Total**
Allocation of Purchase consideration	33	17	50
Less: Acquired identifiable tangible and intangible assets	(25)	(10)	(35)
Goodwill assigned to CGUs	8	7	15

Q30: On 1 January Year 1, Entity Q purchased a machine costing ₹ 2,40,000 with an estimated useful life of 20 years and an estimated zero residual value. Depreciation is computed on straight-line basis. The asset had been re-valued on 1 January Year 3 to ₹ 2,50,000, but with no change in useful life at that date. On 1 January Year 4 an impairment review showed the machine's recoverable amount to be ₹ 1,00,000 and its estimated remaining useful life to be 10 years.

Calculate:

a) The carrying amount of the machine on 31 December Year 2 and the revaluation surplus arising on 1 January Year 3.

b) The carrying amount of the machine on 31 December Year 3 (immediately before the impairment).

c) The impairment loss recognised in the year to 31 December Year 4 and its treatment thereon

d) The depreciation charge in the year to 31 December Year 4.

Note: During the course of utilization of machine, the company did not opt to transfer part of the revaluation surplus to retained earnings

Ans:

a) Calculation of Carrying amount of machine at the end of Year 2

	₹
Cost of machine	2,40,000
Accumulated depreciation for 2 years [2 years × (2,40,000 ÷ 20)]	(24,000)
Carrying amount of the machine at the end of Year 2	2,16,000

b) Calculation of carrying amount of the machine on 31 December Year 3

	₹
Carrying amount at the beginning of Year 3	2,16,000
Revaluation done at the beginning of Year 3	2,50,000
Revaluation surplus	34,000

(c) Calculation of Impairment loss at the end of Year 4

When machine is revalued on 1 January Year 3, depreciation is charged on the revalued amount over its remaining expected useful life.

Valuation at 1 January (re-valued amount)	2,50,000
Accumulated depreciation in Year 3 (2,50,000 / 18)	(13,889)
Carrying amount of the asset at the end of Year 3	2,36,111

On 1 January Year 4, recoverable amount of the machine	1,00,000
Impairment loss (2,36,111 – 1,00,000)	1,36,111

An impairment loss of ₹ 34,000 will be taken to other comprehensive income (reducing the revaluation surplus for the asset to zero)

The remaining impairment loss of ₹ 1,02,111 (1,36,111 – 34,000) is recognised in the Statement of Profit and Loss for the Year 4.

(d) Calculation of depreciation charge in the Year 4

Carrying value of the machine at the beginning of Year 4 ₹ 1,00,000

Estimated remaining useful life 10 years

Depreciation charge is (₹ 1,00,000 / 10 years) ₹ 10,000

QUESTIONS FROM OTHER SOURCE

Q31: Himalaya Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 20X4, the Government put restriction on export of goods exported by Himalaya Ltd. and due to that restriction Himalaya Ltd. impaired its assets. Himalaya Ltd. acquired identifiable assets worth of ₹ 4,000 lakhs for ₹ 6,000 lakh at the end of the year 20X0. The difference is treated as goodwill. The useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 20X4, the company recognised the impairment loss by determining the recoverable amount of assets for ₹ 2,720 lakh. In 20X6 Government lifted the restriction imposed on the export and due to this favourable change, Himalaya Ltd. re-estimate recoverable amount, which was estimated at ₹ 3,420 lakh.

Required:

(i) Calculation and allocation of impairment loss in 20X4.

(ii) Reversal of impairment loss and its allocation as per IND AS 36 in 20X6. **[RTP May 2018]**

Ans: (i) Calculation and allocation of impairment loss in 20X4 **(Amount in ₹ lakhs)**

	Goodwill	Identifiable assets	Total
Historical cost	2,000	4,000	6,000
Accumulated depreciation/amortisation (4 yrs.)	--	(1,067)	(1,067)
Carrying amount before impairment	2000	2,933	4,933
Impairment loss*	(2000)	(213)	(2,213)
Carrying amount after impairment loss	0	2,720	2,720

* Notes:

1. As per IND AS 36, an impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:
   a. first, to goodwill allocated to the cash-generating unit (if any); and

b. then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

Hence, first goodwill is impaired at full value and then identifiable assets are impaired to arrive at recoverable value.

(ii) Carrying amount of the assets at the end of 20X6 (Amount in ₹ lakhs)

End of 20X6	Goodwill	Identifiable assets	Total
Carrying amount in 20X6 Add: Reversal of impairment loss (W.N.2) Carrying amount after reversal of impairment loss	0 - -	2,225 175 2,400	2,225 175 2,400

Working Note:

1. Calculation of depreciation after impairment till 20X6 and reversal of impairment loss in 20X6

(Amount in ₹ lakhs)			
	Goodwill	**Identifiable assets**	**Total**
Carrying amount after impairment loss in 20X4	0	2,720	2,720
Additional depreciation (i.e. (2,720/11) x 2)	–	(495)	(495)
Carrying amount	0	2,225	2,225
Recoverable amount			3,420
Excess of recoverable amount over carrying amount			1,195

Note: It is assumed that the restriction by the Government has been lifted at the end of the year 20X6.

2. Determination of the amount to be impaired by calculating depreciated historical cost of the identifiable assets without impairment at the end of 20 X6 (Amount in ₹ lakhs)

End of 20X6	Identifiable assets
Historical cost	4,000
Accumulated depreciation	(266.67 x 6 years) = (1,600)
Depreciated historical cost	2,400
Carrying amount (in W.N. 1)	2,225
Amount of reversal of impairment loss	175

Notes:

1. As per para IND AS 36, in allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above the lower of:

   a. its recoverable amount (if determinable); and

b. the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior accounting periods.

Hence impairment loss reversal is restricted to ₹ 175 lakhs only.

Q32: Enterprise M has three cash-generating units: A, B and C. There are adverse changes in the technological environment in which M operates. At the end of 2010, the carrying amounts of A, B and C are ₹ 100 lakhs, ₹ 150 lakhs and ₹ 200 lakhs respectively.

The operations are conducted from a headquarter. The carrying amount of the headquarter assets is ₹ 200 lakhs: a headquarter building of ₹ 150 lakhs and a research centre of ₹ 50 lakhs. The relative carrying amounts weighted according to life, of the cash-generating units are a reasonable indication of the proportion of the head-quarter building devoted to each cash-generating unit. The carrying amount of the research centre cannot be allocated on a reasonable basis to the individual cash-generating units.

The remaining estimated useful life of cash-generating unit A is 10 years. The remaining useful lives of B, C and the headquarter assets are 20 years. The headquarter assets are depreciated on a straight-line basis.

The recoverable amount of each cash generating unit is based on its value in use since Fair Value less Cost to Sell for each CGU cannot be calculated. Therefore, Value in use is equal to

	A	B	C	M Ltd. as a whole
Recoverable amount	199	164	271	720*

*The research centre generates additional future cash flows for the enterprise as a whole. Therefore, the sum of the value in use of each individual CGU is less than the value in use of the business as a whole. The additional cash flows are not attributable to the headquarter building.

Calculate and show allocation of impairment loss as per IND AS 36. Ignore tax effects.

RTP Nov 2018]

Ans: The carrying amount of the headquarter building 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.

Calculation of a weighted allocation of the carrying amount of the headquarter building

	(Amount in ₹ lakhs)			
End of 20X0	A	B	C	Total
Carrying amount	100	150	200	450
Useful life	10 years	20 years	20 years	
Weighting based on useful life	1	2	2	
Carrying amount after weighting	100	300	400	800
Pro-rata allocation of the building	12.5%	37.5%	50%	100%
Allocation of the carrying amount of the				

building				
(based on pro-rata above)	19	56	75	150
Carrying amount (after allocation of the building)	119	206	275	600

The 1st Stage of Impairment testing requires calculation of the recoverable amount of each individual cash-generating unit. The 2nd Stage of Impairment testing requires calculation of the recoverable amount of M as a whole (the smallest cash generating unit that includes the research centre).

Calculation of Value in use

	A	B	C	M
Value in use	199	164	271	720

Calculation of Impairment Losses

In accordance with the 1stnd Stage of Impairment testing, M compares the carrying amount of each cash-generating unit (after allocation of the carrying amount of the building) to its recoverable amount.

Application of 1st Stage Impairment testing	**(Amount in ₹ lakhs)**		
End of 20X0	A	B	C
Carrying amount (after allocation of the building)	119	206	275
Recoverable amount	199	164	271
Impairment loss	0	(42)	(4)

The next step is to allocate the impairment losses between the assets of the cash-generating units and the headquarter building.

Allocation of the impairment losses for cash-generating units B and C	**(Amount in ₹ lakhs)**	
Cash-generating unit	B	C
To headquarter building	(12) (42*56/206)	(1) (4*75/275)
To assets in cash-generating unit	(30) (42*150/206)	(3) (4*200/275)
	(42)	(4)

In accordance with the 2nd Stage of Impairment testing, since the research centre could not be allocated on a reasonable and consistent basis to A, B and C's cash-generating units, M compares the carrying amount of the smallest cash generating unit to which the carrying amount of the research centre can be allocated (i.e., M as a whole) to its recoverable amount.

Application of the 2nd Stage Impairment testing	**(Amount in ₹ lakhs)**					
End of 20X0	A	B	C	Building	Research	M
Carrying amount	100	150	200	150	50	650

Impairment loss arising from the 1st Stage of Impairment testing	–	(30)	(3)	(13)	–	(46)
Carrying amount after the 1st Stage of Impairment testing	100	120	197	137	50	604
Recoverable amount						720
Impairment loss arising from '2nd Stage of Impairment testing						0

Therefore, no additional impairment loss results from the application of the 2nd Stage of Impairment testing. Only an impairment loss of ₹ 46 lakhs is recognised as a result of the application of the 1st Stage of Impairment testing.

Q33: A plant was acquired 15 years ago at a cost of ₹ 5 crores. Its accumulated depreciation as at 31st March, 2009 was ₹ 4.15 crores. Depreciation estimated for the financial year 2009-10 is ₹ 25 lakhs. Estimated Fair Value less Cost to Sell as on 31st March, 2009 was ₹ 30 lakhs, which is expected to decline by 20 per cent by the end of the next financial year. Its value in use has been computed at ₹ 35 lakhs as on 1st April, 2009, which is expected to decrease by 30 per cent by the end of the financial year.

(i) Assuming that other conditions for applicability of the impairment Accounting Standard are satisfied, what should be the carrying amount of this plant as at 31st March, 2010?

(ii) How much will be the amount of write off for the financial year ended 31st March, 2010?

(iii) If the plant had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 12 lakhs, how would you answer to questions (i) and (ii) above?

(iv) If the value in use was zero and the enterprise were required to incur a cost of ₹ 2 lakhs to dispose of the plant, what would be your response to questions (i) and (ii) above?

Ans: As per IND AS 36 "Impairment of Assets", if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount and that reduction is an impairment loss. An impairment loss on a revalued asset is recognised as an expense in the statement of profit and loss. However, an impairment loss on a revalued asset is recognised directly against any revaluation surplus for the asset to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. In the given case, recoverable amount (higher of asset's Fair Value less Cost to Sell and value in use) will be ₹ 24.5 lakhs on 31.3.2010 according to the provisions of IND AS 36 [Refer working note].

		(₹ in lakhs)
(i)	Carrying amount of plant (after impairment) as on 31st March, 2010	24.50
(ii)	Amount of write off (impairment loss) for the financial year ended 31st March, 2010 [₹ 60 lakhs – ₹ 24.5 lakhs]	35.50
(iii)	If the plant had been revalued ten years ago	
	Debit to revaluation reserve	12.00

	Amount charged to profit and loss account (₹ 35.50 lakhs–₹ 12 lakhs)	23.50
(iv)	If Value in use is zero	
	Value in use (a)	Nil
	Fair Value less Cost to Sell (b)	(-)2.00
	Recoverable amount [higher of (a) and (b)]	Nil
	Carrying amount (closing book value)	Nil
	Amount of write off (impairment loss)(₹ 60 lakhs – Nil)	60.00

Entire book value of plant will be written off and charged to profit and loss account.

Working Note:

Calculation of Closing Book Value, Estimated Fair Value less Cost to Sell and Estimated Value in Use of Plant at 31stMarch, 2010. (₹ in lakhs)

Opening book value as on 1.4.2009 (₹ 500 lakhs –₹ 415 lakhs)	85
Less: Depreciation for financial year 2009 – 10	(25)
Closing book value as on 31.3.2010	60
Estimated Fair Value less Cost to Sell as on 1.4.2009	30
Less: Estimated decrease during the year (20% of ₹ 30 lakhs)	(6)
Estimated Fair Value less Cost to Sell as on 31.3.2010	24
Estimated value in use as on 1.4.2009	35.0
Less: Estimated decrease during the year (30% of ₹ 35 lakhs)	(10.5)
Estimated value in use as on 31.3.2010	24.5

Q34: A Ltd. is the sole manufacturer of product X. A particular machine is exclusively used for production of product X. The company had near monopoly of the product. A competitor has recently come out with a cheaper substitute of product X. The company is anticipating significant fall in demand for its product and cash flow from the machine used in production of X is also expected to fall. As per the latest budget estimates, taking the entry of the competitor in consideration, the operating pre-tax cash flows from the machine expected over next 5 years are ₹ 9 lakh, ₹ 8 lakh, ₹ 6 lakh, ₹ 5.5 lakh and ₹ 5 lakh respectively. The expected life of the machine is 10 years. Declining growth rates for future cash flows are estimated from year 6 onwards at 10%, 20%, 30%, 40%, 60% respectively. The disposal value (net of expected cost of disposal) realisable at the end of year 10 is ₹ 1 lakh.

The machine can be disposed off immediately for ₹ 25 lakh subject to payment of brokerage 2% on disposal value. The carrying amount of the machine on the current date is ₹ 35 lakh. Taking the risk involved in the use of the machine for production of X in consideration, a pre-tax rate of return of 10% seems to be appropriate. Determine impairment loss if any and give the journal entries in the books of A Ltd.

Ans: As per IND AS 36 'Impairment of Assets', if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss which should be recognised as an expense in the statement of profit and loss immediately.

Impairment Loss

Fair Value less Cost to Sell = Disposal value – Brokerage = ₹ 25 lakh – 2% of ₹ 25 lakh = ₹ 24.5 lakh

Value in use = ₹ 32.98 lakh (Refer Working Note)

Recoverable value = ₹ 32.98 lakh (Higher of value in use and Fair Value less Cost to Sell)

Carrying amount = ₹ 35 lakh

Impairment loss = ₹ 35 lakh - ₹ 32.98 lakh = ₹ 2.02 lakh.

Journal Entries		₹ in lakhs	₹ in lakhs
Impairment Loss A/c	Dr.	2.02	
To Machine A/c			2.02
(Being impairment loss recognised)			
Profit & Loss A/c	Dr.	2.02	
To Impairment Loss A/c			2.02
(Being impairment loss transferred to Profit and Loss Account)			

Working Note: Calculation of Value in use

Year	Growth Rate	Operating cash flow ₹ 000	Disposal value ₹ 000	Cash flow ₹ 000	DF (10%)	Present Value ₹ 000
1		900		900	0.909	818.10
2		800		800	0.826	660.80
3		600		600	0.751	450.60
4		550		550	0.683	375.65
5		500		500	0.621	310.50
6	-10%	450		450	0.564	253.80
7	-20%	360		360	0.513	184.68
8	-30%	252		252	0.467	117.68
9	-40%	151.20		151.20	0.424	64.11
10	-60%	60.48	100	160.48	0.386	61.95
						3,297.87

Q35: On 31-3-1999 A Ltd. acquired B Ltd. for ₹ 600 Lakhs. B Ltd. has three cash generating unit X, Y and Z, net fair values of ₹ 240 lakhs. 160 lakhs and 80 lakhs respectively. A Ltd recognize goodwill of ₹ 120 Lakhs. For the accounting year ended 31-3-2003, X unit incurred substantial losses and its recoverable amount is estimated to be ₹ 270 lakhs Carrying amount of different cash generating units are as under :-

X	260 lakhs
Y	240 lakhs
Z	160 lakhs

Goodwill 24 lakhs

Total 684 lakhs

Calculated the impairment loss to be recognized in Financial statement if goodwill can be allocated on reasonable and consistent basis to cash generating unit.

Ans: Impairment loss – (272 - 270) = ₹ 2 lakhs.

Q36: At the end of 2000, enterprise F tests a plane for impairment. The plane is a cash-generating unit. It is carried at depreciated historical cost and its carrying amount is ₹ 1,500 lakhs. It has an estimated remaining useful life of 10 years.

It is assumed that the plane's Fair Value less Cost to Sell is not determinable. Value in use is calculated using a pre-tax discount rate of 14%.

Management approved budgets reflect that:

(a) in 2004, capital expenditure of ₹ 250 lakhs will be incurred to renew the engine of the plane; and

(b) this capital expenditure will improve the performance of the plane by decreasing fuel consumption.

At the End of 2000 value in use is estimated at ₹ 1211.28 Lakhs excluding renewal effects and ₹ 1235.66 after including renewal effects.

At the end of 2004, renewal costs are incurred. The plane's estimated future cash flows reflected in the most recent management approved budgets are ₹ 1220.72 discounted at 14%. This includes estimated benefits from renewal of engine.

Calculate carrying amount of plane account at the end of 2004 after reversal of impairment of loss.

Ans: **At the End of 2000**

The plane's carrying amount is less than its recoverable amount (value in use). Therefore, F recognises an impairment loss for the plane at the end of 2000.

Calculation of the impairment loss at the end of 2000	**(Amount in ₹ lakhs)**
	Plane
Carrying amount before impairment loss	1,500.00
Recoverable amount	1,211.28
Impairment loss	(288.72)
Carrying amount after impairment loss	1,211.28
Impairment of Assets	599

Years 2001-2003

No event occurs that requires the plane's recoverable amount to be re-estimated. Therefore, no calculation of recoverable amount is required to be performed.

At the End of 2004

The capital expenditure is incurred. Therefore, in determining the plane's value in use, the future benefits expected from the renewal of the engine are considered in forecasting cash flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. Therefore, the recoverable amount of the plane is recalculated at the end of 2004.

Calculation of the reversal of the impairment loss at the end of 2004	**(Amount in ₹ lakhs)**
	Plane
Carrying amount at the end of 2000	1,211.28
End of 2004	
Depreciation charge (2001 to 2004)	(484.52)
Renewal expenditure	250.00
Carrying amount before reversal	976.76
Recoverable amount	1,220.72
Maximum impairment loss	243.96

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

Maximum impairment loss		243.96
Recoverable amount	1,220.72	
Carrying amount: depreciated historical cost at the end of 2004	1,150.00	
Reversal not allowed		70.72
Reversal of the impairment loss		173.24

Calculation of Carrying amount of plane after reversal at the end of 2004

Carrying amount before reversal at the end of 2004	976.76
Add: Reversal of the impairment loss	173.24
Carrying amount after reversal at the end of 2004	1,150.00

Working Note:

Calculation of depreciated historical cost at the end of 2004

Year	**Depreciated historical cost**
2000	1,500.00
2001	1,350.00
2002	1,200.00
2003	1,050.00
2004	900.00
Add: Renewal Expenditure	250.00
	1,150.00

Q37: At the end of 2000, enterprise K tests a plant for impairment. The plant is a cash-generating unit. The plant's assets are carried at depreciated historical cost. The plant has a carrying amount of ₹ 3,000 lakhs and a remaining useful life of 10 years.

The plant is so specialised that it is not possible to determine its Fair Value less Cost to Sell. Therefore, the plant's recoverable amount is its value in use. Value in use is calculated using a pre-tax discount rate of 14%.

Management approved budgets reflect that:

(a) at the end of 2003, the plant will be restructured at an estimated cost of ₹ 100 lakhs. Since K is not yet committed to the restructuring, a provision has not been recognised for the future restructuring costs; and

(b) there will be future benefits from this restructuring in the form of reduced future cash outflows.

At the End of 2000 value in use is estimated at ₹ 2051 Lakhs excluding renewal effects.

At the end of 2002, K becomes committed to the restructuring. The costs are still estimated to be ₹ 100 lakhs and a provision is recognised accordingly. The plant's estimated future cash flows reflected in the most recent management approved budgets and a current discount rate is the same as at the end of 2000. At the End of 2002 value in use is estimated at ₹ 2162 Lakhs including estimated benefits expected from the restructuring reflected in management budgets.

At the end of 2003, restructuring costs of ₹ 100 lakhs are paid. Again, the plant's estimated future cash flows reflected in the most recent management approved budgets and a current discount rate are the same as those estimated at the end of 2002.

Calculate carrying amount of plane account at the end of 2002 and 2003 after reversal of impairment of loss.

Ans: **At the End of 2000**

Calculation of the impairment loss at the end of 2000	**(Amount in ₹ lakhs)**
	Plant
Carrying amount before impairment loss	3,000
Recoverable amount	2,051
Impairment loss	(949)
Carrying amount after impairment loss	2,051

At the End of 20X1

No event occurs that requires the plant's recoverable amount to be re estimated. Therefore, no calculation of the recoverable amount is required to be performed.

At the End of 20X2

The enterprise is now committed to the restructuring. Therefore, in determining the plant's value in use, the benefits expected from the restructuring are considered in forecasting cash

flows. This results in an increase in the estimated future cash flows used to determine value in use at the end of 20X0. Therefore, the recoverable amount of the plant is re-determined at the end of 2002.

The plant's recoverable amount (value in use) is higher than its carrying amount. Therefore, K reverses the impairment loss recognised for the plant at the end of 2000.

Calculation of the reversal of the impairment loss at the end of 2002	**(Amount in ₹ lakhs)**
	Plant
Carrying amount at the end of 2000	2,051
End of 2002	
Depreciation charge (for 20X1 and 20X2) [2051/10]X2	(410)
Carrying amount before reversal	1,641
Recoverable amount	2,162
Reversal of the impairment loss	521
Carrying amount after reversal	2,162
Carrying amount: depreciated historical cost	2,400

Note: The reversal does not result in the carrying amount of the plant exceeding what its carrying amount would have been at depreciated historical cost. Therefore, the full reversal of the impairment loss is recognised. Hence carrying amount of plant after reversal is ₹ 2,162 lakhs.

At the End of 2003

There is a cash outflow of ₹ 100 lakhs when the restructuring costs are paid. Even though a cash outflow has taken place, there is no change in the estimated future cash flows used to determine value in use at the end of 2002. Therefore, the plant's recoverable amount is not calculated at the end of 2003.

Questions From RTP/MTP/Exams

Q38: Elia limited is a manufacturing company which deals in to manufacturing of cold drinks and beverages. It is having various plants across India. There is a Machinery A in the Baroda plant which is used for the purpose of bottling. There is one more machinery which is Machinery B clubbed with Machinery A. Machinery A can individually have an output and also sold independently in the open market. Machinery B cannot be sold in isolation and without clubbing with Machine A it cannot produce output as well. The Company considers this group of assets as a Cash Generating Unit and an Inventory amounting to ₹ 2 Lakh and Goodwill amounting to ₹ 1.50 Lakhs is included in such CGU.

Machinery A was purchased on 1st April 2013 for ₹ 10 Lakhs and residual value is ₹ 50 thousands. Machinery B was purchased on 1st April, 2015 for ₹ 5 Lakhs with no residual value. The useful life of both Machine A and B is 10 years. The Company expects following cash flows in the next 5 years pertaining to Machinery A. The incremental borrowing rate of the company is 10%.

Year	Cash Flows from Machinery A

1	1,50,000
2	1,00,000
3	1,00,000
4	1,50,000
5	1,00,000 (excluding Residual Value)
Total	6,00,000

On 31st March, 2018, the professional valuers have estimated that the current market value of Machinery A is ₹ 7 lakhs. The valuation fee was ₹ 1 lakh. There is a need to dismantle the machinery before delivering it to the buyer. Dismantling cost is ₹ 1.50 lakhs. Specialised packaging cost would be ₹ 25 thousand and legal fees would be ₹ 75 thousand.

The Inventory has been valued in accordance with Ind AS 2. The recoverable value of CGU is ₹ 10 Lakh as on 31st March, 2018. In the next year, the company has done the assessment of recoverability of the CGU and found that the value of such CGU is ₹ 11 Lakhs ie on 31st March, 2019. The Recoverable value of Machine A is ₹ 4,50,000 and combined Machine A and B is ₹ 7,60,000 as on 31st March, 2019.

Required:

a) Compute the impairment loss on CGU and carrying value of each asset after charging impairment loss for the year ending 31st March, 2018 by providing all the relevant working notes to arrive at such calculation.

b) Compute the prospective depreciation for the year 2018-2019 on the above assets.

c) Compute the carrying value of CGU as at 31st March, 2019. **[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)	₹ 10,00,000
Residual Value		₹ 50,000
Useful life		10 years
Useful life already elapsed		5 years
Yearly depreciation	(B)	₹ 95,000
WDV as at 31st March, 2018 [A- (B x 5)]		₹ 5,25,000

Machinery B

Cost	(C)	₹ 5,00,000
Residual Value		-

Useful life			10 years
Useful life already elapsed			3 years
Yearly depreciation		(D)	₹ 50,000
WDV as at 31st March, 2018 [C- (D x 3)]			₹ 3,50,000

(ii) Calculation of Value-in-use of Machinery A

Period	Cash Flows (₹)	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
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

	₹
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

	₹
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 ₹ 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 ₹ 45,000 on Machinery A. However, the impairment loss of Machinery A cannot exceed ₹ 35,350.Hence, impairment to CGU will be as follows:

	Carrying value before impairment loss	Impairment loss	Carrying value after impairment loss
	₹	₹	₹
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

	₹
Machinery A [4,89,650 – {(4,89,650-50,000)/5}]	4,01,720
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 ₹ 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 ₹ 62,266 only (₹ 9,30,000 – ₹ 8,67,734).

Q39: East Ltd. (East) owns a machine used in the manufacture of steering wheels, which are sold directly to major car manufacturers.

- The machine was purchased on 1st April, 20X1 at a cost of ₹ 500 000 through a vendor financing arrangement on which interest is being charged at the rate of 10 per cent per annum.
- During the year ended 31st March, 20X3, East sold 10 000 steering wheels at a selling price of ₹ 190 per wheel.
- The most recent financial budget approved by East's management, covering the period 1st April, 20X3 – 31st March, 20X8, including that the company expects to sell each steering wheel for ₹ 200 during 20X3-X4, the price rising in later years in line with a forecast inflation of 3 per cent per annum.
- During the year ended 31st March, 20X4, East expects to sell 10 000 steering wheels. The number is forecast to increase by 5 per cent each year until 31st March, 20X8.
- East estimates that each steering wheel costs ₹ 160 to manufacture, which includes ₹ 110 variable costs, ₹ 30 share of fixed overheads and ₹ 20 transport costs.
- Costs are expected to rise by 1 per cent during 20X4-X5, and then by 2 per cent per annum until 31st March, 20X8.
- During 20X5-X6, the machine will be subject to regular maintenance costing ₹ 50,000.
- In 20X3-X4, East expects to invest in new technology costing ₹ 100 000. This technology will reduce the variable costs of manufacturing each steering wheel from ₹ 110 to ₹ 100 and the share of fixed overheads from ₹ 30 to ₹ 15 (subject to the availability of technology, which is still under development).
- East is depreciating the machine using the straight line method over the machine's 10 year estimated useful life. The current estimate (based on similar assets that have reached the end of their useful lives) of the disposal proceeds from selling the machine is ₹ 80 000 net of disposal costs. East expects to dispose of the machine at the end of March, 20X8.
- East has determined a pre-tax discount rate of 8 per cent, which reflects the market's assessment of the time value of money and the risks associated with this asset.

Assume a tax rate of 30%. What is the value in use of the machine in accordance with Ind AS 36?

Ans: Calculation of the value in use of the machine owned by East Ltd. (East) includes the projected cash inflow (i.e. sales income) from the continued use of the machine and projected cash outflows that are necessarily incurred to generate those cash inflows (i.e cost of goods sold). Additionally, projected cash inflows include ₹ 80,000 from the disposal of the asset in March, 20X8. Cash outflows include routing capital expenditures of ₹ 50,000 in 20X5-X6

As per Ind AS 36, estimates of future cash flows shall not include:

- Cash inflows from receivables
- Cash outflows from payables

- Cash inflows or outflows expected to arise from future restructuring to which an entity is not yet committed
- Cash inflows or outflows expected to arise from improving or enhancing the asset's performance
- Cash inflows or outflows from financing activities
- Income tax receipts or payments.

Hence in this case, cash flows do not include financing interest (i.e. 10%), tax (i.e. 30%) and capital expenditures to which East has not yet committed (i.e. ₹ 100 000). They also do not include any savings in cash outflows from these capital expenditure, as required by Ind AS 36.

The cash flows (inflows and outflows) are presented below in nominal terms. They include an increase of 3% per annum to the forecast price per unit (B), in line with forecast inflation. The cash flows are discounted by applying a discount rate (8 %) that is also adjusted for inflation.

Note: Figures are calculated on full scale and then rounded off to the nearest absolute value.

Year ended	20X3-X4	20X4-X5	20X5-20X6	20X6-X7	20X7-X8	Value in use
Quantity (A)	10,000	10,500	11,025	11,576	12,155	
Price per unit(B)	₹ 200	₹ 206	₹ 212	₹ 219	₹ 225	
Estimated cash inflows (C=A x B)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 27,34,875	
Misc. cash inflow disposal proceeds (D)					₹ 80 000	
Total estimated Cash inflows (E=C+D)	₹ 20,00,000	₹ 21,63,000	₹ 23,37,300	₹ 25,35,144	₹ 28,14,875	
Cost per unit (F)	₹ 160	₹ 162	₹ 165	₹ 168	₹ 171	
Estimated cash outflows (G = A x F)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,19,125)	(₹ 19,44,768)	(₹ 20,78,505)	
Misc. cash outflow: maintenance costs (H)			(₹ 50,000)			
Total estimated Cash outflows (I=G+H)	(₹ 16,00,000)	(₹ 17,01,000)	(₹ 18,69,125)	(₹ 19,44,768)	(₹ 20,78,505)	

Net cash flows (J=E-I)	₹ 4,00,000	₹ 4,62,000	₹ 4,68,175	₹ 5,90,376	₹ 7,36,370	
Discount factor 8% (K)	0.9259	0.8573	0.7938	0.7350	0.6806	
Discounted future cash flows (L=J x K)	₹ 3,70,360	₹ 3,96,073	₹ 3,71,637	₹ 4,33,926	₹ 5,01,173	₹20,73,169

Q40: PQR Ltd. is the company which has performed well in the past but one of its major assets, an item of equipment, suffered a significant and unexpected deterioration in performance. Management expects to use the machine for a further four years after 31 st March 20X6, but at a reduced level. The equipment will be scrapped after four years. The financial accountant for PQR Ltd. has produced a set of cash-flow projections for the equipment for the next four years, ranging from optimistic to pessimistic. CFO thought that the projections were too conservative, and he intended to use the highest figures each year. These were as follows:

	₹ '000
Year ended 31st March 20X7	276
Year ended 31st March 20X8	192
Year ended 31st March 20X9	120
Year ended 31st March 20Y0	114

The above cash inflows should be assumed to occur on the last day of each financial year. The pre-tax discount rate is 9%. The machine could have been sold at 31st March 20X6 for ₹ 6,00,000 and related selling expenses in this regard could have been ₹ 96,000. The machine had been re valued previously, and at 31st March 20X6 an amount of ₹ 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31st March 20X6 was ₹ 660,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount.

Calculate impairment loss, if any and revised depreciation of asset. Also suggest how Impairment loss, if any would be set off and how compensation from government be accounted for? **[RTP May 2020]**

Ans: Carrying amount of asset on 31st March 20X6 =₹ 6,60,000

Calculation of Value in Use:

Year ended	Cash flow ₹	Discount factor @ 9%	Amount ₹
31st March, 20X7	2,76,000	0.9174	2,53,202
31st March, 20X8	1,92,000	0.8417	1,61,606
31st March, 20X9	1,20,000	0.7722	92,664
31st March, 20Y0	1,14,000	0.7084	80,758

Total (Value in Use)	**5,88,230**

Calculation of Recoverable amount:

Particulars	Amount (₹)
Value in use	5,88,230
Fair value less costs of disposal (6,00,000 – 96,000)	5,04,000
Recoverable amount (Higher of value in use and fair value less costs of disposal)	5,88,230

Calculation of Impairment loss:

Particulars	Amount (₹)
Carrying amount	6,60,000
Less: Recoverable amount	(5,88,230)
Impairment loss	71,770

Calculation of Revised carrying amount:

	Amount (₹)
Carrying amount	6,60,000
Less: Impairment loss	(71,770)
Revised carrying amount	5,88,230

Calculation of Revised Depreciation:

Revised carrying amount – Residual value

Remaining life = (5,88,230 - 0) / 4 = ₹ 1,47,058 per annum

Set off of Impairment loss:

The impairment loss of ₹ 71,770 must first be set off against any revaluation surplus in relation to the same asset. Therefore, the revaluation surplus of ₹ 36,000 is eliminated against impairment loss, and the remainder of the impairment loss ₹ 35,770 (₹ 71,770 –

₹ 36,000) is charged to profit and loss.

Treatment of Government compensation:

Any compensation by government would be accounted for as such when it becomes receivable. At this time, the government has only stated that it may reimburse the company and therefore credit should not be taken for any potential government receipt.

Q41: One of the senior engineers at XYZ has been working on a process to improve manufacturing efficiency and, consequently, reduce manufacturing costs. This is a major project and has the full support of XYZ's board of directors. The senior engineer believes that the cost reductions will exceed the project costs within twenty four months of their implementation. Regulatory testing and health and safety approval was obtained on 1 June 20X5. This removed uncertainties concerning the project, which was finally completed on 20 April 20X6. Costs of ₹

18,00,000, incurred during the year till 31st March 20X6, have been recognized as an intangible asset. An offer of ₹ 7,80,000 for the new developed technology has been received by potential buyer but it has been rejected by XYZ. Utkarsh believes that the project will be a major success and has the potential to save the company ₹ 12,00,000 in perpetuity. Director of research at XYZ, Neha, who is a qualified electronic engineer, is seriously concerned about the long term prospects of the new process and she is of the opinion that competitors would have developed new technology at some time which would require to replace the new process within four years. She estimates that the present value of future cost savings will be ₹ 9,60,000 over this period. After that, she thinks that there is no certainty about its future. What would be the appropriate accounting treatment of aforesaid issue? **[RTP May 2020]**

Ans: Ind AS 38 'Intangible Assets' requires an intangible asset to be recognised if, and only if, certain criteria are met. Regulatory approval on 1 June 20X5 was the last criterion to be met, the other criteria have been met as follows:

- Intention to complete the asset is apparent as it is a major project with full support from board
- Finance is available as resources are focused on project
- Costs can be reliably measured
- Benefits are expected to exceed costs – (in 2 years)

Amount of ₹ 15,00,000 (₹ 18,00,000 x 10/12) should be capitalised in the Balance sheet of year ending 20X5-20X6 representing expenditure since 1 June 20X5.

The expenditure incurred prior to 1 June 20X5 which is ₹ 3,00,000 (2/12 x ₹ 18,00,000) should be recognised as an expense, retrospective recognition of expense as an asset is not allowed.

Ind AS 36 'Impairment of assets' requires an intangible asset not yet available for use to be tested for impairment annually.

Cash flow of ₹ 12,00,000 in perpetuity would clearly have a present value in excess of ₹ 12,00,000 and hence there would be no impairment. However, the research director is technically qualified, so impairment tests should be based on her estimate of a four-year remaining life and so present value of the future cost savings of ₹ 9,60,000 should be considered in that case.

₹ 9,60,000 is greater than the offer received (fair value less costs to sell) of ₹ 7,80,000 and so ₹ 9,60,000 should be used as the recoverable amount.

So, the carrying amount should be consequently reduced to ₹ 9,60,000.

Calculation of Impairment loss:

Particulars	**Amount ₹**
Carrying amount (Restated)	15,00,000
Less: Recoverable amount	9,60,000
Impairment loss	5,40,000

Impairment loss of ₹ 5,40,000 is to be recognised in the profit and loss for the year 20X5-20X6.

Necessary adjusting entry to correct books of account will be:

	₹	₹
Operating expenses- Development expenditure Dr.	3,00,000	
Operating expenses–Impairment loss of intangible assets Dr.	5,40,000	8,40,000
To Intangible assets – Development expenditure		

Q42: The UK entity with a sterling functional currency has a property located in US, which was acquired at a cost of US$ 1.8 million when the exchange rate was £1 = US$ 1.60. The property is carried at cost. At the balance sheet date, the recoverable amount of the property (as a result of an impairment review) amounted to US$ 1.62 million, when the exchange rate £1 = US$ 1.80. Compute the amount which is to be reported in Profit & Loss of UK entity as a result of impairment, if any. Ignore depreciation. Also analyse the total impairment loss on account of change in value due to impairment component and exchange component. **[RTP Nov 2020]**

Ans: Ignoring depreciation, the loss that would be reported in the Profit and Loss as a result of the impairment is as follows:

	£
*Carrying value at balance sheet date-US$ 16,20,000 @ £ 1.8 =	9,00,000
Historical cost- US$ 18,00,000 @ £ 1.6 =	11,25,000
Impairment loss recognized in profit and loss	(2,25,000)
The components of the impairment loss can be analyzed as follows:	
Change in value due to impairment = US$ 1,80,000 @ £ 1.8 =	(1,00,000)
Exchange component of change =	
US$ 18,00,000 @ 1.8 – US$ 18,00,000 @ £ 1.6	(1,25,000)

*Recoverable amount being less than cost becomes the carrying value.

Q43: On 31 March 20X1, Vision Ltd acquired 80% of the equity shares of Mission Ltd for ₹ 190 million. The fair values of the net assets of Mission Ltd that were included in the consolidated statement of financial position of Vision Ltd at 31 March 20X1 were ₹ 200 million. It is the Group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 31 March 20X4, Vision Ltd carried out its annual review of the goodwill on consolidation of Mission Ltd and found evidence of impairment. No impairment had been evident when the reviews were carried out at 31 March 20X2 and 31 March 20X3. The review involved allocating the assets of Mission Ltd into three cash- generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

Unit A ₹ in million		Unit B ₹ in million	Unit C ₹ in million
Intangible assets	30	10	-
Property, Plant and Equipment	80	50	60
Current Assets	60	30	40
Total	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Mission Ltd are allocated in the table shown above.

The intangible assets of Mission Ltd have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Mission Ltd as a single cash-generating unit on 31 March 20X4 is ₹ 350 million.

Discuss and compute the accounting treatment of impairment of goodwill as per Ind AS 36?

RTP May 2021

Ans: The goodwill on consolidation of Mission Ltd that is recognized in the consolidated balance sheet of Vision Ltd is ₹ 30 million (₹ 190 million – 80% x ₹ 200 million). This can only be reviewed for impairment as part of the cash generating units to which it relates. Since here the goodwill cannot be meaningfully allocated to the units, the impairment review is in two parts.

Units A and C have values in use that are more than their carrying values. However, the value in use of Unit B is less than its carrying amount. This means that the assets of unit B are impaired by ₹ 24 million (₹ 90 million – ₹ 66 million). This impairment loss will be charged to the statement of profit and loss.

Assets of Unit B will be written down on a pro-rata basis as shown in the table below:

(₹ in million)

Asset	Impact on carrying value		
	Existing	Impairment	Revised
Intangible assets	10	(4)	6
Property, plant and equipment	50	(20)	30
Current assets	30	Nil*	30
Total	90	(24)	66

* The current assets are not impaired because they are expected to realize at least their carrying value when disposed of.

Following this review, the three units plus the goodwill are reviewed together i.e. treating Mission Limited as single cash generating Unit. The impact of this is shown in the following table, given that the recoverable amount of the business as a whole isc ₹ 350 million:

(₹ in million)

Component	**Impact of impairment review on carrying value**		
	Existing	**Impairment**	**Revised**
Goodwill (see note below)	37.50	(23.50)	14.00
Unit A	170.00	Nil	170.00
Unit B (revised)	66.00	Nil	66.00
Unit C	100.00	Nil	100.00
Total	373.50	(23.50)	350.00

Note: As per Appendix C of Ind AS 36, given that the subsidiary is 80% owned the goodwill must first be grossed up to reflect a notional 100% investment. Therefore, the goodwill will be grossed up to ₹ 37.50 million (₹ 30 million x 100/80).

The impairment loss of ₹ 23.50 million is all allocated to goodwill, leaving the carrying values of the individual units of the business as shown in the table immediately above.

The table shows that the notional goodwill that relates to a 100% interest is written down by ₹ 23.50 million to ₹ 14.00 million. However, in the consolidated financial statements the goodwill that is recognized is based on an 80% interest so the loss that is actually recognized is ₹ 18.80 million (₹ 23.50 million x 80%) and the closing consolidated goodwill figure is ₹ 11.20 million (₹ 14.00 million x 80%) or (₹ 30 million – ₹ 18.80 million).

Q44. Pacific Ocean Railway Ltd. has three Cash Generating units namely Train, Railway station and Railway tracks, the carrying amounts of which as on 31 March 2020 are as follows:

Cash Generating units	Carrying amount (₹ in crore)	Remaining useful life
Train	1,500	10
Railway station	2,250	20
Railway tracks	3,300	20

Pacific Ocean Railway Ltd. also has two Corporate Assets having a remaining useful life of 20 years.

	(₹ in crore)	
Corporate Assets	**Carrying amount**	**Remarks**
Land	1,800	The carrying amount of Land can be allocated on a reasonable basis (i.e., pro rata basis) to the

		individual cash generating units.
Buildings	600	The carrying amount of Buildings cannot be allocated on a reasonable basis to the individual cash-generating units.

Recoverable amount as on 31 March 2020 is as follows:

Cash Generating units	**Recoverable Amount (₹ in crore)**
Train	1,800
Railway station	2,700
Railway tracks	4,200
Company as a whole	9,600

Calculate the impairment loss, if any. Ignore decimals.

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Ans: Allocation of corporate assets

The carrying amount of land 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 Train's cash-generating unit is 10 years, whereas the estimated remaining useful lives of Railway station and Railway tracks's cash-generating units are 20 years.

				(₹ in crore)
Particulars	**Train**	**Railway station**	**Railway tracks**	**Total**
Carrying amount (a)	1,500	2,250	3,300	7,050
Useful life	10 years	20 years	20 years	-
Weight based on useful life	1	2	2	-
Carrying amount (after assigning weight)	1,500	4,500	6,600	12,600
Pro-rata allocation of Land	12% (1,500/12,600)	36% (4,500/12,600)	52% (6,600/12,600)	100%
Allocation of carrying amount of Land (b)	216	648	936	1,800
Carrying amount (after allocation of Land) (a+b)	1,716	2,898	4,236	8,850

Calculation of impairment loss

Step I: Impairment losses for individual cash-generating units and its allocation:

(a) Impairment loss of each cash-generating units

(₹ in crore)			
Particulars	**Train**	**Railway station**	**Railway tracks**
Carrying amount (after allocation of land)	1,716	2,898	4,236
Recoverable amount	1,800	2,700	4,200
Impairment loss	-	198	36

(b) Allocation of the impairment loss

(₹ in crore)				
Allocation to	**Railway station**		**Railway tracks**	
Land	44	[198 x (648 / 2,898)]	8	[36 x (936 / 4,236)]
Other assets in cash-generating units	154	[198 x 2,250 / 2,898)]	28	[36 x (3,300/ 4,236)]
Impairment loss	198		36	

Step II: Impairment losses for the larger cash-generating unit, i.e., Pacific Ocean Railway Ltd. as a whole

(₹ in crore)						
Particulars	**Train**	**Railway station**	**Railway tracks**	**Land**	**Building**	**Pacific Ocean Railway Ltd.**
Carrying amount	1,500	2,250	3,300	1,800	600	9,450
Impairment loss (Step I)	-	(154)	(28)	(52)	-	(234)
Carrying amount (after Step I)	1,500	2,096	3,272	1,748	600	9,216
Recoverable amount						9,600
Impairment loss for the 'larger' cash-generating unit						Nil