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Ind AS Question Bank - Compiler

Paper 1: Financial Reporting

3.0

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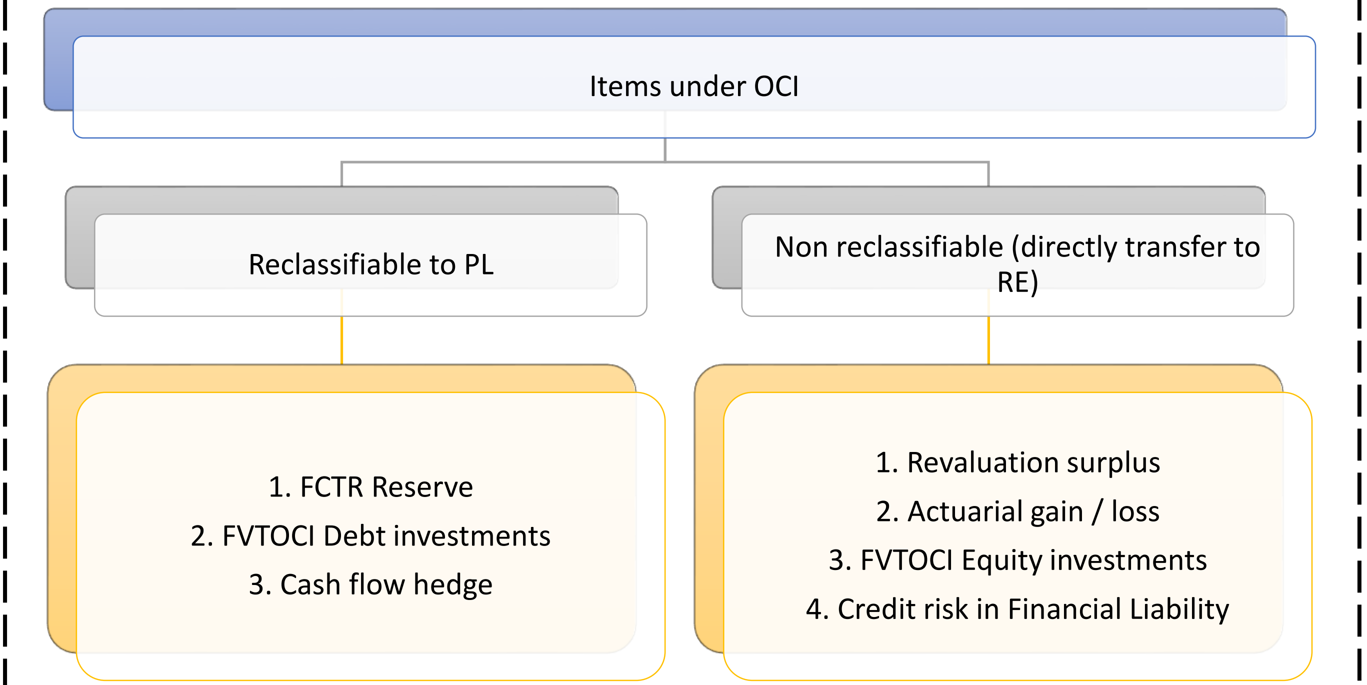
Ind AS 1

Concept no.1

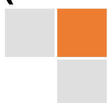


Identificaion of Presentation head (PL vs OCI)

6(b) Entity A has undertaken various transactions in the financial year ended 31st March, 20X1. Identify and present the transactions in the financial state ments 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**
Sharebased payments cost	**3,35,000**

(MTP April 2021) / (MTP March 2018) / (Exam May 19)



[Video link: https://youtu.be/axOjfAoMJY8 time: 7.00]

Answer

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

Concept no.2: Current asset or liability – if any on econdition satisfied

a. **Expected to be realized or settled within 12 months from Reporting date**
b. **Expected to be realized or settled within 12 months from Accounting date**
c. **SIT / FG / Bank OD / Bank CC**
d. **Cash and Cash equivalent unless restricted from being used within 12months from Reporting date**
e. **No unconditional right to defer settlement beyond 12months from Reporting date**

Current / non-current identification

16.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)

Video link: https://youtu.be/axOjfAoMJY8, time: 1.09.05]

Answer

(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 ifit 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 additionaldisclosure 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-currentasset.

(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.

2. 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? (RTP May 2022) / (MTP May 2022)

[Video link: https://youtu.be/rxTiMeT0IDU, time: 12:31]

Answer

Inventory and debtors need to be classified in accordance with the requirement of paragraph 66(a) 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 norm al 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 realization 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.

Additional information as required by paragraph 61 of Ind AS 1 will be required to be made by the entity, which provides "Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

(a) No more than twelve months after the reporting period, and

(b) More than twelve months after the reporting period."

2. (ii) On 1st April, 20X3, Charming Ltd issued 1,00,000 ` 10 bonds for ` 10,00,000. On 1st April, each year, interest at the fixed rate of 8% per year is payable on outstanding capital amount of the bonds (ie the first payment

will be made on 1st April, 20X4). On 1st April each year (i.e from 1st April, 20X4), Charming Ltd has a contractual obligation to redeem 10,000 of the bonds at ` 10 per bond. In its statement of financial position at 31st March, 20X4. How should this be presented in the financial statements? (MTP May 2022)

[Video link: https://youtu.be/H5VbXddxql4, time: 26:32]

Answer

Charming Ltd must present ` 80,000 accrued interest and ` 1,00,000 current portion of the non-current bond (i.e. the portion repayable on 1st April, 20X4) as current liabilities. The ` 9,00,000 due later than 12 months after the end of the reporting period shall be presented as a non-current liability.

1b) Charm Limited (the 'Company') is a manufacturing company, which is into manufacturing of wires and cables and has assessed its operating cycle to be 15 months. The Company has some trade receivables which are receivable within a period of 12 months from the reporting date i.e. 31st March 2021.

With respect to the following transactions, which took place during the financial year 2020-2021, give your opinion based on relevant Ind AS:

- **The Company has received a contract of ` 10 crore on 31st March 2021. The terms of the contract require the Company to make a security deposit of 20% of the contract value with the customer. The Company made a security deposit of ` 2 crore on 31st March 2021. This contract will be completed in about 14 months. 70% of the deposit will be refunded immediately and the balance 30% of the deposit will be refunded after 3 months from the completion of the contract. The Company wants to present the security deposit of ` 2 crore as non-current. Is the management's decision correct?**

- **The Company has some trade receivables that are due after 14 months from the date of the balance sheet; the management of the Company expects to receive the amount within the period of the operating cycle. Despite the fact that these are receivables in 14 months, the management would like to present these as current. Is the management's decision correct?**

- **In the normal course of business, the Company has gi ven 2 contracts and received a total security deposit of ` 4 crore. ` 3 crore is received from X Limited and ` 1 crore is received from Y Limited on 31st March 2021. These are repayable on completion of the contract. However, if the contract is**

cancelled with in the contract term of 18 months, then the deposit becomes payable immediately. The Company is positive about the contract with X Limited but is in doubt about the contract received from Y Limited. The Company wants to present the amount of ` 3 crore as non-current and ` 1 crore as current in the balance sheet. Is the management's decision correct?

- **The Company is planning to replace a machinery. It has given an advance of ` 1 crore for purchase of new machinery which will be delivered in 6 months from the date of the balance sheet. It has sold the old machinery for ` 0.5 crore, the payment of which is due in 10 months from the date of the balance sheet. The Company wants to present both these amounts as current since they will be settled within twelve months from the end of the reporting period. Is the management's decision correct? (Exam July 2021)**

[Video link: https://youtu.be/tZSGT1KBYBI, time: 14:19]

Answer

Operating cycle of Charm Limited = 15 months

(i) The security deposit made by the Company with the customers be classified as current assets to the extent of 70% (` 2 crore x 70% = ` 1.40 crore) as it will be refunded immediately on completion of 14 months of contract i.e. within the operating cycle of 15 months.

However, 30% of the security deposit will be refunded after 3 months of completion of the contract (14+3 = 17 months) i.e. after 2 months of operating cycle (Operating cycle of the Company is 15 months). Hence, it will be classified as non -current. Therefore, management's decision is not correct. (Refer Para 66 of Ind AS 1)

(ii) Yes, the Company's decision of presenting the trade receivables as Current Assets is correct despite the fact that these are receivables in 14 months' time since the operating cycle of the company is 15 months and any event arising due to trade will be considered as current if its settlemen t is within the tenure of operating cycle.

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)

(iii) Paragraph 69(d) of Ind AS 1 states that an entity shall classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Although it is expected that X Limited will fulfil the contract and the deposit will not be refunded, but in case of cancellation within the contract term, refund of security

deposit is a condition that is not within the control of the entity. Hence , Charm Limited does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Accordingly, the deposit will have to be classified as current liability in case of both X and Y Limited.

(iv) Yes, the management decision to classify the payment of ` 0.5 crore as a current asset is correct since the payment will be realised in less than twelve months from the end of the reporting period. Capital advances are advances given for procurement of Property, Plant and Equipment etc. Typically, companies do not expect to realize them in cash. Rather, over the period, these get converted into non -current assets. Hence, capital advances should be treated as other non -current assets irrespective of when the Property, Plant and Equipment is expected to be received. Under Ind AS Schedule III, Capital Advances are not to be classified under Capital Work in Progress since they are specifically to be disclosed under other non –current assets.

Accordingly, advance of ` 1 crore given for purchase of machinery is 'Capital advance' which will be classified as non-current as it relates to acquisition of non-current item i.e., machinery. Hence, management decision to classify it as current is incorrect.

7.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)Should the loan be classified as current or non-current 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? (RTP Nov 19)

Video link: https://youtu.be/axOjfAoMJY8 time: 1.00.40]

Answer

Para 69 of Ind AS 1 defines current liabilities as follows:An entity shall classify aliability as current when:

(i)it expects to settle the liability in its normal operating cycle;

(ii)it holds the liability primarily for the purpose of trading;

(iii)the liability is due to be settled within twelve months after the reporting period; or

(iv)it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

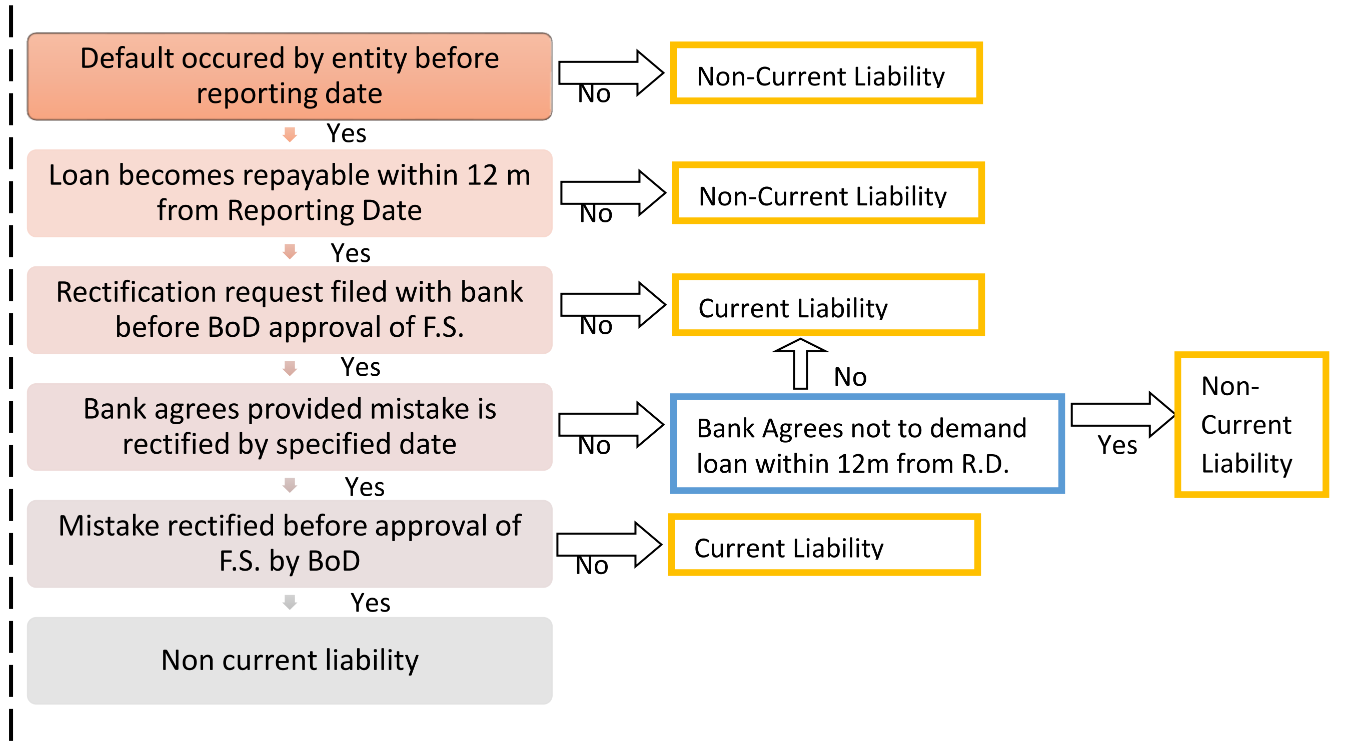
Accordingly, following will be the classification of loan in the given scenarios:

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 because as per paragraph 72 of Ind AS 1, “an entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if: (a) the original term was for a period longer than twelve months, and (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.” 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.



3.(a)In December 20X1 an entity entered into a loan agreement with a bank. The loan is repayable in three equal annual installments starting from December 20X5.One of the loan covenants is that an amount equivalent to the loan amount should be contributed by promoters by March 24 20X2, failing which the loan becomes payable ondemand. As on March 24, 20X2, the entity has not been able to get the promoter's contribution. On March 25, 20X2, the entity approached the bank and obtained a grace period up to June 30, 20X2 to get the promoter's contribution.

The bank cannot demand immediate repayment during the grace period. The annual reporting period of the entity ends on March 31, 20X2.

(i)As on March 31, 20X2, examine the classification of the loan to be done by the entityas per Ind AS?

(ii)Assume in anticipation that it may not be able to get the promoter's contributionby due date. InFebruary 20X2, the entity approached the bank and got the compliance date extended up to June 30, 20X2 for getting promoter's contribution. In this case, examine whetherthe loan classification as on March 31, 20X2 be different from (a) above? (MTP March 2018) / (Exam May 22)

[video link: https://youtu.be/axOjfAoMJY8 time: 23.47]

Answer

(i)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 periodof 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, 20X2, the loan will be classified as current.

(ii)Ind AS 1 deals with classification of liability as current or non-current in case of breach of a loancovenant 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, 20X2, i.e., after the reporting date. Consequently, in the absence of actual breach of the loan covenant as on March 31, 20X2, the loan will retain its classification as non-current.

1(b) Entity A had obtained a long-term bank loan during January 2019, which is subje ct 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 Jan 21)

[video link: https://youtu.be/axOjfAoMJY8 time: 49.08]

Answer

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 i n 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 en d 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.

Offsetting

2. Is offsetting permitted under the following circumstances?

(a) Expenses incurred by a holding company on behalf of subsidiary, which is reimbursed by the subsidiary - whether in the separate books of the holding company, the expenditure and related reimbursement of expenses can be offset?

(b) Whether profit on sale of an asset against loss on sale of another asset can be offset?

(c) When services are rendered in a transaction with an entity and services are received from the same entity in two different arrangements, can the receivable and payable be offset? (RTP Nov 2021)

[video link: https://youtu.be/4BBd21zl_hM, time: 33.28]

Answer

(a) As per paragraph 33 of Ind AS 1, offsetting is permitted only when the offsetting reflects the substance of the transaction.

In this case, the agreement/arrangement, if any, between the holding and subsidiary company needs to be considered. If the arrangement is to reimburse the cost incurred by the holding company on behalf of the subsidiary company, the same may be presented net. It should be ensured that the substance of the arrangement is that the payments are actually in the nature of reimbursement.

(b) Paragraph 35 of Ind AS 1 requires an entity to present on a net basis gains and losses arising from a group of similar transaction s. Accordingly, gains or losses arising on disposal of various items of property, plant and equipment shall be presented on net basis. However, gains or losses should be presented separately if they are material.

(c) Ind AS 1 prescribes that assets and liabilities, and income and expenses should be reported separately, unless offsetting reflects the substance of the transaction. In addition to this, as per paragraph 42 of Ind AS 32, a financial asset and a financial liability should be offset if the entity has legally enforceable right to set off and the entity intends either to settle on net basis or to realise the asset and settle the liability simultaneously.

In accordance with the above, the receivable and payable should be offset against each other and net amount is presented in the balance sheet if the entity has a legal right to set off and the entity intends to do so. Otherwise, the receivable and payable should be reported separately.

2(b) In the plant of PQR Ltd., there was a fire on 10th May, 20X1 in which the entire plant was damaged and the loss of ` 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 31st March, 20X1 were approved by the Board of Directors on 12th June, 20X1. Show how should it be disclosed? (MTP May 2022)

[video link: https://youtu.be/H5VbXddxql4, time: 29:13]

Answer

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 material 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, if 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 financial year 20X0-20X1 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 t he fire, no adjustment is required in the financial statements for the year ending 31 st March, 20X1.

Concept no.4: Applicability of Ind AS(only to companies registered under companies act), any of the following

a. Debt / Equity listed or in the process of being listed anytime during the year
b. Other entities having net worth more than equal to 250cr in last audited F.S.
c. Holding / Subsidiary / Associate / JV of such entity

Applicability of Ind AS

3. Fresh Vegetables Limited (FVL) was incorporated on 2nd April, 20X1 under the provisions of the Companies Act, 2013 to carry on the wholesale trading business in vegetables.

As per the audited accounts of the financial year ended 31st March, 20X7 approved in its annual general meeting held on 31st August, 20X7 its net worth, for the first time since incorporation, exceeded ` 250 crore. The financial statements since inception till financial year ended 31st March, 20X6 were prepared in accordance with the Companies (Accounting Standards) Rules 2006. It has been advised that henceforth it should prepare its financial statements in accordance with the Companies (Indian Accounting Standards) Rules, 2015.

The following additional information is provided by the Company:

− FVL has in the financial year 20X2-20X3 entered into a 60:40 partnership with Logistics Limited and incorporated a partnership firm 'Vegetable Logistics Associates' (VLA) to carry on the logistics business of vegetables from farm to market.

− FVL also has an associate company Social Welfare Limited (SWL) that was incorporated in July, 20X5 as a charitable organization and registered under section 8 of the Companies Act, 2013. Social Welfare Limited has been th e associate company of FVL since its incorporation. Examine the applicability of Ind AS on VLA & SWL (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU, time: 14:00]

Answer

• Currently Ind AS is applicable to the following companies except for companies other than banks and Insurance Companies, on mandatory basis:

(a) All companies which are listed or in process of listing in or outside India on Stock Exchanges.

(b) Unlisted companies having net worth of ` 250 crore or more but less than ` 500 crore.

(c) Holding, Subsidiary, Associate and Joint venture of above.

• Companies listed on SME exchange are not required to apply Ind AS on mandatory basis.

• Once a company starts following Ind AS either voluntarily or mandatorily on the basis of criteria specified, it shall be required to follow Ind AS for all the subsequent financial statements even if any of the criteria specified does not subsequently apply to it.

• Application of Ind AS is for both standalone as well as consolidated financial statements if threshold criteria met or adopted voluntarily.

• Companies meeting the thresholds for the first time at the end of an accounting year shall apply Ind AS from the immediate next accounting year with comparatives.
• Companies not covered by the above roadmap shall continue to apply existing Accounting Standards notified in the Companies (Accounting Standards) Rules, 2006

Since the net worth of FVL in immediately preceding year exceeded ` 250 crore, Ind AS is applicable to it. The entity VLA and SWL have to be examined as they may fall in criteria (c) above.

Applicability of Ind AS on VLA

Joint arrangement can be either joint operation or joint venture. However, for the purpose of identifying the applicability of Ind AS, the Act defines Joint venture (as an explanation to section 2(6) of the Companies Act, 2013), as follows:

“The expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement”.
Accordingly, if an entity is classified as joint operation and not joint venture, then Ind AS would not be applicable to such entity.

In the case of VLA, if partners conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation.

However, Ind AS would not be applicable on VLA in such a case since it is the case of joint operation (and not a joint venture).

Alternatively, if partners conclude that they have joint control of the arrangement and have rights to the net assets of the arrangement relating to the partnership firm, then this would be a joint venture. In such a case, Ind AS would be applicable to the m.

Applicability of Ind AS on SWL Social Welfare Limited (SWL) is the associate company of FVL. Accordingly, Ind AS would be applicable on SWL too irrespective of the fact that SWL has been incorporated as a charitable organisation.

Ind AS 2

Allocaion of overhead

1.The following is relevant information for an entity :

•Full capacity is 10,000 labour hours in a year.

•Normal capacity is 7,500 labourhours 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 goodssold and closing inventory? (RTP May 20)

[Video link: https://youtu.be/K3HfG34stUA, time: 18:02]

Answer

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

= `2,600/6,500hours= `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 xNumber of hours to produce each unit x(Fixed production overhead absorption rate +Variable production overhead absorption rate)

= 2,300unitsx1hour 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, notincluded in the cost of goods sold	200
Total	2,720

12.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 20)

[video link: https://youtu.be/K3HfG34stUA, time: 27:19]

Answer

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.

6c. 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 AS2 'Inventories' if (i) Actual production is 7,50,000 units. (ii) Actual production is 15,00,000 units. (Exam May 18)

[video link: https://youtu.be/K3HfG34stUA, time: 44:44]

Answer

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

(ii)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

Joint product / by product

Q3(c) In a manufacturing process ofSolarLtd., one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing stock 31.3.2018
Raw material Wages Fixed overhead Variable overhead	14,500	150,000 90,000 65,000 50,000	MP I-5,000 units MP II -4,000 units BP-2,000 units	250 100

Average market price of MP1 and MP2 is Rs.60 per unit and Rs.50 per unit respectively, by-product is sold @ Rs.20 per unit. There is a profit of Rs.5,000 on sale of by-product after incurring separate processing charges of Rs.8,000 and packing charges of Rs.2,000, Rs.5,000 was realised from sale of scrap.Calculate the value of closing stock of MP1 and MP2 as on 31-03-2018. (MTP Oct 18) / (Exam Dec 21)

[video link: https://youtu.be/K3HfG34stUA, time: 5:37]

Answer

As per Ind 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 NRV of By-product BP

Selling price of by-product (2000 * 20)	40,000
Less: Separate processing charges of by-product BP	(8000)

Packing charges	(2000)
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	150,000
Wages	90,000
Fixed overhead	65,000
Variable overhead	50,000
Less: NRV of by-product BP (See calculation 1)	(30000)
Sale value of scrap	(5000)
Joint cost to be allocated between MP1 and MP2	3,20,000

(3)Determination of "basis forallocation" and allocation of joint cost to MP1 and MP2

	MP1	MP2
Output in units (a)	5000	4000
Sales price per unit (b)	60	50
Sales value (a x b)	300000	200000
Ratio of allocation	3	2
Joint cost of Rs.3,20,000 allocated in the ratio of 3:2 (c)	192000	128000
Cost per unit [c/a]	38.4	32

(4)Determination of value of closing stock of MP1 and MP2

Particulars	MP I	MP 2
Closing stock in units	250	100
Cost per unit	38.4	32
Value of closing stock	9600	3200

Inclusion in inventory cost

2.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

•depreciationof plant used to perform the modifications = `5,000.

During February 20X1the 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 andcalculations, wherever required. (RTP May 2021) / (MTP Sept 22)

[video link: https://youtu.be/K3HfG34stUA, time: 32:00]

Answer

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	55000	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 costsand labourcost for specific customer
Other costs	37,000	Refer working note
Borrowing costs		Recognised as an expense in profit or loss
Total cost of inventories	682,000	

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.

16. (i) A retailer company imported goods at a cost of ` 1,30,000 including ` 20,000 non-refundable import duties and ` 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred ` 5,000 to transport the goods to its retail outlet and a further ` 2,000 in delivering the goods to its customer. Further selling costs of ` 3,000 were incurred in selling the goods.

State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory. (RTP Nov 22)

Answer

Calculation of Inventory cost:

Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	5,000

Total	1,25,000

Note: The cost of purchase excludes the refundable purchase taxes paid on acquisition of the goods as the ` 10,000 paid will be refunded to the retailer. Ind AS 2 specifically exclude selling cost from forming part of cost of inventory .

However, selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories.
Accordingly, though the word ‘distribution costs’ is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories.

Therefore, it excludes the selling expenses incurred (i.e., ` 2,000 delivery costs and ` 3,000 other selling costs).

Obsolete inventory treatment

3 c) Sophia Ltd. has fabricated special equipment (Inverter panel) during the financial year 2018-2019 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 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 March 2020 are as follows:

Inverter panel (WIP)	**`255 lakhs**
Inverter panel (Finished goods)	**`165 lakhs**
Sundry Debtor (Inverter panel)	**`195 lakhs**

The petition for winding up against the customer has been filed during the financial year 2019-2020 by Sophia Ltd.

You are required to Comment with explanation on provision to be made for `615 lakh included in Sundry Debtors, Finished goods and Work-in-Progress in the financial statement for the Financial year 2019-2020. (Exam nov 20)

[Video link: https://youtu.be/K3HfG34stUA, time: 47:07]

Answer

Sophia Ltd. is a manufacturer of inverter panel. As per Ind AS 2 '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, inverter panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year isto 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 inverter panel which were to be supplied has been shown in Inventory. The inverter panel are in the possession of the Company which can be sold in themarket. Hence company should value such inventory as per principle laid down in Ind AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of the buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such inverter 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 2 at` 420 lakhs [i.e inverter panel (WIP) ` 255 lakhs + inverter panel (finished products) ` 165 lakhs].

Alternatively, if it is assumed that there is no buyer for such fabricated inverter 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 balance of Sundry Debtors, since the Company has filed a petition for winding up against the customer in 2019-2020, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ` 195 lakhs shall be made in the books against the amount of debtors.

Fixed overhead allocation

6a. Heavy Limited has a plant with normal capacity to produce 90,000 units of a product per annum and expected fixed production overhead for the year is ` 18,00,000. There are no quarterly / seasonal variations.

Hence, normal expected production of each quarter is uniform. The actual production of the year is 87,000 units. The production details of each quarter are as under:

Quarter I: 20,000 units

Quarter II: 24,000 units

Quarter III: 23,500 units

Quarter IV: 19,500 units

Calculate the allocation of fixed production overhead for all the four quarters. Will the quarterly results affect annual result?

Give your answer as per Ind AS 34 read with Ind AS 2 . (Exam july 21)

[video link: https://youtu.be/tZSGT1KBYBI, time: 48:34]

Answer

Since it is considered that there is no quarterly / seasonal variation, then normal expected production for each quarter is 22,500 units (90,000 units / 4 quarters) and fixed production overheads for the quarter are ` 4,50,000 (` 18,00,000 / 4 quarters).

Fixed production overhead to be allocated per unit of production in every quarter will be ` 20 per unit. (Fixed overheads / Normal production i.e. ` 4,50,000 / 22,500 units

Particulars	Quarters			
	I	II	III	IV
Actual fixed production overheads on year to date basis	450,000	900000	13,50,000	18,00,000
Actual production (Units)	20000	24000	23500	19500
Actual production year to date basis (Units)	20000	44000	67500	87000
Fixed overheads to be absorbed on year to date basis	400000	880000	13,50,000	17,40,000
Under recovery year to date	50,000	20000	Nil	60,000

Quarter I:

Unallocated fixed production overheads ` 50,000 (i.e. ` 4,50,000 – ` 4,00,000) to be charged as expense as per Ind AS 2 and consequently as per Ind AS 34 .

Quarter II:

Since production increased in second quarter by 1,500 units (24,000 – 22,500) i.e. more than the normal expected production, hence ` 30,000 (1,500 units x ` 20 per unit) will be reversed by way of a credit to the statement of profit and loss of the 2 nd quarter and debit to cost of production / inventory cost.

Quarter III:

Earlier, ` 50,000 was not allocated to production / inventory cost in the 1 st quarter. Out of it, ` 30,000 was reversed in the 2nd quarter. To allocate entire ` 13,50,000 till third quarter to the production, as per Ind AS 34, remaining ` 20,000 (` 50,000 – ` 30,000) will be reversed by way of a credit to the statement of profit and loss of the 3 rd quarter and debit to the cost of production / inventory cost .

Quarter IV:

Unallocated fixed production overheads ` 60,000 {i.e. ` 4,50,000 – (` 20 x 19,500)} in the 4th quarter will be expensed off as per the principles of Ind AS 2 and Ind AS 34 by way of a charge to the statement of profit and loss .

For the year:

The cumulative result of all the quarters would also result in unallocated overheads of ` 60,000, thus, meeting the requirements of Ind AS 34 that the quarterly results should not affect the measurement of the annual result .

Inclusion in NRV

16. Whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?
(a) Costs of completion of work-in-progress;
(b) Trade discounts expected to be allowed on sale; and
(c) Cash discounts expected to be allowed for prompt payment

Answer

Ind AS 2 defines Net Realisable Value as 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."

Costs of completion of work-in-progress are incurred to convert the work -in-progress into finished goods. Since these costs are in the nature of completion costs, in accordance with the above definition, the same should be deducted from the estimated selling price to determine the NRV of work-in-progress.

Trade Discount is "A reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment". Trade discount is allowed either expressly through an agreement or through prevalent commercial practices in the terms of the trade and the same is adjusted in arriving at the selling price. Accordingly, the trade discount expected to be allowed should be deducted to determine the estimated selling price.

Cash Discount is "A reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period." These types of costs are incurred to recover the sale proceeds immediately or before the end of the specified period or credit period allowed to the customer. In other words, these costs are not incurred to make the sale, therefore, the same should not be considered while determining NRV.

Ind AS 7

Operating vs Investing vs Financing

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

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 (RTP May 2021)

[video link: https://youtu.be/5eZJgfaSfo0, time: 2:19]

Answer

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

Presentation of taxation in CFS

4 (c)During the financial year 20X1-20X2, Akola Limited have paid various taxes & reproduced the below mentioned records for your perusal:

-Capital gain tax of Rs. 20 crore on sale of office premises at a sale consideration of Rs. 100 crore.

-Income Tax of Rs. 3 crore on Business profits amounting Rs. 30 crore (assume entire business profit as cash profit).

-Dividend Distribution Tax of Rs. 2 crore on payment of dividend amounting Rs. 20 crore to its shareholders.

-Income tax Refund of Rs. 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. (MTP March 2021) / RTP Nov 20

[video link: https://youtu.be/6FQuGvb8-WI, time: 51:50]

Answer

Para 36 of Ind AS 7 inter alia states thatwhen 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, the 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

Foreign currency fluctuation presentation

17. 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 19)

[video link: https://youtu.be/6FQuGvb8-WI, time: 55:12]

Answer

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.

(b)A Ltd., whose functional currency is Indian Rupee, had a balance of cash and cash equivalents of Rs. 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:

ϖA Ltd. purchased goods for resale from Europe for €2,00,000 when the exchange rate was €1 = Rs. 50. This balance is still unpaid at 31st March, 2018 when the exchange rate is €1 = Rs. 45. An exchange gain on retranslation of the trade payable of Rs. 5,00,000 is recorded in profit or loss.

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

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

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

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

ϖIgnore taxation.

How cash flows arising from the above transactions would be reported in the statement of cash flows of A Ltd. under indirect method? (MTP April 2018)

[Video link: https://youtu.be/6FQuGvb8-WI, time: 2:35]

Answer

Statement of cash flows

Particulars Amount (Rs.)

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 Rs. (50 – 45)] (10,00,000)

Decrease in trade payables [1,00,000 x Rs. (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	50,00,000
Net increase in cash and cash equivalents	1,13,00,000
Cash and cash equivalents at the beginning of the period	2,00,000
Cash and cash equivalents at the end of the period	1,15,00,000

6. 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	2740	3615
Total non-current liabilities	4740	8615

Current liabilities		
Financial liabilities		
Trade payables	**150**	**90**
Bank Overdraft	**75**	**60**
Other current liabilities	**300**	**200**
Total current liabilities	**525**	**350**
Total liabilities	**5265**	**8965**
Total Equity and Liabilities	**17,565**	**17,265**

Additional Information:

(1) Profit after tax for the year ended 31st March, 20X2- ` 4,450 lacs

(2) Interim Dividend paid during the year - ` 450 lacs

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

(a) Property, Plant and Equipment - ` 500 lacs

(b) Intangible Assets - ` 20 lacs

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

(5) 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 19)

[video link: https://youtu.be/5eZJgfaSfo0, time: 6:37]

Answer

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)
	4,960
Change in operating assets and liabilities	
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

2(b) From the following data of Galaxy Ltd., prepare statement of cash flows showing cash generated from Operating Activities using direct method as per Ind AS 7:

	31.3.20X2	31.3.20X1
Current Assets:		
Inventory	1,20,000	1,65,000
Trade receivables	2,05,000	1,88,000
Cash & cash equivalents	35,000	20,500
Current Liabilities:		
Trade payable	1,95,000	2,15,000
Provision for tax	48,000	65,000

Summary of Statement of Profit and Loss

Sales	85,50,000
Less: Cost of sales	(56,00,000)
	29,50,000
Other Income	
Interest income	20,000
Fire insurance claim received	1,10,000
	1,30,000
	30,80,000
Depreciation	(24,000)
Administrative and selling expenses	(15,40,000)
Interest expenses	(36,000)
Foreign exchange loss	(18,000)
	(16,18,000)
Net Profit before tax and extraordinary income	14,62,000
Income Tax	(95,000)
Net Profit	13,67,000

Additional information:

(i) Trade receivables and Trade payables include amounts relating to credit sale and credit purchase only.

(ii) Foreign exchange loss represents increment in liability of a long-term borrowing due to exchange rate fluctuation between acquisition date and balance sheet date. (MTP Sept 22)

Answer

Statement of Cash Flows from Operating Activities (Direct Method) of Galaxy Ltd.

for the year ended 31 March 20X2

Particulars	`	`
Operating Activities:		
Cash received from Trade receivables (W.N. 3)	85,33,000	
Less:		
Cash paid to Suppliers (W.N.2)	55,75,000	
Payment for Administration and Selling expenses	15,40,000	
Payment for Income Tax (W.N.4)	1,12,000	
	(72,27,000)	
	13,06,000	
Adjustment for exceptional items (fire insurance claim)	1,10,000	
Net cash generated from operating activities	14,16,000	

Working Notes:

1. Calculation of total purchases

Cost of Sales = Opening stock + Purchases – Closing Stock

` 56,00,000 = ` 1,65,000 + Purchases – ` 1,20,000

Purchases = ` 55,55,000

2. Calculation of cash paid to Suppliers

Trade Payables

To Bank A/c (balancing figure)	55,75,000	By Balance b/d	2,15,000
To Balance c/d	1,95,000	By Purchases (W.N. 1)	55,55,000
	57,70,000		57,70,000

3. Calculation of cash received from Customers

Trade Receivables

To Balance b/d	1,88,000	By Bank A/c (balancing figure)	85,33,000
To Sales	85,50,000	By Balance c/d	2,05,000
	87,38,000		87,38,000

4. Calculation of tax paid during the year in cash

Provision for tax

To Bank A/c (balancing figure)	1,12,000	By Balance b/d	65,000
To Balance c/d	48,000	By Profit and Loss A/c	95,000
	1,60,000		1,60,000

Ind AS 8

Change in Policy

2. (c)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 reliablea weighted average valuation model should be used. The effect ofthe change on the valuation of inventory was as follows:

•31stMarch, 2015 -Increase of Rs. 10 million

•31stMarch, 2016 -Increase of Rs. 15 million

•31stMarch,2017-Increase of Rs. 20 million

Profit or loss under the FIFO valuation model are as follows:Rs. in million

	2016-2017	**2015-2016**
Revenue	**324**	**296**
Cost of sales	**(173)**	**(164)**
Gross profit	**151**	**132**
Expenses	**(83)**	**(74)**
Profit	**68**	**58**

Retained earnings at 31stMarch,2015 were Rs. 423 million.

Present the change in accounting policy in the profit or loss and produce an extract of the statement of changes in equity in accordance with Ind AS 8. (MTP Oct 2018) / (RTP May 19)

[video link: https://youtu.be/CZBW7MufIDc, time: 2:09]

Answer

Profit or loss under weighted average valuation are as follows:

Rs. in million

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

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

Statement of changes in equity (extract)		Rs. in million
	Retained earnings	Retained earnings (Original)
At 1st April, 2015	423	423
Change in inventory valuation policy	10	-
At 1st April, 2015(Restated)	433	-
Profit for 2015-2016	63	58
At 31st March, 2016	496	481
Profit for 2016-2017	73	68
At 31st March, 2017	569	549

2.(a)During the year ended 31stMarch,20X2, Blue Ocean group changed its accounting policy for depreciating property, plant and equipment, so as to apply components approachfully, whilst at the same time adopting the revaluation model.In years before 20X1-20X2, Blue Ocean group's asset records were notsufficiently detailed to apply a components approach fully. At the end of 31stMarch, 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values anddepreciable amounts at the beginning of 20X1-20X2. The results are shown as under:

Property, plant and equipment at the end of 31stMarch,20X1	**Rs.**
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)

[video link: https://youtu.be/CZBW7MufIDc, time: 14:07]

Answer

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 31stMarch,20X2:	Rs.
As perthe engineering survey:	
Valuationof PPE	17,000
Estimated residual value	3,000
Average remaining asset life (years)	7
Depreciation expense on existing property, plant and equipment	
for 20X1-20X2(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 20X1-20X2because 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 20X1-20X2would be as under:

Particulars	Rs.
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 (Rs.2,000 –Rs.1,500)	500
Reduce tax expense on depreciation (30%)	150

6(a) PQR Limited acquired a building for its administrative purposes and presented the same as Property, Plant and Equipment (PPE) in the financial year 2019-2020. During the financial year 2020-2021, 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, PQR Limited reclassified it from PPE to Investment Property in the Financial Year 2020 2021. Should PQR Limited account for the change as a change in accounting policy? Examine. (Exam Dec 21)

[video link: https://youtu.be/ngi-Dzq0Kis, time: 52:22]

Answer

Requirement of Ind AS 8:

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

Definition of PPE as per relevant Ind AS:

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.

Definition of Investment Property as per relevant Ind AS: 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.

Analysis and decision making:

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 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.

Error

2 (a) During 20X4-X5, Cheery Limited discovered that some products that had been sold during 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at Rs. 6,500.Cheery Limited's accounting records for 20X4-X5 show sales of Rs. 104,000, cost of goods sold of Rs. 86,500 (including Rs. 6,500 for the error in opening inventory), and income taxes of Rs. 5,250.

In 20X3-X4, Cheery Limited reported:	**Rs.**
Sales	**73,500**
Cost of goods sold	**(53,500)**
Profit before income taxes	**20,000**
Income taxes	**(6,000)**
Profit	**14,000**

Basic and diluted EPS 2.8

The 20X3-X4 opening retained earnings was Rs. 20,000 and closing retained earnings was Rs. 34,000. Cheery Limited's income tax rate was 30% for 20X4-X5 and 20X3-X4. It had no other income or expenses. Cheery Limited had Rs. 50,000 (5,000 shares of Rs. 10 each) of share capital throughout, and no other components of equity except for retained earnings. State how the above will be treated /accounted in Cheery Limited's Statement of profit and loss, statement of changes in equity and in notes wherever required for current period and earlier period(s) as per relevant Ind AS. (MTP March 2021) / (RTP Nov 19) / MTP Oct 22

[video link: https://youtu.be/CZBW7MufIDc, time: 50:46]

Answer

Cheery Limited
Extract from the Statement of profit and loss

	20X4-X5	(Restated) 20X3-X4
Sales	1,04,000	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
Basic and diluted EPS	3.36	1.89

Cheery Limited

Statement of Changes in Equity

	Share capital	Retained earnings	Total
Balance at 31st March, 20X3	50,000	20,000	70,000
Profit for the year ended 31st March, 20X4 as restated		9450	9450
Balance at 31st March,20X4	50,000	29450	79450
Profit for the year ended 31st March, 20X5		16800	16800
Balance at 31st March,20X5	50000	46250	96250

Extract from the Notes

Some products that had been sold in 20X3-X4 were incorrectly included in inventory at 31st March, 20X4 at Rs. 6,500. The financial statements of 20X3-X4 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below:

Effect on 20X3-X4

(Increase) in cost of goods sold	(6,500)
Decrease in income tax expenses	1,950
(Decrease) in profit	(4,550)
(Decrease) in basic and diluted EPS	(0.91)
(Decrease) in inventory	(6,500)
Decrease in income tax payable	1,950
(Decrease) in equity	(4,550)

There is no effect on the balance sheet at the beginning of the preceding period i.e. 1st April, 20X3.

16.While preparing the financial statements for the year ended 31st March, 20X3, Alpha Limited has observed two issues in the previous year Ind ASfinancial 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 31st March, 20X2).

Issue 2:The company had charged off certain expenses as finance costs in the year ended 31st March, 20X2. While preparingannual 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 ended31st March, 20X2? (RTP May 20) / (MTP april 21)

[Video link: https://youtu.be/CZBW7MufIDc, time: 43:04]

Answer

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.

17. While preparing interim financial statements for the half -year ended 30 September 20X2, an entity discovers a material error (an improper expense accrual) in the interim financial statements for the period ended 30 September 20 X1 and the annual financial statements for the year ended 31 March 20X2. The entity does not intend to restate the comparative amounts for the prior period presented in the interim financial statements as it believes it would be sufficient to correct the error by restating the comparatives in the annual financial statements for the year ended 31 March 20 X3. Is this acceptable? Discuss in accordance with relevant Ind AS. (RTP Nov 21)

[video link: https://youtu.be/QJdTojWQ3bw, time: 32:04]

Answer

Paragraph 42 of Ind AS 8, inter alia, states that an entity shall correct material prior period errors retrospectively in the fi rst set of financial statements approved for issue after their discovery by restating the comparative amounts for the prior period(s) presented in which the error occurred.

Paragraph 28 of Ind AS 34 requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statement s).

Paragraph 15B of Ind AS 34 cites 'corrections of prior period errors' as an example of events or transactions which need to be explained in an entity's interim financial report if they are significant to an understanding of the changes in financial p osition and performance of the entity since the end of the last annual reporting period.

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 t he basis of materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding a n entity's financial position and performance during the interim

period."

In view of the above, the entity is required to correct the error and restate the comparative amounts in interim financial statements for the half -year ended 30 September 20X2.

Estimates

3.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 bediscoveredby 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)

[video link: https://youtu.be/CZBW7MufIDc, time: 55:51]

Answer

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, orthe 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 periodsarising 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 ormisinterpretations of facts, and fraud.

On the basis of above provisions, the givensituation would be dealtas follows:

The defect was neither known nor reasonably possible to detect at 31 March 20X3 or before the financial statements were approvedfor 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 arenot 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 reasonablybe expected to have obtained and had taken into accountthe samein 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.

Ind AS 10

Inventory adjustment

2(b)On 5thApril, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. T his inventory had been manufactured prior to 31stMarch 20X2 costing Rs.8 lakhs. T he net realisablevalue of the inventory prior to the damage was estimated at Rs.9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of Rs.2 lakhs on repairing and re-packaging of the inventory.T he inventory was sold on 15thMay, 20X2 for proceeds of Rs.9 lakhs.

The accountant of Jupiter Ltd.treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

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

Analysewhether 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 trea tment alongwith working for the same.

[video link: https://youtu.be/apjqUIV5HaY, time: 2:14]

Answer

T he 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 IndAS 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 approvin g authority in case of any other entity for issue.T wo types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reportin g 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 estimatedcosts of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that:"Inventories shall be measured at the lower of cost and net realisable value". Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

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

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

	Rs.' Lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Management decision treatment

3(b) 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 man y 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 Oct 2020)

[video link: https://youtu.be/apjqUIV5HaY, time: 12:39]

Answer

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 bus iness 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 decisi on 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.

Going concern

7.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 conc ern basis? (RTP May 19)

[video link: https://youtu.be/apjqUIV5HaY, time: 25:34]

Answer

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

"14 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.

15 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 pervasi ve 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, prepa ration of financial statements for 2016-17 and thereafter on going concern basis may not be appropriate.

13.In one of the plant of PQR Ltd., fire broke out on 10.05.2020in which the entire plant was damaged. PQR Ltd. estimated the loss of `40,00,000 due to fire. The company filed a claim with the insurance company and expects recovery of `27,00,000 from the claim. The financial statements for the year ending 31.03.2020were approved by the Board of Directors on

12thJune,2020. Discuss the accounting treatment of the above situation (RTP Nov 20)

[video link: https://youtu.be/apjqUIV5HaY, time: 43:57]

Answer

Events after the reporting period are those events, favourable and unfavourable, thatoccur 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).

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period.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 para 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 financial year 2019-2020on 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 31.03.2020

Mix

3. (a)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.

(i) Moon Ltd. won an arbitration award on 25th April, 20X1 for Rs. 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 31.03.20X1 on 1st May, 20X1. The management did not consider the effect of the above transaction in Financial Year 20X0-20X1, as it was favourable to the Company and the award came after the end of the financial year.

(ii)Zoom Ltd. has a trading business of Mobile telephones. The Company has purchased 1000 mobiles phones at Rs. 5,000 each on 15th March, 20X1. The manufacturers of phone had announced the release of the new version on 1st March, 20X1 but had not announced the price. Zoom Ltd. has valued inventory at cost of Rs. 5,000 each at the year ending 31st March, 20X1. Due to arrival of new advance version of Mobile Phone on 8th April, 20X1, the selling prices of the mobile stocks remaining with Company was dropped at Rs. 4,000 each.The financial statements of the company valued mobile phones @ Rs. 5,000 each and not at the value @ Rs. 4,000 less expenses on sales, as the price reduction in selling price was effected after 31.03.20X1.

(iii) There as an old due from a debtor amounting to Rs. 15 lakh against whom insolvency proceedings was instituted prior to the financial year ending 31st March, 20X1. The debtor was declared insolvent on 15th April, 20X1.

(iv) 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? (MTP March 2021) / (Exam Nov 19) / (MTP Nov 21)

[video link: https://youtu.be/apjqUIV5HaY, time: 17:06]

Answer

As per Ind AS 10, the treatment of stated issues would be as under:

(i)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.

(ii)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 perInd AS 10. Zoom Limited should value its inventory at Rs. 40,00,000. Hence, appropriate provision must be made for Rs. 15 lakh.

(iii)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.

(iv)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.

8.ABC Ltd. received a demand notice on 15thJune, 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 10thAugust, 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. (RTP Nov 19)

[video link: https://youtu.be/apjqUIV5HaY, time: 27:20]

Answer

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:

(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)

In the instant case, the demand notice has been received on 15thJune, 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, conditionexists on 31stMarch, 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.

Govt grant

3.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 drawbackcredit as per the given information? (RTP May 20)

[video link: https://youtu.be/apjqUIV5HaY, time: 30:52]

Answer

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 onlyafter 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 period20X1-20X2, which willbe realised whenthe 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 assetand 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.

Income tax act amendment vs Ind AS 10

5.In order to encourage companies and organisations to generously contribute to the Government's COVID-19 relief fund, taxation laws have been amended to reckon these contributions as deductible for the financial year ending 31st March, 2020 even if the contributions are made after the year end but within three months after year end. Government of India issued the notification on 31st March,2020 by way of an Ordinance. Such contributions to COVID-19 funds are considered for compliance with annual spends on corporate social responsibility (CSR) for the current accounting year under the Companies Act, 2013. In this scenario, whether the contributions to COVID-19 Relief Funds made subsequent to reporting date of the current accounting period can be provided foras expenses of the current accounting period? Also show its impact on deferred tax, if any. (RTP Nov 20)

[video link: https://youtu.be/apjqUIV5HaY, time: 37:48]

Answer

According to paragraph 14 of Ind AS 37, a provision shall be made if:

(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 as of reporting date, no provision shall be recognised for that financial year.

Government of India issued the notification on 31stMarch,2020 by way of an Ordinance and hence, it is most unlikely for any entity to have a present obligation on 31stMarch,2020, for such a commitment. As these conditions are not met as of reporting date of financial year 2019-2020, no provision should be recognised in the financial statements for that financial year.

In the fact pattern given above, the accounting implications for the financial year 2019-2020 is as follows:

•Do not recognize expense/ liability for the contribution to be made subsequent to the year ended 31stMarch,2020 as it does not meet the criteria of a present obligation as at the balance sheet date. However, the expected spendmay be explained in the notes to the accounts as the same will also be considered in measurement of deferred tax liability.

•If the entity claims a deduction in the Income Tax return for the financial year 2019-2020 for that contribution made subsequentto 31stMarch, 2020, recognise Deferred Tax Liability as there would be a tax saving in financial year 2019-2020 for a spend incurred in subsequent year.

Impairment

2(a) 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 fau lt 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 31st December, 2019? (Exam Jan 21)

[video link: https://youtu.be/apjqUIV5HaY, time: 46:36]

Answer

(i) Journal Entries on 31st December 2019 ``

Depreciation expense A/c(W.N.1)Dr.	19,608	
To Warehouse or Accumulated depreciation A/c		19,608

(Being additional depreciation expense recognised for the year ended 31stDecember 2019 arising from the reassessment of the useful life of the warehouse)

Impairment loss A/c (W.N.2)Dr.	2,47,059	
To Warehouse or Accumulated depreciation A/c		2,47,059

(Being impairment loss recognised due to discovery of structural fault in the construction of warehouse at 31stDecember 2019)

(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

Ind AS 12

Mix questions

2.PQR Ltd., a manufacturing company, prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 2018, the following events affected the tax position of the group:

•QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of ` 30,00,000. QPR Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR Ltd. to carry th e loss forward and utilise it against company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.

•During the year ended 31st March, 2018, PQR Ltd. capitalised development costs which satisfied the criteria as per Ind AS 38 'Intangible Assets'. The total amount capitalised was ` 16,00,000. The development project began to generate economic benefits for PQR Ltd. from 1st January, 2018. The directors of PQR Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 2018.

•On 1st April, 2017, PQR Ltd. borrowed ` 1,00,00,000. The cost to PQR Ltd. of arranging the borrowing was ` 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be ` 1,30,43,800.This equates to an effective annual interest rate of 10%. As per the Income –tax Act, a further tax deduction of ` 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%. (RTP May 19) / (Exam Nov 20)

[Video link: https://youtu.be/2QXXsdbdatl, time: 47:11]

Answer

Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 2018

•The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is ` 30,00,000. However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

•The development costs have a carrying value of ` 15,20,000 (` 16,00,000 –(` 16,00,000 x 1/5 x 3/12)). The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be ` 4,56,000 (` 15,20,000 x 30%). All deferred tax liabilities are shown as non - current.

•The carrying value of the loan at 31st March, 2018 is ` 1,07,80,000 (` 1,00,00,000 –` 200,000 + (` 98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of ` 7,80,000 and a potential deferred tax asset of ` 2,34,000 (` 7,80,000 x 30%).

5 (b) A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is `100 thousand and taxable profit for year 20X1-20X2 is ` 104 thousand. The difference between these amounts arose as follows:

1. On 1st February, 20X2, it acquired a machine for ` 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.

2. In the year 20X1-20X2, expenses of ` 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

Prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation. (MTP Oct 21)

[video link: https://youtu.be/zNXsu2FRgBo, time: 34:53]

Answer

Current tax= Taxable profit x Tax rate = ` 104 thousand x 25% = ` 26 thousand

Computation of Taxable Profit:

	` in thousand
Accounting profit	100
Add: Donation not deductible	8

Less: Excess Depreciation (6 - 2)	(4)
Total Taxable profit	104

` in thousand

Profit & loss A/c Dr.	26	
To Current Tax		26

Deferred tax:

Machine's carrying amount according to Ind AS = ` 118 thousand (` 120 thousand – ` 2 thousand)

Machine's carrying amount for taxation purpose = ` 114 thousand (` 120 thousand – ` 6 thousand)

Deferred Tax Liability = ` 4 thousand x 25%

` in thousand

Profit & loss A/c Dr.	1	
To Deferred Tax Liability		1

Tax reconciliation in absolute numbers:	` in thousand
Profit before tax according to Ind AS	100
Applicable tax rate @	25%
Tax	25
Expenses not deductible for tax purposes (` 8 thousand x 25%)	2
Tax expense (Current and deferred)	27
Tax rate reconciliation	
Applicable tax rate	25%
Expenses not deductible for tax purposes	2%
Average effective tax rate	27%

3(c) K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 20X2, K Ltd entered into the following transactions:

(a) On 1st April, 20X1, K Ltd purchased an equity investment for ` 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March, 20X2, the fair value of the investment was ` 2,40,000. In the tax

jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.

(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ` 80,000. The goods had cost to K Ltd for ` 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.

(c) On 31st October, 20X1, K Ltd received ` 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November, 20X1 to 31st July, 20X2. K Ltd recognised revenue of ` 1,20,000 in respect of this transaction in the year ended 31st March, 20X2 and will recognise the remainder in the year ended 31st March, 20X3. Under the tax jurisdiction in which K Ltd operates, ` 2,00,000 received on 31st October, 20X1 was included in the taxable profits of K Ltd for the year ended 31st March, 20X2.

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensiv e income for the year ended 31st March, 20X2. Assume tax rate to be 25%. (MTP Oct 22)

Answer

(a) Because the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences. The tax base of the investment is ` 2,00,000. The revaluation creates a taxable temporary difference of ` 40,000 (` 2,40,000 – ` 2,00,000).

This creates a deferred tax liability of ` 10,000 (` 40,000 x 25%). The liability would be non-current. The fact that there is no intention to dispose of the investment does not affect the accounting treatment. Since, the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in other comprehensive income.

(b) When K Ltd. sold the products to A Ltd., K Ltd. would have generated a taxable profit of ` 16,000 (` 80,000 – ` 64,000). This would have created a current tax liability for K Ltd and the group of ` 4,000 (` 16,000 x 25%). This liability would be shown as a current liability and charged as an expense in arriving at profit or loss for the period.

In the consolidated financial statements the carrying value of the unsold inventory would be ` 38,400 (` 64,000 x 60%). The tax base of the unsold inventory would be ` 48,000 (` 80,000 x 60%). In the consolidated financial statements there would be a deductible temporary difference of ` 9,600 (` 38,400 – ` 48,000) and a

potential deferred tax asset of ` 2,400 (` 9,600 x 25%). This would be recognised as a deferred tax asset since A Ltd. Is expected to generate sufficient taxable profits against which to utilise the deductible temporary difference. The resulting credit would reduce consolidated deferred tax expense in arriving at profit or loss.

(c) The receipt of revenue in advance on 1st October 20X1 would create a current tax liability of ` 50,000 (` 2,00,000 x 25%) as at 31st March 20X2. The carrying value of the revenue received in advance at 31st March 20X2 is ` 80,000 (` 2,00,000 – ` 120,000). Its tax base is nil. The deductible temporary difference of ` 80,000 would create a deferred tax asset of ` 20,000 (` 80,000 x 25%). The asset can be recognised because K Ltd. has sufficient taxable profits against which to utilise the deductible temporary difference.

Impairment

19. The entity has an identifiable asset ASSOTA with a carrying amount of `10,00,000. Its recoverable amount is `6,50,000. The tax base of ASSOTA is `8,00,000 and the tax rate is 30% . Impairment losses are not tax deductible. Entity expects to continue to earn profits in future. For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period? (RTP May 2021)

[video link: https://youtu.be/j1tQn2yRugg, time: 8:37]

Answer

As per Ind AS 36, the revised carrying amount of asset ASSOTA would be `6,50,000.

The tax base of asset ASSOTA is given as `8,00,000.

Carrying base of asset = `6,50,000

Tax base of asset = `8,00,000

Since tax base is greater than carrying base of asset, so deferred tax asset would be created on the temporary difference of `1,50,000 (`8,00,000 –`6,50,000) at the given tax rate of 30% .Hence, Deferred tax asset for the asset ASSOTA would be `1,50,000 x30% = `45,000

Equity method and Taxes

Q3 b. QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS. QA Ltd.had acquired 40% shares in GK Ltd.for an aggregate amount of Rs.45 crores.The shareholding gives QA Ltd. significant influence over GK Ltd.but not control and therefore the said

interest in GK Ltd.is accounted using the equity method. Under the equity method, the carrying value of investment in GK Ltd.was Rs.70 crores on 31stMarch, 2017and Rs.75 crores as on 31stMarch, 2018.As per the applicable tax laws, profits recognised under the equity method are taxed if and when they are distributed as dividend or the relevant investment is disposed of. (Aug 2018 MTP)

[video link: https://youtu.be/2QXXsdbdatI, time: 2:37]

Answer

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	Tax base	Taxable temp diff	DTL @ 20%	Charged to PL
31.3.2017	70 crore	45 crore	25 crore	5 crore	5 crore
31.3.2018	75 crore	45 crore	30 crore	6 crore	1 crore

Limitation in accounting for DTA

5 (b)B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a)T axable temporary differences relating to accelerated depreciation of Rs.9,000. T hese are expected to reverse equally over next 3 years.

(b)Deductible temporary differences of Rs.4,000 expected to reverse equally over next 4 years.

It is expected thatB Limited will continue to make losses for next 5 years. T ax rate is 30%. Losses can be carried forward but not backwards.Discuss the treatment of defe rred tax as on March 31, 20X1. (MTP April 2019) / (Dec 21 Exam)

[video link: https://youtu.be/2QXXsdbdatI, time: 12:20]

Answer

T he year-wise anticipated reversal of temporary differences is as under

Particulars	Year ending on March 31, 20X2	Year ending on March 31, 20X3	Year ending on March 31, 20X4	Year ending on March 31, 20X5
Reversal of taxable temporary	3000	3000	3000	Nil

difference relating to accelerated depreciation over next 3 years (Rs.9,000/3)				
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (Rs.4,000/4)	1000	1000	1000	1000

B Limited will recognise a deferred tax liability of Rs.2,700 on taxable temporary difference relating to accelerated depreciation of Rs.9,000 @ 30%.However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending March 31, 20X4 amounting to Rs.900 (Rs.3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 20X5 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on March 31, 20X5 deferred tax asset on the remainder of Rs.1,000 (Rs.4,000 –Rs.3,000) of deductible temporary difference could be recognised at the 30% tax rate.

MAT

2(b)QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:

(i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its books profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. T he Company is recognising the MAT credit as a current asset under IGAAP. T he amount of MAT credit as on 31st March, 2016 is Rs.8.5 crores and as on 31st March, 2017 is Rs.9.75 crores;

(ii) T he Company measures its head office property using the revaluation model. T he prope rty is revalued every year as on 31stMarch. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs.40 crores whereas itstax base was Rs.22 crores. During the year ended 31stMarch, 2017, the Company charged depreciation in its Stateme n t of Profit and Loss of Rs.2 crores and claimed a tax deduction for tax depreciation of Rs.1.25 crores. On 31stMarch, 2017, the propertywas revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation.

The Company has no other temporary differences other than those indicated above. T he Company wants you to compute the deferred tax liability as on 31stMarch, 2017 and the charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Con side r the tax ra te a t 20% (MTP March 2019)

[video link: https://youtu.be/2QXXsdbdatl, time: 24:31]

Events occurring after the balance sheet date

3b. A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of ` 10,000 and the tax rate was 25%. On February 28, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 20X2. Determinethe treatment of deferred tax,as per Ind AS,in case the reporting date of A Ltd.'s financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2. (MTP March 2018)

[Video link: https://youtu.be/2QXXsdbdatl, time:38:26]

Answer

The difference of `10,000 between the carrying value of interest receivable of `10,000 and its tax base of NIL is a taxable temporary difference. A Limited has to recognise a deferred tax liability of `2,500 (`10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1. It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted or enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

Change in tax rate

19.An entity is finalising its financial statements for the year ended 31stMarch, 20X2. Before31stMarch, 20X2, the government announced that the tax rate was to be amended from 40 per cent to 45 per cent of taxable profit from 30thJune,20X2.

The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

Deferred tax asset `80,000
Deferred tax liability `60,000

Of the deferred tax asset balance, `28,000 related to a temporary difference. This deferred tax asset had previously been recognisedin OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilisation of the deferred tax asset would be available in the future.

Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries (RTP Nov 19)

[video link: https://youtu.be/j1tQn2yRugg, time: 1:54]

Answer

Calculation of Deductible temporary differences:
Deferred tax asset=`80,000
Existing tax rate=40%
Deductible temporary differences=80,000/40%=`2,00,000
Calculation of Taxable temporary differences:
Deferred tax liability=`60,000
Existing tax rate=40%
Deductible temporary differences=60,000/40% =`1,50,000
Of the total deferred tax asset balance of `80,000, `28,000 is recognized in OCI
Hence, Deferred tax asset balance of Profit & Loss is `80,000-`28,000=`52,000
Deductible temporary difference recognized in Profit & Loss is `1,30,000 (52,000/40%)
Deductible temporary difference recognized in OCI is `70,000 (28,000/40%)
The adjusted balances of the deferred tax accounts under the new tax rate are:

Deferred tax asset`	
Previously credited to OCI-equity`70,000 x 0.45	31,500
Previously recognised as Income `1,30,000 x 0.45	58,500
	90,000
Deferred tax liability	
Previously recognized as expense`1,50,000x 0.45	67,500

The net adjustment to deferred tax expense is a reduction of `2,500. Of this amount,`3,500 is recognised in OCI and `1,000 is charged to P&L.
The amounts are calculated as follows:

	Carrying amount at 45%	Carrying amount at 40%	Increase (decrease) in deferred tax expense

Deferred tax assets			
Previously credited to OCI-equity	31500	28000	(3500)
Previously recognised as Income	58500	52000	(6500)
Deferred tax liability			
Previously recognized as expense	67500	60000	7500
Net adjustment			(2500)

An alternative method of calculation is: `

DTA shown in OCI `70,000 x (0.45 -0.40) 3,500

DTA shown in Profit or Loss`1,30,000 x (0.45-0.40) 6,500

DTL shown in Profit or Loss`1,50,000 x (0.45 -0.40) 7,500

Journal Entries

Deferred tax asset	3,500	
OCI –revaluation surplus		3,500
Deferred tax asset	6,500	
Deferred tax expense		6,500
Deferred tax expense	7,500	
Deferred tax liability		7,500

Alternatively, a combined journal entry may be passed as follows:

Deferred tax asset Dr.	10,000	
Deferred tax expenseDr.	1,000	
To OCI –revaluation surplus		3,500
To Deferred tax liability		7,500

5. Following is the summarized statement of profit and loss of EARTH Limited as per Ind AS for the year ended 31st March 20X1:

Particulars	` in Crore
Revenue from operations	1,160.00
Other income	56.00
Total Income (A)	1,216.00
Purchase of stock-in-trade	40.00
Changes in inventories of stock-in-trade	6.00
Employee benefits expense	116.00
Finance costs	130.00
Depreciation and amortization expense	30.00
Other expenses	300.00
Total Expenses (B)	622.00
Profit Before Tax (A-B)	594.00
Current tax	165.40
Deferred tax	1.50
Tax Expenses	166.90
Profit after Tax	427.10

Additional information:

- **Corporate income tax rate applicable to EARTH Limited is 30%.**

• Other income includes long-term capital gains of ` 10 crore which are taxable at the rate of 10%.
• Other expenses include the following items which are not deductible for income tax purposes:

Item	` in Crore
Penalties	**1.00**
Impairment of goodwill	**44.00**
Corporate Social Responsibility expense	**6.00**

• Other expenses include research and development (R & D) expenditure of ` 8 crore in respect of which a 200% weighted deduction is available under income tax laws.
• Other income includes dividends of ` 4 crore, which is exempt from tax.
• Profit before tax of ` 594 crore includes (i) agriculture income of ` 55 crore which is exempt from tax; and (ii) profit of ` 60 crore earned in the USA on which EARTH Limited is required to pay tax at the rate of 20%.
• Depreciation as per income tax laws is ` 25.0 crore.
During review of the financial statements of EARTH Limited, the CFO multipl ied profit before tax by the income tax rate and arrived at ` 178.2 crore as the tax expense (` 594 crore x 30% = ` 178.2 crore). However, actual income tax expense appearing in the summarized statement of profit and loss is ` 166.9 crore.
The CFO has sought your help in reconciling the difference between the two tax expense amounts. Prepare a reconciliation containing the disclosure as required under the relevant Ind AS. (RTP Nov 22) / Exam Nov 22

Answer

Reconciliation of income tax expense and current tax as per accounting profit for the year ended 31st March, 20X1

Particulars	` in crore	
Accounting profit		594.00
Tax at the applicable tax rate of 30%		178.20
Tax effect of expenses that are not deductible in determining taxable profits:		
Penalties (1.00 x 30%)		0.30
Impairment of goodwill (44.00 x 30%)		13.20
Corporate social responsibility expense (6.00 x 30%)		1.80
		15.30
Tax effect of expenses that are deductible in determining taxable profits:		
Research and development expenses (8.00 x 30%)		(2.40)
Tax effect of income that are exempted in determining taxable profits:		
Dividend income (Exempt) (4.00 x 30%)		1.20
Agriculture income (Exempt) (55.00 x 30%)		16.50
		(17.70)

Tax effect of income on which different tax rates are used for determining taxable profits:
Differential income tax on long term capital gain [10.00 x(30% - 10%)] 2.00
Foreign income in USA [60.00 x (30%-20%)] 6.00
(8.00)
Income tax expense (Current) reported in the Statement of Profit and Loss for the current year 165.40
Reconciliation of deferred tax:
Particulars ` in crore
Deferred tax in relation to depreciation and amortization [(30 – 25) x 30%] 1.50
Tax expense (deferred) reported in the Statement of Profit or Loss for the current year 1.50

Ind AS 16

Determination of Intial cost

1.(a)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	AmountRs.'000
Costs of the basic materials	
(list price Rs.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 Rs.3,00,000 caused by a major electrical fault.

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

Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is Rs.3 million.The Company computes its depreciation charge on a monthly basis.No impairment of the plant had occurred by 31 March 20X2.

Analyze the accounting implications of costs related to production line to be recognized in the balance sheet and profit and loss for the year ended 31 March, 20X2. (MTP May 2020)

[video link: https://youtu.be/VAoi21stL1g, time: 44:59]

Answer

Statement showing Cost of production line:

Particulars	AmountRs.’000
Purchase cost	10,000
Goods and services tax –recoverable goods and services tax not included	-
Employment costs during the period of getting the production line ready for use (1,200 x 2 months / 3 months)	800
Other overheads –abnormal costs	600
Payment to external advisors –directly attributable cost	500
Dismantling costs –recognized at presentvalue where an obligation exists(2,000 x 0.68)	1360
Total	13,260

Carrying value of production line as on 31st March, 20X2:

Particulars	Amount Rs. ’000
Cost of Production line	13260
Less: Depreciation (W.N.1)	(1694)
Net carrying value carried to Balance Sheet	11,566

Provision for dismantling cost:

Particulars	AmountRs. ’000
Non-current liabilities	1360
Add: Finance cost (WN3)	57

Net book value carried to Balance Sheet	1,417

Extract of Statement of Profit & Loss

Particulars	Amount Rs. '000
Depreciation (W.N.1)	1694
Finance cost (W.N.2)	57
Amounts carried to Statement of Profit & Loss	1,751

Extract of Balance Sheet

Particulars Amount	Rs. '000
Assets	
Non-current assets	
Property, plant and equipment	11,566
Equity and liabilities	
Non-current liabilities	
Other liabilities	
Provision for dismantling cost	1417

Working Notes:

1. Calculation of depreciation charge

Particulars	Amount Rs. '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(3,000x¼ 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.Financecosts

Particulars	Amount Rs. '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

3(a)On 1st April, 2017 Good Time Limited purchased some land for `1.5 crore (including legal cost of `10 lakhs) for the purpose of constructing a new factory. Construction work commenced on 1st May, 2017. Good Time Limited incurred the following costs in relation to its construction.

Preparation and levelling of the land	**4,40,000**
Purchase of materials for the construction	**92,00,000**
Employment costs of the construction workers (per month)	**1,45,000**
Overhead costs incurred directly on the construction of the factory (per month)	**1,25,000**
Ongoing overhead costs allocated to the construction project (using the company's normal overhead allocation model) per month	**75,000**
Costs of relocating employees to work at new factory	**3,25,000**
Costs of the opening ceremony on 1st January, 2018	**2,50,000**
Income received during the temporary use of the factory premises as a store during the construction period.	**60,000**

The construction of the factory was completed on 31st December, 2017 and production began on 1st February, 2018. 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 theroof at current prices would be 25% of the total cost of the building.

At the end of the 40 years period, Good Time Limited has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The company estimates that the cost of demolition in 40

year's time (based on price prevailingat that time) will be `3 crore. The 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 0.046.

The construction of the factory was partly financed. by a loan of `1.4 croretaken out on 1st April, 2017. The loan was at an annual rate of interest of 9%. During the period 1stApril, 2017 to 30th September, 2017 (when the loan proceeds had been fully utilized to finance the construction), GoodTime Limited received investment income of `1,25,000 on the temporary investment of the proceeds.

You are required to compute the cost of the factory and the carrying amount of the factory in the Balance Sheet o f Good Time Limited as at 31stMa rch, 2018 . (Exam Nov 18) / (MTP Nov 21)

[video link: https://youtu.be/hLJ47ta0MK4, time: 34:09]

Answer

Computation of the cost of the factory`Purchase of land	1,50,00,000
Preparation and leveling	4,40,000
Materials	92,00,000
Employment costs of construction workers	
(1,45,000 x 8 months)	11,60,000
Direct overhead costs (1,25,000 x 8 months)	10,00,000
Allocated overhead costs	Nil
Income from use of a factory as a store	Nil
Relocation costs	Nil
Cost of the opening ceremony	Nil
Finance costs	8,40,000
Investment income on temporary investment of the loan	
Proceeds	(1,25,000)
Demolition cost recognised as a provision	
(3,00,00,000 x 0.046)	13,80,000
T otal	2,88,95,000

Computation of carrying amount of the factory as at 31st March, 2018`

	Land (Non-depreciable asset)	Factory (Depreciable asset)
Cost of the asset		
(T otal cost 2,88,95,000)	1,50,00,000	1,38,95,000
Less:		
Depreciation On Land	Nil	
On Factory		
Depreciation on roof component		
(1,38,95,000 × 25% × 1/20 x 3/12)		43,422
Depreciation on remaining factory		
(1,38,95,000 × 75% × 1/40 × 3/12)		65,133
Carrying amount of		
depreciable asset ie factory	1,50,00,000	1,37,86,445
T otal cost		2,87,86,445

Note:

1.Interest cost has been capitalized based on eight month period. This is because, purchase of land would trigger off capitalisation.

2.All of the net finance cost of `7,15,000 (`8,40,000-`1,25,000) has been allocated to the depreciable asset i.e Factory. Alternatively, it can be allocated proportionatel y between land and factory.

6(a) 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 Jan 21) / (MTP April 22)

[video link: https://youtu.be/C0Ax_JnQZmg, time: 1:07]

Answer

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 1stOctober2019	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, abnormal 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, t he leased-out property to a subsidiary does not qualify as invest ment 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.

20. On 1st January, 20X1 an entity purchased an item of equipment for ` 600,000, including ` 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ` 605,000. In addition, the entity has to pay ` 5,000 in loan raising fees to the Bank. The loan is secured against the equipment.

In January 20X1 the entity incurred costs of ` 20,000 in transporting the equipment to the entity's site and ` 100,000 in installing the equipment at the site. At the end of the equipment's 10-year useful life the entity is required to dismantle the equipment and restore the building housing the equipment. The present value of the cost of dismantling the equipment and restoring the building is estimated to be ` 100,000.

In January 20X1 the entity's engineer incurred the following costs in modifying the equipment so that it can produce the products manufactured by the entity:

• Materials – ` 55,000

• Labour – ` 65,000

• Depreciation of plant and equipment used to perform the modifications – ` 15,000
In January 20X1, the entity's production staff were trained in how to operate the new item of equipment. Training costs included:

• Cost of an expert external instructor – ` 7,000

• Labour – ` 3,000

In February 20X1 the entity's production team tested the equipment and the engineering team made further modifications necessary to get the equipment to function as intended by management. 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 – ` 16,000

The equipment was ready for use on 1st March, 20X1. However, because of low initial order levels the entity incurred a loss of ` 23,000 on operating the equipment during March. Thereafter the equipment operated profitably. What is the cost of the equipment at initial recognition? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU, time: 1:39:31]

Answer

Purchase price	
(` 600,000 purchase price minus ` 50,000 refundable purchase taxes)	550,000
Loan raising fee	
(Offset against the measurement of the liability)	-
Transport cost	
Directly attributable expenditure	20,000
Installation costs Directly attributable expenditure	100,000
Environmental restoration costs	
(The obligation to dismantle and restore the environment arose	
from the installation of the equipment)	100,000

Preparation costs	
(` 55,000 materials + ` 65,000 labour + ` 15,000 depreciation)	135,000
Training costs	
(Recognised as expenses in profit and loss account. The equipment was capable of operating in the manner intended by management without incurring the training costs.)	-
Cost of testing	
` 21,000 materials (ie net of the ` 3,000 recovered from the sale of the scrapped output) + ` 16,000 labour	37,000
Operating loss	
Recognised as expenses in profit and loss account	-
Borrowing costs	
Recognised as expenses in profit and loss account	–
Cost of equipment	9,42,000

16. (ii) Company A incurred ` 20,000 as cost for restoring the site on which the item of PPE was located. This item was used for manufacturing of goods and the requirement for restoring will arise due to manufacturing of goods. What will the treatment of this ` 20,000 in the books of Company A? Analyse on the basis of the provisions of relevant Ind AS (RTP Nov 22)

Answer

Paragraph 16 of Ind AS 16, Property, Plant and Equipment, inter alia states that the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Further, paragraph 18 of Ind AS 16 states that an entity applies Ind AS 2 to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with Ind AS 2 or Ind AS 16 are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

Paragraph 16 of Ind AS 16 clarifies that decommissioning costs that meet the recognition criteria under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, for a provision are added to the cost of an item of property, plant and equipment if such costs are not incurred through the asset's use to produce inventories. Paragraph 18 fills the gap by clarifying where such costs are incurred through the asset's use to produce inventories, they are added to the cost of inventories.

Where the obligation to restore the asset arises due to the use of the asset to produce inventories but not due to the asset's installation, construction or acquisition, the costs are added to the costs of inventories.

Based on the above provisions and discussion, cost of restoring the site ` 20,000 incurred during the period of production as a consequence of having used the item to produce inventories during that period should be added to the cost of inventories.
However, later the inventories are measured at the lower of cost and net realizable value in accordance with paragraph 9 of Ind AS 2.

Class of PPE

6.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)

[video link: https://youtu.be/hLJ47ta0MK4, time: 29:54]

Answer

To answer this question one must make a materiality judgement. A 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 abuilding. 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.

5(b) M Ltd. is setting up a new factory outside the Delhi city limits. In order to facilitate the construction of the factory and its operations, M Ltd. is required to incur expenditure on the construction/ development of electric-substation. Though M Ltd. incurs (or contributes to) the expenditure on the construction/development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether M Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)?If yes, then how should these items be depreciated and presented in the financial statements of M Ltd. as per Ind AS? (Exam Nov 19)

[Video link: https://youtu.be/hLJ47ta0MK4, time: 48:10]

Answer

As per Ind AS 16, 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, Ind AS 16 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.

Ind AS 16, further, 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, electric-substation is 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 M Ltd. may not be able to recognise expenditure incurred on electric-substation 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 electric-substation should be considered as the cost of constructing the factory and accordingly, expenditure incurred on electric-substation should be allocated and capitalised as part of the items of property, plant and equipment of the factory.

Depreciation

As per Ind AS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Further, Ind AS 16 provides that, 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 electric-substation should not exceed that of the asset to which it relates.

Presentation

Electric-substation should be presented within the class of asset to which they relate ie factory.

Concept of valuation

- There are two models, cost model and revaluation model
- All assets in the same class of asset will use same model
- If revalued upwards, difference charged to OCI (Revaluation surplus)
- If revaluaed downwards, difference charged to PL
- If first revaluaed then devalued later, devaluation loss first adjusted to RS and balance charged to PL
- If first devalued then revalued lated, gain first adjusted against the loss booked earlier in PL and any amount above that carged to RS

Revaluation model

(b)Company X performed a revaluation of all of its plant and machinery at the beginning of 20X1. The following information relates to one of the machinery:

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

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

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries. (MTP March 2021) / (RTP May 19) / (RTP May 20)

[video link: https://youtu.be/VAoi21stL1g, time: 2:27]

Answer

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.

In such a situation, the revised carrying amount of the machinery will be as follows:

Gross carrying amount Rs. 250 [(200/120) x 150]

Net carrying amount Rs. 150

Accumulated depreciation Rs. 100 (Rs. 250 –Rs. 150)

Journal entry

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

Depreciation subsequent to revaluation

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

Journal entry

Accumulated DepreciationDr.	Rs. 25 p.a.	
To Plant and Machinery (Gross Block)		Rs. 25 p.a.

(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.In this case, the gross carrying amount is restated to Rs. 150 to reflect the fair value and accumulated depreciation is set at zero.

ournal entry

Accumulated DepreciationDr.	Rs. 80	
To Plant and Machinery (Gross Block)		Rs. 80
Plant and Machinery (Gross Block)Dr.	Rs. 30	
To Revaluation Reserve		Rs. 30

Depreciation subsequent to revaluation

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

Journal entry

Accumulated DepreciationDr. Rs. 25 p.a.

To Plant and Machinery (Gross Block) Rs. 25 p.a.

20. Heaven Ltd. had purchased a machinery on 1.4.2 X01 for ` 30,00,000, which is reflected in its books at written down value of ` 17,50,000 on 1.4.2X06. The company has estimated an upward revaluation of 10% on 1.4.2 X06 to arrive at the fair value of the asset. Heaven Ltd. availed the option given by Ind AS of transferring some of the surplus as the asset is used by an enterprise.

On 1.4.2X08, the machinery was revalued downward by 15% and the company also re -estimated the machinery's remaining life to be 8 years. On 31.3.2X10 the machinery was sold for ` 9,35,000. The company charges depreciation on straight line method.

Calculate machinery amount in the books of Heaven Ltd. over its useful life to record the above transactions. (RTP Nov 21)

[video link: https://youtu.be/QJdTojWQ3bw, time: 44:03]

Answer

1. Calculation of useful life of machinery on 1.4. 2X01

Depreciation charge in 5 years = (30,00,000 – 17,50,000) = ` 12,50,000

Depreciation per year as per Straight Line method = 12 ,50,000 / 5 years

= ` 2,50,000

Remaining useful life = ` 17,50,000 / ` 2,50,000 = 7 years

Total useful life = 5 years + 7 years = 12 years

2. Depreciation after upward revaluation as on 31.3.2 X06 `

Book value as on 1.4.2X06	17,50,000
Add: 10% upward revaluation	1,75,000
Revalued amount	19,25,000

Remaining useful life 7 years (Refer W.N.1)

Depreciation on revalued amount = 19 ,25,000 / 7 years = ` 2,75,000 lakh

3. Depreciation after downward revaluation as on 31.3.2 X08 `

Book value as on 1.4.2X08	13,75,000
Less: 15% Downward revaluation	(2,06,250)

Revalued amount 11,68,750

Revised useful life 8 years

Depreciation on revalued amount = 11 ,68,750 / 8 years = ` 1,46,094

Concept of replacement

1. **If cost of replaced part known at the time of purchase**
   a. **Derecognize such cost from gross block value and add the replaced part cost to gross block**
   b. **Calculate depreciation charged on old part till date and derecognize the same from Accumulated depreciation**
   c. **Journal entry – Dr. Accumulated depreciation by amount in b. above, Credit PPE by amount deducted in a above and difference charged to PL(debit balance)**
2. **If cost of replaced part not known at the time of purchase**
   a. **Determine PV of new purchased part price by no. of years asset has been used till date as per PVF given**
   b. **Derecognize such cost determined in a above from gross block value and add the replaced part cost (non discounted) to gross block**
   c. **Calculate depreciation charged on old part till date and derecognize the same from Accumulated depreciation**
   d. **Journal entry – Dr. Accumulated depreciation by amount in b. above, Credit PPE by amount deducted in a above and difference charged to PL(debit balance)**

Replacement of parts

3 (c)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.Advise a per Ind AS whetherthe cost of the new turbine be recognised as an asset, and, if so, what treatment should be used. Alsocalculate the revised carrying amount of the machinery?Consider the discount rate of 5% per annum. (MTP March 2018)

[video link: https://youtu.be/VAoi21stL1g, time: 57:06]

Answer

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.

Estimates

6. (a) WLL Ltd. was incorporated on 1st April, 20X1 and follows Ind AS in preparing its financial statements. In preparing its financial statements for financial year ending 31st March, 20X4, WLL Ltd. used these useful lives for its property, plant, and equipment:

Buildings : 15 years

Plant and machinery : 10 years

Furniture and fixtures : 7 years

On 1st April, 20X4, the entity decides to review the useful lives of the property, plant, and equipment. For this purpose it hired external valuation experts. These independent experts certified the remaining useful lives of the property, plant, and equipment o f WLL Ltd. on 1st April, 20X4 as

Buildings : 10 years

Plant and machinery : 7 years

Furniture and fixtures : 5 years

WLL Ltd. uses the straight-line method of depreciation. The original cost of the various components of property, plant, and equipment were

Buildings : ` 1,50,00,000

Plant and machinery : ` 1,00,00,000

Furniture and fixtures : ` 35,00,000

Compute the impact on the statement of profit and loss for the year ending 31st March, 20X5, if WLL Ltd. decides to change the useful lives of the property, plant, and equipment in compliance with the recommendations of external valuation experts. Assume that 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. (MTP Oct 21)

[video link: https://youtu.be/zNXsu2FRgBo, time: 18:44]

Answer

1. The annual depreciation charges prior to the change in estimate 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)

2. The revised annual depreciation for the year ending 31st December, 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)

3. The impact on Statement of profit and loss for the year ending 31st March, 20X5
= (B) – (A)

= ` 26,00,000 – ` 25,00,000

= ` 1,00,000

Change in the useful lives of the various items of property, plant and equipment is a change in accounting estimate. Change in accounting estimate is to be adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected.

1(b) Given the decreased revenue in financial year 20X1-20X2, management of PQR Ltd is keen to identify ways to reduce the overall impact on profit and loss. A consultant has suggested that they could explore changing the basis of depreciation from SLM to hours-in-use but not entirely sure if this is permitted. Annual depreciation charge for financial year 20X1-20X2 would be ` 25 lacs using SLM and ` 7 lacs using new method. This difference is significant for PQR Ltd.'s financial statements.

What are the considerations in determining whether a change in depreciation methodology is appropriate, and how should this change be accounted for? Given the risk of charging lower depreciation per annum and the possibility that the asset will be depreciated over a period longer than it would otherwise be (under SLM basis), what other safeguards do you suggest, in order to ensure compliance with relevant standards in Ind AS and its framework? (MTP Nov 21)

[video link: https://youtu.be/1DKSEXWBG1E, time: 8:45]

Answer

As illustrated in per para 32 of Ind AS 8, Change in method of depreciation is a change in accounting estimates.

Considerations in determining whether the change in depreciation methodology is appropriate:
Paragraphs 60 and 61 of Ind AS 16, Property, Plant and Equipment, state that 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.

Accounting procedure:

Such a change is accounted for as a change in an accounting estimate in accordance with Ind AS 8.

Depreciation is a function of several factors, with extent of usage and efflux of time being its primary determinants. The hours-in-use method relates the amount of periodic depreciation charge only to one of the above two factors, namely, the extent of usage as reflected by the number of hours. This method may therefore be said to be appropriate as per para 62 of Ind AS 16.

Determination of depreciation method involves an accounting estimate; depreciation method is not a matter of an accounting policy. Accordingly, as per

Ind AS 8 and Ind AS 16, a change in depreciation method shall be accounted for as a change in accounting estimate, i.e; prospectively.

However, given the possibility that the asset will be depreciated over a period longer than it would be under SLM basis, the company will need to assess if there are any impairment triggers and carry out impairment testing as required under Ind AS 36.

Ind AS 16 vs Ind AS 40

Q3(c)UK Ltd.has purchased a new head office property for Rs.10 crores. The new officebuilding has 10 floors and the organisation structure of UK Ltd. is as follows:

Floor	1	2	3	4	5	6	7	8, 9, 10
Use	Waiting area	Admin	HR	Accounts	Inspection	MD office	Canteen	Vacant

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

-Tenure of Lease Agreement

-5 Years -Non-Cancellable Period

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

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

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

Advise UK Ltd. on the accounting and disclosures for the above as per the applicable Ind AS. (Aug 2018 MTP) / (RTP Nov 22 similar)

[video link: https://youtu.be/VAoi21stL1g, time: 11:50]

Answer

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 anon-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 floorsleased 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%		IP 30%
		Land 25%	Building75%	
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	0.105	0.06
Carrying value as on 31stMarch, 2018		1.75	5.145	2.94
Impairment loss	No impairment loss since fair value is more than the cost			

1.(a)ALtd. owns three propertieswhich are shown in its financial statements as 'Property, Plant and Equipment'. 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

	Building	Building	building
Purchase price Market value as on 31.03.20X2 Useful Life Subsequent Measurement	500 550 10 yrs Cost model	200 220 10 years Revaluation model	300 330 10 years Revaluation model

Property 1 and 2 are used by ALtd. as factory building whilst property 3 is let-out to a non-related party at a market rent.

A Ltd. 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.

Evaluate whether the accounting policies adopted by ALtd. in relation to these properties, on various accounting aspects,arein accordance with Ind ASor not.If not, advise the correct treatment alongwith the workingsfor the samein all the cases (MTP March 2018) / (Exam May 18) / (Exam July 2021)

[video link: https://youtu.be/hLJ47ta0MK4, time: 19:14]

Answer

(i)For classification of assets

Para6 of Ind AS 16 'Property, Plant and Equipment'interalia,states that Property, plant and equipment are tangible items are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.

As per para 6 of Ind AS 40 'Investment property', Investment property is 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.

According, to the facts given in the questions, since Property 1 and 2 are used as factory buildings, their classification as PPE is correct. However, Property 3 is held to earn rentals; hence,it should be classified as Investment Property. Thus, its classification as PPE is not correct. Property '3' shall be presented as separate line item as Investment Propertyas per Ind AS 1.

(ii)For valuation of assets

Paragraph 29 of Ind AS 16 states thatan 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.Also, 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.

However, for investment property,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".

Also, paragraph 79 (e) of Ind AS 40 inter alia requires that an entity shall disclose the fair value of investment property.

Since property 1 and 2 is used as factory building, they should be classifiedunder same category or classi.e. 'factory building'. Therefore, both the properties shouldbe valued either at cost model or revaluation model. Hence,the valuation model adopted by A Ltd. is not consistent and correct as per Ind AS 16.

In respect to property '3' being classified as Investment Property, there is no alternative of revaluation model i.e.only cost model is permitted for subsequent measurement. However, A Ltd. is required to disclose the fair value of the investment property in the Notes to Accounts.

(iii)For changes in value on account of revaluation and treatment thereof

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 '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.Accordingly, the revaluation gain shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus.

(iv) For treatment of depreciation

Paragraph 52 of Ind AS 16 states that Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, aslong as the asset's residual value doesnot exceed its carrying amount.

Accordingly, ALtd. isrequired to depreciate these properties irrespective of thattheir fair value exceeds the carrying amount.

(v) Rectified presentation in the balance sheet

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 should be as follows:

Case 1:If ALtd. has applied the Cost Model to an entire class of property, plant and equipment.

Balance Sheet extracts as at 31stMarch 20X2 INRin lakhs

Assets

Non-Current Assets

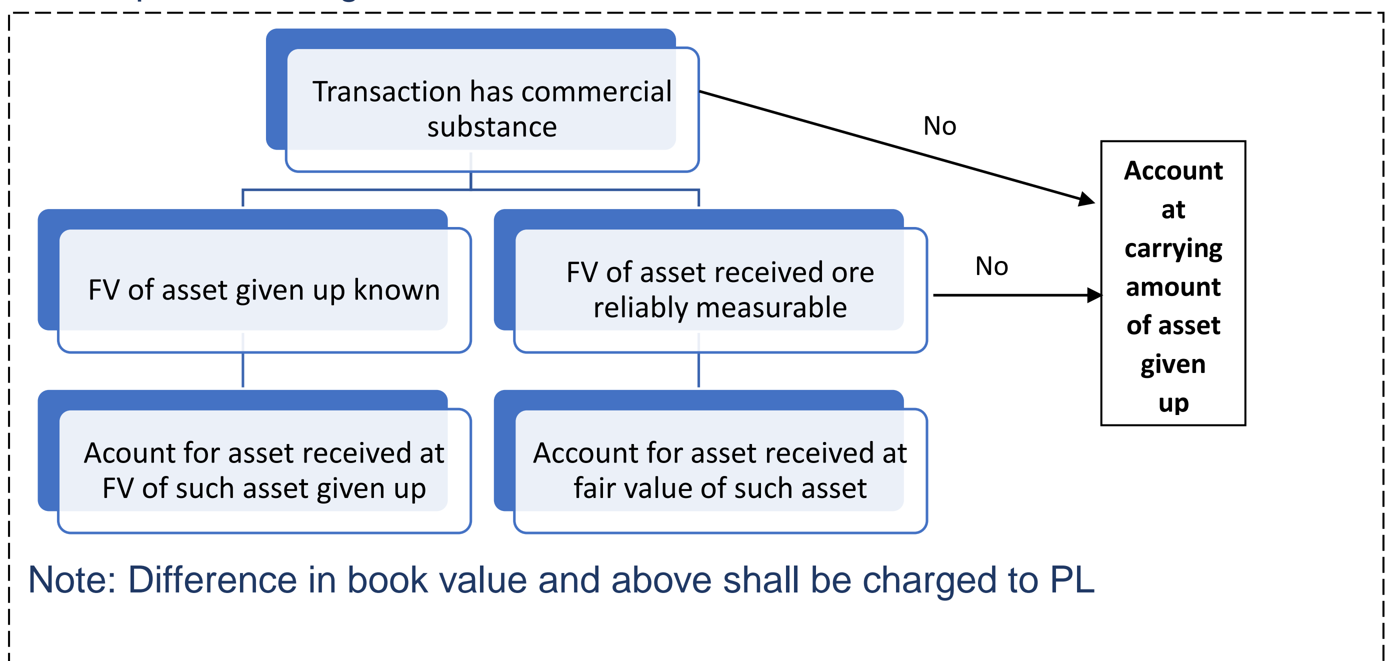
Property, Plant and Equipment		
Property '1'	450	
Property '2'	180	630
Investment Property		
Property '3'(Fair value being 330 lakhs) (Cost = 300-30)		270

Case 2: If A Ltd. has applied the Revaluation Modelto an entire class of property, plant and equipment.

Balance Sheet extracts as at 31st March 20X2		INRin lakhs
Assets		
Non-Current Assets		
Property, Plant and Equipment		
Property '1'	550	
Property '2'	220	770
Investment Properties		
Property '3'(Fair value being 330lakhs) (Cost = 300-30)		270
Equity and Liabilities		
Other Equity		
Revaluation Reserve*		
Property '1' (550-450)	100	
Property '2' (220-180)	40	140

*The revaluation reserve should be routed through Other Comprehensive Income(OCI)(subsequently not reclassified to Profit and Loss) in the Statement of Profit and Loss and shown as aseparate column in Statement of Changes in Equity

Concept of exchange



Note: Difference in book value and above shall be charged to PL

Exchange of assets

15.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 20)

Answer

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 ofmonetary 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 upis 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, timingand 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 aresult 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.

Concept of change in decommissioning cost

1. Any unwinding of interest related to provision for decommissioning is charged to PL
2. If asset is measured using cost model, change is estimate of increase / decrease in decommissioning cost is added/ deducted respectively from the carrying amount of such PPE
3. If asset is measured using revaluation model, change in estimate of increase / decrease in decommissioning cost is deducted / added to Revaluation surplus

Decommisioning

3. (a) On 1st April 2017, A Ltd. assumes a decommissioning liability in a business combination. The entity is legally required to dismantle and remove an offshore oil platform at the end of its useful life, which is estimated to be 10 years. A Ltd. uses the expected present value technique to measure the fair value of the decommissioning liability. If A Ltd. was contractually allowed to transfer its decommissioning liability to a market participant, it concludes that a market participant would use the following inputs, probability-weighted as appropriate, when estimating the price, it would expect to receive:

(i)Labour costs are developed on the basis of current market place wages, adjusted for expectations of future wage increases, required to hire contractors to dismantle and remove offshore oil platforms. A Ltd. assigns probability assessments (basedA Ltd.'s experience with fulfilling obligations of this type and its knowledge of the market) to a range of cash flow estimates as follows:

Cash flow estimate (Rs.)	Probability assessment
50,000	25%
62,500	50%
87,500	25%

(ii)A Ltd. estimates allocated overhead and equipment operating costs to be 80% of expected labour costs in consistent with the cost structure of market participants.

(iii)A Ltd. estimates the compensation that a market participant would require for undertaking the activity and for assuming the risk associated with the obligation to dismantle and remove the asset as follows:

1.A third-party contractor typically adds 20% mark-up on labour and allocated internal costs to provide a profit margin on the job.

2.A Ltd. estimates 5% premium of the expected cash flows, including the effect of inflation for uncertainty inherent in locking in today's price for a project that will not occur for 10 years.

(iv)Entity A assumes a rate of inflation of 4% over the 10-year period on the basis of available market data.

(v)The risk-free rate of interest for a 10-year maturity on 1st April, 2017 is 5 %. A Ltd. adjusts that rate by 3.5 per cent to reflect its risk of non-performance (ie the risk that it will not fulfil the obligation), including its credit risk.

A Ltd. concludes that its assumptions would be used by market participants. In addition, A Ltd. does not adjust its fair value measurement for the existence of a restriction preventing it from transferring the liability. Measure the fair value of its decommissioning liability.

Discount factor:

@ 5% for 10thyear	**0.6139**
@ 3.5% for 10thyear	**0.7089**
@ 8.5% for 10thyear	**0.4423 (MTP April 2018) / (RTP Nov 21)**

[video link: https://youtu.be/hLJ47ta0MK4, time: 1:50]

Answer

(a) Measurement of the fair value of its decommissioning liability

	Expected cash flows (Rs.) 1st April 2017
Expected labour costs(Refer W.N.)	65,625
Allocated overhead and equipment costs (0.80 × Rs.65,625)	52,500
Contractor's profit mark-up [0.20 × (Rs.65,625+ Rs.52,500)]	23,625
Expected cash flows before inflation adjustment	1,41,750
Inflation factor (4% for 10 years)on compounding	1.4802
Expected cash flows adjusted for inflation	2,09,818
Market risk premium (Rs.2,09,818 x 5%)	10,491
Expected cash flows adjusted for market risk	2,20,309
Expected present value using discount rate of (5 +3.5) 8.5% for 10 years	97,443

Working Note:

Cash flow estimate (Rs.)	Probability assessment	Expected cash flows (Rs.)
50,000	25%	12,500
62,500	50%	31,250
87,500	25%	21,875
		65,625

2.(a)An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on April 1, 2015. T he plant has a useful life of 40 years. Its initial cost was Rs.1,20,000. T his included an amount for decommissioningcosts of Rs.10,000, which represented Rs.70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on March 31. Assume that a market-based discounted cash flow valuation of Rs.1,15,000 is obtained at March 31, 2018. It includes an allowance of Rs.11,600 for decommissioning costs, which represents no change to the original estimate, after the unwinding of three years' discount. On March 31, 2019, the entity estimates that, as aresult of technological advances, the present value of the decommissioning liability has decreased by Rs.5,000. T he entity decides that a full valuation of the asset is needed at March 31, 2019, in order to ensure that the carrying amount does not differmaterially from fair value. T he asset is now valued at Rs.1,07,000, which is net of an allowance for the reduced decommissioning obligation.How the entity will account for the above changes in decommissioning liability if it adopts re valua tion model? (MTP March 2019)

[video link: https://youtu.be/VAoi21stL1g, time: 25:45]

Answer

At March 31, 2018:	Rs.
Asset at valuation (1)	1,26,600
Accumulated depreciation	Nil
Decommissioning liability	(11,600)
Net assets	1,15,000
Retained earnings (2)	(10,600)
Revaluation surplus (3)	15,600

Notes:

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

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

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

The depreciation expense for 2018-2019is therefore Rs.3,420 (Rs.1,26,600 × 1/37) and the discount expensefor 2019is Rs.600. On March 31, 2019, the decommissioning liability (before any adjustment) is Rs.12,200. However, as per estimate of the entity, the present value of the decommissioning liability has

decreased by Rs.5,000. Accordingly, the entity adjusts the decommissioning liability from Rs.12,200 to Rs.7,200.

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

Decommissioning liabilityDr.	5,000	
To Revaluation surplus		5,000

As at March 31, 2019, the entity revalued its asset at Rs.1,07,000, which is net of an allowance of Rs.7,200 for the reduced decommissioning obligation that should be recognised as a separate liability. T he valuation of the asset for financial reporting purposes, before deducting this allowance, is therefore Rs.1,14,200. The following additional journal entry is needed:

Notes:

Accumulated depreciation (1)Dr.	3,420	
T o Asse t a t valuation		3,420
Revalua tion su rplus (2)Dr.	8,980	
ToAsse t a t valuation (3)		8,980

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

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

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

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

Asset a t valua tion	1,14,200
Accumulated depreciation	Nil
Decommissioning liability	(7,200)
Net assets	1,07,000
Retained earnings (1)	(14,620)
Revalua tion surplus (2)	11,620

Notes:

(1)Rs.10,600 at March 31, 2018, plus depreciation expense of Rs.3,420 and discount expense of Rs.600 = Rs.14,620.

(2)Rs.15,600 at March 31, 2018, plus Rs.5,000 arising on the decrease in the liability, less Rs.8,980 deficit on revaluation = Rs.11,620.

Ind AS 19

Leave wages accounting

4(b)Mr. Niranjan is working for Infotech Ltd. Consider the following particulars:

	Year 20X0-20X1	Year 20X1-20X2
Annual salary	30,00,000	30,00,000
No. of working days during the year	300 days	300 days
Leave allowed	10 days	10 days
Leave taken	7 days	13 days
Leave unutilized carried forward to next year	3 days	Nil

Based on past experience, Infotech Ltd. assumes that Mr. Niranjan will avail the unutilized leaves of 3 days of 20X0-20X1 in 20X1-20X2. Infotech Ltd. contends that it will record Rs. 30,00,000 as employee benefits expense in each of the years 20X0-20X1 and 20X1-20X2, stating that the leaves will, in any case, be utilized by 20X1-20X2. Comment on the accounting treatment proposed to be followed by Infotech Ltd. Also pass journal entries for both the years. (MTP April 2021)

[video link: https://youtu.be/cBzMVGkzdco, time: 16:31]

Answer

Particulars	Year 20X0-20X1	Year 20X1-20X2
Annual Salary	Rs.30,00,000	Rs.30,00,000
No. of working days (A)	300 days	300 days
Leaves Allowed	10 days	10 days
Leaves Taken (B)	7 days	13 days
Therefore, No. of days worked (A –B)	293 days	287 days
Expense proposed to be recognized by Infotech Ltd.	Rs.30,00,000	Rs.30,00,000

Based on the evaluation above, Mr. Niranjan has worked for 6 days more (293 days –287 days) in 20X0-20X1 as compared to 20X1-20X2.

Since he has worked more in 20X0-20X1 as compared to 20X1-20X2, the accrual concept requires that the expenditure to be rec ognized in 20X0-20X1 should be more as compared to 20X1-20X2.

Thus, if Infotech Ltd. recognizes the same expenditure of Rs. 30,00,000 for each year, it would be in violation of the accrual concept.

The expenditure to be recognized will be as under:

Particulars	Year 20X0-20X1	Year 20X1-20X2
Annual salary (A)	Rs.30,00,000	Rs.30,00,000
No. of working days (B)	300 days	300 days
Salary cost per day (A ÷ B)	Rs.10,000 per day	Rs.10,000 per day
No. of days worked (from above)	293 days	287 days
Expense to berecognised:		
In 20X0-20X1:Rs.30,00,000 + [Rs.10,000 per day x 3 days (leaves unutilized expected to be utilized subsequently)]	Rs.30,30,000	
In 20X1-20X2: Rs.30,00,000 –[Rs.10,000 per day – 3 days (excess leave utilized in 20X1-20X2)]		Rs.29,70,000

Journal Entry for 20X0-20X1

Employee Benefits Expense Account Dr.	30,30,000	
To Bank Account		30,00,000
To Provision for Leave Encashment		30,000

Journal Entry for 20X1-20X2

Employee Benefits Expense Account Dr.	29,70,000	
Provision for Leave Encashment Account Dr.	30,000	
To Bank Account		30,00,000

Misc

4.(a)A company has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rule and to a lump-sum payment to cover expenses on food and stay during the travel. Alternatively, employees can claim a lump sum amount equal to one month pay last drawn.The company's contentions in this matter are:

(i)Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the Travel rule of the company or where option for lump-sum payment is exercised, equal to the last pay drawn.

(ii)Since it is not related to the length of service of the employees, it is accounted for on claim basis.

State whether the contentions of the company are correct as per relevant Accounting Standard. Give reasons in support of your answer (MTP March 2019)

[video link: https://youtu.be/EyerpuPO13Q, time: 17:34]

(d) In 2017-18, DianaLtd. has around 3,000 employees in the company. As per the company policy, the employees are given 30 days of Privilege Leave (PL), 12 days of Sick Leave (SL) and 12 days of Casual Leave. Out of the total PL and SL, 10 PL and 5 SL can be carried forward to next year. On the basis of past trends, it has been noted that 1,000 employees will take 5 days of PL and 2 days of SL and 2,000 employees will avail 10 as PL and 5 as SL.

Also the company has been incurring profits since incorporation. It has been decided in 2017-18 to distribute profits to its employees @ 8% during the year. However, due to the employee turnover in the organisation, the expected pay-out of the Diana Ltd. is to be around 7%. The profits earned during 2017-18 is `12,000 lakh.

Diana Ltd. also has a post-employment benefit plan available which is in the nature of defined contribution plan where contribution to this fund amounts to`500 lakh which will fall due within 12 months from the end of accounting period. The company has paid`120 lakh to its employees in 2017-18.

What is the treatment for the short-term compensating absences, profit-sharing plan and the defined contribution plan by Diana Ltd. as per the

provisions of relevant Ind AS? (Exam Nov 19) / (Exam nov 20) / (MTP March 22)

[video link: https://youtu.be/cBzMVGkzdco, time: 48:33]

Answer

(i)For short term compensating expenses:Diana. Ltd. will recognise a liability in its books to the extent of 5 days of PL for 1,000 employees and 10 days of PL forremaining 2,000 employees and 2 days of SL for 1,000 employees and 5 days of SL for remaining 2,000 employees in its books as an unused entitlement that has accumulated in 2017-2018.

(ii)For profit sharing plan:Diana. Ltd. will recognise `840 lakh (12,000 x 7%) as a liability and expense it in books of accounts.

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

(a)Under Ind AS 19, the amount of `380 lakh(500-120)may be recognised as a liability (accrued expense), after deducting contribution already paid. However, if the contribution already paid would have exceeded the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense); and

(b)Also, `380 lakh will be recognised as an expense in this case study which will be disclosed as an expense in the statement of profit and loss.

Projected unit credit method

6(b)An employee Roshan has joined a company XYZ Ltd. in the year 2018. The annual emoluments of Roshan as decided is Rs.14,90,210. The company also has a policy of giving a lump sum payment of 25% of the last drawn annual salary of the employee for each completed year of service if the employee retires after completing minimum 5 years of service. The salary of the Roshanis expected to grow @ 10% per annum.

The company has inducted Roshan in the beginning of the year and it is expected that he will complete the minimum five year term before retiring.

What is the amount the company should charge in its Profit and Loss account every year as cost for the Defined Benefit obligation? Also calculate the current service cost and the interest cost to be charged per year assuming a discount rate of 8%.(P.V factor for 8% -0.735, 0.794, 0.857, 0.926, 1) (MTP Oct 2018)

[video link: https://youtu.be/EyerpuPO13Q, time: 1:10]

Answer

(b)Calculation of Defined Benefit Obligation

Expected last drawn salary

= Rs.14,90,210 x 110% x 110% x 110% x 110% x 110% = Rs.24,00,000

Defined Benefit Obligation (DBO) = Rs.24,00,000 x 25% x 5 = Rs.30,00,000

Amount of Rs.6,00,000 will be charged to Profit and Loss Account of the company every year as cost for Defined Benefit Obligation.

Calculation of Current Service Cost

Year	Equal apportionment of DBO	PVF @ 8%	PV
1	600,000	0.735	441,000
2	600,000	0.794	476,000
3	600,000	0.857	514,200
4	600,000	0.926	555,600
5	600,000	1	600,000

Calculation of Interest Cost to be charged per year

Year	Opening	Interest @ 8%	Current service cost	Closing
1	0	0	441,000	441,000
2	441,000	35,280	476,400	952,680
3	952,680	76,214	514,200	15,43,094
4	15,43,094	123,447	555,600	22,22,141
5	22,22,141	177,859	600,000	30,00,000

DPA and DBO combine

2(b) On 1 April 2019, the fair value of the assets of XYZ Ltd .'s defined benefit plan were valued at ` 20,40,000 and the present value of the defined obligation was ` 21,25,000. On 31 March 2020 the plan received contributions from XYZ Ltd . amounting to ` 4,25,000 and paid out benefits of ` 2,55,000. The current service cost for the financial year ending 31 March 2020is ` 5,10,000. An interest rate of 5% is to be applied to the plan assets and obligations. The fair value of the plan's assets at 31 March 2020 was ` 23,80,000, and the present value of the defined benefit obligation was ` 27,20,000. Provide a reconciliation from the opening balance to the closing balance for Plan assets and Defined benefit obligation. Also show how much amount should be recognised in the statement of profit and loss, other comprehe nsive income and balance sheet? (MTP Oct 2020) / (MTP May 2020) / (RTP May 20) / (Exam May 22)

[video link: https://youtu.be/EyerpuPO13Q, time: 21:22]

Answer

	Plan Assets	Defined benefit obligation
Fair value/present value as at 1st April 2019	20,40,000	21,25,000
Interest @ 5%	102,000	106,250
Current service cost		510,000
Contributions received	425,000	-
Benefits paid	(255,000)	(255,000)
Return orgain (assets) (balancing figure)	68,000	-
Actuarial Loss (balancing figure)		233,750
Closing balance as at 31 March2020	23,80,000	27,20,000

In the Statement of Profit and loss, the following will be recognized: `

Current service cost 5,10,000

Net interest on net defined liability (` 1,06,250 –` 1,02,000) 4,250

Defined benefit re-measurements recognized in Other Comprehensive Income:
Loss on defined benefit obligation (2,33,750)

Gain on plan assets 68,000

(1,65,750)

In the Balance sheet, the following will be recognized : `

Net defined liability (` 27,20,000 –` 23,80,000) 3,40,000

9.(All numbers in `'000unless otherwise stated) ABL Ltd.operates a defined retirement benefits plan on behalf of current and former employees. ABL Ltd.receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1st April,20X1, the actuaries advised that the present value of the defined benefit obligation was `60,000.On the same date, the fair value of the assets of the defined benefit plan was `52,000. On 1st April,20X1, the annual market yield on high quality corporate bonds was 5%. During the year ended 31st March 20X2, ABL Ltd.made contributions of `7,000into the plan and the plan paid out benefits of `4200to retired members. Assume that both these payments were made on 31st March 20X2. The actuaries advised that the current service cost for the year ended 31st March 20X2 was `6,200. On 28th February,20X2, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by `1500from that date. During the year ended 31st March,20X2, ABL Ltd.was in

negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly beforethe year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by `8000. Before 31stMarch,20X2, ABL Ltd.made payments of `7500to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan. On 31stMarch,20X2, the actuaries advised that the present value of the defined benefit obligation was `68,000. On the same date, the fair value of the assets of the defined benefit plan were `56,000. (RTP Nov 19)

[video link: https://youtu.be/EyerpuPO13Q, time: 39:16]

Answer

(All numbers in `'000 unless otherwise stated)

On 31stMarch 20X2, ABL Ltd.will report a net pension liability in the statement of financial position. The amount of the liability will be `12,000 (68,000 –56,000).

For the year ended 31stMarch 20X2, ABL Ltd.will report the current service cost as an operating cost in the statement of profit or loss. The amount reported will be `6,200. The same treatment applies to the past service cost of `1,500.

For the year ended 31stMarch 20X2, ABL Ltd.will report a finance cost in profit or loss based on the net pension liability at the start of the year of `8,000 (60,000 – 52,000). The amount of the finance cost will be `400 (8,000 x 5%).

The redundancy programme represents the partial settlement ofthe curtailment of a defined benefit obligation.The gain on settlement of `500 (8,000 –7,500) will be reported in the statement of profit or loss.

Other movements in the net pension liability will be reported as remeasurement gains or losses in othercomprehensive income.

For the year ended 31stMarch 20X2, the remeasurement loss will be `3,400 (refer W.N.).

Working Note:

Calculation of remeasurement gain or loss:`'000

Liability at the start of the year (60,000 –52,000)	8,000
Current service cost	6,200
Past service cost	1,500
Net finance cost	400

Gain on settlement	(500)
Contributions to plan	(7,000)
Remeasurement loss (balancing figure)	3,400
Liability at the end of the year (68,000 –56,000)	12,000

18.At 1 April, 20X0, the fair value of the Plan Assets was `10,00,000. The Plan paid benefits of `1,90,000 and received contributions of `4,90,000 on 30 September, 20X0. The company computes the Fair Value of Plan Assets to be `15,00,000 as on 31 March, 20X1 and the Present Value of the Defined Benefit Obligation to amount to `14,79,200 on the same date. Actuarial losses on defined benefit obligation were `6,000.Compounding happens half-yearly. The normal interest rate for 6 months period is 10%per annum, while the effective interest rate for 12 months period is based on the following data:

At 1 April, 20X0, the company made the following estimates based on market prices at that date:

Particulars	**%**
Interest and Dividend Income, after tax payable by the fund	**9.25**
Add:Realized and Unrealized Gains on Plan Assets (after tax)	**2.00**
Less:Administration Costs	**(1.00)**
Expected Rate of Return	**10.25**

Determine actual return and expected return on plan asset. Also compute amount to be recognized in 'Other Comprehensive Income'in this case (RTP May 21)

[video link: https://youtu.be/cBzMVGkzdco, time: 36:10]

Answer

Computation of Expected Return on Plan Assets

Particulars`

Return on `10,00,000 for 20X0-20X1 at 10.25%

= `10,00,000 x 10.25% 1,02,500

Add:Return on `3,00,000 for 6 months at 10%

Normal Rate =[3,00,000 (Inflow `4,90,000 less

Payments `1,90,000) x 10%x 6/12]	15,000
Expected Return on Plan Assets	1,17,500

Computation of Actual Return on Plan Assets

Particulars`	
Fair Value of Plan Assets at the year-end –31 March 20X1	15,00,000
Less:Fair Value of Plan Assets at the beginning –1 April 20X0	(10,00,000)
Less:Contributions received during the year 20X0-20X1	(4,90,000)
Add:Benefits paid during the year 20X0-20X1	1,90,000
Actual Return on Plan Assets	2,00,000

Computation of Net Actuarial Gain

Particulars`	
Actual Return on Plan Assets	2,00,000
Less:Expected Return on Plan Assets	(1,17,500)
Actuarial Gain on Plan Assets	82,500
Less:Actuarial Loss on Defined Benefit Obligation (given)	(6,000)
Net Actuarial Gain to be recognized in 'Other Comprehensive Income'	76,500

Change in Benefit plan

14.ABC Limited operates a defined benefit plan which provides to the employees covered under the plan a pension benefit which is equal to 0.75% final salary for each year of completed service. An employee needs to complete minimum of five years' service for becoming eligible to the benefit. On 1st April, 2015, the entity improves the pension benefit to 1% of final salary for each year of service, including prior years. The present value of the defined benefit obligat ion is therefore, increased by ` 80 million. Given below is the composition of this amount:

Employees with more than5 years' of service at 1stApril,2015	**`60 million**
Employees with less than 5 years' of service at 1stApril,2015	**`20 million**

The employees in the second category have complete d average 2 and half years of service. Hence, they need to complete another two and half year of service until vesting. Comment on the treatment of ` 80 million of the

defined benefit obligation in the financial statements both as per Ind AS 19. (RTP May 19)
[video link: https://youtu.be/cBzMVGkzdco, time: 27:55]

Answer

Under Ind AS 19, the entire past service cost of ` 80 million needs to be recognized and charged in profit or loss immediately. ABC Ltd. cannot defer any part of this cost.

Curtailment

4(b) RS Ltd. discontinues a business segment. Under the agreement with employee's union, the employees of the discontinued segment will earn no further benefit. This is a curtailment without settlement, because employees will continue to receive benefits for services rendered before discontinuance of the business segment. Curtailment reduces the gross obligation for various reasons including change in actuarial assumptions made before curtailment. If the benefits are determined based on the last pay drawn by employees, the gross obligation reduces after the curtailment because the last pay earlier assumed is no longer valid. RS Ltd. estimates the share of unamortized service cost that relates to the part of the obligation at Rs. 18 (10% of Rs. 180). Calculate the gain from curtailment and liability after curtailment to be recognised in the balance sheet of RS Ltd. on the basis of given information:

(i) Immediately before the curtailment, gross obligation is estimated at Rs. 6,000 based on current actuarial assumption.

(ii) The fair value of plan assets on the date is estimated at Rs. 5,100.

(iii) The unamortized past service cost is Rs. 180.

(iv) Curtailment reduces the obligation by Rs. 600, which is 10% of the gross obligation (MTP April 2018)

[video link: https://youtu.be/cBzMVGkzdco, time: 2:15]

Answer

Gain from curtailment is estimated as under:	Rs.
Reduction in gross obligation	600
Less: Proportion of unamortised past service cost	(18)
Gain from curtailment	582

The liability to be recognised after curtailment in the balance sheet is estimated as under:

	Rs.
Reduced gross obligation (90% of ` 6,000)	5,400
Less: Fair value of plan assets(5,100)	300
Less: Unamortised past service cost (90% of ` 180)	(162)
Liability to be recognised in the balance sheet	138

Ind AS 20

Treatment of various grants		
Nature	**Accounting**	**In case of refund**
Related to capital asset	Deferred government grant (DGG)	Deduct from DGG balance if any trf to PL
Depreciable asset	Deduct from asset	Add to asset
	Treat as DGG	Deduct from DGG balance if any trf to PL
Revenue	Income in PL	Expense in PL
Asset received from government at discounted price	Nominal value	Asset eliminated from BS
	Fair market value and credit to DGG	Asset and DGG eliminated from BS, diff transferred to PL

Conditional vs unconditional grant

6. (a)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% (MTP Oct 2020) / (Exam May 18)

[video link: https://youtu.be/sjr1FeUYXFM, time: 15:55]

Answer

(i) T he 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. Alternative ly if the compa n y is following the policy of recognisingnon-monetary grants at nominal value, the company will no t recognise any government grant. Land will be shown in the financia l statemen ts at `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 betweenthe initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. T he benefit is accounted for as Government grant.

(iii)`25lakh 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, itshould be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood,asper para 21 of Ind AS 20.

(iv)`10lakh 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. Alternative ly, if th e company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. The machinery will be recognised at `70 lakh (`80 lakh -`10 lakh). Reduced depreciatio n will be charged to the State men t of Profit or Loss

(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 tocompensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

6(b)Mediquick Ltd. has received the following grants from the Central Government for its newly started pharmaceutical business:

•`50 lakh received for immediate start-up of business without anycondition.

•`70 lakh received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:

(i) That drugs should be available to the public at 20% cheaper from current market price and

(ii) The drugs should be in accordance with quality prescribed by the Govt. Drug Control department.

•Three acres of land (fair value: `20lakh) received for setup of plant.

•`4lakh received- for purchase of machinery of `10 lakh. Useful life of machinery is 4 years. Depreciation on this machinery is to be charged on straight-line basis. How should Mediquick Ltd. recognize the government grants in its books of accounts as per relevant Ind AS? (Exam May 19)

[video link: https://youtu.be/sjr1FeUYXFM, time: 28:26]

Answer

Mediquick Ltd. should recognise the grants in the following manner:

•`50 lakhs have been received for immediate start-up of business. T his should be recognised in the Statement of Profit and Loss immediately as there are no conditions attached to the grant.

•`70 lakhs should be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expense the related costs for which the grants are intended to compensate. However, for this compliance, there should be reasonable assurance that Mediquick Ltd. complies with the conditions attached to the grant.

•Land should be recognised at fair value of `20 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income.

Alternatively, since the land is granted at no cost, it may be presented in the books at nominal value.

•`4 lakhs should be recognised as deferred income and will be transferred to profit and loss account over the useful life of the asset. In this cases, `1,00,000 [`4 lakhs/ 4 years] should be credited to profit and loss account each year over the period of 4 years.

Alternatively,`4,00,000 will be deducted from the cost of the asset and depreciation will be charged at reduced amount of `6,00,000 (`10,00,000 – `4,00,000) i.e. `1,50,000 each year.

1 (b) 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 hasreceived two grants of Rs. 1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clean river project" which involves research into the effect of various chemicals waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st March, 20X2.

(ii)The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figure prior to the floods, for which the company is required to submit an application form on or before30th 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-re lated compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2. (MTP March 2021) / (RTP May 20)

[video link: https://youtu.be/sjr1FeUYXFM, time: 29:54]

Answer

Accounting treatment for:

1.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 31stMarch, 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 years the expenditure is being incurred.

2.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 31stMarch, 20X2 and 31stMarch, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of Rs. 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 Rs. 100,000 against the cost of the equipment in April, 20X3.

3.For flood related compensation

Rainbow Limited will be able to submit an application form only after 31stMay, 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 31stMarch,20X2

3.EntityA 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. (RTP Nov 20)

[video link: https://youtu.be/sjr1FeUYXFM, time: 41:44]

Answer

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	130,000	21,667	60000 * 130 / 360	18,333	40000 – 21,667
2	110,000	18,333	60000 * 110 / 360	10,000	50,000 – 21667 – 18333
3	120,000	20,000	60000 * 120/360	0	
	360,000	60,000			

Therefore,Grant income to be recognisedin 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.

Government Loan

3a. A Limited received from the government a loan of Rs.1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant be realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset (Aug 2018 MTP) / Nov 22 RTP

[video link: https://youtu.be/sjr1FeUYXFM, time: 1:36]

Answer

The fair value of the loan is calculated at Rs.74,76,656

Year	Opening	Interest @ 12%	Cash flow	Closing
1	74,76,656	897,200	500,000	78,73,856
2	78,73,856	944,862	500,000	83,18,718
3	83,18,718	998,246	500,000	88,16,964
4	88,16,964	10,58,036	500,000	93,75,000
5	93,75,000	11,25,000	105,00,000	Nil

A Limited will recognise Rs.25,23,344 (Rs.1,00,00,000 –Rs.74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account Dr. Rs. 1,00,00,000

To Deferred Income Rs. 25,23,344

To Loan Account Rs. 74,76,656

Rs.25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognise the related costs (which the grant intends to compensate) as expenses.

If the loan is to finance a depreciable asset,Rs.25,23,344 will be recognised in profit or loss on the same basis as depreciation.

13. A Limited is engaged in the manufacturing of certain specialized chemicals. During the manufacturing process, certain wastewater is produced which is released by A Limited in the nearby river. To reduce pollution of the rivers, the state government has introduced a scheme with the following salient features:

• If a manufacturer installs certain pre-approved wastewater treatment plant, the government will provide an interest free loan equal to 50% of the cost of the plant;

• Such loan will be repayable to the government in 5 years from the date of disbursal;

• The manufacturer availing the benefit of this scheme must treat the wastewater of its factory using the specified plant before releasing it to the river. If this condition is violated, the entire loan shall become immediately repayable to the government along with a penalty of ` 10 lakh.

Cost of the wastewater treatment plant to be installed to avail the benefit of the scheme is ` 50 lakh. A Limited decided to utilise this scheme because, if it were to obtain the similar loan from a bank, it would be available at a market interest rate of 12% per annum. Accordingly, A Limited applied for and obtained the government loan of ` 25 lakh on 1st April, 20X1. A Limited purchased and installed the plant such that it became ready for use on the same date.

A Limited has an accounting policy of recognising government grant in relation to depreciable assets in the proportion of depreciation expense. It has determined that the plant will be depreciated over a period of 5 years using straight-line method. In the month of March, 20X3, government officials conducted a surprise audit, and it was found that A Limited was not using the wastewater treatment plant as prescribed. Accordingly, on 31st March, 20X3, the government ordered A Limited to repay the entire loan along with penalty. A Limited repaid the loan with interest and penalty as per the order on 31st March, 20X3.

Measure the amount of government grant as on 1st April, 20X1. Determine the nature of the government grant and its accounting treatment (principally) for the year ended 31st March, 20X2. Also determine the impact on profit or loss if any, on account of revocation of government grant as on 31st March, 20X3. (RTP May 2022) / (MTP Sept 22)

[video link: https://youtu.be/rxTiMeT0IDU, time: 1:15:22]

Answer

As per the principles of Ind AS 20 "Accounting for Government Grants and Disclosure of Government Assistance", the benefits of a government loan at a below market rate of interest is treated as a government grant. The loan shall be recognized and measured in accordance with Ind AS 109 "Financial Instruments".

The benefit of the below market rate of interest shall be measured as the difference between the initial c arrying value of the loan determined in accordance with Ind AS 109 and the proceeds received. The benefit is accounted for in accordance with Ind AS 20. As per Ind AS 109, the loan should be initially measured at its fair value.

Initial recognition of grant as on 1st April, 20X1

Fair value of loan = ` 25,00,000 x 0.567 (PVF @ 12%, 5th year) = ` 14,17,500

A Limited will recognize ` 10,82,500 (25,00,000 – 14,17,500) as the government grant and will make the following entry on receipt of loan:

1.4.20X1	Bank account	Dr.	25,00,000	
	To Deferred Grant Income			10,82,500
	To Loan account			14,17,500

(Being grant initially recorded at fair value)

Accounting treatment for year ending 31st March, 20X2

As per para 3 of Ind AS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets.

As per para 24-27 of Ind AS 20, Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

A Ltd. has adopted first method of recognising the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset. Here, deferred income is recognised in profit or loss in the proportion in which depreciation expense on the asset is recognised.

Depreciation for the year (20X1-20X2) = ` 50,00,000 / 5 years = ` 10,00,000

As the loan is to finance a depreciable asset, ` 10,82,500 will be recognized in Profit or Loss on the same basis as depreciation.

Since the depreciation is provided on straight line basis by A Limited, it will credit ` 2,16,500 (10,82,500 / 5) equally to its statement of profit and loss over the 5 years.

31.3.20X2 Depreciation (Profit or Loss A/c) Dr. 10,00,000

To Property, Plant & Equipment 10,00,000

(Being depreciation provided for the year)

Deferred grant income Dr. 2,16,500

To Profit or Loss 2,16,500

(Being deferred income adjusted)

Impact on profit or loss due to revocation of government grant as on 31st March 20X3

As per para 32 of Ind AS 20, a government grant that becomes repayable shall be accounted for as a change in accounting estimate. 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.

Amount payable to Government on account of principal loan = ` 25,00,000

Amount payable to Government on account of penalty = ` 10,00,000

Journal Entries

31.3.20X3 Deferred grant income Dr. 2,16,500

To Profit or Loss 2,16,500

(Being deferred income adjusted)

Loan account (W.N.1) Dr. 17,78,112

Deferred grant income (W.N.2) Dr. 6,49,500

Profit or Loss Dr. 72,388

	Dr.	Cr.
To Government grant payable		25,00,000
(Being refund of government grant)		
Profit or Loss Dr.	10,00,000	
To Government grant payable		10,00,000
(Being penalty payable to government)		

Therefore, total impact on profit or loss on account of revocation of government grant as on 31st March, 20X3 will be ` 10,72,388 (10,00,000 + 72,388).

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.

Working Notes:

1. Amortisation Schedule of Loan

Year	Opening balance of Loan	Interest @ 12%	Closing balance of Loan
31.03.20X2	14,17,500	1,70,100	15,87,600
31.03.20X3	15,87,600	1,90,512	17,78,112

2. Deferred Grant Income

Year	Opening balance	Adjustment	Closing balance
31.03.20X2	10,82,500	2,16,500	8,66,000
31.03.20X3	8,66,000	2,16,500	6,49,500

Compensation for loss

6. A Ltd. has been conducting its business activities in backward areas of the country and due to higher operating costs in such regions, it has collectively incurred huge losses in previous years. As per a scheme of government announced in March 20 X1, the company will be partially compensated for the losses incurred by it to the extent of ` 10,00,00,000, which will be received in October 20 X1. The compensation being paid by the government meets the definition of government grant as per Ind AS 20. Assume that no other conditions are to be fulfilled by the company to receive the compensation.

When should the grant be recognised in statement of profit and loss? Discuss in light of relevant Ind AS. (RTP Nov 21)

[video link: https://youtu.be/4BBd21zl_hM, time: 52:20]

Answer

Paragraph 7 of Ind AS 20 states that, Government grants, including non - monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(e) the entity will comply with the conditions attaching to them; and

(f) the grants will be received.

Further, paragraphs 20 and 22 of Ind AS 20 state as follows:

"A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable".

"A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

In accordance with the above, in the given case, as at March 20X1, A Ltd. is entitled to receive government grant in the form of compensation for losses already incurred by it in the previous years. Therefore, even though the compensation will be received in the month of October 20X1, A Ltd. should recognise the compensation receivable by it as a government grant in the profit or loss for the period in which it became receivable, i.e., for the financial year 20X0-20X1 with disclosure to ensure that its effect is clearly understood.

5(b) M Limited had constructed another factory few years ago with the assistance of yet another government grant, 'Innovative Product'. The grant is non-repayable and, following the construction of the factory, cannot be clawed back by the government. There are no further conditions attached to the grant that the Company is required to satisfy. The grant received has been treated as deferred income and is being credited to the income statement over the same period as the factory is being depreciated. Following an adverse change in the demand of the product the factory manufactures, during the year at the reporting date, the directors have concluded that the factory's carrying value is no longer recoverable in full and that a write down for impairment is required. The write down is more than covered by the amortized deferred income balance related to the grant. Discuss, in the context of Ind AS framework and Ind AS 20, the impairment of the factory for which 'Innovative Product' government grant, has been received. Would your answer be different, if there are further conditions attached to grant beyond construction of factory?(MTP March 22)

[video link: https://youtu.be/H5VbXddxql4, time: 1:27:40]

Answer

Accounting treatment for Government Grant:

Government grants, related to assets, including non-monetary grants at fair value should be presented in the Balance Sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the asset's carrying amount. (Para 24 of I nd AS 20)

Government grants should be recognised as income over the periods in which the entity recognises as expenses the related costs that they are intended to compensate, on a systematic basis. The outcome should be same in the Profit and Loss account statement regardless of whether grants are netted or deferred. In case the grant had been offset against the acquisition cost of the factory and net carrying value is less than the recoverable amount, there would be no need for an impairment write -down. The Profit and Loss account would be charged with annual depreciation on the net acquisition cost .

Government grant relating to 'Innovative Product':

To match the same result for the grant 'Innovative Product' which has been shown as deferred income and the factory is initially recorded at its cost, it is reasonable to release an amount of deferred income to the Profit and Loss account to compensate for the impairment write-down.

Treatment in case of further conditions attached:

If there are further conditions attached to the grant beyond construction of the factory, it may not be appropriate to release an amount of the deferred income to compensate for the impairment write down. An entity would need to assess those further conditions to determine the amou nt, if any, of deferred income to release.

Ind AS 21

Treatment of advance in foreign currency

5. Supplier, A Ltd., enters into a contract with a customer , B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are ` 72 per USD and ` 75 per USD respectively. (RTP May 19)

[video link: https://youtu.be/1V9trIvs4e0, time: 1:39]

Answer

This is the case of Revenue recognised at a single point in time with multiple payments. As per the guidance given in Appendix B to Ind AS 21:

A Ltd. will recognise a non-monetary contract liability amounting ` 1,440 million, by translating USD 20 million at the exchange rate on 1st January, 2018 ie ` 72 per USD.

A Ltd. will recognise revenue at 31st March, 2018 (that is, the date on which it transfers the goods to the customer).

A Ltd. determines that the date of the transaction for the revenue relating to the advance consideration of USD 20 million is 1st January, 2018. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31st March, 2018.

On 31st March, 2018, A Ltd. will:

•derecognise the non-monetary contract liability of USD 20 million and recognise USD 20 million of revenue using the exchange rate as at 1st January, 2018 ie ` 72 per USD; and

•recognise revenue and a receivable for the re maining USD 30 million, using the exchange rate on 31st March, 2018 ie ` 75 per USD.

•the receivable of USD 30 million is a monetary item, so it should be translated using the closing rate until the receivable is settled.

Foreign currency loan

17.On1stApril, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. Itincurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31stMarch, starting from 31stMarch, 20X2. The loan is repayable in FCY on 31stMarch, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

-1stApril, 20X1 -FCY 1 = `2.50.

-31stMarch, 20X2 –FCY 1 = `2.75.

-Average rate for the year ended 31stMatch, 20X2 –FCY 1 = `2.42.

The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain/loss. (RTP May 20)

[video link: https://youtu.be/1V9trIvs4e0, time: 19:13]

Answer

Initial carrying amount of loan in books

Loan amount received= 60,00,000 FCY

Less: Incremental issue costs= 2,00,000 FCY

58,00,000FCY

Ind AS 21, "The Effect of Changes in Foreign Exchange Rates"states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in INR=58,00,000 FCY x `2.50/FCY=`1,45,00,000

Therefore, the loan would initially be recorded at `1,45,00,000.

Calculation of amortized cost of loan (in FCY) at the year end:

Period	Opening Financial Liability (FCY)	Interest @12%(FCY)	Cash Flow(FCY)	Closing Financial Liability (FCY)

20X1-20X2	58,00,000	696,000	600,000	58,96,000

The finance cost in FCYis 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 20X1-20X2 in INR is ` 16,84,320 (6,96,000 FCYx `2.42/FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = INR 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So the closing loan balance in INR is58,96,000 FCYx INR 2.75/FCY= `1,62,14,000

The exchange differences that are created by this treatment are recognized in profit and loss.

In this case, the exchange difference is

`[1,62,14,000 -(1,45,00,000 + 16,84,320 –16,50,000)] = `16,79,680.

This exchange difference is takento profit and loss.

3(a) Hari Ltd. purchased an equipment for 10,200 CAD from Canada supplier on credit basis on 31st January, 2020. Hari Ltd.'s functional currency is INR. The fair value of the equipment determined on 31st March, 2020 is 12,100 CAD. The payment to overseas supplier done on 31st March 2021 and the fair value of the equipment remains unchanged for the year ended on 31st March, 2021.
The exchange rates are as follow:

- **On the date of transaction - 1 CAD = INR 57.68**
- **On 31st March, 2020 - 1 CAD = INR 62.12**
- **On 31st March 2021 -1 CAD = INR 69.24**

Prepare the journal entries for the year ended on 31st March, 2020 and 31st March, 2021 according to Ind AS 21. Tax rate is 25%. Hari Ltd. follows revaluation model as per Ind AS 16 in respect of Property Plant & Equipment. (Exam Dec 21)

[video link: https://youtu.be/ngi-Dzq0Kis, time: 28:25]

Answer

Journal Entries

Purchase of an equipment on credit basis on 30th January 2020:

Equipment A/c (10,200 CAD x ` 57.68) Dr. 5,88,336

To Creditors – Equipment A/c 5,88,336

(Being initial transaction recorded at exchange rate on the date of transaction)

Exchange difference arising on translating monetary item on 31st March 2020:

Profit & Loss A/c Dr.45,288

[(10,200 CAD x ` 62.12) – (10,200 CAD x ` 57.68)]

To Creditors – Equipment A/c 45,288

(Being loss on exchange difference recognised)

Equipment A/c Dr. 1,09,592

To Revaluation Surplus (OCI) 1,09,592

(Being equipment revalued to 12,100 CAD [` 57.68 x (12,100 CAD – 10,200 CAD)])

Equipment A/c Dr. 53,724

To Revaluation Surplus (OCI) 53,724

(Being equipment measured at the exchange rate on 31.3.2020 [12,100 CAD x (` 62.12 - ` 57.68)]

Revaluation Surplus (OCI) [(1,09,592 + 53,724) x 25%] Dr. 40,829

To Deferred Tax Liability 40,829

(Being DTL created @ 25% of the total OCI amount)

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 2021:

Creditors - Equipment A/c (10,200 CAD x ` 62.12) Dr. 6,33,624

Profit & loss A/c [(10,200 CAD x (` 69.24 - ` 62.12)] Dr. 72,624

To Bank A/c 7,06,248

(Being final settlement of creditors done)

Equipment A/c [(12,100 CAD x (` 69.24 - ` 62.12)] Dr. 86,152

To Revaluation Surplus (OCI) 86,152

(Being equipment revalued)

Revaluation Surplus (OCI) (86,152 x 25%) Dr.	21,538	
To Deferred Tax Liability		21,538

(Being DTL created @ 25% of the total OCI amount)

Foreign currency bank balance

6(c) 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 (Date of purchase of computer)	**71.00**
31st March 2020	**71.50**
Average for 2019-2020	**70.50**

Please prepare the extract of Cash Flow Statement for the year ended 31st 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 Jan 21)

[video link: https://youtu.be/1V9trIvs4e0, time: 33:55]

Answer

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	INR
Opening balance	1.4.2019	7000	70	490000
Less: Purchase of Computer	30.11.2019	280	71	19880
Closing balance calculated		6720		470120
Closing balance (at year end spot rate)	31.3.2020	6720	71.5	480480
Foreign Exchange Gain credited to Profit and Loss account				10360

F2P vs F2F

1. (a) PQR Holdings Limited is based in London and has Pound sterling ("GBP") as its functional and presentation currency. On 1st April, 20X1, PQR Holdings Limited incorporated PQR India Limited as its wholly owned subsidiary in India. PQR India will be engaged in trading of items purchased from PQR Holdings. The shares of PQR India, having a face value of ` 10 each amounting to total of ` 500 crore, were issued to PQR Holdings in GBP on 1st April, 20X1.

PQR India has adopted Ind AS with effect from its incorporation. In accordance with Ind AS, management of PQR India has concluded that its functional currency is Indian Rupee ("INR"). Following is the summarized trial balance of PQR India as on 31st March, 20X2, being the reporting date of PQR India and PQR Holdings:

(Note: All amounts in the below mentioned trial balance are ` in crore)

S. No. Particulars Debit Balances Credit Balances

1. Share capital	-	500.0
2. Securities premium reserve on issue of equity shares	-	150.0
3. Retained earnings	-	110.0
4. Long-term borrowings	-	30.0
5. Deferred tax liability	-	10.0
6. Income tax payable	-	25.0
7. Import duty payable	-	5.0
8. Employee benefits payable		7.5
9. Sundry trade payables	-	2.5
10. Property, plant and equipment (net of depreciation)	550.0	–
11. Computer software (net of amortisation)	70.0	–
12. Inventories purchased on 15th March, 20X2 (there is no indicator of impairment)	200.0	
13. Cash and bank balance	5.0	–
14. Sundry trade receivables	17.0	–
15. Allowance for doubtful trade receivables	-	2.0
Total	842.0	842.0

Additional information relating to property, plant and equipment, and computer software:

Line item	Date of acquisition
Property, plant and equipment	30th April, 20X1
Computer software	5th May, 20X1

PQR India has adopted the following accounting policy in relation to shareholders' funds to translate equity:

Share capital	To be translated using historical exchange rate
Securities premium	To be translated using historical exchange rate
Retained earnings	To be translated using average exchange rate

Since the presentation currency of PQR Holdings is GBP, PQR India is required to translate its trial balance from INR to GBP. Following table provides relevant foreign exchange rates:

Closing spot rate as on 1st April, 20X1 1 INR = 0.0123 GBP
Closing spot rate as on 30th April, 20X1 1 INR = 0.0120 GBP
Closing spot rate as on 5th May, 20X1 1 INR = 0.0119 GBP
Closing spot rate on 15th March, 20X2 1 INR = 0.0108 GBP
Closing spot rate as on 31st March, 20X2 1 INR = 0.0109 GBP
Average exchange rate for the year ended 31st March, 20X2 1 INR = 0.0116 GBP

As the accountant of PQR India, you are required to do the following for its separate financial statements:

(a) Explain the principle of monetary and non-monetary items. Based on this principle, bifurcate the line items of the trial balance into monetary and non-monetary items.

(b) Translate the trial balance of PQR India from INR to GBP. (MTP Nov 21)

[video link: https://youtu.be/1DKSEXWBG1E, time: 2:15]

Answer

(a) Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. Para 15 of Ind AS 21 states that the essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item.

Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency.

On the basis of above principles, the line items of trial balance should be bifurcated as follows:

Particulars	Monetary item / Non-monetary item
Share Capital	Non-monetary item
Securities Premium reserve on issue of equity shares	Non-monetary item
Retained earnings	Non-monetary item
Long-term borrowings	Monetary item
Deferred tax liability	Non-monetary item
Income tax payable	Monetary item
Import duty payable	Monetary item
Employee benefits payable	Monetary item
Sundry trade payables	Monetary item
Property, plant and equipment (net of depreciation)	Non-monetary item
Computer software (net of amortization)	Non-monetary item
Inventories purchased (there is no indicator of impairment)	Non-monetary item
Cash and bank balance	Monetary item
Sundry trade receivables	Monetary item
Allowance for doubtful trade receivables	Monetary item

As per para 38 of Ind AS 21, an entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

(b) Translation of the balances for the purpose of consolidation

Particulars	INR in crore	Rate (GBP)	Amount in GBP
Property, plant and equipment (net of depreciation)	550.0	0.0109	5.995
Computer software (net of amortization)	70.0	0.0109	0.763
Inventories	200.0	0.0109	2.18
Cash and bank balance	5.0	0.0109	0.0545
Sundry trade receivables net of allowance for doubtful			

trade receivables (17.0-2.0)	15.0	0.0109	0.1635
Total Assets	840.0		9.156
Share Capital	500.0	0.0123	6.15
Securities Premium reserve	150.0	0.0123	1.845
Retained earnings	110.0	0.0116	1.276
Long-term borrowings	30.0	0.0109	0.327
Deferred tax liability	10.0	0.0109	0.109
Income tax payable	25.0	0.0109	0.2725
Import duty payable	5.0	0.0109	0.0545
Employee benefits payable	7.5	0.0109	0.08175
Sundry trade payables	2.5	0.0109	0.02725
Foreign Currency Translation reserve recognised in OCI (balancing figure)			(0.987)
Total Equity and liabilities	840.0		9.156

3(c)XYZGlobal Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of XYZ Info. (Euro).

The following isthe statement of financial position of XYZ Global Ltd. prior to translation :

	USD	Euro
Property, plant andequipment	60,000	
Receivables	9,00,000	
Total assets	9,60,000	
Issued capital	40,000	25,000
Opening retained earnings	25,000	15,000
Profit for the year	22,000	
Accounts payable	8,15,000	
Accrued liabilities	58,000	
Total equity and liabilities	9,60,000	

Additional inform ation:

Relevant exchange rates are:

Rate at the beginning of the year -Euro 1=USD1.25

Average rate for the year -Euro 1 = USD1.20

Rate at the end of the year -Euro 1 = USD1.15

You are required to :

(i) Translate the statement of financial position of XYZ Global Ltd. into Euro which is ready for consolidation by XYZ Info. (Share capital and opening retained earnings have been pre-calculated.)

(ii)Prepare a working of the cumulative balance of the foreign currency translation reserve as per relevant Ind AS. (Exam Nov 19)

[video link: https://youtu.be/FEJxAuWItsM, time: 12:11]

Answer

	USD	Rate/Euro	Euro
Property, plant and equipment Receivables	60,000 900000	1.15 1.15	52174 782609
Total assets	960000		834783
Issued capital Opening retained earnings Profit for the year Accounts payable Accrued liabilities	40000 25000 22000 815000 58000	 1.20 1.15 1.15	25000 15000 18333 708696 50435
Total equity and liabilities	960000		817464
Foreign Currency T ranslation Reserve (FCT R)(Refer the below working)			17319
Total equity and liabilities			834783

Working of the cumulative balance of the FCTR

Particulars	Actual translated amount in Euro	Amount	Difference translated at closing rate of USD 1.15/EURO
Issued capital Opening retained earnings Profit for the year	25000 15000 18333	34783 21739 19130	9783 6739 797

40,000 / 1.15 = 34,783, 25,000 / 1.15 = 21,739, 22,000 / 1.15 = 19,130

Accounting for FCTR and Deferred tax

ABC Ltd. works out translation gain/loss over the years on its investment in foreign subsidiary 2014-15: Rs. 2 lakhs, 2015-16: Rs. 4 lakhs, 2016-17: Rs. 3 lakhs. The foreign subsidiary is sold on 30thJune 2017. The translation gain on sale of such investment as on that date is Rs. 2 lakhs. Assuming that deferred tax effect is computed @ 30%. How should the company present the translation gain/loss, deferred taxation and reclassification adjustment in the Profit and loss, other comprehensive income, equity and liabilities? (MTP Oct 2018)

[video link: https://youtu.be/FEJxAuWItsM, time: 1:23]

Answer

	Statement of Profit and loss		Equity Liabilities	
	Profit and loss	Other-comprehensive income	Equity	Liabilities
2014-15 Translation Gain Less: Deferred Tax Expenses Translation Reserve Deferred tax liabilities		2 (0.6) 1.4	 1.4	 0.6
2015-16 Translation Gain Less: Deferred Tax Expenses Translation Reserve Deferred tax liabilities		2 (0.6) 1.4	 2.8	 1.2
2016-17 Translation Loss Less: Deferred Tax Expenses Translation Reserve Deferred tax liabilities		(1) 0.3 (0.7)	 2.1	 0.9
2017-18 Translation Loss Less: Deferred Tax Expenses Translation Reserve Deferred tax liabilities		(1) 0.3 (0.7)	 1.4	 0.6
Reclassification adjustment credited to P&L Current Tax Adjustment of deferred tax liabilities	1.4 0.6			 (0.6)

Sale/ Purchase of goods to foreign subsidiary

11.Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in

Germany. The functional currency of Global Limited is Rupeesand its financial year end is 31stMarch,20X2.

(i) The fair value of the net assets of Mark Limited was 23 millionEURO and the purchase consideration paid is 17.5 million EURO on 30thSeptember, 20X1.

The exchange rates as at 30thSeptember, 20X1was `82 /EURO and at 31stMarch, 20X2was `84 /EURO.What is the value at which the goodwill has to be recognised in the financial statements of Global Limited ason 31stMarch, 20X2?

(ii)Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31stMarch, 20X2. The exchange rate on the date of purchase by Global Limited was `83 /EURO and on 31stMarch, 20X2was `84 /EURO. The entire goods purchased from Mark Limited are unsold as on 31stMarch,20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements. (RTP Nov 19) / (Exam May 22)

[video link: https://youtu.be/1V9trIvs4e0, time: 10:03]

Answer

(i)Para 47 of Ind AS 21 requires that goodwill arose on business combinationshall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.In this case the amount of goodwill will be as follows:

Net identifiable asset Dr.	23 million	
Goodwill(bal. fig.)Dr.	1.4 million	
To Bank		17.5 million
To NCI (23 x 30%)		6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x `84= `117.6million

(ii)Particulars	EURO in million
Sale price of Inventory	4.20
Unrealised Profit [a]	1.80
Exchange rate as on date of purchase of Inventory [b]	`83 /Euro
Unrealized profit to be eliminated [a x b]	`149.40 million

As per para 39 of Ind AS 21“income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions”.

In the given case, purchase of inventory is an expense item shown in the statement profit and loss account. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

3(c) SB Limited is engaged in the business of producing extracts from the natural plants for pharmaceuticals and Ayurvedic companies. It has a wholly owned subsidiary, UB Limited which is engaged in the business of pharmaceuticals. UB Limited purchases the pharmaceuticals extracts from its parent company. The demand of UB Limited is very high and hence to cater its shortfall, UB Limited also purchases the pharmaceutical extracts from other companies. Purchases are made at the competitive prices.

SB Limited sold pharmaceutical extracts to UB Limited for Euro 10 lakhs on 1st February, 2021. The cost of these extracts was ` 770 lakh in the books of SB Limited at the time of sale. At the year-end, i.e. 31st March 2021, all these pharmaceutical extracts were lying as closing stock and payable with UB Limited.

Euro is the functional currency of UB Limited while Indian -Rupee is the functional currency of SB Limited.

Following additional information is available:

Exchange rate on 1st February 2021 1 Euro = ` 85

Exchange rate on 31st March 2021 1 Euro = ` 88

Provide the accounting treatment of the above in the books of SB Limited and UB Limited. Also show its impact on consolidated financial statements. Support your answer by journal entries, wherever necessary. Assume NRV to be higher than the cost. (Exam July 2021) / (MTP April 22)

[video link: https://youtu.be/zHYIGfZ1Djo, time: 1:13:22]

Answer

Accounting treatment in the books of SB Ltd (Functional Currency INR)

SB Ltd will recognize sales of ` 850 lakh (10 lacs Euro x ` 85)

Profit on sale of inventory = 850 lakh – 770 lakh = ` 80 lakh.

On balance sheet date receivable from UB Ltd. will be translated at closing rate i.e. 1 Euro = ` 88. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ` 30 lakh [i.e. (` 88 - ` 85) x 10 lakh Euro]. Journal Entries

Date			(`in lakh)
1.2.2021	UB Ltd. A/c Dr.	850	
	To Sales		850

(Being revenue recorded on initial recognition)

31.3.2021	UB Ltd. A/c Dr.	30	
	To Foreign exchange difference (unrealised)		30

(Being foreign exchange difference recorded at year end)

Accounting treatment in the books of UB Ltd (Functional currency EURO)

Date		in Euros	in Euros
1.2.2021	Purchase account Dr.	10 lakh	
	To SB limited		10 lakh

(Being purchased recorded at the date of transaction)

UB Ltd will recognize inventory on 1st February, 2021 of Euro 10 lakh which will also be its closing stock at year end

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of abovementioned sale / purchase between SB Ltd and UB Ltd will get eliminated

The closing stock of UB Ltd will be recorded at lower of cost or NRV.

Since the question ask to assume that NRV is higher than cost, inventory will be measured at cost only. Therefore, no write off is required.

The amount of closing stock of ` 850 lakh include two components–

- Cost of inventory for ` 770 lakh ; and
- Profit element of ` 80 lakh; and

At the time of consolidation, the second element amounting to ` 80 lakh will be eliminated from the closing stock.

Journal Entry	(` in lakh)
Consolidated P&L A/c Dr.	80

To Inventory 80

(Being profit element of intragroup transaction eliminated)

Goodwill F2P

17.Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30 September, 20X2.

The exchange rates as on 30 September, 20X2 was `82 per EURO and at 31 March, 20X3 was `84 per EURO.

On acquisition of Mark limited, what is the value at which the goodwill / capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3? (RTP May 2021)

[video link: https://youtu.be/zmavI0v6v8g, time: 51:10]

Answer

Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

In this case, the amount of goodwill will be as follows:

Net identifiable asset Dr.	`23 million	
Goodwill (bal. fig.)Dr.	`1.4 million	
To Bank (Purchase consideration)		`17.5 million
To NCI (23 x 30%)		`6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be = 1.4 million EURO x `84 = `117.6 million.

Ind AS 23

Steps for capitalization of foreign currency fluctuation

1. Interest to be capitalized = Loan amunt in foreign currency * closing rate * interest rate
2. Notional interest in India = loan amount in foreign currency * opening rate * India interest rate
3. Foreign exchange fluctuation = loan amount in foreign currency * (closing rate – opening rate)
4. FEF to be capitalized = (S2 – S1) or S3 whichever is lower
5. FEF transfer to PL = S3 – S4

Foreign currency loan

3(b)ABC Ltd. has taken a loan of USD 20,000 on April 1, 20X1 for constructing a plant at an interest rate of 5% per annum payable on annual basis. On April 1, 20X1, the exchange rate between the currencies i.e USD vs Rupees was Rs.45 per USD. T he exchange rate on the reporting date i.e March 31, 20X2 is Rs.48 per USD.T he corresponding amount could have been borrowed by ABC Ltd.from State bank of India in local currency at an interest rate of 11% per annum as on April 1, 20X1. Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd(MTP April 2019) / (MTP April 22)

[video link: https://youtu.be/Wleb-YUnbsY, time: 1:19]

Answer

In the above situation, the Borrowing cost needs to determine for interestcost on such foreign currency loan and eligible exchange loss difference if any.

(a) Interest on Foreign currency loan for the period :

USD 20,000 x 5% = USD 1,000

Converted in Rs.: USD 1,000 x Rs.48/USD = Rs.48,000

Increase in liability due to change in exchange difference :

USD 20,000 x (48 -45) = Rs.60,000

(b)Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x Rs.45/USD x 11% = Rs.99,000

(c)Difference between Interest on Foreign Currency borrowing and local Currency borrowing : Rs.99,000 -48,000 = Rs.51,000

Hence, out of Exchange loss of Rs.60,000 on principal amount of foreign currency loan, only exchange loss to the extent of Rs.51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under :

(a) Interest cost on borrowing	Rs.48,000
(b)Exchange difference to the extent considered to be an adjustment to Interest cost	Rs.51,000
	Rs.99,000

The exchange difference of Rs.51,000 has been capitalized as borrowing cost and the remaining Rs.9,000 will be expensed off in the Statement of Profit and loss.

Qualifying vs non qualifying asset

9. Nikka Limited has obtained a term loan of ` 620 lacs for a complete renovation and modernisation of its Factory on 1st April, 20X1. Plant and Machinery was acquired under the modernisation scheme and installation was completed on 30 th April, 20X2. An expenditure of ` 510 lacs was incurred on installation of Plant and Machinery, ` 54 lacs has been advanced to suppliers for additional assets (acquired on 25th April, 20X1) which were also installed on 30th April, 20X2 and the balance loan of ` 56 lacs has been used for working capital purposes.

Management of Nikka Limited considers the 12 months period as substantial period of time to get the asset ready for its intended use.

The company has paid total interest of ` 68.20 lacs during financial year 20 X1-20X2 on the above loan. The accountant seeks your advice how to account for the interest paid in the books of accounts. Will your answer be different, if the whole process of renovation and modernization gets completed by 28 th February, 20X2? (RTP Nov 21) / (Exam May 22)

[video link: https://youtu.be/QJdTojWQ3bw, time: 1:00]

Answer

As per Ind AS 23, Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Purpose	Nature	Interest to be capitalized	Interest to be charged to profit and loss account
Modernisation and renovation of plant and machinery	Qualifying asset	[68.20 x (510/620)] = 56.10	
Advance to suppliers for additional assets	Qualifying asset	[68.20 x (54/620)] = 5.94	
Working Capital	Not a qualifying asset		[68.20 x (56/620)] = 6.16
		62.04	6.16

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

Accordingly, the treatment of Interest of ` 68.20 lacs occurred during the year 20X1-20X2 would be as follows:

(i) When construction of asset completed on 30th April, 20X2 The treatment for total borrowing cost of ` 68.20 lakh will be as follows:

(ii) When construction of assets is completed by 28 th February, 20X2

When the process of renovation gets completed in less than 12 months, the plant and machinery and the additional assets will not be considered as qualifying assets (until and unless the entity specifically considers that the assets took substantial period of time for completing their construction) . Accordingly, the whole of interest will be required to be charged off / expensed off to Profit and loss account.

Capitalization period for specific and general borrowing

	Specific	General
Commencement	Latter of the 3 1. Loan taken 2. Work on QA commence Cost incurred	
Period of capitalization	From commencement date till the date asset is ready for its intended use or sale irrespective of when cost was incurred	From the date cost is incurred till the date asset is ready for its intended use or sale

Specific vs general borrowing

5. (a) On 1 April 2019, 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 a sset. The building was completed at the end of March, 2020, and during the period the following payments were made to the contractor:

Payment date	Amount (`)
1 April 2019	2,00,000
30 June 2019	6,00,000
31 December 2019	12,00,000
31 March 2020	2,00,000
Total	22,00,000

Entity A's borrowings at its year end of 31 March 2020 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31 March 2020 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 1 April 2019amounted to ` 10,00,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1 April 2019amounted to ` 15,00,000 and remained unchanged during the year. What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS? (MTP Oct 2020) / (RTP Nov 19)

[video link: https://youtu.be/Wleb-YUnbsY, time: 18:08]

Answer

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	Amount allocated in general borrowings	Weighted for period outstanding
1.4.2019	200,000	0	0
30.6.2019	600,000	100,000	100000 * 9/12 = 75000
31.12.2019	1200,000	12,00,000	1200,000 * 3/12 = 300,000
31.3.2020	200,000	200,000	200,000 * 0/12 = 0
	22,00,000		375,000

*Specific borrowings of ` 7,00,000 fully utilized on 1 April & on 30 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%) = 11%

10,00,000 + 15,00,000

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

7. X Ltd. commenced the construction of a plant (qualifying asset) on 1st September, 20X1, estimated to cost ` 10 crores. For this purpose, X has not raised any specific borrowings, rather it intends to use general borrowings, which have a weighted average c ost of 11%.

Total borrowing costs incurred during the period, viz., 1st September, 20X1 to 31st March, 20X2 were ` 0.5 crore.

The other relevant details are as follows: (` in crore)

Month	Cost of construction Accrued	Cash outflows (paid in advance at the start of each month)
September	**1.50**	**3.00**
October	**0.50**	**1.70**
November	**1.50**	**2.50**
December	**0.50**	**-**
January	**1.80**	**1.00**
February	**0.70**	**-**
March	**3.00**	**1.50**

Based on the above information, discuss the treatment of borrowing cost as per cash outflow basis and accrual basis and also suggest the appropriate amount of interest that should be capitalised to the cost of the plant in the financial statements for the year ended 31st March, 20X2? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU, time: 46:23]

Answer

Paragraph 14 of Ind AS 23, inter-alia, states that to the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset.

The capitalisation rate shall be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period.

However, an entity shall exclude from this calculation borrowing costs applicable to borrowings made specifically for the purpose of obtaining a qualifying asset until substantially all the activities necessary to prepare that asset for its intended use or sale are complete. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

In this context, a question arises whether such expenditure should be based on costs accrued or actual cash outflows. To contrast these two alternatives, presented below is the computation of borrowing costs based on both the alternatives:

Month	Cost of construction Accrued	Average capital expenditure	Cash outflows (paid in advance at the start of each month)	Average capital expenditure
September	1.50	1.50 x 7/12 = 0.875	3.00	3.00 x 7/12 = 1.75
October	0.50	0.50 x 6/12 = 0.25	1.70	1.70 x 6/12 = 0.85

November December January February March	1.50 0.50 1.8 0.70 3.00	1.50 x 5/12 = 0.625 0.50 x 4/12 = 0.17 1.80 x 3/12 = 0.45 0.70 x 2/12 = 0.12 3.00 x 1/12 = 0.25	2.50 - 1.00 0 1.50	2.50 x 5/12 = 1.04 - 1 x 3/12 = 0.25 - 1.50 x 1/12 = 0.125
	9.50	2.74	9.70	4.02

If the average capital expenditure on the basis of costs accrued is taken, the borrowing costs eligible to be capitalised would be ` 2.74 crore x 11% = 0.30 crore. Whereas, ifaverage capital expenditure on the basis of cash flows is taken, the borrowing costs eligible to be capitalised would be ` 4.02 crore x 11% = 0.44 crore. Thus, there is a wide variance in the amount of borrowing cost to be capitalised, based on the accrual basis and on actual cash flows basis. This divergence is often experienced during the implementation of large projects, for example, an advance given to a supplier involves an upfront cash outflow while the actual expenditure accrues in later periods (with the receipt of goods and services).

As per paragraph 18 of Ind AS 23, expenditures on a qualifying asset include only those expenditures that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditures are reduced by any progress payments received and grants received in connection with the asset (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance). The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditures to which the capitalization rate is applied in that period.

Where cash has been paid but the corresponding cost has not yet accrued interest becomes payable on payment of cash. Therefore, the amount so paid should be considered for determining the amount of interest eligible for capitalisation, subject to the fulfillment of other conditions prescribed in paragraph 16 of Ind AS 23. Accordingly, in the present case, interest should be computed on the basis of the cash flows rather than on the basis of costs accrued. Therefore, the amount of interest eligible for capitalisation would be ` 0.44 crore.

Another important factor to be noted is that paragraph 14 requires, inter alia, that the amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period. Thus, the amount of borrowing costs to be capitalised should not exceed the total borrowing costs incurred during the period, that is ` 0.5 crore.

8. Harish Construction Company is constructing a huge building project consisting of four phases. It is expected that the full building will be constructed over several

years but Phase I and Phase II of the building will be operational as soon as they are completed.

Following is the detail of the work done on different phases of the building during the current year:

(` in lakh)

	Phase I	Phase II	Phase III	Phase IV
Cash expenditure Building purchased Total expenditure	10 24 34	30 34 64	25 30 55	30 38 68
Total expenditure of all phases Loan taken @ 15% at the beginning of the year				221 200

After taking substantial period of construction, at the mid of the current year, Phase I and Phase II have become operational. Find out the total amount to be capitalized and to be expensed during the year. (RTP Nov 22)

Answer

Particulars `

1. Interest expense on loan ` 2,00,00,000 at 15% — 30,00,000

2 Total cost of Phases I and II (` 34,00,000 +64,00,000) — 98,00,000

3. Total cost of Phases III and IV (` 55,00,000 + ` 68,00,000) — 1,23,00,000

4. Total cost of all 4 phases — 2,21,00,000

5. Total loan — 2,00,00,000

6. Interest on loan used for Phases I & II, based on proportionate

Loan amount = 30,00,000 * 98,00,000 / 221,000,00 — 13,30,317 (approx.)

7. Interest on loan used for Phases III & IV, based on proportionate Loan amount= 30,00,000 * 123,00,000 / 221,000,00 — 16,69,683 (approx.)

Accounting treatment:

1. For Phase I and Phase II

Since Phase I and Phase II have become operational at mid of the year, half of the interest amount of ` 6,65,158.50 (i.e. ` 13,30,317/2) relating to Phase I and Phase II should be capitalized (in the ratio of asset costs 34:64) and added to respective assets in Phase I and Phase II and remaining half of the interest amount of ` 6,65,158.50 (i.e. ` 13,30,317/2) relating to Phase I and Phase II should be expensed off during the year.

2. For Phase III and Phase IV

Interest of ` 16,69,683 relating to Phase III and Phase IV should be held in Capital Work-in-Progress till assets construction work is completed, and thereafter capitalized in the ratio of cost of assets. No part of this interest amount should be charged/expensed off during the year since the work on these phases has not been completed yet.

Weighted average rate calculation

(c)An entity constructs a new 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 Rs. 2 lakh in September 20X1 and Rs. 4 lakh in each of the months of October to December 20X1.

The entity has not taken any specific borrowings to finance the construction of the building but has incurred finance costs on its general borrowings during the construction period. During the year, the entity had issued 9% debentures with a face value of Rs. 30 lakh and had an overdraft of Rs. 4 lakh, which increased to Rs. 8 lakh in December 20X1. Interest was paid on the overdraft at 12% until 1st October, 20X1 and then the rate was increased to 15%.

Calculate the capitalization rate for computation of borrowing cost for the period ending 31st December 20X1, in accordance with Ind AS 23 'Borrowing Cost'. (MTP March 2021) / (Exam nov 19)

[video link: https://youtu.be/Wleb-YUnbsY, time: 35:30]

Answer

Nature of general borrowings	Period of outstanding balance	Amount of loan (Rs.)	Rate of interest p.a.	Weighted average amount of interest(Rs.)
9% Debentures Bank overdraft	12 m 9 m 2 m	30,00,000 400,000 400,000	9% 12% 15%	270,000 36,000 10,000

	1 m	800,000	15%	10,000
		46,00,000		326,000

Weighted average cost of borrowings

= {30,00,000 x(12/12)} + {4,00,000 x (11/12)} + {8,00,000 x (1/12)}= 34,33,334

Capitalisation rate

= (Weighted average amount of interest / Weighted average of general borrowings) x 100

= (3,26,000 / 34,33,334) x 100 = 9.50% p.a.

Capitalization of discount / Premium

7.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)

[video link: https://youtu.be/Wleb-YUnbsY, time: 51:41]

Answer

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	180,000	24,102	204,102	20,000	184,102
2	184,102	24,651	208,753	20,000	188,753

Accordingly, borrowing cost of `48,753 will be capitalized to the cost of qualifying asset.

Ind AS 24

<table>
<tr><td>Individuals to an entity</td><td>Entity to Entity</td></tr>
<tr><td>Individuals include close family members(CF)</td><td></td></tr>
<tr><td>Control
Significant influence
Joint control
KMP</td><td>Control
Significant influence
Joint control</td></tr>
<tr><td>Individual common between two entities will be related if such individual + CF
<table>
<tr><td>Entity 1</td><td>Entity 2</td></tr>
<tr><td>Control</td><td>Control</td></tr>
<tr><td>Control</td><td>Joint control</td></tr>
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<tr><td>Joint control</td><td>Joint control</td></tr>
</table>
Inshort SI and SI are not related</td></tr>
</table>

Note: JV and Associate include subsidiary of such JV and associate

6(c)An Indian company has a parent company out side India. Parent company negotiates software licenses withend vendor and based on number of licences,parent company get its reimbursement from Indian company. Say,license cost of Rs. 12 Lac is charged forcalendar yearof 2018. Parent company generates is invoice in February'18. Indian company accounts full invoice in February'18 and then forIndian financial year, accountsReimbursement expense of Rs. 3. 00 Lac during FY 1718 (for licencing cost relating to period January'18 to March'18) and Prepaid expenses of Rs. 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of Rs. 9 Lac is accounted for in FY18-19.Wha t amount shoul d b e di sclosed a t R elated p arty tran saction? (MTP March 2019)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 1:07]

Answer

Paragraph 9 of Ind AS 24 Related Party Disclosures defines Related Party T ransactions as under:

“A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.”

Paragraph 6 of Ind AS 24 states as under:

“6 A related party relationship could have aneffect on the profit or loss and financial position of an entity...”

In the given case, there is a transfer of resources to the extent of Rs.12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to Rs.3 lac of software license cost which is recognise in profit or loss. The benefits relating to Rs.9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in balance sheet as prepaid expenses.

Paragraph 18 of Ind AS 24 states as under:“18If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:

a.The amount of the transactions;

b.The amount of outstanding balances, including commitments, and;

(i)Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

(ii)Details of any guarantees given or received;

c.Provisions for doubtful debts related to the amount of outstanding balances; and

d.The expense recognised during the period in respect of bad and doubtful debts due from related parties."

T herefore, the company has to disclose:

1.T he amount of transaction with the parent of Rs.12 lac towards software license;

2.Outstanding balance of Rs.9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.

3.T he amount of Rs.3 lac recognised as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.

Paragraph 113 of Ind AS 1 Presentation of Financial Statements states as under:"113 An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes."

T herefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in balance sheet to the notes disclosing related party transactions.

6c. ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1 June 2019. Sales of products from XYZ Ltd.to ABC Ltd. in the two-month period from 1 April 2019to 31 May 2019totalled `8,00,000. Following the share purchase by Mrs. P, XYZ Ltd.began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd.to ABC Ltd. in the ten-month periodfrom 1 June 2019to 31 March 2020totalled `60,00,000. On 31 March 2020, the trade receivables of XYZ Ltd. included `18,00,000 in respect of amounts owing by ABC Ltd.Analyse and show (where possible by quantifying amounts) how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2020 as per Ind

AS. You are required to mention the disclosure requirements as well. (MTP Oct 2020)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 18:57]

Answer

XYZ Ltd. would include the total revenue of ` 68,00,000 (` 60,00,000 + ` 8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2020 within its revenue and show ` 18,00,000 within trade receivables at 31 March 2020.

Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd.

From 1st June 2019, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.

Since ABC Ltd. is a related party with whom XYZ Ltd. has transactions, XYZ Ltd. should disclose:

–The nature of the related party relationship.

–The revenue of ` 60,00,000 from ABC Ltd. since 1st June 2019.

–The outstanding balance of ` 18,00,000 at 31st March 2020.

In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

2(c) Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of Rs.2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged Rs.1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS? (MTP May 2020)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 25:19]

Answer

As per paragraph 9 of Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning,

directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

Accordingly, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per paragraph 7 and 9 of Ind AS 19, 'Employee Benefits', an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.Paragraph 17 of Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity shall disclose key management personnel compensation in total i.e. disclosure of directors' fee of (Rs.10,00,000 + Rs.7,50,000) Rs.17,50,000 is to be made as employees benefits (under various categories).

Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

3(b) Huge Ltd. has a controlling interest in Subsidiaries P, Q and R and has significant influence over Associates A and B. Subsidiary R has significant influence over Associate C. Determine the related party relationship, as per Ind AS 24, of the entities referred in the question in the following financial statements:

(i) In consolidated financial statements of Huge Ltd.

(ii)In individual financial statements of Huge Ltd.

(iii) In individual financial statements of Subsidiary P

(iv) In individual financial statements of Subsidiary Q

(v)In individual financial statements of Subsidiary R

(vi) In individual financial statements of Associates A, B and C (MTP April 2018)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 34:31]

Answer

As per para 9 (b) (i) and (ii) of Ind AS 24,

"An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member)."

Accordingly,

(i) For Huge Ltd.'s consolidated financial statements- Associates A, B and C are related to the Group.

(ii) For Huge Ltd.'s separate financial statements- Subsidiaries P, Q and C and Associates A, B and C are related parties.

(iii)For Subsidiary P's financial statements- Parent, Subsidiaries Q and R and Associates A, B and C are related parties.

(iv)For Subsidiary Q's separate financial statements- Parent, Subsidiaries P and R and Associates A, B and C are related parties.

(v)For Subsidiary R's financial statements- Parent, Subsidiaries P and Q and Associates A, B and C are related parties.

(vi)For the financial statements of Associates A, B and C- Parent and Subsidiaries

15.Uttar Pradesh State Government holds 60% shares in PQR Limited and 55% shares in ABC Limited. PQR Limited has two subsidiaries namely P Limited and Q Limited. ABC Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the Key management personnel in PQR Limited.

(a) Determine the entity to whom exemption from disclosure of related party transactions is to be given. Also examine the transactions and with whom such exemption applies.

(b) What are the disclosure requirements for the entity which has availed the exemption? (RTP Nov 19)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 46:35]

Answer

(a)As per para 18 of IndAS 24, 'Related Party Disclosures', if an entity had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about

those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

However, as per para 25 of the standard areporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

(i)a government that has control or joint control of, or significant influence over, the reporting entity; and

(ii)another entity that is a related party because the same government has control or joint controlof, or significant influence over, both the reporting entity and the other entity

According to the above paras, for Entity P's financial statements, the exemption in paragraph25 applies to:

(i)transactions with Government Uttar Pradesh State Government; and

(ii)transactions with Entities PQR and ABC and Entities Q, A and B.

Similar exemptions are available to Entities PQR, ABC, Q, A and B, with the transactions with UP State Government and other entities controlled directly or indirectly by UP State Government. However, that exemption does not apply to transactions with Mr. KM. Hence, the transactions with Mr. KM needs to be disclosed under related party transactions.

(b)It shall disclose the following about the transactions and related outstanding balances referred to inparagraph25:
(a)the name of the government and the nature of its relationship with the reporting entity (ie control,joint control or significant influence);
(b)the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
(i)the nature and amount of each individually significant transaction; and
(ii)for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

8.Mr. X owns 95% of entity A and is its director.He is also beneficiary of a trust that owns 100% of entity B, of which he is a director.
Whether entities A and B are related parties?
Would the situation be different if:
(a) Mr. X resigned as a director of entity A, but retained his 95% holding?
(b) Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust? (RTP Nov 20)

[video link: https://youtu.be/vDnh5xFJtKQ, time: 52:46]

Answer

Entities A and B are related parties, because the director (Mr. X) controls entity A and is a member of the key management personnel of entity B.

Answers to different given situations would be as under:

(a) Mr. X resigned as a director of entity A, but retained his 95% holdingMr. X continues to control entity A through his 95% holding even though he is not (nominally) a director of the entity. Entities A and B are related if Mr.X controls the trust.Mr. X controls entity A and also, through the trust, controls entity B. Entities A and B are controlled by the same person, and so they are related parties.

Mr. X might still be a member of 'key management personnel' even though he is not (nominally) a director of entity A. Key management personnel includes, but is not restricted to, directors, which include those who are executive 'or otherwise' provided they had authority and responsibility for planning, directing and controlling the activities of the entity. There could be two reasons why entities A and B would continue to be related parties: Mr.X being a member of 'Key management personnel' of entity Aand Mr.X controlling entity A.

(b)Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust.

If Mr. X controls the trust, he controls entities A and B through the trust, so they will be related parties (see reason in (a) above)Mr. X is a member of 'key management personnel' of the two entities (see (a) above) if, as seems likely, he continues to direct their operating and financial policies. The substance of the relationship and not merely the legal form should be considered. If Mr X is regarded as a member of the key management personnel of, say, entity A, entity B is a related party, because he exercises control or significant influence over entity B by virtue of his control over the trust.

1 (b) Mr. X has a 100% investment in A Ltd. He is also a member of the key management personnel (KMP) of B Ltd. B Ltd has a 100% investment in C Ltd.

Examine related party relationship of A Ltd., as per Ind AS 24, in the financial statements of C Ltd. (MTP Aug 2018)

Answer

Para 9 of Ind AS 24 defines the term "key management personnel" as persons having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly, including any director (whether executive or not). Further, significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Therefore, a key management personnel (KMP) has significant influence over the entity.
Accordingly, Mr. X has significant influence over B Ltd. since he is a key management personnel of B Ltd.
Now, para 9(vii) of the standard states that an entity is related to a reporting entity if the person identified in para 9(a)(i) (here KMP ie. Mr. X) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)"
Therefore, if C Ltd. is a reporting entity, A Ltd. is related to C Ltd. because a key management personnel of parent B Limited has control over A Limited. Therefore, the relationship of C Ltd. and A Ltd. will be "Entities controlled by key management personnel of the Parent Entity".

4b. Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.
Required
(a) Examine related party relationships from the perspective of C Limited for A Limited.
(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.
(c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

(d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited. (MTP Nov 21)

[video link: https://youtu.be/1DKSEXWBG1E, time: 46:15]

Answer

(a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.
(b) Still A Limited will be related to C Limited.
(c) No, Still A Limited will be related to C Limited.
(d) Yes, A Ltd. is not controlled by Mr. X. Therefore, despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.

11. Entity A owns 30% of the share capital of entity B and has the ability to exercise significant influence over it.

Entity B holds the following investments:

• 70% of the share capital of its subsidiary, entity C; and

• 30% of the share capital of entity D, with the ability to exercise significant influence.

Entity A transacts with entities C and D. Should entity A disclose these transactions as related party transactions in its separate financial statements? Also explain the disclosure of such transactions in the financial statements of C and D as related party transaction. (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=3947]

Answer

Entity A should disclose its transactions with entity C in entity A's separate financial statements. Entity C is a related party of entity A, because entity C is the subsidiary of entity A's associate, entity B.

Entity A's management is not required to disclose entity A's transactions with entity D in its financial statements. Entity D is not a related party of entity A, because entity A has no ability to exercise control or significant influence over entity D.

Entity C is required to disclose its transactions with entity A in its financial statements, because entity A is a related partly.

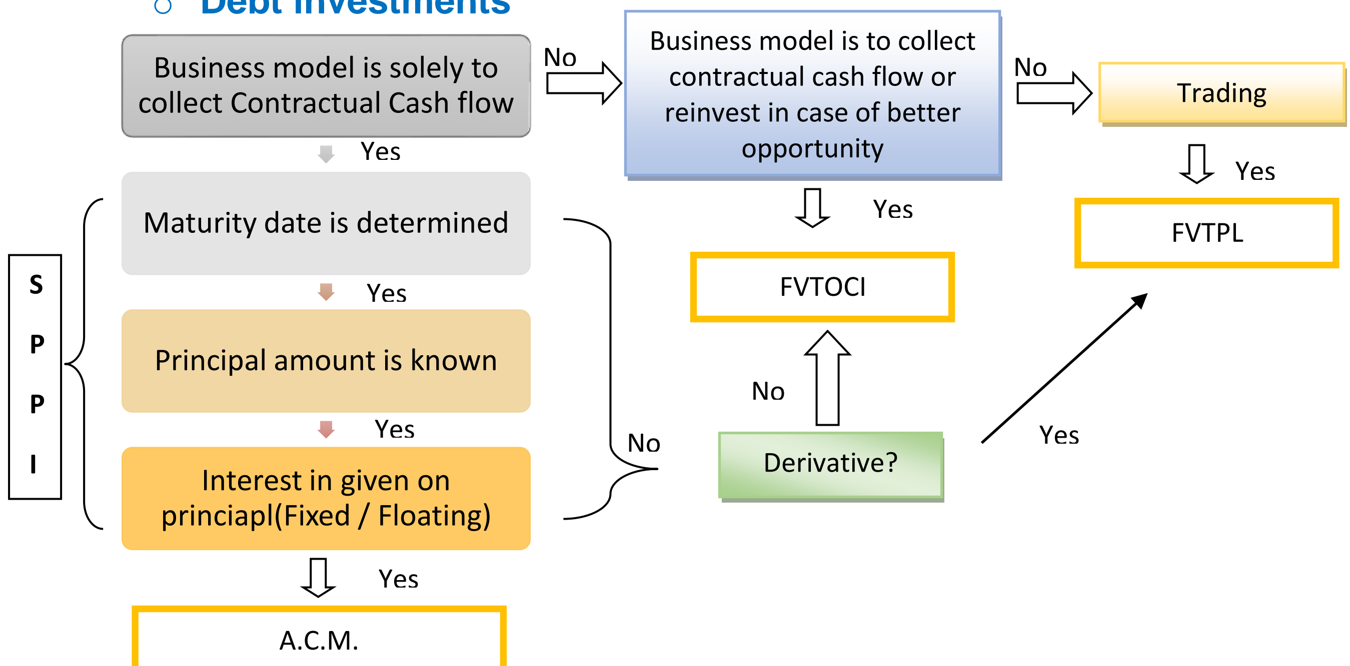
Entity D is not required to disclose transactions with entity A, because they are not related parties.

Financial Instruments

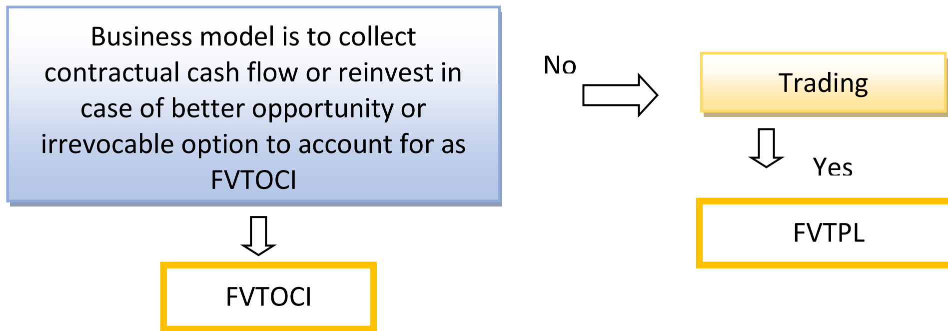
- Financial Instruments = FA for one entity and FL/Equity for another Entity FA = Unconditional right to receive Cash or Cash Equivalent or another FA
- FL = Unconditional obligation to pay cash or cash equivalent or another FA
- Equity = no obligation other than pro rata right over residual value at the time of liquidation
  - Also if satisfied fixed to fixed test, then equity

Fixed to fixed test		
Shares	Cash	Result
If fixed no. of shares issued today	Fixed amount to be received in future	Then Equity
If fixed no. of shares to be issued in future	Fixed amount received today	Then Equity
If fixed no. of shares to be issued in future	Fixed amount to be received in future	Then Equity
If any one of the two is variable in all three cases above		Then FL
Buyback all three conditions above if amount and equity is fixed		Then Equity
Buyback all three conditions above if amount or equity is variable		Then FA

- FA can be accounted using 3 methods – ACM / FVTPL / FVTOCI
- FL can be accounted using 2 methods – ACM / FVTPL
- Accounitng is decided using Business Model test and SPPI test
  - Debt investments



- Equity investments

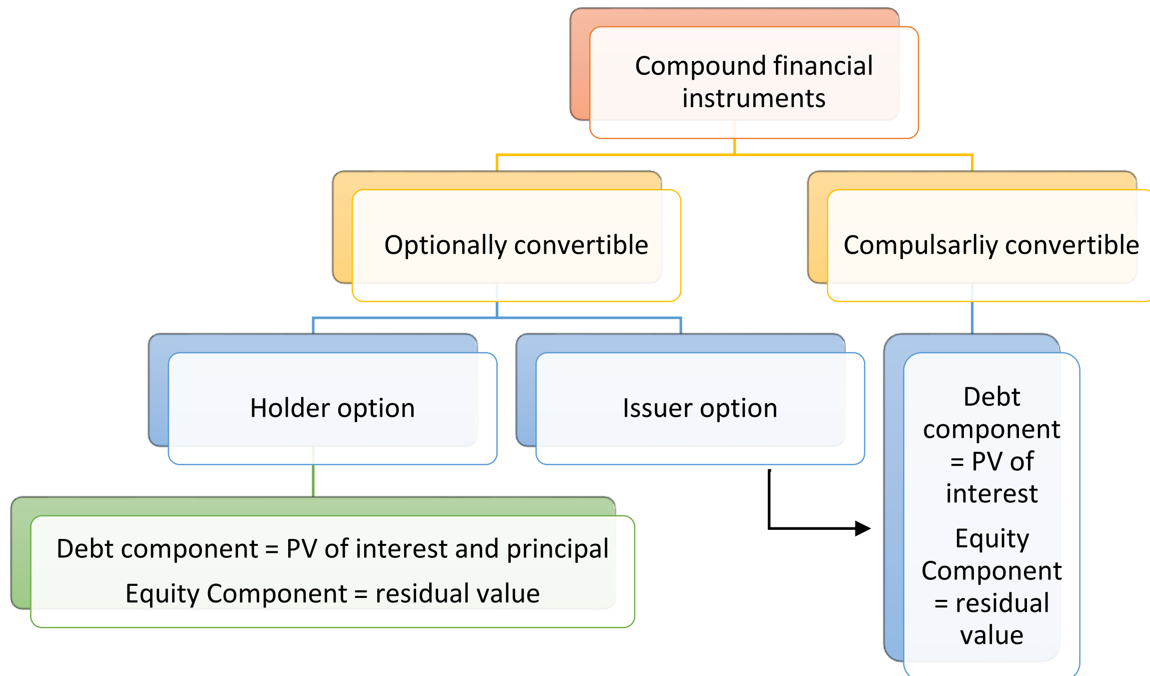


- **Exception rule to ACM accounting**
  - **Inflation linked bonds are accounted as ACM**
  - **Credit rating degradation leading to sale of investment are still accounted as ACM**
- **FVTOCI can be opted optionally by entity**
  - **Debt investments – Reclassifiable**
  - **Equity – non reclassifiable**

- **Accounitng**

	ACM	FVTOCI	FVTPL
Initial recognition	Fair value (PV of future inflow/outflow at market rate / EIR)		
Transaction cost	FA – Add FL - Deduct	FA – Add	Transfer to PL
Subsequent recognition • Interest • Fair value	At EIR (rate at which discounted above) in PL N.A.	At EIR (rate at which discounted above) in PL Transfer to OCI	All fair value diff transfer to PL
Sale	Diff in CA and FV transfer to PL	In case of Debt – Reclassify FV reserve t PL Equity – Transfer FV reserve to RE	All fair value diff transfer to PL

- **Note – Amount received / paid is deducted from FA / FL in ACM and FVTOCI**
- **FV and FVLCTS are two diff things, while determining fair value for subsequent recognition, IGNORE Transaction cost**
- **Compund financial instruments (issuer concept)**
  - **PV of obligation to pay is liability**
  - **Amt received less PV is Equity**



- **Reclassification of FA**
  - **Not permitted in case of FVTOCI irrevocable option Equity Investments**
  - **Allowed only if change in business model and business management**

• **ACM to FVTOCI** ○ **Recognize FV** ○ **Transfer Diff to OCI**	• **ACM to FVTPL** ○ **Recognize FV** ○ **Transfer diff to PL**
• **FVTPL to FVTOCI** ○ **Future fair value diff transfer to OCI**	• **FVTPL to ACM** ○ **Fair value on such date is deemed cost** ○ **MR on such date is deemed EIR**
• **FVTOCI to FVTPL** ○ **Future fair value diff transfer to PL** ○ **Existing OCI balance transfer to PL for debt investments or RE for equity investments**	• **FVTOCI to ACM** ○ **OCI is transfer to CA of investments** ○ **Interest is accounted at original EIR**

- **Financial Guarantee (from angle of entity who issues guarantee)**

	Journal Entry
Initial Recognition **Loan Amount * (Market rate – Guarantee rate) * PVAF(yrs, MR)**	**Cash / Investment dr.** **To Provision for guarantee**
Subsequent recognition **Determine lower of 2 (New Carrying amount)** 1. **Loan Amount * (Market rate above – Guarantee rate) * PVAF(remaing years, MR above)** 2. **Loan amount * Probability of default * Loss given default**	**Difference of initial and subsequent recognition transfer to PL** **If subsequent value is lower** **Provision for guarantee dr** **To other income** **If subsequent value is higher** **PL dr** **To Provision for guarantee**

- Modification vs Extinguishment – only for FL

<table>
<tr><td colspan="2">Determine PV of revised cash flow at original EIR – Carrying Amount * 100
Carrying Amount
PV of EIR above will include legal fees if any charged</td></tr>
<tr><td>If >=10%</td><td>Extinguishment
• Derecognize old loan carrying amount
• Recognize new loan at PV of revised cash flow at MR
• Legal fees if any charged to PL (not adjusted in PV above)
• Balancing figure transfer to PL</td></tr>
<tr><td>If < 10%</td><td>Modification
• Carrying amount will not change
• Legal fees if any deducted from carrying amount of loan
• EIR for future interest exp booking to be revised (will be given)</td></tr>
</table>

- FL – Own credit impairment
  - If FL is accounted as FVTPL
  - Our credit rating is impaired
  - Loss due to credit impairment is booked in OCI
  - Other losses recorded in PL
- Sale of FA with recourse
  - Debit Cash received
  - Debit guaranteed asset value
  - Credit Asset
  - Credit Assocaited liability being sum of fair value of guarantee and amount guaranteed)
  - Balancing figure transfer to PL
- Derivatives - Own use exemption
  - Physical delivery of FA – covered in Ind AS 109
  - Physical delivery of Non-FA – not covered under Ind AS 109
  - Net settlement – covered under Ind AS 109
  - Open ended – based on past experience account as per above

Basic

2. (b) Which of the following would meet and not meet the definition of financial instruments and fall outside the scope of Ind AS 32?

(1) Cash deposited in banks

(2) Gold deposited in banks

(3) Trade receivables

(4) Investments in debt instruments

(5) Investments in equity instruments

(6) Prepaid expenses

(7) Inter-corporate loans and deposits

(8) Deferred revenue

(9) Tax liability

(10) Provision for estimated litigation losses. (MTP Oct 21)

[video link: https://youtu.be/sjJB6IjiZGM?t=2336]

Answer

Table showing classification of various items:

S. No. Item	Classification
(1) Cash deposited in banks	Financial Instrument
(2) Gold deposited in banks	Not a financial instrument
(3) Trade receivables	Financial Instrument
(4) Investments in debt instruments	Financial Instrument
(5) Investments in equity instruments	Financial Instrument
(6) Prepaid expenses	Not a financial instrument
(7) Inter-corporate loans and deposits	Financial Instrument
(8) Deferred revenue	Not a financial instrument
(9) Tax liability	Not a financial instrument
(10) Provision for estimated litigation losses	Not a financial instrument

Lease security deposit

6(c)Make necessary journal entries for accounting of the security deposit made by Admire Ltd.,whose details are described below. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of Security Deposit (Starting Date)	**1st April,2014**
Date of Security Deposit (Finishing Date)	**31st March, 2019**
Description	**Lease**
Total Lease Period	**5 years**
Discount rate	**12%**
Security deposit (A)	**20,00,000**

Present value factor at the 5th year 0.567427 (Exam Nov 19) / (Exam Dec 21)

[video link: https://youtu.be/1FdEXD0O35g?t=121]

Answer

The above security deposit is an interest free deposit redeemable at the end of lease term for `20,00,000. Hence, this involves collection of contractual cash flows and shall be accounted at amortised cost.

Upon initial measurement

Particulars	Details
Security deposit (A)	20,00,000
Total lease period (Years)	5
Discount rate	12.00%
Present value annuity factor	0.567427
Present value of deposit at beginning	(B)11,34,854
Prepaid lease payment at beginning (A-B)	8,65,146

Journal entry at initial recognition

Security deposit A/c Dr.	11,34,854
Prepaid lease expenses A/c Dr.	8,65,146
To Bank A/c	20,00,000

Subsequently, every annual reporting year, interest income shall be accrued@ 12% per annum and prepaid expenses shall be amortised on straight line basis over the lease term.

Preference shares

3(a) S Limited issued redeemable preference shares to its Holding Company -H Limited. The terms of the instrument have been summarized below. Analyse the given situation, applying the guidance in Ind AS 109 'Financial Instruments', and account for this in the books of H Limited.

Nature	**Non-cumulative redeemable preference shares**
Repayment	**Redeemable after 3 years**
Date of Allotment	**1st April 2015**

Date of Repayment **31st March 2018**

Total Period **3 Years**

Value of Preference Shares issued **5,00,00,000**

Dividend Rate **0.0001% Per Annum**

Market rate of interest **12% Per Annum**

Present value factor **0.7118 (Exam May 18)**

[video link: https://youtu.be/1FdEXD0O35g?t=921]

Answer

(a)1.Analysis of the financial instrument issued by S Ltd. to its holding company H Ltd.

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

For example, a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument.

In the above case, since S Ltd has issued preference shares to its Holding Company–H Ltd, the relationship between the parties indicates that the difference in transaction price and fair value is akin to investment made by H Ltd. in its subsidiary. This can further be substantiated by the nominal rate of dividend i.e.0.0001% mentioned in the terms of the instrument issued.

Computations on initial recognition:

Transaction value of the Redeemable preference shares	5,00,00,000
Less: Present value of loan component @ 12%	
(5,00,00,000 x .7118)	(3,55,90,000)
Investment in subsidiary	1,44,10,000

Subsequently, such preference shares shall be carried at amortised cost at each reporting date as follows:

Year	Date	Opening Balance	Interest @ 12%	Closing balance

	1.4.2015	355,90,000	-	355,90,000
1	31.3.2016	355,90,000	42,70,800	398,60,800
2	31.3.2017	398,60,800	47,83,296	446,44,096
3	31.3.2018	446,44,096	53,55,904	500,00,000

* `4,46,44,096x 12% = `53,57,292. The difference of `1,388 (`53,57,292 – `53,55,904) is due to approximation in present value factor.

2. In the books of H Ltd.

Journal Entries to be done at every reporting date

Date	Particulars	
1st April, 2015	Investment (Equity portion)Dr.	1,44,10,000
	Redeemable Preference Shares Dr.	3,55,90,000
	To Bank	5,00,00,000

(Being initial recognition of transactionrecorded)

31st March, 2016	Redeemable Preference SharesDr.	42,70,800
To Interest income		42,70,800

(Being interest income on loan component recognized)

31st March, 2017	Redeemable Preference SharesDr.	47,83,296
	To Interest income	47,83,296

(Being interest income on loan component recognized)

31st March, 2018	Redeemable Preference Shares Dr.	53,55,904
	To Interest income	53,55,904

(Being interest income on loan component recognized)

31st March, 2018	Bank Dr.	5,00,00,000
To Redeemable PreferenceShares		5,00,00,000

(Being settlement of transaction done at the end of the third year)

Processing fees adjustment

(b) ABC Bank gave loans to a customer – Target Ltd. that carry fixed interest rate @ 10% per annum for a 5 year term and 12% per annum for a 3 year term. Additionally, the bank charges processing fees @1% of the principal amount borrowed. Target Ltd borrowed loans as follows:

- 10 lacs for a term of 5 years

- 8 lacs for a term of 3 years.

Compute the fair value upon initial recognition of the loan in books of Target Ltd. and how will loan processing fee be accounted? (MTP April 2021)

[video link: https://youtu.be/ssByAq0-xS8?t=1472]

Answer

The loans from ABC Bank carry interest @ 10% and 12% for 5 year term and 3 year term respectively. Additionally, there is a processing fee payable @ 1% on the principal amount on date of transaction. It is assumed that ABC Bank charges all customers in a similar manner and hence this is representative of the market rate of interest.

Amortised cost is computed by discounting all future cash flows at market rate of interest. Further, any transaction fees that are an integral part of the transaction are adjusted in the effective interest rate and recognised over the term of the instrument.

Hence loan processing fees shall be reduced from the principal amount to arrive the value on day 1 upon initial recognition.

Fair value (5 year term loan) = 10,00,000 – 10,000 (1% x 10,00,000) = 9,90,000

Fair value (3 year term loan) = 8,00,000 – 8,000 (1% x 8,00,000) = 7,92,000.

Now, effective interest rate shall be higher than the interest rate of 10% and 12% on 5 year loan and 3 year loan respectively, so that the processing fees gets recognised as interest over the respective term of loans.

Premium adjustment under ACM

4. (a)XYZ issued Rs. 4,80,000 4% redeemable preference shares on 1st April 20X5 at par. Interest is paid annually in arrears, the first payment of interest amounting Rs. 19,200 was made on 31st March 20X6 and it is debited directly to retained earnings by accountant. The preference shares are redeemable for a cash amount of Rs. 7,20,000 on 31st March 20X8. The

effective rate of interest on the redeemable preference shares is 18% per annum. The proceeds of the issue have been recorded within equity by accountant as this reflects the legal nature of the shares. Board of directors intends to issue new equity shares over the next two years to build up cash resources to redeem the preference shares.

Mukesh, Accounts manager of XYZ has been told to review the accounting of aforesaid issue. CFO has asked from Mukesh the closing balance of preference shares at the year end. If you were Mukesh, then how much balance you would have shown to CFO on analysis of the stated issue. Prepare necessary adjusting journal entry in the books of account, if required. Analyze. (MTP March 2021) / (RTP May 20)

[video link: https://youtu.be/ssByAq0-xS8?t=1625]

Answer

The preference shares provide the holder with the right to receive a predetermined amount of a n n u a l dividend out of profits of the company, together with a fixed amount on redemption. Whilst the legal form is equity, the shares are in substance debt. The fixed level of dividend is interest and the redemption amount is equivalent to the repayment of a loan.Under Ind AS 32 'Financial Instruments: Presentation' these instruments should be classified as financial liabilities because there is a contractual obligation to deliver cash. The preference shares should be accounted for at amortised cost using the effective interest rate of 18% .

Year	1.04.20X5	Int @ 18%	Paid @ 4%	31.3.20X6
20X5-X6	480,000	86,400	(19,200)	547,200

Accordingly, the closing balance of Preference shares at year end i.e. 31st March, 20X6 would be Rs. 5,47,200

Accountant has inadvertently debited interest of Rs. 19,200 in the profit and loss. However, the interest of Rs. 86,400 should have been debited to profit and loss as finance charge.

Similarly, amount of Rs. 5,47,200 should be included in borrowings (non-current liabilities) and consequently, Equity should be reduced by Rs. 480,000 proceeds of issue and Rs. 67,200 (86,400 –19,200) i.e. total by 5,47,200.

Necessary adjusting journal entry to rectify the books of accounts will be:

	Dr.	Cr.
Preference share capital (equity) (Balance sheet)Dr.	4,80,000	
Finance costs (Profit and loss)Dr.	86,400	
To Equity –Retained earnings (Balance sheet)		19,200
To Preference shares (Long-term Borrowings) (Balance sheet)		5,47,200

Employee Loan accounting

5(a)On April 1, 20X1, Pluto Ltd. has advance a loan for Rs.10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. Rs.10 lakhs. T he interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. Rs.40,000 (Rs.10 lakhs x 4%).

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If no t, advise the correct treatment along with working for the same. (MTP March 2019) / (Exam Nov 20) / (MTP April 22)

[video link: https://youtu.be/DjYJygtmEqU?t=1489]

Answer

T he above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on Financial Instruments' and Ind AS 19 'Employee Benefits'.

Para 11 (c) (i) of Ind AS 32 'Financial Instruments : Presentation'states that: "A financial asset is any asset that is:

(c)a contractual right:

(i)to receive cash or....."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 states that:

"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or

reduction of income unless it qualifies for recognition as some other type of asset".

Further, paragraph 5.2.1 of Ind AS 109 states that:

"After initial recognition, an entity shall measure a financial asset at:

(a) amortised cost;

(b) fair value through other comprehensive income; or

(c) fair value through profit or loss.

Further, paragraph 5.4.1 of Ind AS 109 states that:

"Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset"

Paragraph 8 of Ind AS 19 states that:

"Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment".

The Accountant of Pluto Ltd. has recognisedthe staff loan in the balance sheet at Rs.10 lakhs being the amount disbursed and Rs.40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. T he interest income is calculated by using the effecti ve interest method. T he difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit andloss.

a)Calculation of Fair Value of the Loan

Year	Cash Inflow	PVF @ 10%	PV
1	240000	0.909	218160
2	232000	0.826	191632
3	224000	0.851	168224
4	216000	0.683	147528
5	208000	0.621	129168
			854712

Staff loan should be initially recorded at Rs.8,54,712.

b)Employee Benefit ExpenseLoan Amount –Fair Value of the loan = Rs.10,00,000 –Rs.8,54,712 = Rs.1,45,288Rs.1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.

Amortisation table:

Year	Opening balance of Staff Advance	Interest (10%)	Repayment	Closing balance of Staff Advance
1	854,712	85,471	240,000	700,183
2	700,183	70,018	232,000	538,201
3	538,201	53,820	224,000	368,021
4	368,021	36,802	216,000	188,823
5	188,823	19,177	208,000	Nil

Balance Sheet extracts showing the presentation of staff loan as at 31stMarch 20X2Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS

Assets

Non-Current Assets

Financial Assets

(i) Loan 5,38,201

CurrentAssets

Financial Assets

(i)Loans (7,00,183 -5,38,201) 1,61,982

4 (a) Lovely Limited has a policy of providing subsidized loans to its employees for the purpose of buying 2 Wheelers and 4 Wheelers vehicle.

Simran who is a Sales Executive, took a loan for a Four-wheeler vehicle from the Company. The following were the terms of the loan:

- Principal Amount : ` 9,00,000

- Interest: 5% p.a. for the First ` 3,00,000 and 8% p.a. for the remaining amount.

- Loan disbursed date: 1st April 2017

- Loan Tenure: 3 Years

- Pre-Payment : Full or Partial payment at the option of the employee.

- Simran shall remain in service till the term of the loan ends.

- The Principal amount should be recovered in 3 equal installments at the end of each year and will be first applied to 8% interest bearing principal.

- The accrued interest shall be paid on annual basis.

The market rate of a comparable loan available to Simran is 12 % per annum.
Following table shows the expected contractual cash flows from the loan given to Simran. (In `)

Date	Outflows	Principal	Interest Income 8%	Interest Income 5%	Principal Outstanding
01.04.2017	(9,00,000)				9,00,000
31.03.2018		3,00,000	48,000	15,000	6,00,000
31.03.2019		3,00,000	24,000	15,000	3,00,000
31.03.2020		3,00,000	-	15,000	-

Simran pre-pays ` 1,00,000 on 31st March, 2019.

Following table shows the actual cash flows from the loan, considering the prepayment on 31st March 2019.

Date	Outflows	Principal	Interest Income 8%	Interest Income 5%	Principal Outstanding
01.04.2017	(9,00,000)				9,00,000
31.03.2018		3,00,000	48,000	15,000	6,00,000
31.03.2019		4,00,000	24,000	15,000	2,00,000
31.03.2020		2,00,000	-	10,000	-

You are required to pass journal entries in the books of Lovely Limited considering the requirements of Ind AS 109. (Exam Jan 21) / MTP Oct 22

[video link: https://youtu.be/3zhr6lFu8NI?t=3703]

Answer

As per requirement of Ind AS 109, a financial instrument is initially measured and recorded at its fair value. Therefore, considering the market rate of interest of similar loan available to Simran is 12%, the fair value of the contractual cash flows shall be as follows:

Date	Principal	Interest Income 8%	Interest Income 5%	Total inflow	Discount factor @ 12%	PV
31.03.2018	3,00,000	48,000	15,000	3,63,000	0.893	324,159
31.03.2019	3,00,000	24,000	15,000	3,39,000	0.797	270,183
31.03.2020	3,00,000	-	15,000	3,15,000	0.712	224,280
Total						818,622

Benefit to Simran, to be considered as part of employee cost for Lovely Ltd. ` 81,378 (9,00,000 – 8,18,622).

The deemed employee cost is to be amortised over the period of loan i.e. the minimum period that Simran must remain in service.

The amortization schedule of the ` 8,18,622 loan is shown in the following table:

Amount in `

Date	Opening outstanding Loan	Total cash inflows (principal repayment + interest	Interest @ 12%	Closing outstanding Loan
1.04.2017	8,18,622			8,18,622
31.03.2018	8,18,622	3,63,000	98,235	5,53,857
31.03.2019	5,53,857	3,39,000	66,463	5,53,857
31.03.2020	2,81,320	3,15,000	33,680*	Nil

* Difference is due to approximation of discounting factor and interest amount.

Journal Entries to be recorded at every period end:

a. 1 April 2017 –

Loan to employee A/c Dr.	818622	
Pre-paid employee cost A/c Dr.	81378	
To Bank A/c		900000

(Being loan asset recorded at initial fair value)

b. 31 March 2018 –

Bank A/c Dr.	363000	
To Interest income A/c		98235
To Loan to employee A/c		264765

(Being first instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)

Employee benefit A/c Dr.	27126	
To Pre-paid employee cost A/c		27126

(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost on straight line basis)

c. On 31 March 2019, due to pre-payment of a part of loan by Simran, the carrying value of the loan shall be re-computed by discounting the future remaining cash flows by the original effective interest rate.

There shall be two sets of accounting entries on 31 March 2019, first the realisation of the contractual cash flow as shown below and then the accounting for the pre -payment of ` 1,00,000 included in (d) below:

31 March 2019 –

Bank A/c Dr. 339000

To Interest income A/c 66463

To Loan to employee A/c 272537

(Being second instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)

Employee benefit (profit and loss) A/c Dr. 27126

To Pre-paid employee cost A/c 27126

(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)

Computation of new carrying value of loan to employee:

Date	Principal	Interest income @ 8%	Interest income @ 5%	PVF @ 12%	PV
31.03.2020	200,000	-	10,000	0.893	187,530
Total (revised carrying value) Less: Current carrying value					1,87,530 (2,81,320)
Adjustment required					93,790

The difference between the amount of pre-payment and adjustment to loan shall be considered a gain, though will be recorded as an adjustment to pre -paid employee cost, which shall be amortised over the remaining tenure of the loan.

d. 31 March 2019 prepayment–

Bank A/c Dr. 100,000

To Pre-paid employee cost A/c 6210

To Loan to employee A/c 93,790

(Being gain to Lovely Limited recorded as an adjustment to pre-paid employee cost)

The amortisation schedule of the new carrying amount of loan shall be as follows:

Date	Loan outstanding	Total cash inflows (principal repayment + interest)	Interest @ 12%
31.03.2019	187,530		
31.03.2020		210,000	22,4470

Amortisation of employee benefit cost shall be as follows:

Date	Opening Balance	Amortised to P&L	Adjustment	Closing balance
01.04.2017	81,378			81,378
31.03.2018	81,378	27,126		54,252
31.03.2019	54,252	27,126	6,210	20,916
31.03.2020	20,916	20,916		Nil

e. 31 March 2020 –

Bank A/c Dr.	210,000	
To Interest income (profit and loss) @ 12% A/c		22,470
To Loan to employee A/c		187,530

(Being last instalment of repayment of loan accounted for using the amortised cost and effective interest rate of 12%)

Employee benefit (profit and loss) A/c Dr.	20,916	
To Pre-paid employee cost A/c		20,916

(Being amortization of pre-paid employee cost charged to profit and loss as employee benefit cost)

Loan to subsidiary or vice versa

3(c) KK Ltd. has granted an interest free loan of ` 10,00,000 to its wholly owned Indian Subsidiary YK Ltd. There is no transaction cost attached to the said loan. The Company has not finalised any terms and conditions including the applicable interest rates on such loans. The Board of Directors of the Company are evaluating various options and has requested your firm to provide your views under Ind AS in following situations:

(i) The Loan given by KK Ltd. to its wholly owned subsidiary YK Ltd. is interest free and such loan is repayable on demand.

(ii) The said Loan is interest free and will be repaya ble after 3 years from the date of granting such loan. The current market rate of interest for similar

loan is 10%. Considering the same, the fair value of the loan at initial recognition is `8,10,150.

(iii) The said loan is interest free and will be repaid as and when YK Ltd. has funds to repay the Loan amount. Based on the same, KK Ltd. has requested you to suggest the accounting treatment of the above loan in the stand-alone financial statements of KK Ltd. and YK Ltd. and also in the consolidated financial statements of the group. Consider interest for only one year on the above loan for the purpose of providing journal entries. (MTP Oct 2020) / (RTP May 19) / (MTP Oct 21) / (Exam Dec 21)

[video link: https://youtu.be/ssByAq0-xS8?t=77]

Answer

Scenario (i)

Since the loan is repayable on demand, it has fair value equal to cash consideration given. KK Ltd. and YK Ltd. should recognize financial asset and liability, respectively, at the amount of loan given (assuming that loan is repayable within a year). Upon, repayment, both the entities should reverse the entries that were made at the origination.

Journal entries in the books of KK Ltd.

At origination

Loan to YK Ltd. A/c Dr.	`10,00,000	
To Bank A/c		`10,00,000

On repayment

Bank A/c Dr.	`10,00,000	
To Loan to YK Ltd. A/c		`10,00,000

Journal entries in the books of YK Ltd.

At origination

Bank A/cDr.	`10,00,000	
To Loan from KK Ltd. A/c		`10,00,000

On repayment

Loan from KK Ltd. A/cDr.	`10,00,000	
To Bank A/c		`10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan receivable and loan payable will get set off.

Scenario (ii)

Applying the guidance in Ind AS 109, a 'financial asset' shall be recorded at its fair value upon initial recognition. Fair value is normally the transaction price. However, sometimes certain type of instruments may be exchanged at off market terms (ie, different from market terms for a similar instrument if exchanged between market participants).

If a long-term loan or receivable that carries no interest while similar instruments if exchanged between market participants carry interest, then fair value for such loan receivable will be lower from its transaction price owing to the loss of interest that the holder bears. In such cases where part of the consideration given or received is for som ething other than the financial instrument, an entity shall measure the fair value of the financial instrument. The difference in fair value and transaction cost will treated as investment in Subsidiary YK Ltd.

Both KK Ltd. and YK Ltd. should recognise financial asset and liability, respectively, at fair value on initial recognition, i.e., the present value of ` 10,00,000 payable at the end of 3 years using discounting factor of 10%. Since the question mentions fair value of the loan at initial recogniti on as ` 8,10,150, the same has been considered. The difference between the loan amount and its fair value is treated as an equity contribution to the subsidiary. This represents a further investment by the parent in the subsidiary.

Journal entries in the books of KK Ltd. (for one year)

At origination

Loan to YK Ltd. A/cDr.`8,10,150

Investment in YK Ltd. A/cDr.`1,89,850

To Bank A/c`10,00,000

During periods to repayment-to recognise interest

Year 1 –Charging of Interest

Loan to YK Ltd. A/cDr.`81,015

To Interest income A/c`81,015

Transferring of interest to Profit and Loss

Interest income A/cDr.`81,015

To Profit and Loss A/c`81,015

On repayment

Bank A/c Dr.`10,00,000

To Loan to YK Ltd. A/c` 10,00,000

Note-Interest needs to be recognised in statement of profit and loss. The same cannot be adjusted against capital contribution recognised at origination.

Journal entries in the books of YK Ltd. (for one year)

At origination

Bank A/cDr.` 10,00,000

To Loan from KK Ltd. A/c` 8,10,150

To Equity Contribution in KK Ltd. A/c` 1,89,850

During periods to repayment-to recognise interest

Year 1

Interest expense A/cDr.` 81,015

To Loan from KK Ltd. A/c` 81,015

On repayment

Loan from KK Ltd. A/cDr.` 10,00,000

To Bank A/c ` 10,00,000

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

Scenario (iii)

Generally, a loan which is repayable when funds are available, cannot be stated as loan repayable on demand. Rather the entity needs to estimate the repayment date and determine its measurement accordingly by applying the concept prescribed in Scenario (ii).

In the consolidated financial statements, there will be no entry in this regard since loan and interest income/expense will get set off.

In case the subsidiary YK Ltd. is planning to grant interest free loan to KK Ltd., then the difference between the fair value of the loan on initial recognition and its nominal value should be treated as dividend distribution by YK Ltd. and dividend income by the parent KK Ltd.

ACM vs FVTOCI vs FVTPL determination

2(b)Blueberry Ltd entered into the following transactions during the year ended 31stMarch,20X2:

(a) Entered into a speculative interest rate option costing Rs. 10,000 on 1stApril,20X0 to borrow Rs. 6,000,000 from Exon Bank commencing 30thJune,20X2for 6 months at 4%. The value of the option at 31stMarch.20X2was Rs.15,250.

(b)Purchased 6% debentures in Fox Ltd on 1stApril,20X1(their issue date) for Rs. 150,000 as an investment. Blueberry Ltd. intends to hold the debentures,until their redemption at a premium,in 5 years' time. The effective rate of interest of the bond is 8%.

(c) Purchased 50,000 shares in Cox Ltd on 1stOctober,20X2for Rs.3.50each as an investment. The share price on 31stMarch,20X2was Rs. 3.75.

Show the accounting treatment and relevant extracts from the financial statements for the year ended 31stMarch,20X2 of transactions related to financial instruments. Blueberry Ltd designates financial assets at fair value through Profit or loss onlywhen this is unavoidable. (MTP May 2020)

[video link: https://youtu.be/ssByAq0-xS8?t=825]

Answer

Balance Sheet as at 31stMarch, 20X2(Extracts)

Financial Assets:	Rs.
Interest rate option (W.N.1)	15,250
6% Debentures in Fox Ltd.(W.N.2)	1,53,000
Shares in Cox Ltd. (W.N.3)	1,87,500

Statement of Profit and Loss (Extracts)

Finance Income:	
Gain on interest rate option (W.N.1)	5,250
Effective interest on 6% Debentures (W.N.2)	12,000

WorkingNotes:

1.Interest rate option

This is a derivative and so it must be treated as at fair value through profit or loss

Initial measurement (at cost)

Financial AssetDr. 10,000

To CashA/c 10,000

At 31stMarch, 20X2

(Re-measured to fair value)

Financial Asset (Rs. 15,250 -Rs.10,000) Dr. 5,250

To Profit andloss A/c 5,250

Financial Assets (Rs.10,000 + Rs.5,250) = Rs.15,250 (Balance Sheet)

Gain on interest option = Rs.5,250 (Statement of Profit andLoss)

2.Debentures

On the basis of information provided, this can be treated as a held-to-maturity investment

Initial measurement (at cost)

Financial AssetDr. 1,50,000

To Cash A/c 1,50,000

At 31stMarch, 20X2(Amortized cost)

Financial Asset (Rs.1,50,000 x 8%)Dr. 12,000

ToFinance Income 12,000

Cash (Rs. 1,50,000 x 6%) Dr. 9,000

To Financial asset 9,000

Amortized cost at 31stMarch, 20X2(Rs. 150,000 + Rs. 12,000 –Rs. 9,000) = Rs. 153,000 (Balance Sheet)

Effective interest on 6% debenture = Rs. 12,000 (Statement of Profit and Loss)

3.Sharesin Cox Ltd.

These are treated as an available for sale financial asset (shares cannot normally beheld to maturity and they are clearly not loans or receivables)

Initial measurement (at cost)

Financial Asset (Rs.50,000 x Rs.3.50)Dr. 1,75,000

To Cash A/c 1,75,000

At 31stMarch, 20X2(Re-measured at fair value)

Financial Asset [(Rs.50,000 x 3.75)–1,75,000]Dr. 12,500

To Other EquityA/c 12,500

Shares in Cox Ltd (Rs.1,75,000 + Rs.12,500) = Rs.1,87,500 (Balance Sheet)

6cCroton Limited is engaged in the business of trading commodities. T he company's main asset are investments in equity shares, preference shares, bonds, non-convertible debenture (NCD) and mutual funds.
The Company collects the periodical income (i.e. interest, dividend, etc.) from the investments and regularly sells the investment in case of favouable market conditions.
Such investments have been classified as non-current investments in the financial statements.
Also, the company buys and sells equity shares of companies for earning short term profits from the stock market.
The CFO of company classified all the non-current investments as Fair Value Through Other Comprehensive Income (FVTOCI) and all the current investment as Fair value Through Profit and Loss (FVTPL).
Croton Limited raised the following queries:
(a) Can the Company classify the equity shares previously held under current investment as FVTOCI if the company decides to hold them for more than one-year (i.e. classify it as non-current)?
(b) The Company had classified NCDs with a maturity period of less than twelve months from the reporting period as current. This has been classified as FVTPL by the CFO of the company. The Company wants to know whether these NCDs can be recognized as FVTOCI?
[video link: https://youtu.be/ssByAq0-xS8?t=2203]
Answer

(a)It seems that the equity shares are acquired for the purpose of selling it in the near term and therefore are held for trading. Such investments have been appropriatel y classified as subsequently measured at fair value through profit or loss. Such investments in equity shares cannot be classified as subsequently measured at fair value through other comprehensive income. T he option to measure investment in equity shares at fair value through other comprehensive income has to be made at initial recognition. T herefore, equity shares that were held for trading previousl y cannot be reclassified to fair value through other comprehensive income due to change in business model to not held for trading.

(b)In absence of contractual terms of NCDs, it is assumed that the contractual terms give rise on specified dates to cash flows that are solely payment of principal and interest on the principal outstanding. T he business model also includes sales of these instruments on a regular basis. Hence, these instruments will be classified as FVT OCI. T herefore, such NCD investments shall be classified as subsequentl y measured at Fair Value through Other Comprehensive

Income. T he classification does not change based on whether the investment is current or non-current as the end of the reporting period. It seems the company has previously classified these investments at fair value through profit or loss. T he company must rectify this by reclassifying as FVT OCI.

FVTOCI and impairment

5(b) An entity purchases a debt instrument with a fair value of Rs. 1,000 on 15th March, 20X1 and measures the debt instrument at fair value through other comprehensive income. The instrument has an interest rate of 5% over the contractual term of 10 years, and has a 5% effective interest rate. At initial recognition, the entity determines that the asset is not a purchased or original credit-impaired asset.

On 31st March 20X1 (the reporting date), the fair value of the debt instrument has decreased to Rs. 950 as a result of changes in market interest rates. The entity determines that there has not been a significant increase in credit risk since initial recognition and that ECL should be measured at an amount equal to 12 month ECL, which amounts to Rs. 30.

On 1st April 20X1, the entity decides to sell the debt instrument for Rs. 950, which is its fair value at that date.

Pass journal entries for recognition, impairment and sale of debt instruments as per Ind AS 109. Entries relating to interest income are not to be provided. (MTP March 2021) / (RTP Nov 19)

[video link: https://youtu.be/ssByAq0-xS8?t=1930]

Answer

On Initial recognition

Financial asset-FVOCIDr.	1,000	
To Cash		1,000

On Impairment of debt instrument

Impairment expense (P&L)Dr.	30	
Other comprehensive incomeDr.	20	
To Financial asset-FVOCI		50

The cumulative loss in other comprehensive income at the reporting date was Rs. 20. That amount consists of the total fair value change of Rs. 50 (that is, Rs. 1,000-Rs. 950) offset by the change in the accumulated impairment amount representing 12-month ECL, that was recognized (Rs. 30).

On Sale of debt instrument

Cash	950	
To Financial asset –FVOCI		950
Loss on sale (P&L)	20	
To Other comprehensive income		20

Impairment

18. On 1st April, 20X1 an entity granted an interest-free loan of ` 5,00,000 to an employee for a period of three years. The market rate of interest for similar loans is 5% per year.

On 31st March, 20X3, because of financial difficulties, the employee asked to extend the interest-free loan for further three years. The entity agreed. Under the restructured terms, repayment will take place on 31st March, 20X7. However, the entity only expects to receive a payment of ` 2,50,000, given the financial difficulty of the employee.

Explain the accounting treatment on initial recognition of loan and after giving effect of the changes in the terms of the loan as per Ind AS 109. Support your answer with Journal entries and amortised cost calculation, as on the date of initial recognition and on the date of change in terms of loan. (RTP Nov 22)

Answer

As the loan is not at a market interest rate, hence it is not recorded at the transaction price of ` 5,00,000. Instead, the entity measures the loan receivable at the present value of the future cash inflows discounted at a market rate of interest available for a similar loan.
The present value of the loan receivable (financial asset) discounted at 5% per year is ` 5,00,000 ÷ $(1.05)^3$ = ` 4,32,000. Therefore, ` 4,32,000 is recorded on initial measurement of the loan receivable. This amount will accrete to ` 5,00,000 over the three-year term using the effective interest method.

The difference between ` 5,00,000 and ` 4,32,000 i.e., ` 68,000 is accounted for as prepaid employee cost in accordance with Ind AS 19 'Employee Benefits', which will be deferred and amortised over the period of loan on straight line basis.

The journal entries on initial recognition are:
Loan receivable (financial asset) Dr. 4,32,000

Prepaid employee cost (asset) Dr. 68,000

To Cash / Bank (financial asset) 5,00,000

(Being loan granted to the employee recognised)

The amortised cost calculation at 1st April, 20X1 is as follows:

Period	Carrying amount at 1st April	Interest at 5%	Cash inflow	Carrying amount at 31st March
20X1-20X2	432,000	21,600		453,600
20X2-20X3	453,600	22,680		476,280
20X3-20X4	476,280	23,720	(500,000)	-

*Difference of ` 94 (` 23,814 – ` 23,720) is due to approximation.

On 31st March, 20X3, the carrying amount of the loan receivable is ` 4,76,280.

As a result of that modification, on 31st March, 20X3, the present value of estimated cash flows is recalculated to be ` 2,05,750 using the asset's original effective interest rate of 5% (` 2,50,000 ÷ $(1.05)^4$).

An impairment loss of ` 2,70,530 (` 4,76,280 – ` 2,05,750) is recognised in profit or loss in the year 20X2-20X3.

The carrying amount of the loan receivable may be reduced directly, as follows:

Profit or loss - impairment loss Dr. 2,70,530

To Loan receivable 2,70,530

(Being impairment loss recognised)

In this case, the loan receivable will be measured at ` 2,05,750 at 31st March, 20X3.

The revised amortised cost calculation at 1st April, 20X3 is as follows:

Period	Carrying amount at 1st April	Interest at 5% (the original effective interest rate)	Cash inflow	Carrying amount at 31st March
20X3-20X4	205,750	10,288		216,038
20X4-20X5	216,038	10,802		226,840
20X5-20X6	226,840	11,342		238,182
20X6-20X7	238,182	11,818	(250,000)	-

ACM and CFI

3(b)(1) QA Ltd. issued 10,00,000 of 8% Long T erm bond-A Series of Rs.1 each on 1stApril, 2016. T he bond tenure is 3 years. Interest is payable annually on 1stApril each year. T he investors expect an effective interest rate on the loan at 10%. QA Ltd. wants you to suggest the suitable accounting entries for the issue of these bonds as per applicable Ind AS. Consider the discounting factor 3 years, 10% discounting factor is 0.751315 and 3 years cumulative discounting factor is 2.48685.

(i) What is the principal value of the bond at the initial recognition at the time of issue of bond as per applicable Ind AS?

(ii) What is the present value of the interest payment to be recognised as part of the sale price of the bond as per applicable Ind AS?

(iii) What are the proceeds of the sale of the bond to be recognized at the time of initial recognition as per applicable Ind AS?

(iv) What is the accounting entry tobe passed at the time of accounting for payment of interest for the first year?

(2) QA Ltd. has also issued 10,00,000 of 8% Long T erm Bond-B Series of Rs.1 each on 1stApril, 2016. T he bond tenure is 3 years. Interest is payable annually on 1stApril each year. However, the bond holders of this series are entitled to convert the bonds to share s of Rs.1 each on the date of maturity, instead of receiving the principal repayment. Intere st rate on the similar bond without conversion option is 10%. QA Ltd. has requested you to suggest the following for this type of instrument:

(a) What is entry to be passed at the date of issuance of the bond as per applicable Ind AS?

(b) What is entry to be passed at the date of conversion of the bond as per applicable Ind AS? (MTP March 2019)

[video link: https://youtu.be/kH7V-tjbpoA?t=1667]

Answer

(1)(i)Option (C) : Rs. 7,51,315

(ii)Option (C) : Rs. 1,98,948

(iii)Option (B) : Rs. 9,50,263

(iv)Option (B) : Bond Interest Expenses A/c Dr. Rs. 95,026

T o Discount on Bond A/s Rs. 15,026

T o Cash/Bank A/c Rs. 80,000

Workings for the above

Since the Effective interest rate on the loan is 10% while theBond has been issued at 8%, the financial liability will be recognized at fair value determined as follows:

Calculation of initial recognition amount of 8% Long term Loan Bond A Series

Particulars	Rs.
Present value of the principal repayable after 3 years	
(10,00,000 x .751315)	751,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]	198,948
T otal Present Value of Long term Loan Bond	9,50,263

Interest for the first year recognized in the books as per effective interest rate method = Rs.9,50,263 x 10% = Rs. 95,026

However, interest paid is @ 8% i.e. Rs. 10,00,000 x 8% = Rs. 80,000

(2)(a)Option (B) : Cash/Bank A/cRs.	10,00,000	
T o 8% LT Bond Series B A/cRs.		9,50,263
T o Share Option A/cRs.		49,737

Workings for the above

It is a compound instrument.

Calculation of initial recognition amount of 8% Long term Loan Bond B Series liability and equity component

Particulars		Rs.
Present value of the principal repayable after 3 years		
(10,00,000 x .751315)		721,315
Present value of Interest [(10,00,000 x 8%) x 2.48685]		198,948
T otal Present Value of Long term Loan Bond B	I	
Issue proceeds from convertible bond	II	950,263
Value of equity component (II –I)		10,00,000
		49,737

(b) 8% LT Bond Series B A/c	Rs. 10,00,000
Share Option A/c	Rs. 49,737

T o Share Capital A/c	Rs. 10,00,000
To Share Premium A/c	Rs. 49,737

Reasoning:

As per para AG32 of Ind AS 32, on conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. T he original equity component remains as equity (although it may be transferred from one line item within equity to another). T here is no gain or loss on conversion at maturity.

Compound Financial Instruments

6(b)On 1 April 2018, an 8% convertible loan with a nominal value of Rs.6,00,000 was issued at par. It is redeemable on 31 March 2022 also at par. Alternativel y, it may be converted into equity shares on the basis of 100 new shares for each Rs.200 worth of loan. An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs.48,000 has already been paid and included as a finance cost. How will the Company present the above loan notes in the financial statements for the year ended 31 March 2 019? (MTP March 2019)

[video link: https://youtu.be/kH7V-tjbpoA?t=2390]

Answer

Step 1 There is an 'option' to convert the loans into equity i.e. the loan note holders do not have to accept equity shares; they could demand repayment in the form of cash.

Ind AS 32 states that where there is an obligation to transfer economic benefits there should be a liability recognised. On the other hand, where there is not an obligation to transfer economic benefits, a financial instrument should be recognised as equity.

In the above illustration we have both –'equity' and 'debt' features in the instrument. There is an obligation to pay cash –i.e. interest at 8% per annum and a redemption amount –this is 'financial liability' or 'debt component'. The 'equity' part of the transaction is the option to convert. So it is a compound financial instrument.

Step 2

Debt element of the financial instrument so as to recognise the liability is the presentvalue of interest and principal T he rate at which the same is to be

discounted, is the rate of equivalent loan note without the conversion option would have carried interest at 10%, therefore this is the rate to be used for discounting

Step 3 Calculation of the debt element of the loan note as follows: 8% Interest discounted at a rate of 10% Present Value (6,00,000 x 8%)

Year	Interest Amount	PVF	Amount
2019	48000	0.91	43680
2020	48000	0.83	39840
2021	48000	0.75	36063
2022	648000	0.68	440640
			560223
Initial Proceeds			600,000
Equity			39,777

Step 4

T he next step is to recognise the interest component equivalent to the loan that would carry if there was no option to cover. T herefore, the interest should be recognised at 10%. As on date Rs.48,000 has been recognised in the statement of profit and loss i.e. 6,00,000 x 8% but we have discounted the present value of future interest payments and redemption amount using discount factors of 10%, so the finance charge in the statement of profit and loss must also be recognised at the same rate i.e. for the purpose of consistency.

T he additional charge to be recognised in the income statement is calculated as:

Debt component of the financial instrument	Rs.5,60,000
Interest charge (5,60,000 x 10%)	Rs.56,000
Already charged to the income statement	(Rs.48,000)
Additional charge required	Rs.8,000

Journal Entries for recording additional finance cost for year ended 31 March 2019

Particulars		
Finance cost A/cDr.	8000	
T o Debt component A/c		8000

(Being interest recorded for difference between amount recorded earlier and that to be recorded per Ind AS 32)

4(b)D Ltd. issues preference shares to G Ltd. for a consideration of Rs.10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime up to a period of 3 years. If the option is not exercised by the holder, the preference shares are redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a.The prevailing market rate for similar preference shares, without the conversion feature or issuer's redemption option, is RBI base rate plus 4% p.a. On the date of contract, RBI base rate is 9% p.a.Calculate the value of the liability and equity components. (MTP May 2020) / (Exam July 2021) / (RTP May 2022)

[video link: https://youtu.be/kH7V-tjbpoA]

Answer

The values of the liability and equity components are calculated as follows:

Present value of principal payable at the end of 3 years (Rs.10 lakhs discounted at 13% for 3 years) = Rs.6,93,050

Present value of interest payable in arrears for 3 years (Rs.100,000 discounted at 13% for each of 3 years) = Rs.2,36,115

Paragraph AG31 of Ind AS 32 states that a common form of compound financial instruments is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary sharesof the issuer, and without any other embedded derivatives features.

The liability component = Present value of principal + Present value of Interest

= Rs.6,93,050 + Rs.2,36,115 = Rs.9,29,165

Equity Component = Rs.10,00,000 –Rs.9,29,165 = Rs.70,835

2(a)Vedika Ltd. issued 80,000 8% convertible debenturesof`100 each on 1st April, 2015. The debentures are due for redemption on 31st March,2019 at a premium of 20%, convertible into equity shares to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentureswithout conversion right was 12%. The conversion to equity qualifies as fixed for fixed.You are required to separate the debt and equity components at the time of issue and show the accounting entries in Vedika Ltd.'s books at initial recognition only. (Exam Nov 19)

[video link: https://youtu.be/DjYJygtmEqU?t=2738]

Answer

Computation of debt component of convertible debentures on 1st April,2015

Particulars	Amount(`)
Present value of principal amount repayable after 4 years	
(A)80,00,000 x 50% x 120% x 0.625 (12% discount factor)	30,00,000
(B)Present value of interest [8,00,000 x 80% x 3.001]	
(4 years cumulative 10% discount factor)	19,20,640
Total present value of debt component (A) + (B)	49,20,640
Issue proceeds from convertible debentures	80,00,000
Value of equity component	30,79,360

Journal entry at initial recognition

Particulars		
Bank A/cDr.	80,00,000	
To 8% Debentures A/c (liability component)		49,20,640
To 8% Debentures A/c (equity component)		30,79,360
(Being disbursement recorded at fair value)		

Note: The question has been solved on the basis of the discounting factors given in the question.

5.(a)(i)On 1stApril, 2014, S Ltd. issued 5,000, 8% convertible debentures with a face value of Rs. 100 each maturing on 31stMarch, 2019. The debentures are convertible into equity shares of S Ltd. at a conversion price of Rs. 105 per share.Interest is payable annually in cash. At the date of issue, S Ltd. could have issued non-convertible debentures with a 5 year term bearing a coupon interest rate of 12%.

On 1stApril, 2017, the convertible debentures have a fair value of Rs. 5,25,000. S Ltd. makes a tender offer to debenture holders to repurchase the debentures for Rs. 5,25,000, which the holders accepted. At the date of repurchase, S Ltd. could have issued non-convertible debt with a 2 year term bearing a coupon interest rate of 9%.Examine the accounting treatmentin the books of S Ltd.,by passing appropriate journalentries,for recording of equity and liability component:

(1)At the time of initial recognition and

(2)At the time of repurchase of the convertible debentures (MTP Aug 2018) / (MTP April 2019)/ (MTP Oct 2020) / (RTP Nov 21)

[video link: https://youtu.be/kH7V-tjbpoA?t=75]

Answer

(A)(i)At the time of initial recognition Rs.

Liability component

	Rs.
Present value of 5 yearly interest payments of Rs.40,000, discounted at 12% annuity (40,000 x 3.605)	1,44,200
Present value of Rs.5,00,000 due at the end of 5 years, discounted at 12%, compounded yearly (5,00,000 x 0.567)	2,83,500
	4,27,700
Equity component(Rs.5,00,000 –Rs.4,27,700)	72,300
Total proceeds	5,00,000

Note: Since Rs.105 is the conversion price of debentures into equity shares and not the redemption price, the liability component is calculated @ Rs.100 each only.

Journal Entry

Bank Dr.	5,00,000	
T o 8% Debentures (Liability component)		4,27,700
T o 8% Debentures (Equity component)		72,300

(Being Debentures are initially recorded a fair value)

(ii)At the time of repurchase of convertible debentures

The repurchase price is allocated as follows:

	Carrying Value @ 12%	Fair Value @ 9%	Difference
Liability component Present value of 2 remaining yearly interest payments of Rs.40,000, discounted at 12% and 9%, respectively	67,600	70,360	
Present value of Rs.5,00,000 due in 2 years, discounted at 12% and 9%, compounded yearly, respectively	398,500	421,000	

Liability component Equity component (5,25,000 -4,91,360) Total	466,100 72,300 538,400	491,360 33640 525,000	(25,260) 38,660 13,400

*(5,25,000 –4,91,360) = 33,640

Journal Entries

8% Debentures (Liability component)Dr. 4,66,100

Profit and loss A/c (Debt settlement expense) Dr. 25,260

To Bank A/c 4,91,360

(Being the repurchase of the liability component recognised)

8% Debentures (Equity component)Dr. 72,300

T o Bank A/c 33,640

T o Reserves and Surplus A/c 38,660

(Being the cash paid for the equity component recognised)

6. On 1st April, 2X01, Entity X issued a 10% convertible debenture with a face value of` 1,000 maturing on 31st March, 2X11. The debenture is convertible into ordinary sharesof Entity X at a conversion price of ` 50 per share. Interest is payable yearly in cash.

On 1st April, 2X02, to induce the holder to convert the convertible debenture promptly, Entity X reduces the conversion price to ` 40 if the debenture is converted before 1st June, 2X02 (ie, within 60 days). The market price of Entity X's ordinary shares on the date the terms are amended is ` 80 per share. How will the revised terms be accounted? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=2398]

Answer

The fair value of the incremental consideration paid by Entity X is calculated as follows:
Number of ordinary shares to be issued to debenture holders under amended terms
Particulars
Face value ` 1,000

New conversion price ` 40 per share

Number of ordinary shares to be issued to debenture holders under amended terms (1,000 / ` 40) = 25 Shares

Number of ordinary shares to be issued to debenture holders under original terms

Face value ` 1,000

Original conversion price ` 50 per share

Number of ordinary shares to be issued to debenture holders under original terms (1,000 / ` 50) = 20 Shares

Number of additional shares to be issued to debenture holders under amended terms = 5 Shares

Value of additional shares upon conversion (to be recognised as loss in P&L) 5 shares x ` 80 per share ` 400

5(a) Perfect Ltd. issued 50,000 Compulsory Cumulative Convertible Preference Shares (CCCPS) as on 1st April, 2017 @ `180each. The rate of dividend is 10% payable at the end of every year. The preference shares are convertible into 12,500 equity shares (Face value `10 each) of the company at the end of 5thyear from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion option is 15% per annum.

Transaction cost on the date of issuance is 2% of the value of the proceeds. Effective Interest Rate is 15.86%. (Round off the figures to the nearest multiple of Rupee)

You are required to compute Liability and Equity Component and Pass Journal Entries for entire term of arrangement i.e. from the issue of Preference Shares till their conversion into Equi ty Shares. Keeping in vie w the provision s o f relevant Ind AS (Exam May 19) / (MTP Oct 21)

[video link: https://youtu.be/kH7V-tjbpoA]

Answer

This is a compound financial instrument with two components –liability representing present value of future cash outflows and balance represents equity component.

Total proceeds = 50,000 Shares x `180 each = `90,00,000

Dividend @ 10%= `9,00,000

Date	Particulars	Cash Flow	DCF	NPV
01-04-2017		0	1	0.00
31.03.2018	Dividend	900,000	0.8696	782640

31.03.2019 31.03.2020 31.03.2021 31.03.2022		900,000 900,000 900,000 900,000	0.7561 0.6575 0.5718 0.4971	680490 591750 514620 447390
Total Liability Component Total Proceeds				3016890 9000000
Total Equity component				5983110

b.Allocation of transaction costs

Particulars	Amount	Allocation	Net Amount
Liability Component Equity Component	3016890 5983110	60338 119662	2956552 5863448
Total Proceeds	90,00,000	180,000	88,20,000

c.Accounting for liability at amortised cost−Initial accounting = Present value of cash outflows less transaction costs−Subsequent accounting = At amortised cost, ie initial fair value adjusted for interest and repayments of the liability.

d. Journal Entries to be recorded for entire term of arrangement are as follows:

Date Particulars

01-Apr-2017 Bank A/c Dr. 88,20,000

To Preference Shares A/c 29,56,552

To Equity Component of Preference shares A/c58,63,448

(Being compulsorily convertible preference shares issued. T he same are divided into equity component and liability component as per the calculation)

31-Mar-2018 Preference shares A/cDr. 9,00,000

To Bank A/c 9,00,000

(Being dividend at the coupon rate of 10% paid to the shareholders)

31-Mar-2018 Financecost A/c Dr. 4,68,909

To Preference Shares A/c 4,68,909

(Being interest as per EIR method recorded)

31-Mar-2019 Preference shares A/cDr. 9,00,000

To Bank A/c 9,00,000

(Being dividend at the coupon rate of 10% paid to the shareholders)

31-Mar-2019 Finance cost A/cDr. 4,00,538
To Preference Shares A/c 4,00,538
(Being interest as per EIR method recorded)

31-Mar-2020 Preference shares A/cDr. 9,00,000
To Bank A/c 9,00,000
(Being dividend at the coupon rate of 10% paid to the shareholders)

31-Mar-2020 Finance cost A/cDr. 3,21,323
To Preference Shares A/c 3,21,323
(Being interest as per EIR method recorded)

31-Mar-2021 Preference shares A/cDr. 9,00,000
To Bank A/c 9,00,000
(Being dividend at the coupon rate of 10% paid to the shareholders)

31-Mar-2021 Finance cost A/cDr. 2,29,545
To Preference Shares A/c 2,29,545
(Being interest as per EIR method recorded)

31-Mar-2022 Preference shares A/cDr. 9,00,000
To Bank A/c 9,00,000
(Being dividend at the coupon rate of 10% paid to the shareholders)
31-Mar-2022 Finance cost A/cDr. 1,23,133
To Preference Shares A/c 1,23,133
(Being interest as per EIR method recorded)

31-Mar-2022	Equity Component of Preference shares A/cDr.	58,63,448
	To Equity Share Capital A/c	1,25,000
	To Securities Premium A/c	57,38,448

(Being preference shares converted in equity shares and remaining equity component is recognised as securities premium)

Modification vs. Extinguishment

5.(a)On 1 January 20X0, Preet Ltd.issues 10 year bonds for `10,00,000, bearing interest at 10% (payable annually on 31stDecember each year). The bonds are redeemable on 31 December 20X9for `10,00,000. No costs or fees are incurred. The effective interest rate is 10%. On 1 January 20X5(i.e. after 5 years) PreetLtd. and the bondholders agree to a modification in accordance with which:

•the term is extended to 31 December 20Y1;

•interest payments are reduced to 5% p.a.;

•the bonds are redeemable on 31 December 20Y1 for `15,00,000; and

•legal and other fees of `1,00,000 are incurred.

PreetLtd. determines that the market interest rate on 1 January 20X5for borrowings on similar terms is 11%.

Analyse whether the extinguishment accounting will apply or notas per Ind AS. If yes, determine the fair value of the modified liabilityand compute the gain or loss on modification (MTP March 2018)

[video link: https://youtu.be/1FdEXD0O35g?t=1674]

Answer

The repayment schedule for the original debt till the date of renegotiation is as below

Date / year ended	Opening balance	Interest accrual	Cash flows	Closing balance
1.01.20X0	10,00,000			10,00,000
31.12.20X0	10,00,000	1,00,000	(1,00,000)	10,00,000
31.12.20X1	10,00,000	1,00,000	(1,00,000)	10,00,000
31.12.20X2	10,00,000	1,00,000	(1,00,000)	10,00,000
31.12.20X3	10,00,000	1,00,000	(1,00,000)	10,00,000
31.12.20X4	10,00,000	1,00,000	(1,00,000)	10,00,000

On 1 January 20X5, the discounted present value of the remaining cash flows of the original financial liability is `10,00,000.

On this date, Preet Ltd. will compute the present value of:

•cash flows under the new terms –i.e. `15,00,000 payable on 31 December 20Y1 and `50,000 payable for each of the 7 years ending 31 December 20Y1.

•any fee paid (net of any fee received) –i.e. `1,00,000using the original effective interest rate of 10%.

The total of these amounts to `11,13,158 (Refer Working Note). This differs from the discounted present value of the remaining cash flows of the original financial liability by 11.32% i.e. by more than 10%. Hence, extinguishment accounting applies.

The next step is to estimate the fair value of the modified liability. This is determined as the present value of the future cash flows (interest and principal), using an interest rate of 11% (the market rate at which Preet Ltd. could issue new bonds with similar terms). The estimated fair value onthis basis is `958,097 (Refer Working Note). A gain or loss on modification is then determined as:

Gain (loss) = carrying value of existing liability -fair value of modified liability -fees and costs incurred i.e. `10,00,000 –`9,58,097 –`1,00,000= Loss of `58,097

Working Note:

Year	Discount factor @ 10%	Discount factor @ 11%
1	0.909091	0.900901
2	0.826446	0.811622
3	0.751315	0.731191
4	0.683013	0.658731
5	0.620921	0.593451
6	0.564474	0.534641
7	0.513158	0.481658
Annuity	4.868418	4.712195

Amount	Discounting factor @ 10%	Present value	Discounting factor @ 11%	Present value
15,00,000 100,000 50,000 for 7yrs	0.513158 4.868418	769,737 100,000 243,421	0.481658 4.712195	722,487 235610
		11,13,158		958,610

PV of original cash flows @ original EIR	10,00,000		
Difference	1,13,158	11.32%	

5.(a)Hello Limited borrowed Rs.500,000,000 from a bank on 1 January 2017. The original terms of the loan were as follows:

•Interest rate: 11%

•Repayment of principal in 5 equal instalments

•Payment of interest annually on accrual basis

•Upfront processing fee: Rs.5,870,096

Effective interest rate on loan: 11.50%

On 31 December 20X2, HelloLimited approached the bank citing liquidity issues in meeting the cash flows required for immediate instalments and re-negotiated the terms of the loan with banks as follows:

•Interest rate 15%

•Repayment of outstanding principal in 10 equal instalments starting 31stDecember 2018.

•Payment of interest on an annual basis

Record journal entries in the books of Hello Limited till 31stDecember 2018, after giving effect of the changes in the terms of the loan on 31stDecember 2017. (MTP Oct 2018) / (Exam Dec 21) / (MTP March 22)

[video link: https://youtu.be/DjYJygtmEqU?t=98]

Answer

On the date of initial recognition, the effective interest rate of the loan shall be computed keeping in view the contractual cash flows and upfront processing fee paid. The following table shows the amortisation of loan based on effective interest rate:

Date	Principal	Interest and fees	Amortized cost	Interest @ 11.5%
1.01.2016	(500,000,000)	5,870,096	494,129,904	
31.12.2016	100,000,000	55,000,000	395,954,843	56,824,939
31.12.2017	100,000,000	44,000,000	297,489,843	45,534,807
31.12.2018	100,000,000	33,000,000	198,700,959	34,211,310

31.12.2019	100,000,000	22,000,000	99,551,570	22,850,610
31.12.2020	100,000,000	11,000,000	0	11,448,430

a.1 January 2016

Particulars

Cash A/cDr. 494,129,904

To Loan from bank A/c 494,129,904

(Being loan recorded at its fair value less transaction costs on the initial recognition date)

b.31 December 2016

Loan from bank A/cDr. 98,175,061

Interest expense (profit and loss)Dr. 56,829,939

To Cash A/c 155,000,000

(Being first instalment of loan and payment of interest accounted for as an adjustment to the amortised cost of loan)

c.31 December 2017–Before HelloLimited approached the bank –

Interest expense (profit and loss)Dr. 45,534,807

To Loan from bank A/c 1,534,807

To cash A/c 44,000,000

(Being loan payment of interest recorded by the Company before it approached the Bank for deferment of principal)

Upon receiving the new terms of the loan, Hello Limited, re-computed the carrying value of the loan by discounting the new cash flows with the original effective interest rate and comparing the same with the current carrying value of the loan. As per requirements of Ind AS 109, any change of more than 10% shall be considered a substantial modification, resulting in fresh accounting for the new loan:

Date	Cash flows (principal)	Interest outflow @15%	Discount factor	PV of cash flows
31.12.2017	(400,000,000)		0	
31.12.2018	40,000,000	60,000,000	0.8969	89,686,099
31.12.2019	40,000,000	54,000,000	0.8044	75,609,805
31.12.2020	40,000,000	48,000,000	0.7214	63,483,092
31.12.2021	40,000,000	42,000,000	0.6470	53,053,542
31.12.2022	40,000,000	36,000,000	0.5803	44,100,068
31.12.2023	40,000,000	30,000,000	0.5204	36,429,133

31.12.2024	40,000,000	24,000,000	0.4667	29,871,422
31.12.2025	40,000,000	18,000,000	0.4186	24,278,903
31.12.2026	40,000,000	12,000,000	0.3754	19,522,235
31.12.2027	40,000,000	6,000,000	0.3367	15,488,493
PV of new contractual cash flows discounted at 11.50%				451,522,791
Carrying amount of loan				397,489,650
Difference				54,033,141
Percentage of carrying amount				13.59%

Note: Above calculation have been done on full decimal, though in the table discount factor is limited to 4 decimals.

Considering a more than 10% change in PV of cash flows compared to the carrying value of the loan, the existing loan shall be considered to have been extinguished and the new loan shall be accounted for as a separate financial liability. The accounting entries for the same are included below:

d.31 December 2017–accounting for extinguishment

Particulars		
Loan from bank (old) A/c Dr	397,489,650	
Finance cost (profit and loss)Dr	2,510,350	
To Loan from bank (new) A/c		400,000,000

(Being new loan accounted for at its principal amount in absence of any transaction costs directly related to such loan and correspondingly a de-recognition of existing loan)

e.31 December 2018

Loan from bank A/c Dr.	40,000,000	
Interest expense (profit and loss) Dr.	60,000,000	
To cash A/c		100,000,000

(Being first instalment of the new loan and payment of interest accounted for as an adjustment to the amortised cost of loan)

(c) A Ltd. (the 'Company') makes a borrowing for Rs. 10 lacs from RBC Bank, with bullet repayment of Rs. 10 lacs and an annual interest rate of 12% per annum. Now, Company defaults at the end of 5th year and consequently, a rescheduling of the payment schedule is made beginning 6th year onwards. The Company is required to pay Rs. 1,300,000 at the end of 6th year for one time settlement, in lieu of defaults in payments made earlier.

(a) Does the above instrument meet definition of financial liability? Please explain.

(b) Analyse the differential amount to be exchanged for one -time settlement (MTP April 2021)

[video link: https://youtu.be/DjYJygtmEqU?t=1949]

Answer

(a) A Ltd. has entered into an arrangement wherein against the borrowing, A Ltd. has contractual obligation to make stream of payments (including interest and principal). This meets definition of financial liability.

(b) Let's compute the amount required to be settled and any differential arising upon one time settlement at the end of 6th year –

- Loan principal amount = Rs. 10,00,000
- Amount payable at the end of 6th year = Rs. 12,54,400 [10,00,000 x 1.12 x 1.12 (Interest for 5th & 6th year in default plus principal amount)]
- One time settlement = INR 13,00,000
- Additional amount payable = Rs. 45,600

The above represents a contractual obligation to pay cash against settlement of a financial liability under conditions that are unfavorable to A Ltd. (owing to additional amount p ayable in comparison to amount that would have been paid without one time settlement). Hence the rescheduled arrangement meets definition of 'financial liability'.

FVTOCI and Foreign currency investment

11. An Indian entity, whose functional currency is rupees, purchases USD dominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = `40 and USD 1 = `45, respectively. The weighted average exchange ratefor the year is 1 USD = `42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees) (RTP Nov 20) / MTP OCT 22

[video link: https://youtu.be/YtrGC8vn8cU?t=2270]

Answer

Computation of amounts to be recognized in the P&L and OCI:

Particulars`		
Cost of the bond1,000 * 40		40,000
Interest accrued @ 10% p.a.100 * 42		4,200
Interest received (USD 1,250x 4.7%)	(59) * 45	(2,655)
Amortized cost at year-end 1,041 * 45		46,845
Fair value at year end1,060 * 45		47,700
Interest income to be recognized in P & L		4,200
Exchange gain on the principal amount [1,000 x (45-40)]		5,000
Exchange gain on interest accrual [100 x (45-42)]		300
Total exchange gain/loss to be recognized in P&L		5,300
Fair value gain to be recognized in OCI [45 x (1,060 -1,041)]		855

Journal entry to recognize gain/loss

Bond (`47,700 –`40,000) Dr.	7,700	
Bank (Interest received) Dr.	2,655	
To Interest Income (P & L)		4,200
To Exchange gain (P & L)		5,300
To OCI (fair value gain)		855

Derivative fixed to fixed test

Q5 (ii)On 1 January 2018, Entity X writes a put option for1,00,000 of its own equity shares for which it receives a premium of Rs.5,00,000.

Under the terms of the option, Entity X may be obliged to take delivery of 1,00,000 of its own shares in one year's time andto pay the option exercise

price of Rs.22,000,000. The option can only be settled through physical delivery of the shares (grossphysical settlement). Examine the nature of the financial instrumentand how it will be accountedassuming that the present value of option exercise price is Rs. 2,00,000? (MTP Aug 2018)

[video link: https://youtu.be/YtrGC8vn8cU?t=98]

Answer

This derivative involves Entity X taking delivery of a fixed number of equity shares for a fixed amount of cash. Even though the obligation for Entity X to purchase its own equity shares for Rs.22,000,000 is conditional on the holder of the option exercising the option, Entity X has an obligation to deliver cash which it cannot avoid.

As per para 23 of Ind AS 32 'Financial Instruments: Presentation', the accounting for financial instrument will be as below:

•The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity. This would imply that a financial liability for an amount of present value of Rs.22,000,000, say Rs.20,000,000 will be recognised through a debit to equity. The initial premium received (Rs.5,00,000) is credited to equity.

•Subsequently, the financial liability is measured in accordance with Ind AS 109. While a subsequent paragraph will deal with measurement of financial liabilities. The financial liability of Rs.20,000,000 will be measured at amortised costas per Ind AS 109and finance cost of Rs.2,000,000 will be recognised over the exercise period.

•If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity ie.an amount of Rs.22,000,000 will be reclassified from financial liability to equity

6(b) Jewels Ltd. entered into a transaction to purchase 1,000 gms of platinum on 15th January, 2020. The transaction provides for a price payable wh ich is equal to market value of 1,000 gms of platinum on 15th April 2020 and shall be settled by issue of such number of equity shares as is required to settle the aforementioned transaction, at a price of ` 100 per share on 15th April 2020. Whether this is to be classified as liability or equity as on 31st March 2020 as per Ind AS 109? You are required to explain with reasons. (Exam Jan 21)

[video link: https://youtu.be/YtrGC8vn8cU?t=3137]

Answer

There is a contract for purchase of 1 ,000 gms of platinum whose consideration varies in response to changing value of platinum. Analysing this contract as a derivative with all three of the following characteristics:

(a) Value of contract changes in response to change in market value of platinum;

(b) There is no initial net investment

(c) It will be settled at a future date, i.e. 15th April 2020.

Since the above criteria are met, this is a derivative contract. Now, a derivative contract that is settled in own equity other than exchange of fixed amount of cash for fixed number of shares is classified as 'liability'. In this case, since the contract results in issue of variable number of shares based on transaction price to be determined in future, hence, this shall be classified as' derivative financial liability' as per Ind AS 109.

Derivative

3(b)On 1st January 2017, Expo Limited agreed to purchase USD ($) 40,000 from E&I Bank in future on 31st December 2017 for a rate equal to `65 per USD. Expo Limited did not pay any amount upon entering into the contract. Expo Limited is a listed company in India and prepares its financial statements on a quarterly basis.

Using the definition of derivative included in Ind AS 109 and following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchases of USD.

For the purpose of accounting, use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March,2017	**`(50,000)**
As at 30th June,2017	**`(30,000)**
As at 30th September,2017	**`24,000**
Spot rate of USD on 31st December,2017	**`62 per USD**

(Exam May 18)

[video link: https://youtu.be/ka0KCC5suW8?t=1368]

Answer

(b)Assessment of the arrangement using the definition of derivative included under Ind AS 109.

Derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

(a) its value changes in response to the change in foreign exchange rate (emphasis laid)

(b) it requires no initial net investment or an initial net investment is smaller than would be required for other types of contracts with similar response to changes in market factors.

(c) it is settled at a future date.

Upon evaluation of contract in question, on the basis of the definition of derivative, it is noted that the contract meets the definition of a derivative as follows:

(a) the value of the contract to purchase USD at a fixed price changes in response to changes in foreign exchange rate.

(b) the initial amount paid to enter into the contract is zero. A contract which would give the holder a similar response to foreign exchange rate changes would have required an investment of USD 40,000 on inception.

(c)the contract is settled in future

The derivative is a forward exchange contract. As per Ind AS 109, derivatives are measured at fair value upon initial recognition and are subsequently measured at fair value through profit and loss.

Accounting in each Quarter

(i) Accounting on 1st January 2017

As there was no consideration paid and without evidence to the contrary the fair value of the contract on the date of inception is considered to be zero. Accordingly, no accounting entries shall be recordedon the date of entering into the contract.

(ii)Accounting on 31st March 2017

Profit and loss A/cDr.	50,000	
To Derivative financial liability		50,000

(Being mark to market loss onforward contract recorded)

(iii) Accounting on 30th June 2017

Derivative financial liability A/cDr.	20,000	
To Profit and Loss A/c		20,000

(Being partial reversal of mark to market loss on forward contract recorded)

(iv)Accounting on 30th September 2017

Derivative financial liability A/cDr.	30,000	
Derivative financial asset A/cDr.	24,000	
To Profit and Loss A/c		54,000

(Being gain on mark to market of forward contract booked as derivative financial asset and reversal of derivative financial liability)

(v)Accounting on 31st December 2017

The settlement of the derivative forward contract by actual purchase of USD 40,000

Cash (USD Account) (USD 40,000 x `62)Dr.	24,80,000	
Profit and loss A/cDr.	1,44,000	
To Cash (USD 40,000 x `65)		26,00,000
To Derivative financial asset A/c		24,000

(Being loss on settlement of forward contract booked on actual purchase of USD)

Embedded Derivative

5 (a) On 1st April, 2017, XYZ Ltd., a company incorporated in India enters into a contract to buy solar panels from Good Associates, a firm domiciled in UAE, for which delivery is due after 6 months i.e. on 30th September, 2017.

The purchase price for solar panels is US$ 50 million.

The functional currency of XYZ is Indian Rupees (INR) and of Good Associates is Dirhams.

The obligation to settle the contract in US Dollars has been evaluated to be an embedded derivative which is not closely related to the host purchase contract.

Exchange rates:

1. Spot rate on 1st April 2017: USD 1 = Rs. 60

2. Six-month forward rate on 1st April, 2017: USD 1 = Rs. 65

3. Spot rate on 30th September, 2017: USD 1 = Rs. 66

Analyse the contract and pass the necessary journal entries. (MTP April 2018)

[video link: https://youtu.be/ka0KCC5suW8?t=86]

Answer

This contract comprises of two components:

•Host contract to purchase solar panels denominated in Rs. i.e. a notional payment in Rs. at 6-month forward rate (Rs. 3,250 million or Rs. 325 crores)

•Forward contract to pay US Dollars and receive Rs. i.e. a notional receipt in Rs. In other words, a forward contract to sell US Dollars at Rs. 65 per US Dollar.

It may be noted that the notional Rupees payment in respect of host contract and the notional Rupees receipt in respect of embedded derivative create an offsetting position.

Subsequently, the host contract is not accounted for until delivery. The embedded derivative is recorded at fair value through profit or loss. This gives rise to a gain or loss on the derivative, and a corresponding derivative asset or liability.

On delivery XYZ records the inventory at the amount of the host contract (Rs. 325 crores). The embedded derivative is considered to expire. The derivative asset or liability (i.e. the cumulative gain or loss) is settled by becoming part of the financial liability that arises on delivery.

In this case the carrying value of the currency forward at 30th September 2017 on maturity is Rs. 50 million X (66 minus 65) = Rs. 5 crores (liability/loss). The loss arises because XYZ has agreed to sell US Dollars at ` 65 per US Dollar whereas in the open market, US Dollar can be sold at Rs. 66 per US Dollar.

No accounting entries are passed on the date of entering into purchase contract. On that date, the forward contract has a fair value of zero (refer section "option and non-option based derivatives" below).

Subsequently, say at 30th September 2017, the accounting entries are as follows: (all Rs. in crores):

	Dr.	Cr.
1. Loss on derivative contract	5	
To Derivative liability		5
(Being loss on currency forward)		
2. Inventory	325	

To Trade payables (financial liability) 325

(Being inventory recorded at forward exchange rate determined on date of contract)

3. Derivative liability 5

To Trade payables (financial liability) 5

(Being reclassification of derivative liability to trade payables upon settlement)

The effect is that the financial liability at the date of delivery is Rs. 330 crores (Rs. 325 crores + Rs. 5 crores), equivalent to US$ 50 million at the spot rate on 30th September 2017.

Going forward, the financial liability is a US$ denominated financial instrument. It is retranslated at the dollar spot rate in the normal way, until it is settled.

Hedge Accounitng

2 (a) Besides construction activity, Buildings & Co. Limited is also engaged in the trading of Copper.On 1st April, 20X1, it had 100 kg of copper costing Rs. 70 per kg - totalling Rs. 7000. The Company has a scheduled delivery of these 100 kgs of copper to its customer on 30th September, 20X1 at the rate of USD 100 on that date. To protect itself from decline in currency exchange rate (USD to Rs.), the entity hedges its position by entering into currency futures contract for equivalent currency units at Rs. 76 / USD. The future contract mature on 30th September, 20X1. The management performed an assessment of hedge effectiveness and concluded that the hedging relationship qualifies for cash flow hedge accounting. The entity determines and documents that changes in fair value of the currency futures contract will be highly effective in offsetting variability in cash flow of currency exchange. On 30th September, 20X1, the entity closes out its currency futures contract. On the same day, it also sells its inventory of copper at USD 100 when the spot rate is Rs. 72 / USD.

You are required to prepare detailed working and pass necessary journal entries for the sale of copper and the corresponding hedge instrument taken by the company. Pass the journal entries as on the initial date (i.e. 1st April 20X1), first quarter end reporting (i.e. 30th June 20X1) and date of sale of copper and settlement of forward contract (i.e. 30th September 20X1). Assume the exchange rates as follows and yield @ 6% per annum.

Date	**Future price for 30thSeptember 20X1delivery (Rs./ USD)**
1stApril, 20X1	**76**

30thJune, 20X1 **74**

30thSeptember, 20X1 **71 (MTP April 2021)**

[Video link: https://youtu.be/YtrGC8vn8cU?t=829]

Answer

Calculation of discounting factor based on yield @ 6% p.a.

Date	Spot rate at indicated date	Forward rate for 30thSeptember 20X1	Discount factor @ 6% p.a. on quarter basis
1stApril, 20X1 30thJune 20X1 30thSeptember, 20X1	 72	76 74 71	0.971 0.985 1

Determination of fair value change

	1stApril, 20X1	30thJune, 20X1	30thSeptember, 20X1
aNominal value in Rs.@ Rs.76 / USD	7,600	7600	7600
bNominal value in USD (100 kg for USD 100	100	100	100
cForward rate for 30thSeptember, 20X1	76	74	71
dValue in Rs.(b x c)	7600	7400	7100
eDifference (a-d)	0	200	500
fDiscount factor (as calculated in the above table)	0.971	0.985	1
gFair value (e x f)	0	197	500
hFair value change for the period	0	197	303

* 500 – 197= 303

Journal Entries

1stApril, 20X1 No entry as initial fair value is zero

30thJune, 20X1

FutureContract Dr. 197

To Cash Flow Hedge Reserve (Other Equity)-OCI 197

(Being Change in Fair Value of Hedging Instrument recognised in OCI accumulated in a separate component in Equity)

30thSeptember, 20X1

FutureContract Dr. 303

To Cash Flow Hedge Reserve (Other Equity) –OCI 303

(Being change in fair value of the hedging instrument recognised in OCI)

Bank/Trade Receivable Dr.	7,200	
To Revenue from Contracts with Customers		7,200

(Being sale of 100 kgs. of copper for USD 100 recognised at spot rate of Rs.72 for USD 1)

Cash Flow Hedge Reserve (Other Equity) -OCIDr.	500	
To Revenue from Contracts with Customers		500

(Being fair value change in forward contract reclassified to profit and loss and recognised in the line item affected by the hedge item)

Bank / Cash Dr.	500	
To Future Contract		500

Guarantee Accounting

15.On 1 April 20X1, Sun Limited guarantees a `10,00,000loan of Subsidiary– Moon Limited, which Bank STDK has provided to Moon Limited for three years at 8%.

Interest payments are made at the end of each year and the principal is repaid at the end of the loan term.

If Sun Limited had not issued a guarantee, Bank STDK would have charged Moon Limited an interest rate of 11%.Sun Limited does not charge Moon Limited for providing the guarantee.

On 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited.

On 31 March 20X3, there is 3% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limiteddoes not expect to recover any amount from Moon Limited.

Provide the accounting treatment of financial guarantee as per Ind AS 109in the books of Sun Ltd., on initial recognition and in subsequent periods till 31 March 20X3. (RTP May 2021) / (MTP Nov 21) / Exam Nov 22 / MTP Sept 22

[Video link: https://youtu.be/4aPf8wntczY]

Answer

1 April 20X1

A financial guarantee contract is initially recognised at fair value. The fair value of the guarantee will be the present value of the difference between the net contractual cash flows required under the loan, and the net contractual cash flows that would have been required without the guarantee.

Particular	Year 1	Year 2	Year 2	Total
Cash flows based on interest rate of 11% (A)	110,000	110,000	110,000	330,000
Cash flows based on interest rate of 8% (B)	80,000	80,000	80,000	240,000
Interest rate differential (A-B)	30,000	30,000	30,000	90,000
Discount factor @ 11%	0.901	0.812	0.731	
Interest rate differential discounted at 11%	27,030	24,360	21,930	73,320
Fair value of financial guarantee contract (at inception)				73,320

Journal Entry

Investment in subsidiaryDr. 73,320

To Financial guarantee (liability) 73,320

(Being financial guarantee initially recorded)

31 March 20X2

Subsequently at the end of the reporting period, financial guarantee is measured at the higher of:

-the amount of loss allowance; and

-the amount initially recognised less cumulative amortization, where appropriate.

At 31 March 20X2, there is 1% probability that Moon Limited may default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses are therefore `10,000 (`10,00,000 x 1%).

The initial amount recognised less amortisation is `51,385 (`73,320 + `8,065 (interest accrued based on EIR)) –`30,000 (benefit of the guarantee in year 1) Refer table below. The unwound amount is recognised as income in the books of Sun Limited, being the benefit derived by Moon Limited not defaulting on the loan during the period.

Year	Opening balance	EIR @ 11%	Benefits provided	Closing balance
1	73,320	8065	(30,000)	51,385
2	51,385	5652	(30,000)	27,037
3	27,037	2963	(30,000)	-

The carrying amount of the financial guarantee liability after amortisation is therefore `51,385, which is higher than the 12-month expected credit losses of `10,000. The liability is therefore adjusted to `51,385 (the higher of the two amounts) as follows

Financial guarantee (liability)Dr. 21,935

To Profit or loss 21,935

(Being financial guarantee subsequently adjusted)

31 March 20X3

At 31 March 20X3, there is 3% probability that Moon Limited will default on the loan in the next 12 months. If Moon Limited defaults on the loan, Sun Limited does not expect to recover any amount from Moon Limited. The 12-month expected credit losses aretherefore `30,000 (`10,00,000 x 3%).

The initial amount recognised less accumulated amortisation is `27,037, which is lower than the 12-month expected credit losses (`30,000). The liability is therefore adjusted to `30,000 (the higher of the two amounts) as follows:

Financial guarantee (liability)Dr. 21,385*

To Profit or loss (Note) 21,385

(Being financial guarantee subsequently adjusted)

* The carrying amount at the end of 31 March 20X2 = `51,385 less 12-month expected credit losses of `30,000.

Ind AS 33

Weighted Average no. of shares

6(d)Explain whyweighted average number of sharesare used in the calculation of earnings per share and how it is calculated.Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS.

S. No.	Date	Particulars	Numberof shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	1,00,000
2	15-Jun-20X1	Issue of equity shares	75,000
3	8-Nov-20X1	Conversion of convertible preference shares in Equity	50,000
4	22-Feb-20X2	Buy back of shares	(20,000)
5	31-Mar-20X2	Closing balance of outstanding equity shares	205,000

(MTP May 2020) / MTP Oct 22

[video link: https://youtu.be/-i1VPGwY5fg?t=2980]

Answer

As per para 20 of Ind AS 33, Earnings per share, the weighted average number of ordinary shares outstanding during the period reflects the possibility that the amount of shareholders' capital varied during the period as a result of a larger or smaller number of shares being outstanding at any time. The weighted average number of ordinary shares outstanding during the period is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor. The time weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

Formula

The weighted average number of shares is calculated as follows:

Numberof shares x (numberof days the shares were held during the year / 365)

Following the above formula, the weighted average number of shares for calculation of EPS for the year 20X1-20X2 will be as follows:

Date	Particulars	No of shares	No of days shares were outstanding	Weighted average no of shares
1April 20X1	Opening balance of outstanding equity shares	100,000	365	100,000
15June 20X1	Issue of equity shares	75,000	290	59,589
8November 20X1	Conversion of convertible preference shares in Equity	50,000	144	19,726
22February 20X2	Buy back of share	(20,000)	(38)	(2082)
31March 20X2	Closing balance of outstanding equity shares	205,000		177,233

*These shares had already been considered in the shares issued. The same has been deducted assuming that the bought back shares have been extinguished immediately.

Diluted EPS for CFI

6c An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three -year term and are issued at par with a face value of ` 1,000 per bond, giving total proceeds of ` 20,00,000. Interest is payable annually in arrears at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has given an option to settle the principal amount of the convertible bonds in ordinary shares or in cash. When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9%. At the issue date, the market price of one ordinary share is ` 3. Income tax is ignored. Calculate basic and diluted EPS when

Profit attributable to ordinary equity holders of the parent entity Year 1`10,00,000

Ordinary shares outstanding 12,00,000

Convertible bonds outstanding 2,000

(MTP Oct 2020) / (RTP May 19) / (MTP Oct 21)

[video link: https://youtu.be/-i1VPGwY5fg?t=2030]

Answer

Allocation of proceeds of the bond issue:

Liability component (W.N.1)	`18,47,720
Equity component	`1,52,280
	`2,000,000

The liability and equity components would be determined in accordance with Ind AS 32. These amounts are recognised as the initial carrying amounts of the liability and equity components. The amount assigned to the issuer conversion option equity element is an addition to equity and is not adjusted.

Basic earnings per share Year 1:`10,00,000 / 12,00,000 = `0.83 per ordinary share

Diluted earnings per share Year 1:

It is presumed that the issuer will settle the contract by the issue of ordinary shares. The dilutive effect is therefore calculated in accordance with the Standard.

`10,00,000 + `1,66,295 (W.N.2) = `0.69 per ordinary share

12,00,000 + 5,00,000(W.N.3)

Working Notes:

1. This represents the present value of the principal and interest discounted at 9%

1,20,000 x 2.531 = Rs. 3,03,720

20,00,000 x 0.772 = Rs. 15,44,000

Rs. 18,47,720

2. Profit is adjusted for the accretion of ` 1,66,295 (` 18,47,720 × 9%) of the liability because of the passage of time. However, it is assumed that interest @ 6% for the year has already been adjusted.

3. 5,00,000 ordinary shares = 250 ordinary shares x 2,000 convertible bonds

3d Mittal Motors Limited is preparing financials for the year ended March 31, 20X2. The Company had some queries in preparation of certain data that is required to be presented in the financials. As the retainer of the Company, please advise the company for the following issues:
(i) Mittal Motors has issued 10,00,000 numbers of 9% cumulative preference shares. The Company has arrears of Rs. 15 crores of preference dividend as

on March 31, 20X2, it includes current year arrears of Rs. 1.75 crores. The Company did not declare any dividend for equity shareholders as well as for preference shareholders. What is the amount of dividend to be reduced from profit or loss for the year for calculating basic Earnings Per Share?
(ii) Further Mittal Motors has also issued certain convertible debentures, which are outstanding as at the year end. For the purpose of computation of weighted average number of shares (to arrive at diluted EPS) when should the dilutive potential shares should be deemed to have been converted into shares?
(A) At the start of the period.
(B) The date of issue of the potential shares
(C) At the start of the period or, if later, the date of the issue of the potential shares
(D) At the end of the period.

[video link: https://youtu.be/c_cNnyHKW3o?t=2413]

Answer

(i)As per para 14 (b) of IndAS 33 “Earnings per share”, “The after-tax amount of preference dividends that is deducted from profit or loss is the after-tax amount of the preference dividends for cumulative preference shares required for the period, whether or not the dividends have been declared. T he amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods”.In the given case, the amount of preference dividends Rs.1.75 crores declared for the year ended March 31, 20X2(i.e., the current period) is to be deducted from profi t or loss for calculating EPS.

(ii)As per para 36 of IndAS 33 “Earnings per share’, “For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares

Diluted EPS

6c ABC Ltd. has 1,000,000 Rs. 1 ordinary shares and 1,000 Rs. 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period.

ABC Ltd.'s share price is Rs. 4.50 per share and earnings for the period are Rs. 500,000. The tax rate applicable to the entity is 21%.

Calculate basic EPS, earnings per incremental share for the convertible bonds and diluted EPS. (MTP March 2021)

[video link: https://youtu.be/c_cNnyHKW3o?t=1165]

Answer

Basic EPS is Rs. 0.50 per share (ie 500,000/1,000,000)

The earnings per incremental share for the convertible bonds is calculated as follows:

Earnings effect = No. of bonds x nominal value x interest cost x (1 –applicable tax rate)

= 1,000 x 100 x 10% x (1-0.21) = Rs. 7,900.

Incremental shares calculation

Assume all bonds are converted toshares, even though this converts Rs. 100 worth of bonds into 20 shares worth only Rs. 90 and is therefore not economically rational.

This gives 1000 x 20 = 20,000 additional shares.

Earnings per incremental share= Rs. 7,900 / 20,000 = Rs.0.395

Diluted EPS= (Rs.500,000 + Rs. 7,900) / (1,000,000 + 20,000) = Rs. 0.498 per share.

1(b) Thefollowing information is available relating to Space India Limited for the Financial Year 2019-2020.

Net profit attributable to equity shareholders`90,000

Numberof equity shares outstanding16,000

Average fair value of one equity share during the year`90

Potential Ordinary Shares:

Options: 900 options with exercise price of `75

Convertible Preference Shares: 7,500 shares entitled to a cumulative dividend of `9 per share. Each preference share is convertible into 2 equity shares.

Applicable corporate dividend tax: 8%

10% Convertible Debentures of`100 each: `10,00,000 and each debenture is convertible into 4 equity shares

Tax rate: 25%

You are required to compute Basicand Diluted EPS of the company for the Financial Year 2019-2020. (Exam Nov 20) / (MTP May 2022)

[video link: https://youtu.be/c_cNnyHKW3o?t=1386]

Answer

(i)Basic Earnings per share

	Year ended 31.3.2020
Net profit attributable to equity shareholders (A)	`90,000
Number of equity shares outstanding(B)	16,000
Earnings per share (A/B)	`5.625

(ii)Diluted earnings per share

Options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 10% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (as per W.N.).

	Net profit attributable to equity shareholders	No. of equity shares	Net Profit attributable per share	
Net profit attributable to equity shareholders	90000	16000	5.625	
Options	- 90000	150 16150	5.572	Dilutive
10% Convertible debentures	75000 165000	40000 56150	2.939	Dilutive
Convertible Preference Shares	72900 237900	15000 71150	3.344	Anti dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (`2.939 to `3.344), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per

share for the year ended 31 March 2020. Therefore, diluted earnings per share for the year ended 31 March 2020 is `2.939.

Working Note:

Calculation of incremental earnings per share andallocation of rank

1. Options

Increase in earnings	Nil
No. of incremental shares issued for no consideration [900 x (90-75)/90]	150
Incremental earning per share	Nil
Rank:	1

2. Convertible Preference Shares

Increase in net profit attributable to equity shareholders as adjusted by	
attributable dividend tax [(`9 x 7,500) + 8% (`9 x 7,500)]	72,900
No. of incremental shares (2 x 7,500)	15,000
Incremental earning per share	4.86
Rank:	3

3. 10% Convertible Debentures

Increase in net profit [(`10,00,000 x 10% x (1 –0.25)]	75,000
No. of incremental shares (10,000 x 4)	40,000
Incremental earning per share	1.87
Rank:	2

Note: Grossing up of preference share dividend has been ignored here.At present dividend distribution tax has been abolished. However, the question has been solvedon the basis of the information given in the question.

5(a) At 31st March, 2019 the issued share capital of SB Limited consisted of 20,00,000 ordinary shares of ` 1 each. On 1st July 2019, the Company issued ` 25,00,000 of 8% convertible loan stock for cash at par. Each ` 100 nominal of the loan stock may be converted, at any time during the years ended 2024 to 2027, into the number of ordinary shares set out below:

- **31st March, 2024: 135 Ordinary Shares**

- **31st March, 2025: 130 Ordinary Shares**
- **31st March, 2026: 125 Ordinary Shares**
- **31st March, 2027: 120 Ordinary Shares**

If the loan stock is not converted by 2027, they would be redeemed at par. It is assumed that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options fair value reported on 31st March 2020 and 31st March 2021 amounted to losses of ` 5,000 and ` 5,300 respectively. Further, it is assumed that there are no tax consequences arising from these losses.

The profit before interest, fair value movements and taxation for the year ended 31st March, 2020 and 2021 amounted to ` 16,50,000 and ` 17,90,000 respectively and relate wholly to continuing operations. The rate of tax for both the periods is 33% (including cess and surcharge if any).

Calculate Basic and Diluted EPS for 31st March 2020 & 31st March 2021. (Exam July 21)

[video link: https://youtu.be/npEPsA0chCk?t=86]

Answer

	2021	2020
Trading results		
A. Profit before interest, fair value movements and tax	17,90,000	16,50,000
B. Interest on 8% convertible loan stock (2020: 9/12 × ` 2,00,000)	(200,000)	(150,000)
C. Change in fair value of embedded option		
Profit before tax	(5300)	(5000)
Taxation @ 33% on (A-B)	15,84,700	1495,000
Profit after tax	(524,700)	(495,000)
Calculation of basic EPS	10,60,000	10,00,0000
Number of equity shares outstanding		
Earnings	20,00,000	20,00,000
Basic EPS	10,60,000	10,00,000
	.53	0.50

Calculation of diluted EPS

Test whether convertibles are dilutive:

The saving in after-tax earnings, resulting from the conversion of ` 100 nominal of loan stock, amounts to (` 100 × 8% × 67%) + (` 5,300 / 25,000) = ` 5.36 + ` 0.21 =` 5.57.

There will then be 135 extra shares in issue.

Therefore, the incremental EPS is 4 paise (ie. ` 5.57 / 135). As this incremental EPS is less than the basic EPS at the continuing level, it will have the effect of reducing the basic EPS of 53 paise. Hence the convertibles are dilutive.

	2021	2020
Adjusted earnings		
Profit for basic EPS	10,60,000	10,00,000
Add: Interest and other charges on earnings saved as a result of the conversion	205,300	155,000
Less: Tax relief on interest portion	(66,000)	(49,500)
Adjusted earnings for equity	11,99,300	11,05,500

Adjusted number of shares

From the conversion terms, it is clear that the maximum number of shares issuable on conversion of ` 25,00,000 loan stock after the end of the financial year would be at the rate of 135 shares per ` 100 nominal (that is, 33,75,000 shares).

	2021	2020
Number of equity shares for basic EPS	20,00,000	20,00,000
Maximum conversion at date of issue (33,75,000 × 9/12)	-	25,31,250
Maximum conversion after balance sheet date	33,75,000	
Adjusted shares	53,75,000	45,31,250
Adjusted earnings for equity	11,99,300	11,05,500
Diluted EPS (approx.)	.22	0.24

Consolidation Diluted EPS

4. (a)CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

Particulars	**Attributable to CAB Ltd**	**NCI**	**Total (thousand)**
Profit for the year	**39000**	**3000**	**42000**
Other Comprehensive Income	**5000**	**-**	**5000**
Total Comprehensive Income	**44000**	**3000**	**47000**

The long-term finance of the company comprises of the following:

(i) 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value.

(ii) 8,00,00,000 irredeemable preference shares. These shares were in issue for t he whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.

(iii) Rs. 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of Rs. 1 payable in four years is 0.74 and the cumulative present value of Rs. 1 payable at the end of years one to four is 3.31.

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:

•the finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.

•the basic and diluted earnings per share for the year ended 31st March, 20X3.

Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%. (MTP April 2021) / (RTP May 20) / Exam Nov 22

[video link: https://youtu.be/c_cNnyHKW3o?t=97]

Answer

Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (Rs. 1,80,000 thousand x 0.74) = Rs. 1,33,200 thousand

Present value of interest payable annually for 4 years (Rs. 1,80,000 thousand x 6% x 3.31) = Rs. 35,748 thousand

Total liability component = Rs. 1,68,948 thousand

Therefore, equity component = Rs. 1,80,000 thousand – Rs. 1,68,948 thousand = Rs. 11,052 thousand

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balanceRs.in	Finance cost @ 8%Rs.in	Interest paid@ 6%Rs.in '000	Closing balanceRs.in

	'000	'000		'000
31.3.20X2	168948	13516	10800	171664
31.3.20X3	171664	13733	10800	174597

Finance cost of convertible debentures for the year ended 31.3. 20X3 is Rs. 13,733 thousand and closing balance as on 31.3.20X3 is Rs. 1,74,597 thousand.

Calculation of Basic EPS Rs. in	'000
Profit for the year	39,000
Less:Dividend on preference shares (80,000 thousand x Rs.0.05)	(4,000)
Profit attributable to equity shareholders	35,000

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)}

= 23,75,00,000 shares or 2,37,500 thousand shares

Basic EPS = Rs. 35,000 thousand / 2,37,500 thousand shares = Rs. 0.147

Calculation of Diluted EPS		Rs. in '000
Profit for the year		39,000
Less:Dividend on preference shares (80,000 x 0.05)		(4,000)
		35,000
Add:Finance cost (as given in the above table)	13,733	
Less:Tax @ 25%	(3,433.28)	10,300
		45,300

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)} + 10,00,00,000

= 33,75,00,000 shares or 3,37,500 thousand shares

Diluted EPS = Rs. 45,300 thousand / 3,37,500 thousand shares= Rs. 0.134

4 (b)Calculate Subsidiary's and Group's Basic EPS and Diluted EPS, when

Parent:

Profit attributable to ordinary equity holders of the parent entity - Rs.12,000 (excluding any earnings of, or dividends paid by, the subsidiary)

Ordinary shares outstanding - 10,000

Instruments of subsidiary owned b y the parent

- **800 ordinary shares**

- **30 warrants exercisable to purchase ordinary shares of subsidiary**
- **300 convertible preference shares**

Subsidiary:
Profit - Rs.5,400
Ordinary shares outstanding - 1,000
Warrants - 150, exercisable to purchase ordinary shares of the subsidiary
Exercise price - Rs.10
Average market price of one ordinary share - Rs.20
Convertible preference shares - 400, each convertible into one ordinary share
Dividends on preference shares - Re 1 per share
No inter-company eliminations or adjustments were necessary except for dividends.
Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS32 (MTP April 2019)
[video link: https://youtu.be/-i1VPGwY5fg?t=86]
Answer
Subsidiary's earnings per share
Basic EPS Rs.5.00 calculated:Rs.5,400 (a) –Rs.400 (b)1,000 (c)
Diluted EPS Rs.3.66 calculated: Rs.5,400 (d)(1,000 + 75 (e) + 400(f))
Notes:
(a) Subsidiary's profit attributable to ordinary equity holders.
(b) Dividends paid by subsidiary on convertible preference shares.
(c) Subsidiary's ordinary shares outstanding.
(d) Subsidiary's profit attributable to ordinary equity holders (Rs.5,000) increased by Rs.400 preference dividends for the purpose of calculating diluted earnings per share.
(e) Incremental shares from warrants, calculated: [(Rs.20 –Rs.10) ÷ Rs.20] × 150.
(f) Subsidiary's ordinary shares assumed outstanding from conversion of convertible preference shares, calculated: 400 convertible preference shares × conversion factor of 1.
Consolidated earnings per share
Basic EPS Rs.1.63 calculated: (Rs.12,000(a) + Rs.4,300) / (b)10,000(c)
Diluted EPS Rs.1.61 calculated: (Rs.12,000 + Rs.2,928(d) + Rs.55(e) + Rs.1,098(f)) / 10,000
(a) Parent's profit attributable to ordinary equity holders of the parent entity.
(b) Portion of subsidiary's profit to be included in consolidated basic earnings per share, calculated: (800 × Rs.5.00) + (300 × Re 1.00).
(c) Parent's ordinary shares outstanding.

(d) Parent's proportionate interest in subsidiary's earnings attributable to ordinary shares, calculated: (800 ÷ 1,000) × (1,000 shares × Rs.3.66 per share).
(e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 ÷ 150) × (75 incremental shares × Rs.3.66 per share).
(f) Parent's proportionate interest in subsidiary's earnings attributable to convertible preference shares, calculated: (300 ÷ 400) × (400 shares from conversion × Rs.3.66 per share).

17. Company S is a subsidiary of Company P. Following facts are in respect of Company S:
• Company S has 10,000 ordinary shares and 1,000 options outstanding, of which Company P owns 9,000 shares and 500 options, respectively.
• The options have an exercise price of ` 40.
• The average market price of Company S's ordinary share was ` 50 in 20X1.
• In 20X1, Company S's profit was ` 30,000.
Following facts are in respect of Company P:
• Company P has 5,000 ordinary shares outstanding.
• In 20X1, Company P's profit (excluding any distributed and undistributed earnings of subsidiaries) was ` 7,000.
• The options outstanding are dilutive at P's level.
Determine the diluted EPS of Company P for the year 20X1. Ignore income tax. (RTP Nov 22)
Answer
To determine the diluted EPS of Company P, the diluted EPS of Company S has to be calculated first.
Calculation of Company S's diluted EPS:

Company S's earnings for the period	` 30,000
Weighted average ordinary shares	10,000
Incremental shares (refer W.N.)	200
Company S's diluted EPS ` 30,000/ (10,000 + 200)	` 2.94

Calculation of Company P's diluted EPS:

Company P's earning for the period	` 7,000	
Company P's share of Company S's earning attributable to ordinary shares [(9,000 /10,000) x (2.94 x 10,000)]	` 26,460	
Company P's share of Company S's earning attributable to options [(500 /1,000) x (2.94 x 200)]		` 294
Company P's weighted average ordinary shares outstanding		5,000
Company P's diluted EPS = (7,000 + 26,460 + 294) / 5,000		` 6.75

Working Note:

Computation of Incremental shares related to weighted average options outstanding:
All options are dilutive because their exercise price is below the average market price of Company S's ordinary shares for the period.
The incremental shares are calculated as follows:

Shares issued on assumed exercise of options	1,000
Less: Shares that would be issued at average market Price [(40 x 1,000)/50]	(800)
Incremental shares	200

Discontinued operations

5(b) From the following information you are asked to calculate (a) Basic and Diluted EPS of Duck Ltd. and (b) Diluted EPS of Swan Ltd.:

	Duck Ltd.	Swan Ltd
Income/(Loss) from Continuing Operations	**2,52,000**	**(1,80,000)**
Income/(Loss) from Discontinued Operations	**(4,20,000)**	**3,25,920**
Net Income/(Loss)	**(1,68,000)**	**1,45,920**
Weighted Average Number of Shares outstanding	**80,000**	**96,000**
Incremental common shares outstanding relating To stock options	**16,000**	**25,600**

(Exam Dec 21)
[video link: https://youtu.be/ngi-Dzq0Kis?t=3015]

Answer

(a) For Duck Ltd.
I Calculation of Basic EPS
Basic EPS = Profit for the year / Weighted average number of shares outstanding
Basic EPS (Continued Operations) = Profit from continued operations / Weighted average number of shares outstanding
= ` 2,52,000 / 80,000 = ` 3.15
Basic Loss per share (Discontinued operations) = Loss from discontinued operations / Weighted average number of shares outstanding
= (` 4,20,000)/80,000=(` 5.25)
Overall Basic Loss per share = (` 1,68,000) / 80,000 = (` 2.10) (i)
II Calculation of Diluted EPS
Diluted EPS = Profit for the year / Adjusted weighted average number of shares outstanding
EPS (Continued Operations) = Profit from continued operations / Adjusted weighted average number of shares outstanding
= ` 2,52,000 / 96,000 = ` 2.625
Loss per share (Discontinued operations) = Loss from discontinued operations/ Adjusted weighted average number of shares outstanding
= (` 4,20,000) / 96,000 = (` 4.375)

Overall Diluted Loss per share = (` 1,68,000) / 96,000 = (` 1.75) (ii)

Reporting Status:

The income from continuing operations is the control number, there is a dilution in basic EPS for income from continuing operations (reduction of EPS from ` 3.15 to ` 2.625). Therefore, even though there is an anti-dilution [Loss per share reduced from ` 2.10 (i) to ` 1.75 (ii) above], diluted loss per share of ` 1.75 is reported.

(b) For Swan Ltd.

Treatment of potential shares:

In case of loss from continuing operations, the potential shares are excluded since including those shares would result into anti-dilution effect on the control number (loss from continuing operations).

Therefore, the diluted EPS will be calculated as under:

Diluted EPS = Profit for the year / Adjusted weighted average number of shares outstanding

Overall Profit = Loss from continuing operations + Gain from discontinued operations

= (` 1,80,000) + ` 3,25,920 = ` 1,45,920

Weighted average number of shares outstanding = 96,000

Diluted EPS = ` 1,45,920 / 96,000 = ` 1.52

Reporting Status:

The dilutive effect of the potential common shares on EPS for income from discontinued operations and net income would not be reported because of the loss from continuing operations.

Ind AS 34

5. (a) ABC Limited manufactures automobile parts. ABC Limited has shown a net profit of Rs. 20,00,000 for the third quarter of 20X1.

Following adjustments are made while computing the net profit:

(i) Bad debts of Rs. 1,00,000 incurred during the quarter. 50% of the bad debts have been deferred to the next quarter.

(ii) Additional depreciation of Rs. 4,50,000 resulting from the change in the method of depreciation.

(iii) Exceptional loss of Rs. 28,000 incurred during the third quarter. 50% of exceptional loss have been deferred to next quarter.

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

Analyze and ascertain the correct net profit to be shown in the Interim Financial Report of third quarter to be presented to the Board of Directors. (MTP April 2021) / (Exam Nov 18) / (Exam Dec 21)

[video link: https://youtu.be/0-UZYJ-BvHo?t=67]

Answer

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:

(i) 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, Rs. 50,000 should be deducted from Rs. 20,00,000.

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

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

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

(i) it is appropriate to anticipate or defer that type of cost at the end of the financial year, and

(ii) costs are incurred unevenly during the financial year of an e nterprise.

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

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

Tax related questions

1.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 viewsare correct. If not, then calculate the tax expense for each quarter as well as for the year as per Ind AS 34. (RTP Nov 19)
[video link: https://youtu.be/0-UZYJ-BvHo?t=669]
Answer
As perpara 30 (c) of Ind AS 34 'Interim Financial Reporting', income tax expense is recognised in each interim periodbased 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 zerono 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 inaccordance 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

7.An entity's accounting year endsis 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 31st March,2019and 30% for the year ended 31st March,2020.How the related tax charge would be calculated for the year 2019and its quarters. (RTP Nov 20)
[video link: https://youtu.be/0-UZYJ-BvHo?t=851]

Answer

Table showing computation of tax charge:

	Quarter ending 31st March, 2019	Quarter ending 30th June, 2019	Quarter ending 30th September, 2019	Quarter ending 31st December, 2019	Year ending 31st December, 2019
Profit before tax	10000	10000	10000	10000	40000
Tax charge	(2500)	(3000)	(3000)	(3000)	(11500)
	7500	7000	7000	7000	28500

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.

6(c) Narayan Ltd. provides you the following information and asks you to calculate the tax expense for each quarter with reference to Ind AS 34, assuming that there is no difference between the estimated taxable income and the estimated accounting income:
Estimated Gross Annual Income `33,00,000(inclusive of Estimated Capital Gains of `8,00,000)
Estimated Income of Quarter I is `7,00,000,
Quarter II is `8,00,000,
Quarter III(including Estimated Capital Gains of `8,00,000) is `12,00,000 and Quarter IV is `6,00,000.
Tax Rates: OnCapital Gains12%
On Other Income: First`5,00,000 30%
Balance Income-40% (Exam May 19) / (Exam Nov 20) / (MTP Oct 21) / (MTP April 22 similar)

[video link: https://youtu.be/0-UZYJ-BvHo?t=1294]

6. PQR Ltd. is preparing its interim financial statements for quarter 3 of the year. How the following transactions and events should be dealt with while preparing its interim financials:

(i) It makes employer contributions to government-sponsored insurance funds that are assessed on an annual basis. During Quarter 1 and Quarter 2 larger amount of payments for this contribution were made, while during the Quarter 3 minor payments were made (since contribution is made upto a certain maximum level of earnings per employee and hence for higher income employees, the maximum income reaches before year end).

(ii) The entity intends to incur major repair and renovation expense for the office building. For this purpose, it has started seeking quotations from vendors. It also has tentatively identified a vendor and expected costs that will be incurred for this work.

(iii) The company has a practice of declaring bonus of 10% of its annual operating profits every year. It has a history of doing so. (RTP Nov 22)

Answer

Paragraph 28 of Ind AS 34, Interim Financial Reporting states that an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements.

Further, paragraphs 32 and 33 of Ind AS 34, Interim Financial Reporting state that for assets, the same tests of future economic benefits apply at interim dates and at the end of an entity's financial year. Costs that, by their nature, would not qualify as assets at financial year-end would not qualify at interim dates either.

Similarly, a liability at the end of an interim reporting period must represent an existing obligation at that date, just as it must at the end of an annual reporting period.

An essential characteristic of income (revenue) and expenses is that the related inflows and outflows of assets and liabilities have already taken place. If those inflows or outflows have taken place, the related revenue and expense are recognised otherwise not. The Conceptual Framework does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

Considering the above guidance, while preparing its interim financials, the transaction and events of the given case should be dealt with as follows:

(i) If employer contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised using an estimated average annual effective contribution rate in its interim financial

statements, even though a large portion of the payments have been made early in the financial year. Accordingly, it should work out an average effective contribution rate and account for the same accordingly, in its interim financials.

(ii) The cost of a planned overhaul expenditure that is expected to occur in later part of the year is not anticipated for interim reporting purposes unless an event has caused the entity to have a legal or constructive obligation. The mere intention or necessity to incur expenditure related to the future is not sufficient to give rise to an obligation.

(iii) A bonus is anticipated for interim reporting purposes, if and only if,

(a) the bonus is a legal obligation or past practice would make the bonus a constructive obligation for which the entity has no realistic alternative but to make the payments, and

(b) a reliable estimate of the obligation can be made. Ind AS 19, Employee Benefits provides guidance in this regard.

A liability for bonus may arise out of legal agreement or constructive obligation because of which it has no alternative but to pay the bonus and accordingly, needs to be accrued in the annual financial statements.

Bonus liability is accrued in interim financial statements on the same basis as they are accrued for annual financial statements. In the instant case, bonus liability of 10% of operating profit for the year to date may be accrued. In the given case, since the company has past record of declaring annual bonus every year, the same may be accrued using a reasonable estimate (applying the principles of Ind AS 19, Employee Benefits) while preparing its interim results.

20. While preparing interim financial statements for the half-year ended 30th September, 20X1, an entity notes that there has been an under-accrual of certain expenses in the interim financial statements for the first quarter ended 30 th June, 20X1.

The amount of under accrual is assessed to be material in the context of interim financial statements. However, it is expected that the amount would be immaterial in the context of the annual financial statements. The management is of the view that there is no ne ed 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? (RTP Nov 22)

Answer

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 that 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 non-disclosure. 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.AWM

Ind AS 36

4(a)A machine was acquired by ABC Ltd. 15 years ago at a cost of `20 crore. Its accumulated depreciation as at 31st March, 2018 was `16.60 crore.Depreciation estimated for the financial year 2018-19 is `1 crore. Estimated Net Selling Price of the machine as on 31st March, 2018 was `1.20 crore, 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 `1.40 croreas on 1st April, 2018, which is expected to decrease by 30 per cent by the end of the financial year. Assuming that other conditions of relevant Accounting Standard for applicability of the impairment are satisfied:

(i) What should be the carrying amount of this machine as at 31st March, 2019?

(ii) How much will be the amount of write off (impairment loss) for the financial year ended 31st March, 2019?

(iii) If the machine had been revalued ten years ago and the current revaluation reserves against this plant were to be `48 lakh, how would you answer to questions (i) and (ii) above?

(iv)If the value in use was zero and the company was required to incur a cost of `8 lakhtodispose of the plant, what would be your response to questions (i) and (ii) above? (Exam Nov 18)

[video link: https://youtu.be/Kb9I2bxqTW4?t=92]

Answer

(a)As per the requirement of the question, the following solution has been drawn on the basis of Ind AS 36(`in crore)

(i)Carrying amount of plant (before impairment) as on 31st March, 2019	2.4
Carrying amount of plant (after impairment) as on 31st March, 2019	0.98
(ii)Amount of impairment loss for the financial year ended	
31st March, 2019 (2.4 Cr.-0.98 Cr)	1.42
(iii)If the plant had been revalued ten years ago	
Debit to revaluation reserve	0.48

Amount charged to profit and loss (1.42 -0.48)	0.94

(iv)If Value in use was zero

Value in use (a)	Nil
Net selling price (b)	(0.08)
Recoverable amount [higher of (a) and (b)]	Nil
Carrying amount (closing book value)	Nil
Amount of write off (impairment loss) (`2.4 Cr –Nil)	2.4

Entire book value of plant will be written off and charged to profit andloss account.

Working Notes:

(1)Calculation of Closing Book Value, as at 31st March, 2019	`in crore
Opening book value as on 1.4.2018 (`20 crore -16.60 crore)	3.40
Less: Depreciation for financial year 2018–2019	(1.00)
Closing book value as on 31.3.2019(before impairment)	2.40

(2)Calculation of Estimated Net Selling Priceon 31st March,2019	`in crore
Estimated net selling price as on 1.4.2018	1.20
Less: Estimated decrease during the year (20% of `1.20 Cr.)	(0.24)
Estimated net selling price as on 31.3.2019	0.96

(3)Calculation of Estimated Value in Use of Plant on 31st March,2019	`in crore
Estimated value in use as on 1.4.2018	1.40
Less:Estimated decrease during the year (30% of `1.40 Cr.)	(0.42)
Estimated value in use as on 31.3.2019	0.98

(4)Recoverable amount as on 31.3.2019 is equal to higher of Net selling price and value in use	`in crore
Net selling price	0.96

Value in use	0.98
Recoverable amount	0.98
Impairment Loss [Carrying amount –Recoverable amount ie.	
(2.4 0 Cr. –0.98 Cr)]	1.42
Revised carrying amount on 31.3.2019 is equal to	
Recoverable amount(after impairment)	0.98 Cr.

Note: Since question requires computation of Impairment Loss on 31.3.2019, hence impairment probability on 31.3.2018 has been ignored. However, since there is impairment probability at the beginning of the year as well, one may calculate the carrying amount at the beginning of the year after impairment and then calculate the impairment possibilities at the end of the year. Accordingly the solution will be as follows:

Carrying amount before impairment on 1.4.2018 (20-16.60)	3.40
Recoverable amount ie. higher of NSP (1.20cr)	
and Value in use (1.40cr)	1.40
Impairment loss	2.00
Revised carrying amount after impairment as on 1.4.2018	1.40
Less: Depreciation for 2018-2019 (as given in the question)	(1.00)
Carrying amount as on 31.3.2019	0.40
Recoverable amount as on 31.3.2019	
(Refer W.N. 2, 3 and 4above)	0.98
Impairment Loss as on 31.3.2019	
(since carrying amount is less than recoverable amount)	NIL

Available revaluation surplus

2. (a) 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 3 1 March 2020, 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:

Year ended 31 March 2021	**2,76,000**
Year ended 31 March 2022	**1,92,000**
Year ended 31 March 2023	**1,20,000**
Year ended 31 March 2024	**1,14,000**

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 31 March 2020 for ` 6,00,000 and related selling expenses in this regard could have been ` 96,000. The machine was revalued previously, and at 31 March 2020 an amount of ` 36,000 was held in revaluation surplus in respect of the asset. The carrying value of the asset at 31 March 2020 was ` 6,60,000. The Indian government has indicated that it may compensate the company for any loss in value of the assets up to its recoverable amount. (MTP Oct 2020) / (RTP May 20)

[video link: https://youtu.be/LhgsQrpYMrA?t=1959]

Answer

(a) Carrying amount of asset on 31 March 2020= ` 6,60,000

Calculation of Value in Use

Yearended	Cash flow	Discount factor @ 9%	Amount
1	276000	0.9174	253202
2	192000	0.8417	161606
3	120000	0.7722	92664
4	114000	0.7084	80758
			588230

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

Particulars	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.

Revaluation and subsequent impairment

Q6(b)GreatLtd., acquired a machine on 1stApril, 2012for Rs.7 crore that had an estimated useful life of 7 years. The machine is depreciated on straight line basis and does not carry any residual value. On 1stApril, 2016, the carrying value of the machine was reassessed at Rs.5.10 crore and the surplus arisingout of the revaluation being credited to revaluation reserve. For the year ended March 2018, conditions indicating an impairment of the machine existed and the amount recoverable ascertained to be only Rs.79 lakhs.

Calculate the loss on impairment of the machine and show how this loss is to be treated in the books of GreatLtd. GreatLtd., had followed the policy of

writing down the revaluation surplus by the increased charge of depreciation resulting from the revaluation. (MTP Aug 2018)

[video link: https://youtu.be/Kb9I2bxqTW4?t=1491]

Answer

Statement Showing Impairment Loss(Rs.in crores)

Carrying amount of the machine as on 1st April,2012		7.00
Depreciation for 4 years i.e. 2012-2013to 2015-2016		
7 croresx 4 years / 7 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 croresx 2 years / 3 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		(0.70)
Impairment Loss to be debited to profit and loss account		0.21

X Ltd. purchased a Property, Plant and Equipment four years ago forRs.150 lakhs and depreciates it at 10% p.a. on straight line method. At the end of the fourth year, it has revalue d the asset at Rs.75 lakhs and has written off the loss on revaluation to the profit and loss account. However, on the date of revaluation, the market price is Rs.67.50 lakhs and expected disposal costs are Rs.3 lakhs. What will be the treatment in respect of impairment loss on the basis that fair value for revaluation purpose is determined by market value and the value in use is estimated at Rs.60 lakh s? (MTP March 2019)

[video link: https://youtu.be/LhgsQrpYMrA?t=1741]

Value in use determination

6. (a) 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 Rs. 5,00,000 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 Rs. 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 Rs.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 Rs.160 to manufacture, which includes Rs.110 variable costs, Rs.30 share of fixed overheads and Rs.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 Rs.50,000.

•In 20X3-X4, East expects to invest in new technology costing Rs.1,00,000. This technology will reduce the variable costs of manufacturing each steering wheel from Rs.110 to Rs.100 and the share of fixed overheads from Rs.30 to Rs.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 Rs.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? (MTP March 2021) / (RTP Nov 19)

[video link: https://youtu.be/_ZCD35jA43o?t=145]

Answer

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 Rs. 80,000 from the disposal of the asset in March, 20X8. Cash outflows include routing capital expenditures of Rs. 50,000 in 20X5-X6

As per Ind AS 36, estimates of future cash flowsshall 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. Rs. 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-X6	20X6-X7	20X8-X9	VIU
Quantity	10,000	10,500	11025	11576	12,155	
Price per unit	200	206	212	219	225	
Estimated cash flow	20,00,000	21,63,000	23,37,300	25,35,144	27,34,875	
Misc cash inflow disposal proceeds					80,000	
Total	20,00,000	21,63,000	23,37,300	25,35,144	28,14,875	
Cost per unit	160	162	165	168	171	
Estimated cash outflows	16,00,000	17,01,000	18,19,125	19,44,768	20,78,505	
Misc. cash outflow:			50,000			

maintenance costs						
Total	16,00,000	17,01,000	18,69,125	19,44,768	20,78,505	
Net cash flows Discount factor 8% Discounted future cash flows	400,000 0.9259 370,360	462,000 0.8573 396,073	468,175 0.7938 371,637	590,376 0.7350 433,926	736,370 0.6806 501,173	 20,73,169

Reversal of impairment loss

6. (b) Himalaya Ltd. which is in a business of manufacturing and export of its product. Sometimes, back in 2016, 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 Rs.4,000 lakhs for Rs.6,000 lakh at the end of the year 2012. T he difference is treated as goodwill. T he useful life of identifiable assets is 15 years and depreciated on straight line basis. When Government put the restriction at the end of 2016the company recognised the impairment loss by determining the recoverable amount of assets for Rs.2,720 lakh. In 2018,Government lifted the restriction imposed on the export and due to this favourable change, Himalaya Ltd. re-estimate recoverable amount, which was estimated at Rs.3,420 lakh.

Required:

(i)Calculation and allocation of impairment loss in 2016.

(ii)Reversal o f impairment loss and its allocation in 2018. (MTP April 2019)

[video link: https://youtu.be/LhgsQrpYMrA?t=1139]

Answer

(i) Calculation and allocation of impairment loss in 2016

	Goodwill	Identifiable Assets	Total
Historical cost Accumulated depreciation/amortisation (4 yrs.) Carrying amount before impairment Impairment loss* Carrying amount after impairment loss	2000 (1600) 400 (400) 0	4000 (1067) 2933 (213) 2720	6000 (2667) 3333 (613) 2720

(ii)Carrying amount of the assets at the end of 2018(Am ount in Rs.lakhs)

End of 2018	Identifiable assets
Carrying amount in 2018	2,225

Add: Reversal of impairment loss (W.N.2)	175
Carrying amount after reversal of impairment loss	2,400

Working Note:

1.Calculation of depreciation after impairment till 2018and reversal of impairment loss in 2018. (Amount in Rs.lakhs)

	Identifiable assets
Carrying amount after impairment loss in 2016	2,720
Additional depreciation (i.e. (2,720/11) x 2)	(495)
Carrying amount	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 2018

3(b) A Limited purchased an asset of ` 200 lakh on 1st April 2017. It has useful life of 4 years with no residual value. Recoverable amount of the asset is as follows:

As on	Recoverable amount
31st March 2018	` 120 lakh
31st March 2019	` 80 lakh
31st March 2020	` 56 lakh

Calculate the amount of impairment loss or its reversal, if any,

- **On 31st March 2018;**
- **On 31st March 2019;**
- **On 31st March 2020.**

Depreciation is provided on SLM basis under the cost method. (Exam July 2021)

[video link: https://youtu.be/tZSGT1KBYBI?t=1600]

Answer

As on 31st March, 2018

Carrying amount of the asset (opening balance)	` 200 lakh
Depreciation (` 200 lakh / 4 years)	(` 50 lakh)
Carrying amount of the asset (closing balance)	` 150 lakh
Recoverable amount (given)	120 lakh
Difference	30 lakh

Therefore, an impairment loss of ` 30 lakh should be recognised as on 31st March, 2018. Depreciation for subsequent years should be charged on the carrying amount of the asset (after providing for impairment loss), i.e., ` 120 lakh.

As on 31st March, 2019

Carrying amount of the asset (opening balance)	` 120 lakh
Depreciation (` 120 lakh / 3 years)	(` 40 lakh)
Carrying amount of the asset (closing balance)	` 80 lakh
Recoverable amount (Given)	` 80 lakh
Difference	NIL

Therefore, no impairment loss should be recognised as on 31 st March, 2019.

As on 31st March, 2020

Carrying amount of the asset (opening balance)	` 80 lakh
Depreciation (` 80 lakh / 2 years)	(` 40 lakh)
Carrying amount of the asset (closing balance)	` 40 lakh
Recoverable amount (given)	56 lakh
Difference	(16 lakh)

Since, the recoverable amount of the asset exceeds the carrying amount of the asset by ` 16 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 amortization or depreciation) had no impairment loss been recognized for the asset in prior years. Carrying amount as on 31st March, 2020 had no impairment loss being recognised would have been ` 50 lakh [ie. ` 200 lakh – (200 lakh / 4 x 3)].

Therefore, the reversal of an impairment loss of ` 10 lakh (` 50 lakh - ` 40 lakh) should be done as on 31st March, 2020.

Impairment of Foreign asset

10.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 20)

[video link: https://youtu.be/_ZCD35jA43o?t=1389]

Answer

Ignoring depreciation, the loss that would be reported in the Profit and Loss as a result of the impairment isas 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 recognised in profit and loss	(2,25,000)
The components of the impairment loss can be analysed 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.

Cash Generating unit

2(a)XYZ Limited has three cash-generating units-X, Y and Z, the carrying amounts of which as on 31st March, 2018 are as follows:

Cash Generating Units	Carrying Amount (`in lakh)	Remaining useful life in years
X	800	20
Y	1000	10
Z	1200	20

XYZ Limited also has corporate assets having a remaining useful life of 20 years as given below:

Corporate Assets	Carrying amount(` in lakh)	Remarks
AU	800	The carrying amount of AU can be allocated on a reasonable basis to the individual cash generating units.
BU	400	he carrying amount of BU cannot be allocated on a reasonable basis to the individual cash-generating units.

Recoverable amounts as on 31st March, 2018 are as follows:

Cash-generating units	Recoverable amount (` in lakh)
X	1000
Y	1200
Z	1400
XYZ Limited	3900

Calculate the impairment loss if any of XYZ Ltd. Ignore decimals. (Exam Nov 18) / (Exam nov 20) / (MTP March 22)

[video link: https://youtu.be/T-m-BV2IQxc?t=1915]

Answer

(a)(i)Allocation of corporate assets to CGU T he carrying amount of AU 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 Y's cash-generating unit is 10 years, whereas the estimated remaining useful lives of X and Z's cash-generating units are 20 years.

Particulars	X	Y	Z	Total
Carrying amount	800	1000	1200	3000
Useful life	20	10	20	
Weight based on above	16000	10000	24000	50000
Pro rata allocation of AU	32%	20%	48%	100%
Carrying Amount Allocation of AU	800 256	1000 160	1200 384	
Total	1056	1160	1584	
Recoverable Amount	1000	1200	1400	
Impairment Loss	56	Nil	184	
Allocation of impairment loss AU (56x256/1,056) (184x384/1,584) Others	14		45	

(56x800/1056) 184x1,200/ 1,584)	42		139	
Post impairment Carrying amount AU BU	758	1000	1061	2819 741 400
Total Recoverable Amount				3960 3900
Impairment Loss				60

1. 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 19) / Exam Nov 22

[video link: https://youtu.be/LhgsQrpYMrA?t=2437]

Answer

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	5years
Yearly depreciation(B)	`95,000
WDV as at 31stMarch, 2018[A-(B x 5)]	`5,25,000

Machinery B

Cost (C)	`5,00,000
Residual Value	
Useful life10 years	0
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 valueless 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 31stMar 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).

Concept of impairment under total and partial goodwill method in CFS

	Total Goodwill method	Partial goodwill method
S1	Goodwill is equal to carrying amount in CFS	Goodwill is determined as CA divided by %age held by holding company
	Credit part	
S2	Allocate impairment loss first to goodwill completely and balance if any to remaining assets proportionately	Allocate impairment loss first to goodwill completely and balance if any to remaining assets proportionately
	Debit part	
S3	Impairment loss related to goodwill is allocated to both Conso PL and NCI	First determine Impairment loss multiplied by %age held by holding and such amount is allocated to Conso PL completely, remaining amount to be ignored
S4	Impairment loss related to other assets allocated to both Conso PL and NCI	Impairment loss related to other assets allocated to both Conso PL and NCI

Impairment Total Goodwill method

Q3(b) Sun Ltd.is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31stMarch. On 1stJuly 2015Sun ltd acquired an 80% interest in Pluto ltd. Details of the acquisition were as follows:

–Sun Ltd.acquired 800,000 shares in Pluto Ltd.by issuing two equity shares for every five acquired.The fair value of Sun Ltd.'s share on 1stJuly 2015was Rs.4 per share and the fair value of a Pluto's share was Rs.1.40 per share. The cost of issue was5% per share.

–Sun ltd incurred further legal and professional costs of Rs.100,000 that was directly related to the acquisition.

–The fair values of the identifiable net assets of Pluto Ltd at 1stJuly 2015were measured at Rs.1.3 million. Sun Ltd.initially measured the non-controlling interest in Pluto Ltd.at fair value. They used the market value of a Pluto Ltd.share for this purpose. No impairment of goodwill arising on the acquisition of Pluto Ltd.was required at 31stMarch 2016or 2017.

Pluto ltd comprises three cash generating units A, B and C. When Pluto Ltd.was acquired the directors of Sun Ltd.estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount
	Rs.'000	Rs.'000
A	600	740

B	**550**	**650**
C	**450**	**400**

Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd. in the consolidated Balance Sheet of Sun Ltd.at 31stMarch 2018 following the impairment review. Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto Ltd. (MTP Oct 2018) / (MTP Aug 2018)

[video link: https://youtu.be/Kb9l2bxqTW4?t=1584]

Answer

1.Computation of goodwill on acquisition

Particular	Amount (Rs.'000)
Cost of investment (8,00,000 x 2/5 x Rs.4)	1,280
Fair value of non-controlling interest (2,00,000 x Rs.1·4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
So goodwill equals	260

Acquisition costs are not included as part of the fair value of the consideration given under Ind AS 103, Business Combination.

2. Calculation of impairment loss

Unit	Carrying value			Recoverable Amount	Impairment Loss
	Before Allocation	Allocation of goodwill (2:2:1)	After Allocation		
A B C	600 550 400	104 104 52	704 654 452	740 650 400	Nil 4 52

*After writing down assets in the individual CGU to recoverable amount.

3.Calculation of closing goodwill

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4.Calculation of overall impairment loss

On goodwill (W3)	56
On assets in unit C (450 –400)	50
So total loss equals	106

Rs.21.2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

Impairment Partial Goodwill method

1(b)On 1 July 20X1, FA Ltd acquired 75% of the equity shares of Bolton Ltd and gained control of Bolton Ltd. Bolton Ltd has 12 million equity shares in issue. Details of the purchase consideration are as follows:
–On 1 July 20X1, FA Ltd issued two shares for every three shares acquired in Bolton Ltd. On 1 July 20X1, the market value of an equity share in FA Ltd was Rs.6.50 and the marketvalue of an equity share in Bolton Ltd was Rs. 6.00.
–On 30 June 20X2, FA Ltd will make a cash payment of Rs. 7.15 million to the former shareholders of Bolton Ltd. who sold their shares to FA Ltd on 1 July 20X1. On 1 July 20X1, FA Ltd would have needed to pay interest at an annualrate of 10% on borrowings.
–On 30 June 20X3, FA Ltd may make a cash payment of Rs. 30 million to the former shareholders of Bolton Ltd who sold their shares to FA on 1 July20X1. This payment is contingent upon the revenues of FALtd.growing by 15% over the two-year period from 1 July 20X1to 30 June 20X3.
On 1 July 20X1, the fair value of this contingent consideration was Rs. 25 million. On 31 March 20X2, the fair value of the contingent consideration was Rs. 22 million.On 1 July 20X1, the carrying values of the identifiable net assets of Bolton Ltd in the books ofthat company totaled Rs. 60 million. On 1 July 20X1, the fair values of these net assets totaled Rs. 70 million. The rate of deferred tax to apply to temporary differences is 20%.During the nine months ended on 31 March 20X2, Bolton Ltd had a poorer than expected operating performance. Therefore on 31 March 20X2, it was necessary for FA Ltd to recognize an impairment of the goodwill arising on acquisition of Bolton Ltd, amounting to 10% of its total computed value.Compute the impairment of goodwill onacquisition of Bolton Ltd under both the methods permitted in the relevant Ind AS for the initial computation of the non-controlling interest in Bolton Ltd at the date of acquisition. (MTP May 2020) / (Exam May 22)
[video link: https://youtu.be/LhgsQrpYMrA?t=114]

Answer

Method I : NCI measured at Fair value

Method II: NCI measured at proportionate share of identifiable net assets

	Method I Rs.'000	Method II Rs.'000
Cost of investment		
Share exchange (12 million x 75% x2/3 xRs.6·50)	39,000	39,000
Deferred consideration (7.15 million/1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value –3 million x Rs.6·00	18,000	

% of net assets –68,000 (W.N.1) x 25%	17,000	
	88,500	87,500
Net assets at date of acquisition (W.N.1)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment –10%	2,050	1,950

Where the NCI is measured at fair value, the impairment should be attributed partly to retained earnings and partly to NCI. The allocation is normally based on the group structure (75/25 in this case).

Where the NCI is measured at % of net assets, the impairment should be attributed whollyto retained earnings.

Working Notes:

1.Net assets at date of acquisition	Rs. '000
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments (20% x(70,000 –60,000))	(2,000)
	68,000

20.On 31 March 20X1, VisionLtd acquired 80% of the equity shares of MissionLtd for `190 million. The fair values of the net assets of MissionLtd that were included in the consolidated statement of financial position of VisionLtd 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, VisionLtd carried out its annual review of the goodwill on consolidation of MissionLtd and found evidence of impairment. No impairment had been evident when the reviews were carried out at31 March 20X2 and 31 March 20X3. The review involved allocating the assets of MissionLtd 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)

[video link: https://youtu.be/_ZCD35jA43o?t=2358]

Answer

The goodwill on consolidation of MissionLtd that is recognized in the consolidated balance sheetof VisionLtd 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 togetheri.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 is `350 million:(`in million)

Asset	Impact on carrying value		
	Existing	Impairment	Revised
Goodwill (see note below)	37.5	23.5	14
Unit A	170	0	170
Unit B(revised)	66	0	66
Unit C	100	0	100
Total	373.5	23.5	350

Note: As per Appendix C of Ind AS36, 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)

Ind AS 37

Provisions

5(c)During the year, QA Ltd. delivered manufactured products to customer K. T he products were faulty and on 1stOctober, 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. T herefore, on 1stDecember, 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 1stOctober, 2016, QA Ltd. has estimated that the damages it would have to pay K would be Rs.5 crores. T his estimate was revised to Rs.5.2 crores as on 31stMarch, 2017 and Rs.5.25 crores as at 15thMay, 2017. T his case was eventually settled on 1stJune, 2017, when the Company paid damages of Rs.5.3 crores to K.

On 1stDecember, 2016, QA Ltd. had estimated that it would receive damages of Rs.3.5 crores from F. T his estimate was revised to Rs.3.6 crores as at 31stMarch, 2017 and Rs.3.7 crores as on 15thMay, 2017. T his case was eventually settled on 1stJune, 2017 when F paid Rs.3.75 crores to QA Ltd. QA Ltd. had, in its financial statements for the year ended

31stMarch, 2017, provided Rs.3.6 crores as the financial statements were approved by the Board of Directors on 26thApril, 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 on31stMarch, 2017? Give brief reasoning for your choice.
(A)Statement of Profit and Loss A/c Dr. Rs.5.2 crores
T o Current Liability A/c Rs.5.2 crores
(B) Statement of Profit and Loss A/c Dr. Rs.5.3 crores
T o Non-Current Liability A/c Rs.5.3 crores
(C)Statement of Profit and Loss A/cDr. Rs.5.25 crores
T o Current Liability A/c Rs.5.25 crores
(iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable Ind AS? (MTP March 2019)
[video link: https://youtu.be/T-m-BV2IQxc?t=122]
Answer
(i)Yes, QA Ltd. is required to make provision for the claim from customer K as per IndAS 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 ofRs.5.2 crore can be made of the amount of the obligation while preparing the financial statements as on 31stMarch, 2017.
(ii)Option (A) : Statement of Profit and Loss A/c Dr. Rs.5.2 crore
To Current Liability A/c Rs.5.2 crore
(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 onl y and shall not be recognized.

18.(a)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 warrantyhas 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?

(b) Assume thatthe 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 `20,00,000would result.

•If majordefects are detected in all products, costs of `50,00,000would 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. (RTP Nov 19)

[video link: https://youtu.be/T-m-BV2IQxc?t=1191]

Answer

(a)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 24of 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.

(b)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

5. XYZ Ltd. offers a six-month warranty on its small to medium sized equipment, which can be put to use by the customer with no installation support. The warranty comes with the equipment and the customer cannot purchase it separately. This equipment is typ ically sold at a gross margin of 40%. XYZ Ltd. has made a provision of ` 30,000 during the year ended 31st March, 20X2, which is approximately 1% of its gross margin on the sale of these equipment. Based on past experience, it is expected that 1% of equi pment sold have been returned as faulty within the warranty period. Faulty equipment returned to XYZ Ltd. during the warranty period are scrapped and the sale value is fully refunded to the customer.

Assuming that sales occurred evenly during the year, how should XYZ Ltd. Evaluate whether any additional warranty provision is required on equipment sold in the past as at 31st March, 20X2? Had the warranty period been 2 years instead of six months, what additional criteria would XYZ Ltd. need to consider? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=1887]

Answer

Calculation of additional warranty provisions:

Warranty claim covers 1% of gross margin, whereas customers are refunded the full selling price. As the goods are scrapped it is assumed XYZ Ltd has no potential for re - imbursement from its supplier regarding the faulty goods. A calculation of warranty provision is set out below:

1% of annual gross margin is ` 30,000 therefore 100% of annual gross margin must be ` 30,00,000. Since gross margin is 40%, sales should be ` 75,00,000. As provide in the question that the sales are evenly spread during the year and given the six month warranty, half of the sales occurred in the second half of the year is still covered within the warranty period as follows.

	% age	Annual sales	Product under warranty at	Percentage expected to	Warranty provision

			31st March, 20X2	be returned	
Gross margin Selling price	40 100	30,00,000 75,00,000	37,50,000	1%	37,500

The warranty provision should therefore be increased by ` 7,500 (` 37,500 – ` 30,000).

As the provision is expected to be used in the next 6 months no discounting is required.

If the warranty period is 2 years:

Since the outstanding period of warranties is 6 months (i.e. less than a year), no discounting is required. However, if a longer warranty period is to be given, the entity will have to take into account the effect of the time value of money. The amount of provision shall be the present value of the expenditures expected to be required to settle the warranty obligation. (Refer Para 45 of Ind AS 37)

The discount rate shall be a pre-tax rate that reflects current market assessments of thetime value of money and the risks specific to the liability. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted. (Refer Para 47 ofInd AS 37)

	% age	Annual sales	Product under warranty at 31st March, 20X2	Percentage expected to be returned	Warranty provision
Gross margin Selling price	40 100	30,00,000 75,00,000	75,00,000	1%	75,000

The warranty provision should therefore be increased by ` 45,000 (` 75,000 – ` 30,000).

Further discounting of provision would be required.

Onerous contract

6.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 20)

[video link: https://youtu.be/T-m-BV2IQxc?t=1637]

Answer

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).

1(b)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 en try. (Exam May 18)

[video link: https://youtu.be/TLMSnxy-QW0?t=2156]

Answer

(b)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. T herefore, a provision should be made for the onerous element of `4,00,000 ie the full cost of the machine.

Onerous Contract Provision ExpenseA/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 ExpenseA/c		4,00,000
(Being loss due to onerous contract recognized and asset derecognsied)		

15. HVCL manufactures heavy equipment for construction industry. An order for supply of 90 equipment was received from ABIL. The unit price of the equipment was agreed at ` 190 lakhs each. 64 equipment was supplied during the year 20X1-20X2 and balance quantity remaining to be supplied as on 31.3.20X2. HVCL has 5 equipment in its inventory as on 31.3.20X2. HVCL considered that the contract was an onerous contract and therefore, the net realisable value of inventory has been taken as value of inventory as on 31.3.20X2.

The management of HVCL contends that costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision. Hence, the same have not been included in the computation of unavoidable cost.

The management of HVCL has submitted the details of costs that have been considered for creation of provision towards onerous contract:

○ Material cost - includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.

○ Labour cost/ Factory Overheads - includes salaries and other expenses of direct production department, and also expenses allocated from indirect departments to direct department.

○ Material Overheads - Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.

Accordingly, provision has been made considering the above costs only. The value of provision created for 21 remaining equipment to be produced is as per the working shown below:

Particulars	Value (` in lakh)
(i) Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
(ii) Selling price	(190.00)
(iii) Differential cost per equipment	9.00
(iv) Differential cost of ` 9 Lakh per equipment for 21 equipment	189.00

Whether the company's accounting treatment of cost for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37? (RTP Nov 22)

Answer

As per para 68 of Ind AS 37, onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable cost under a contract reflects the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation for penalties arising from failure to fulfilling it.

Ind AS 37 provides that the amount recognised shall be the best estimate of the expenditure required to settle the present obligation, which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. In case of onerous contracts, an amount that an entity would rationally pay to settle the obligation would be the lower of the compensation or penalties arising from failure to fulfil the contacts and excess of unavoidable cost of meeting the obligations under the contract from the economic benefits expected to be received under it.

As per para 68 of Ind AS 37, the cost of fulfilling a contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract consist of both –

(a) the incremental costs of fulfilling that contract—for example, direct labour and materials; and

(b) an allocation of other costs that relate directly to fulfilling contracts — for example, an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling that contract among others.

The unavoidable costs of meeting the obligations under the contract are only costs that:

• "are directly variable with the contract and therefore incremental to the performance of the contract;"

• do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and

• cannot be avoided by the entity's future actions.

Accordingly, HVCL has correctly measured the cost for creation of provision for onerous contracts by considering material cost, labour cost (to the extent it relates directly to production) and material overheads (to the extent it relates directly to production).
Further, HVCL is correct that the period cost will not be considered for measurement of cost for the purpose of creation of provision on onerous contracts as they do not relate directly to fulfilling the contracts.

Ind AS 38

1(b)CARP Ltd.is engaged in developing computer software. The expenditures incurred by CARP Ltd. in pursuance of its development of software is given below:

(i) Paid ` 1,50,000 towards salaries of the program designers.

(ii) Incurred ` 3,00,000 towards other cost of completion of program design.

(iii) Incurred ` 80,000 towards cost of coding and establishing technical feasibility.

(iv) Paid ` 3,00,000 for other direct cost after establishment of technical feasibility.

(v) Incurred ` 90,000 towards other testing costs.

(vi) 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 ` 60,000.

(vii) On 15 March 2020, the development phase was completed and a cash flow budget was prepared.

Net profit for the year 2019-2020 was estimated to be equal to ` 30,00,000. How CARP Ltd. should account for the above -mentioned cost as per relevant Ind AS? (MTP Oct 2020) / (Exam Nov 19)

[video link: https://youtu.be/TLMSnxy-QW0?t=97]

Answer

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, `5,30,000 (salary cost of `1,50,000, program design cost of `3,00,000 and coding and technical feasibility cost of `80,000) would be recorded as expense in Profit and Loss since it belongs to research phase.

Cost incurred from the point of technical feasibility are capitalised as software costs. But the conference cost of `60,000 would be expensed off.

In this situation, direct cost after establishment of technical feasibility of `3,00,000 and testing cost of `90,000 will be capitalised.

The cost of software capitalised is = `(3,00,000 + 90,000) = `3,90,000.

11.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 believesthat 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 31stMarch 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 longterm 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 20)

[video link: https://youtu.be/TLMSnxy-QW0?t=343]

Answer

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 criterionto 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 ofa 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 accountwill be:

Operating expenses-Development expenditureDr.	3,00,000
Operating expenses–Impairment loss of intangible assetsDr.	5,40,000
To Intangible assets –Development expenditure	8,40,000

10. X Ltd. purchased a franchise from a restaurant chain at a cost of ` 1,00,00,000 under a contract for a period of 10 years. Can the franchise right be recognised as an intangible asset in the books of X Ltd. under Ind AS 38 (MTP Oct 22)

Answer

Ind AS 38 ‘Intangible Assets’, defines asset and intangible asset as under:

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 considering an asset as an intangible asset, an entity must be able to demonstrate that the item satisfies the criteria of identifiability, control over a resource and existence of future economic benefits. In the given case, the franchise right meets the identifiability criterion as it is arising from contract to purchase the franchise right for 10 years. In addition, X Ltd. will have future economic benefits and control over them from the franchise right. Accordingly, the franchise right meets the definition of intangible asset. The same can be recognised if the following recognition criteria laid down in para 21 of Ind AS 38 is met:

An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

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

In the instant case, identifiability criterion is fulfilled, future economic be nefits from franchise right are expected to flow to the entity and cost can also be measured reliably, therefore, X Ltd. should recognise the franchise right as an intangible asset.

4. (a) The Company has taken a particular application software of a supplier namely, Crystal Systems Limited, which is available on a cloud infrastructure managed and controlled by the Crystal Systems Limited. The Company contracts to pay a fee of ` 5,00,000 per month in exchange for a right to receive access to the Crystal Systems Limited's application software for 2 years. The Company accesses the software on need basis over the internet. The contract does not convey any rights to New Age Technology Limited over the tangible assets of the Crystal Systems Limited. The Chief Accountant of New Age Technology Limited has sought your advice, whether the IT should account for this transaction for use of software with Crystal Systems Limited in terms of Ind AS 116 leases or an intangible asset in terms of Ind AS 38 'Intangible Assets'. Help him to understand your assessment. (MTP March 22)

[video link: https://youtu.be/H5VbXddxqI4?t=3283]

Answer

Assessment of applicability of Ind AS 38 in the given scenario As per Ind AS 38, to be an intangible asset the asset should meet following criteria:

• Identifiability;

• Control over a Resource (Asset); and

• Existence of Future Economic Benefits.

Crystal Systems Limited manages and controls the application software available on a cloud infrastructure and New Age Technology Limited has limited rights to use the same. Merel y right to access the application of Crystal Systems Limited, does not give New Age Technology Limited power to obtain future economic benefits flowing from the software itself. Hence, the application software should not be recognised as an asset under Ind AS 38.

Assessment of applicability of Ind AS 116 in the given scenario

At the inception of a contract, an entity shall assess whether the contract is or contains a lease. For the purpose, a lease is defined as a contract, or part of a contract that conv eys the right to control the use of an identified asset for a period of time in exchange for consideration. This right to control the asset throughout the period of use is emphasized ONLY if the customer has both (i) right to obtain substantially all the economic benefits from the use of the identified asset, and (ii) the right to direct the use of the identified asset. In the given case, the contract gives the New Age Technology Limited only the right to access the Crystal Systems Limited's application software over the contract term, and hence the contract is not a lease contract within the meaning of Ind AS 116.

Conclusion
The right to access the Crystal Systems Limited's application software for a price over a specified period is a service contract. If the Crystal Systems Limited pays amounts for which the services are yet to be received, then the advance payment is a prepayment and an asset for the Crystal Systems Limited.

Useful Life

12. An entity has an intangible asset in the form of a product protected by patented technology which is expected to be a source of net cash inflows for at least 15 years. It has been recognised in the books on initial date at ` 12,00,000. 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. Company is amortising the asset in 15 years considering its residual value to be Zero. Annual amortization charged to Profit and Loss is ` 80,000. State, whether the accounting treatment done by the Company is in accordance with Ind AS 38? If not, then calculate the annual amortization of the

intangible asset and also the amount at which it will be reflected in the balance sheet. (RTP Nov 22)

Answer

For determination of amortisation of the intangible asset, which has finite useful life, two elements need to be determined: useful life and residual value. Useful life is defined as:

(a) the period over which an asset is expected to be available for use by an entity; or
(b) the number of production or similar units expected to be obtained from the asset by an entity.

In the instant case, since the entity expects that the asset will be available for use by it for the period of 5 years and thereafter it will be transferred, the us eful life of the asset is 5 years.

For residual value, paragraphs 100-102 of Ind AS 38 states that the residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:
(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or

(b) there is an active market (as defined in Ind AS 113) for the asset and:

(i) residual value can be determined by reference to that market; and

(ii) it is probable that such a market will exist at the end of the asset's useful life.

The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used.

On application of above paragraphs, the depreciable amount of the patent will be determined after deducting the residual value, which is 60% of its fair value at the date of its acquisition. Accordingly, the patent will be amortised over its useful life of 5 years, with a residual value equal to 60% of its fair value at the date of its acquisition. The patent will also be reviewed for impairment in accordance with Ind AS 36. Therefore, the accounting policy of amortising the asset over a period of 15 years considering its residual value of Zero is not in accordance with Ind AS 38.
Computation of correct amount of residual value and annual amortization:

Cost of Intangible asset	12,00,000

Residual value (60% of ` 12,00,000)	7,20,000
Depreciable value of intangible asset (12,00,000 – 7,20,000)	4,80,000
Useful life	5 years
Annual amortisation (4,80,000 / 5)	` 96,000 p.a.

Deferred payment

18. D Ltd. a leading publishing house, purchased copyright of a book from its author for publishing the same. As per the terms of the contract, if D Ltd. chooses to make the payment upfront then, copyright consideration of ` 80,00,000 is to be paid (which is in line with general practice in such arrangements). However, the contract also provided that, in case D Ltd. chooses to pay the consideration after 2 years, then it will be required to pay ` 1,00,00,000. At what value should the intangible asset be recognised as per Ind AS 38? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=5749]

Answer

As per paragraph 32 of Ind AS 38, "If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with Ind AS 23, Borrowing Costs."

In the given case, if the payment for an intangible asset i.e. copyright is deferred beyond normal credit terms, the cash price equivalent ` 80,00,000 should be considered as its cost and the intangible asset will be recorded initially at this value.
The difference of ` 20,00,000 between cash price equivalent (i.e. ` 80,00,000) and the total payment (i.e. ` 1,00,00,000) should be recognised as interest expense over the period of credit (i.e. 2 years in this case), unless it is eligible for capitalisation in accordance with Ind AS 23, Borrowing Costs.

Internally generated intangible asset

4.PQR Ltd. is agaming 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)

[video link: https://youtu.be/TLMSnxy-QW0?t=1254]

Answer

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, internallygenerated 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 analused.

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 beenpurchased 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

Player as ITA

14.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 cannotleavethe 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 20)

[video link: https://youtu.be/TLMSnxy-QW0?t=824]

Answer

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 anentity 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 becausean entity may be able to control the future economic benefits in some other way.

Further, paragraph 15 of Ind AS 38 provides thatan 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 5years.

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 assessmentof relevant facts and circumstances of each case is required to be made.

Advertisement cost

6a A Ltd. intends to open a new retail store in a new location in the next few weeks. It has spent a substantial sum on a series of television advertisements to promote this new store. It has paid for advertisements costing Rs. 8,00,000 before 31st March, 20X2. Rs. 7,00,000 of this sum relates to advertisements shown before 31st March, 20X2 and Rs. 1,00,000 to advertisements shown in April, 20X2. Since 31st March, 20X2, A Ltd. has paid for further advertisements costing Rs. 4,00,000. The accountant charged all these costs as expenses in the year to 31 March 20X2. However, CFO of A Ltd. does not want to charge Rs.12,00,000 against my 20X1-20X2 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.
[video link: https://youtu.be/TLMSnxy-QW0?t=2381]
Answer

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. T herefore, 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.

T herefore, of the advertisements paid for before 31st March, 20X2, Rs. 7,00,000 would be recognised as an expense and Rs. 1,00,000 as a pre-payment in the year ended 31st March 20X2.Rs. 4,00,000 cost of advertisements paid for since 31st March, 20X2would be charged as expenses in the year ended 31st March, 20X3

Ind AS 40

Note
1. Transfer from Ind AS 40 to 16/2 or vice versa is done at carrying amount
2. If significant (not majority) portion is owner occupied and separability of property is not possible then such property is accounted as owner occupied prperty

(c)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, 20X2:

Building A was purchased 5 years ago at the cost of Rs.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, 20X1 at the cost of Rs.2 crore. Expected life of the building is 40 years. As usual, the company follows straight line method of depreciation.

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

Rental income from Building A= Rs. 75 lakh

Rental income from Building B= Rs. 25 lakh

Sales promotion expenses= Rs. 5 lakh

Fees & Taxes= Rs. 1 lakh

Ground rent= Rs. 2.5 lakh

Repairs & Maintenance= Rs. 1.5 lakh

Legal & Professional= Rs. 2 lakh

Commission and brokerage= Rs. 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 buildings A and B. The independent valuer has valued the fair value of property as per the valuation model recommended by International valuation standards committee. Fair value has been computed by the method by streamlining present value of future cash flows namely, discounted cash flow method.

The other key inputs for valuation are as follows:

The estimated rent per month per square feet for the period is expected to be in the range of Rs. 50 - Rs. 60. It is further expected to grow at the rate of 10 percent per annum for each of 3 years. The weighted discount rate used is 12% to 13%.

Assume that the fair value of properties based on discounted cash flow method is measured at Rs.10.50 crore on 31st March, 20X2.

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. (MTP March 2021) / (RTP Nov 20)

[video link: https://youtu.be/ieWXIYSRW6A?t=102]

Answer

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, 20X2 (Rs. 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, 20X2 are as follows:

Amount recognised in Profit and Loss with respect to Investment Properties

Particulars	Period ending 31st March, 20X2(Rs. 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 31stMarch, 20X2, the fair value of the properties is Rs.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 propertiesand 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	-Rs. 50 to Rs. 60 -10% every 3 years -12% to 13%

Reclassification

9.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) / (Exam May 22)
[video link: https://youtu.be/ieWXIYSRW6A?t=891]
Answer
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 constructionof 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.

Ind AS 41

14.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) / (MTP Sept 22)

[video link: https://youtu.be/ieWXIYSRW6A?t=2263]

Answer

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 fallin 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 drugs -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.

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, orfor conversion into agricultural produce or into additional biological assets. Hence, they are outside the scope of Ind AS 41.

3(b)A farmer owned a dairy herd of three years old cattle as at 1st April, 20X1 with a fair value of Rs. 13,750 and the number of cattle in the herd was 250. The fair value of three year cattle as at 31st March, 20X2 was Rs. 60 per cattle. The fair value of four year cattle as at 31st March, 20X2 is Rs. 75 per cattle. Calculate the measurement of group of cattle as at 31st March, 20X2 stating price and physical change separately. (MTP April 2021)

[video link: https://youtu.be/ieWXIYSRW6A?t=1293]

Answer

Particulars	Amount (Rs.)
Fair value as at 1st April, 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 31st March, 20X2	18,750

9.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.The auctioneer charges 2% of the selling price, from both, the buyer as well as the seller.

Calculate the amount at which cattle is to be recognised in books on initial recognition and at year end 31st March,2020 (RTP Nov 20) / (MTP Nov 21)

[video link: https://youtu.be/ieWXIYSRW6A?t=1512]

Answer

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

5(c) 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 Jan 21)

[video link: https://youtu.be/ieWXIYSRW6A?t=2787]

Answer

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.

6a As at 31st March, 20X1, 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. T he 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, 20X1: 171
As at 31st March, 20X2: 165
Assume that there would be immaterial cash flow between now and point of harvest.
The present value factor of Rs. 1 @ 6% for
19th year = 0.331
20th year = 0.312
State the value of such plantation as on 31st March, 20X1 and 20X2 and the gain or loss to be recognised as per Ind AS. (MTP Oct 2019)
[video link: https://youtu.be/ieWXIYSRW6A?t=3070]
Answer

As at 31st March, 20X1, the mature plantation would have been valued at 17,100 (171 x 100).As at 31st March, 20X2, the mature plantation would have been valued at 16,500 (165 x 100)

Assuming immaterial cash flow betweennow 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, 20X1: 17,100 x 0.312 = 5,335.20.

As at 31st March, 20X2: 16,500 x 0.331 = 5,461.50.

Gain or loss

The difference in fair value of the plantation between the two yearend 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).

(a) Sewa Dairy Limited prepares financial statements on 31st March each year. On 1st April 2020 the Company carried out the following transactions:

- **Purchased a land for ` 60 lakh.**
- **Purchased 200 dairy cows (Average age at 1 st April 2020 - 2 years) for ` 20 lakh.**

Received a non-refundable grant of ` 10 lakh towards the acquisition of the cows.

During the year ending 31st March 2021, the Company on its dairy cows incurred
` 8.50 lakh to maintain their condition (food and protection) and ` 4.60 lakh as breeding fee to a local farmer.

On 1st October 2020,120 calves were born. There were no other changes in the number of animals during the year ended 31st March 2021. Sewa Dairy Limited had 3,200 litres of unsold milk in inventory as on 31st March 2021. The milk was sold on 1st and 2nd April· 2021 at market prices.

The information regarding fair values is as follows:

Items	Fair values less cost to sell (All values in `)		
	1st April 2020	1st October 2020	31st March 2021
Land	60 lakhs	70 lakhs	80 lakhs
New born calves (per calf)	2000	2300	2500
6 months old calves (per calf)	2200	2500	2800
2 years old cow (per cow)	10000	10250	10500
3 years old cow (per cow)	10500	10800	11000
Milk per litre	25	27	30

Prepare extracts from the Balance Sheet (assuming land under cost method) and Statement of Profit and Loss that would be reflected in the financial statements of Sewa Dairy Limited for the year ended 31 st March 2021. Discuss the relevant Ind AS in support of your workings

Answer

Extract from the Statement of Profit and Loss of Sewa Diary Limited

for the period ended on 31st March, 2021

	WN	Amount
Income		
Change in fair value of purchased dairy cow	WN 2	2,00,000
Government Grant	WN 3	10,00,000
Change in the fair value of newly born calves	WN 4	3,36,000
Fair Value of Milk	WN 5	96,000
Total Income (A)		16,32,000
Expenses		
Maintenance Costs	WN 2	8,50,000
Breeding Fee	WN 2	4,60,000
Total Expense (B)		(13,10,000)
Net Income (A-B)		3,22,000

Extracts from Balance Sheet of Sewa Diary Limited

As at 31st March, 2021

		`
Property, Plant and Equipment:		
Land	WN 1	60,00,000
Biological assets other than bearer plants:		
Dairy Cow	WN 2	22,00,000
Calves	WN 4	3,36,000
		25,36,000
Inventory:		
Milk	WN 5	96,000

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, which is usually considered to be infinite. Hence, no depreciation would be appropriate.

Under Cost Model, no recognition would be made for post -acquisition changes in the value of land.

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 st March, 2021 at the fair value of 200 x ` 11,000 = ` 22,00,000.

Increase in price change 200 x (10,500 - 10,000) = 1,00,000

Increase in physical change 200 x (11,000 – 10,500) = 1,00,000

The total difference between the fair value of matured herd and its initial cost (` 22,00,000 – ` 20,00,000 = a gain of ` 2,00,000) would be recognised in the profit and loss along with the maintenance cost and breeding fee of ` 8,50,000 and ` 4,60,000 respectively.

3. Grant: Grant 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 fee is charged to income and an asset of 120 x ` 2,800 = ` 3,36,000 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 3,200 x ` 30 = ` 96,000. This is regarded as 'cost' for the future application of Ind AS 2 to the unsold milk.

Grant related to agriculture

1(b) 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 IndAS 20

Accounting for Government Grants and Disclosure of Government Assistance.

Required: Evaluate whether the above accounting treatment madeby the management is in compliance with the applicable Ind AS. If not, advise the correct treatment. (Exam Nov 19)

[video link: https://youtu.be/ieWXIYSRW6A?t=2466]

Answer

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":

(i) 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.

(ii)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 plantby Arun Ltd., then Ind AS 20 will be applicable and not Ind AS 41.

7. ABC Ltd. is in the business of manufacturing an apple beverage and requires large quantity of apples to manufacture such beverage. In order to satisfy its

requirement of apples, it enters into 3 years lease contracts with owners of apple orchards. The lea se contracts are mainly of two types:

(1) Contract 1: The owner of the apple orchard (i.e. the lessor) raises the apple trees to produce apples. ABC Ltd. (i.e. lessee) makes a fixed annual payment to the owner of the apple orchard who is required to cultivate the produce as per the specifications of ABC Ltd. ABC Ltd. harvests the apples itself for fulfilling its requirement of apples.

(2) Contract 2: ABC Ltd. obtains the apple orchard from owner (i.e. the lessor) to raise the apple trees for subsequent harvest of the apples to ensure that the apples are as per the requirements of ABC Ltd. ABC Ltd. makes a fixed annual payment to the owner of the apple orchards (i.e. the lessor).

Explain whether ABC Ltd. is engaged in agricultural activity as per Ind AS 41 in both of the cases? (RTP Nov 22)

Answer

Paragraph 5 of Ind AS 41, Agriculture defines agricultural activity and biological transformation as follows:

"Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets."

"Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset."

Contract 1:

As per contract 1, during the 3 years of the contract, ABC Ltd. only harvests apples from the apple orchards whereas biological transformation is managed by the owners of the apple orchards (i.e. the lessor). Since ABC Ltd. is not involved in the biological transformation of the apple orchards and is only harvesting biological assets , it cannot be said to be an agricultural activity as per Ind AS 41.

Hence, ABC Ltd. is not engaged in agricultural activity as per Ind AS 41.

Contract 2:

As per contract 2, ABC Ltd. obtains the apple orchards and is actively involved in the raising of apple trees in order to ensure that the apples are as per its requirements.
Since, it is actively managing the biological transformation and harvest of biological asset, Hence, ABC Ltd. is engaged in agricultural activity as per Ind AS 41.

Ind AS 101

Ind AS 103 exemption

1b) X Ltd. has a subsidiary Y Ltd. On first time adoption of Ind AS by Y Ltd., it availed the optional exemption of not restating its past business combinations. However, X Ltd. in its consolidated financial statements has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of X Ltd. considering that X Ltd. does not avail the business combination exemption? Will the answer be different if X Ltd. adopts Ind AS after Y Ltd? (MTP April 2018)

[video link: https://youtu.be/JjsC5asTaqI?t=80]

Answer

As per para C1 of Appendix C of Ind AS 101, a first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

Based on the above, if X Ltd. restates past business combinations, it would have to be applied to all business combinations of the group including those by subsidiary Y Ltd. for the purpose of Consolidated Financial Statements.

Para D17 of Appendix D of Ind AS 101 states that i f an entity becomes a first-time adopter later than its subsidiary the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary at the same carrying amounts as in the financial statements of the subsidiary, after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Thus, in case where the parent adopts Ind AS later than the subsidiary then it does not change the amounts already recognised by the subsidiary.

1. On 1st April 20X1, Nuogen Ltd. had granted 1,20,000 share options to its employees with the vesting condition being a service condition as follows:

• Vesting date : 31st March 20X2 - 80,000 share options (1-year vesting period since grant date)

• Vesting date : 31st March 20X5 - 40,000 share options (4-year vesting period since grant date)

Each option can be converted into one equity share of Nuogen Ltd. The fair value of the options on grant date, i.e., on 1st April 20X1 was ` 20. Nuogen Ltd. is required to prepare financial statements in Ind AS for the financial year ending 31st March 20X4. The transition date for Ind AS being 1st April 20X2.

The entity has disclosed publicly the fair value of both these equity instruments as determined at the measurement date, as defined in Ind AS 102.

The previous applicable GAAP for the entity was IGAAP (AS) and therein, the entity had not adopted intrinsic method of valuation.

The share options have not been yet exercised by the employees of Nuogen Ltd. How the share based payment should be reflected in, the books of Nuogen Ltd. as on 31st March 20X4, assuming that the entity has erred by not passing any entry for the aforementioned transactions in the books of Nuogen Ltd. on grant date, i.e. 1st April 20X1? (RTP Nov 22)

Answer

For 80,000 share-based options vested before transition date:

Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments that vested before the date of transition to Ind AS. Hence, Nuogen Ltd. may opt for the exemption given in Ind AS 101 for 80,000 share options vested before the transition date. However, since no earlier accounting was done for these share-based options under previous GAAP too, therefore this led to an error on the transition date, as detected on the reporting date i.e. 31st March, 20X4. Hence, being an error, no exemption could be availed by Nuogen Ltd. on transition date with respect to Ind AS 102.

While preparing the financial statements for the financial year 20X3 -20X4, an error has been discovered which occurred in the year 20X1-20X2, i.e., for the period which was earlier than earliest prior period presented. The error should be corrected by restating the opening balances of relevant assets and/or liabilities and relevant component of equity for the year 20X2-20X3. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2).

Accordingly, on retrospective calculation of Share based options with respect to 80,000 options, Nuogen Ltd. will create 'Share based payment reserve (equity)' by ` 16,00,000 and correspondingly adjust the same though Retained earnings.

For 40,000 share based options to be vested on 31st March, 20X5:

Since share-based options have not been vested before transition date, no option as per Ind AS 101 is available to Nuogen Ltd. The entity will apply Ind AS 102 retrospectively.
However, Nuogen Ltd. did not account for the same at the grant date. This will result in consequential restatement of balances as at 1st April, 20X2 (i.e, opening balance sheet as at 1st April, 20X2). Adjustment is to be made by recognising the 'Share based payment reserve (equity)' and adjusting the retained earnings by ` 2,00,000.
Further, expenses for the year ended 31st March, 20X3 and share based payment reserve (equity) as at 31st March, 20X3 were understated because of non-recognition of 'employee benefits expense' and related reserve. To correct the above errors in the annual financial statements for the year ended 31st March, 20X4, the entity should restate the comparative amounts (i.e., those for the year ended 31 st March, 20X3) in the statement of profit and loss. In the given case, 'Share based payment reserve (equity)' would be credited by ` 2,00,000 and 'employee benefits expense' would be debited by ` 2,00,000

For the year ending 31st March, 20X4, 'Share based payment reserve (equity)' would be credited by ` 2,00,000 and 'employee benefits expense' would be debited by ` 2,00,000.

Working Note:

Period	Lot	Proportion A	Fair value B	Cum exp C = A * B	Expenses C – Prev C
20X1-X2	1 (1yr vesting period)	1/1	16,00,000	16,00,000	16,00,000
20X1 – X2 20X2-X3 20X3-X4	2 (4yr vesting period)	¼ 2/4 3/4	800,000 800,000 800,000	200,000 400,000 600,000	200,000 200,000 200,000

Mix

14.Mathur India Private Limited has to present its first financials under Ind AS for the year ended 31stMarch, 20X3. The transition date is 1stApril, 20X1.The following adjustments were made upon transition to Ind AS:

(a) The Company opted to fair value its land as on the date on transition.The fair value of the land as on 1stApril, 20X1 was `10 crores. The carrying amount as on 1stApril, 20X1 under the existing GAAP was `4.5 crores.

(b) The Company has recognised a provision for proposed dividend of `60 lacs and related dividend distribution tax of `18 lacs during the year ended 31stMarch, 20X1. It was written back as on opening balance sheet date.

(c)The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is `75 lacs.

(d)The Company has an Equity Share Capital of `80 crores and Redeemable Preference Share Capital of `25 crores.

(e) The reserves and surplus as on 1st April,20X1 before transition to Ind AS was `95 crores representing `40 crores of general reserve and `5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.

(f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on 1st April, 20X1 after transition to Ind AS? Show reconciliation between total equity as per AS (Accounting Standards)and as per Ind AS to be presented in the opening balance sheet as on 1st April, 20X1.Ignore deferred tax impact. (RTP Nov 19) / (Exam Dec 21)

[video link: https://youtu.be/JjsC5asTaqI?t=796]

Answer

Computation of balance total equity as on 1st April, 20X1after transition to Ind AS

		`in crore
Share capital-Equity share Capital		80
Other Equity		
General Reserve	40	
Capital Reserve	5	
Retained Earnings (95-5-40)	50	
Add: Increase in value of land (10-4.5)	5.5	
Add: De recognition of proposed dividend (0.6 + 0.18)	0.78	
Add: Increase in value of Investment	0.75	102.03
Balance total equity as on 1st April, 20X1after transition to Ind AS		182.03

Reconciliation between Total Equity as per ASand Ind ASto be presented in the opening balance sheet as on 1st April, 20X1

	`in crore
Equity share capital	80
Redeemable Preference share capital	25

	105
Reserves and Surplus	95
Total Equity as per AS	200
Adjustment due to reclassification	
Preference share capital classified as financial liability	(25)
Adjustment due to derecognition	
Proposed Dividend not considered as liability as on 1st April 20X1	0.78
Adjustment due to remeasurement	
Increase in the value of Land due to remeasurement at fair value	5.5
Increase in the value of investment due to remeasurement at fair value	0.75
Equity as on 1st April, 20X1after transition to Ind AS	182.03

1.HIM Limited having net worth of `250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

Issue 1 : As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was `5,00,000. The land was acquired for a consideration of `5,00,000. However, the fair value of land as on the date of transition was `8,00,000.

Issue 2 : Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss.The value of mutual funds as per previous GAAP was `4,00,000 (at cost).However, the fair value of mutual funds as on the date of transition was `5,00,000.

Issue 3 :Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equal instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is `1,80,000 as against the carrying amount of loan which at present equals `2,00,000.

Issue 4 : The company has declared dividend of `30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Issue 5 : The company had acquired intangible assets as trademarks amounting to `2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was `3,00,000. However, the company wants to carry the intangible assets at `2,50,000 only.

Issue 6 : After consideration of possible effects as per Ind AS, the deferred tax impact is computed as `25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments

Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue. (RTP May 2021) / (MTP May 2022) / (MTP Sept 22)

[video link: https://youtu.be/H5VbXddxql4?t=100]

Answer

Preliminary Impact Assessment onTransition to Ind AS in HIMLimited's Financial Statements

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value.

	value) as deemed cost	The resulting impact of fair valuation of land `3,00,000 should be adjusted in other equity.

Journal Entry on the date of transition

Property Plant and EquipmentDr. 3,00,000

To Revaluation Surplus (OCI-Other Equity) 3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments are measured at lower of cost and fair value	On transition, financial assets including investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	All financial assets (other than Investment in subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value.The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics.Since investment in mutual fund are designated at FVTPL, increase of `1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Investment in mutual fundsDr. 1,00,000

To Retained earnings 1,00,000

Issue 3: Borrowings -Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalised as the case may be	As per Ind AS, such expenditure is amortised over the period of the loan.Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is `1,80,000 as against its book value of `2,00,000. Accordingly, the difference of `20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Borrowings / Loan payableDr. 20,000

To Retained earnings 20,000

Issue 4: Proposed dividend

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, provision for proposed divided is made in the year when it has been declared and approved.	As per Ind AS, liability for proposed dividend is recognised in the year in which it has been declared and approved.	Since dividend should be deducted from retained earnings during the year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment

Journal Entry on the date of transition

ProvisionsDr. 30,000

To Retained earnings 30,000

Issue 5 : Intangible assets

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand/trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand/trademark can be indefinite. Not required to be amortised and only tested for impairment.Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by `25,000

Journal Entry on the date of transition

Retained earningsDr. 25,000

To Deferred tax liability 25,000

Compound Financial Instrument

20.On April 1, 20X1, Sigma Ltd. issued 30,000 6% convertible debentures of face value of `100 per debenture at par. The debentures are redeemable at a premium of 10% on March 31, 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentureswithout conversion rights would have been 10%. The date of transition to Ind AS is April 1, 20X3.Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition. (RTP May 20) / (MTP March 22)

[video link: https://youtu.be/JjsC5asTaqI?t=1365]

Answer

Ind AS 32, 'Financial Instruments: Presentation', requires an entity to split acompound financial instrument at inception into separate liability and equitycomponents. If the liability component is no longer outstanding, retrospectiveapplication of Ind AS 32 would involve separating two portions of equity. The firstportion is recognised in retained earnings and represents the cumulative interestaccreted on the liability component. The other portion represents the originalequity component. However, in accordance with Ind AS 101, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option)

Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment on each debenture for years	
1 to 4 (6 x 3.17) (Note 1)	19.02
PV of principal repayment on each debenture (including premium)	
110 x 0.68 (Note 2)	74.80
Total liability component on each debenture (A)	93.82
Total equity component per debenture (Balancing figure) (B) = (C) –(A)	6.18
Face value per debenture (C)	100.00
Equity component per debenture	6.18
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of transition, the amount of `30,00,000 being the amount of debentures will be split as under:

Debt	`28,14,600
Equity	`1,85,400

Notes:

1. 3.17 is annuity factor of present valueof Re. 1 at a discount rate of 10% for 4 years.

2. On maturity, `110 will be paid (`100 as principal payment + `10 as premium)

Government Loan

4b. Government of India provides loans to MSMEs at a below -market rate of interest to fund the set-up of a new manufacturing facility. Sukshma Limited's date of transition to Ind AS is 1st April 2020.

In financial year 2014-2015, the Company had received a loan of ` 2.0 crore at a below - market rate of interest from the government. Under Indian GAAP, the Company had accounted for the loan as equity and the carrying amount was ` 2.0 crore at the date of transition. The amount repayable on 31st March 2024 will be ` 2.50 crore.

The Company has been advised to recognize the difference of ` 0.50 crores in equity by correspondingly increasing the value of various assets under property, plant & equipment by an equivalent amount on proportionate basis . Further, on 31st March 2024 when the loan has to be repaid, ` 2.50 crore should be presented as a deduction from property, plant & equipment.

Discuss the above treatment and share your views as per applicable Ind AS.

Answer

Requirement as per Ind AS:

A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32. A first -time adopter shall apply the requirements in Ind AS 109 and Ind AS 20, prospectively to government loans existing at the date of transition to Ind AS and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

Treatment to be done:

Consequently, if a first-time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind AS.

In the instant case, the loan meets the definition of a financial liability in accordance with Ind AS 32. Company therefore reclassifies it from equity to liability. It also uses the previous GAAP carrying amount of the loan at the date of transition as the carrying amount of the loan in the opening Ind AS balance sheet.

It calculates the annual effective interest rate (EIR) starting 1 st April 2020 as below:
EIR = Amount / Principal$_{(1/t)}$ i.e. 2.50/2$_{(1/4)}$ i.e. 5.74%. approx.

At this rate, ` 2 crore will accrete to ` 2.50 crore as at 31st March 2024.

During the next 4 years, the interest expense charged to statement of profit and loss shall be:

Year ended	Opening amortised cost	Interest expense for the year (`) @ 5.74% p.a. approx.	Closing amortised cost
31.03.2021	200,00,000	11,48,000	211,48,000
31.03.2022	211,48,000	12,13,895	223,61,895
31.03.2023	223,61,895	12,83,573	236,45,468
31.03.2024	236,45,468	13,54,532	250,00,000

An entity may apply the requirements in Ind AS 109 and Ind AS 20 retrospectively to any government loan originated before the date of transition to Ind AS, provided that the information needed to do so had been obtained at the time of initially accounting for that loan.

The accounting treatment is to be done as per above guidance and the advice which the company has been provided is not in line with the requirements of Ind AS 101 .

1. (a) H Ltd. has the following assets and liabilities as at March 31, 20X1, prepared in accordance with previous GAAP:

Particulars	Notes	Amount (Rs.)
Property, Plant and Equipment	**1**	**1,34,50,000**
Investments in S. Ltd.	**2**	**48,00,000**
Debtors		**2,00,000**
Advances for purchase of inventory		**50,00,000**
Inventory		**8,00,000**
Cash		**49,000**
Total assets		**2,42,99,000**
Deferral loan	**3**	**60,00,000**
Creditors		**30,00,000**

Short term borrowing		**8,00,000**
Provisions		**12,00,000**
Total liabilities		**1,10,00,000**
Share capital		**1,30,00,000**
Reserves:		**2,99,000**
Cumulative translation difference	**4**	**1,00,000**
ESOP reserve	**4**	**20,000**
Retained earnings		**1,79,000**
Total equity		**1,32,99,000**
Total equity and liabilities		**2,42,99,000**

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 20X1:

1. In relation to property, plant and equipment, the following adjustments were identified:

• Property, plant and equipment comprise land held for capital appreciation purposes costing Rs. 4,50,000 and was classified as investment property as per Ind AS 40.

• Exchange differences of Rs. 1,00,000 were capitalised to depreciable property, plant and equipment on which accumulated depreciation of Rs. 40,000 was recognised.

• There were no asset retirement obligations.

• The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.

2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for Rs. 48,00,000 that carried a fair value of Rs. 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. Financial instruments:

• Deferral loan Rs. 60,00,000: The deferral loan of Rs. 60,00,000 was obtained on March 31, 20X1, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the

discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 20X1, is Rs. 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for deferral loan.

4. The retained earnings of the Company contained the following:

• ESOP reserve of Rs. 20,000:

The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised Rs. 12,000 towards the vested options and Rs. 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been Rs. 15,000 and Rs. 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options

• Cumulative translation difference : Rs. 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of Rs. 1,00,000 as part of reserves. On firsttime adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero. (MTP Oct 2019)

Answer

(i) 1. Property, plant and equipment: As the land held for capital appreciation purposes qualifies as investment property, such investment property should be reclassified from property, plant and equipment (PPE) to investment property and presented separately. As the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property should be carried at its previous GAAP carrying values. As such, the past capitalised exchange differences require no adjustment in this case.

2. Investment in subsidiary: On first time adoption of Ind AS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the company can recognise such investment at a value of Rs. 68,00,000.

3. Financial instruments: As the deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discounted at an

appropriate discounting factor. Consequently, the deferral loan should be recognised at Rs. 37,25,528 and the remaining Rs. 22,74,472 would be recognised as deferred government grant.

4. ESOPs: Ind AS 101 provides an exemption of not restating the accounting as per the previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-tim e adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date, need to be restated in accordance with Ind AS 102. As such, the additional impact of Rs. 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.

5. Cumulative translation difference: As per paragraph D12 of Ind AS 101, the firsttime adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences. If a first-time adopter uses this exemption the cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of Rs. 1,00,000 should be transferred to retained earnings.

6. Retained earnings should be increased by Rs. 20,99,000 on account of the following:

	Rs.
Increase in fair value of investment in subsidiary (note 2)	20,00,000
Additional ESOP charge on unvested options (note 4)	(1,000)
Transfer of cumulative translation difference balance to retained earnings (note 5)	1,00,000

After the above adjustments, the carrying values of assets and liabilities for the purpose of opening Ind AS balance sheet of Company H should be as under:

Particular	Notes	Previous	Adjustments	Ind AS GAAP
Non-Current Assets				
Property, plant and equipment	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Advances for purchase of inventory		50,00,000		50,00,000
Current Assets				

Debtors		2,00,000		2,00,000
Inventory		8,00,000		8,00,000
Cash		49,000		49,000
Total assets		2,42,99,000	20,00,000	2,62,99,000
Non-current Liabilities				
Deferral loan	3	60,00,000	(22,74,472)	37,25,528
Deferred government grant	3	0	22,74,472	22,74,472
Current Liabilities				
Creditors		30,00,000		30,00,000
Short term borrowing		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		1,10,00,000		1,10,00,000
Share capital		1,30,00,000		1,30,00,000
Reserves:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0
ESOP reserve	4	20,000	1,000	21,000
Other reserves	6	1,79,000	20,99,000	22,78,000
Total equity		1,32,99,000	20,00,000	1,52,99,000
Total equity and liabilities		2,42,99,000	20,00,000	2,62,99,000

11. XYZ Pvt. Ltd. is a company registered unde r the Companies Act, 2013 following Accounting Standards notified under Companies (Accounting Standards) Rules, 2006. The Company has decided to voluntary adopt Ind AS w.e.f 1 st April, 2018 with a transition date of 1st April, 2017.

The Company has one Wholly Owned Subsidiary and one Joint Venture which are into manufacturing of automobile spare parts.

The -consolidated financial statements of the Company under Indian GAAP are as under :

Consolidated Financial Statements (` in Lakhs)

Particulars	**31.03.2018**	**31.03.2017**

Shareholder's Funds		
Share Capital	**7953**	**7953**
Reserves & Surplus	**16547**	**16597**
Non-Current Liabilities		
Long Term Borrowings	**1000**	**1000**
Long Term Provisions	**1101**	**691**
Other Long-Term Liabilities	**5202**	**5904**
Current Liabilities		
Trade Payables	**9905**	**8455**
Short Term Provisions	**500**	**475**
Total	**42,208**	**41,075**
Non-Current Assets		
Property Plant & Equipment	**21,488**	**22,288**
Goodwill on Consolidation of subsidiary and JV	**1507**	**1507**
Investment Property	**5245**	**5245**
Long Term Loans & Advances	**6350**	**6350**
Current Assets		
Trade Receivables	**4801**	**1818**
Investments ·	**1263**	**3763**
Other Current Assets	**1554**	**104**
Total	**42,208**	**41,075**

Additional Information:

The Company has entered into a joint arrangement by acquiring 50% of the equity shares of ABC Pvt. Ltd. Presently, the same has been accounted as per the proportionate consolidated method. The proportionate share of assets and liabilities of ABC Pvt. Ltd. included in the consolidated financial statement of XYZ Pvt. Ltd. is as under:

Particulars	**` in Lakhs**

Property, Plant & Equipment	**1,200**
Long Term Loans & Advances	**405**
Trade Receivables	**280**
Other Current Assets	**50**
Trade Payables	**75**
Short Term Provisions	**35**

The Investment is in the nature of Joint Venture as per Ind AS 111.

The Company has approached you to advice and suggest the accounting adjustments which are required to be made in the opening Balance Sheet as on 1st April, 2017. (RTP May 19)

Answer

As per paras D31AA and D31AB of Ind AS 101, when changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture at transition date to Ind AS.

That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belong ed to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The balance of the investment in joint venture at the date of transition to Ind AS, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at initial recognition.

Accordingly, the deemed cost of the investment will be

Property, Plant & Equipment	1,200
Goodwill (Refer Note below)	119
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Total Assets	2054
Less: Trade Payables	75
Short Term Provisions	35

Deemed cost of the investment in JV	1944

Calculation of proportionate goodwill share of Joint Venture ie ABC Pvt. Ltd.

Property, Plant & Equipment	22,288
Goodwill	1,507
Long Term Loans & Advances	6,350
Trade Receivables	1,818
Other Current Assets	104
Total Assets	32,067
Less: Trade Payables	8,455
Short Term Provisions	475
	23,137

Proportionate Goodwill of Joint Venture

= [(Goodwill on consolidation of subsidiary and JV/Total relative net asset) x Net asset of JV]

= (1507 / 23,137) x 1825 = 119 (approx.)

Accordingly, the proportional share of assets and liabilities of Joint Venture will be removed from the respective values assets and liabilities appearing in the balance sheet on 31.3.2017 and Inv estment in JV will appear under non -current asset in the transition date balance sheet as on 1.4.2017.

Adjustments made in I GAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Particulars	31.3.2017	Ind AS Adjustment	Transition date Balance Sheet as per Ind AS
Non-Current Assets			
Property Plant & Equipment	22,288	(1,200)	21,088
Intangible assets –			
Goodwill on Consolidation	1,507	(119)	1,388
Investment Property	5,245	-	5,245
Long Term Loans & Advances	6,350	(405)	5,945
Non- current investment in JV	-	1,944	1,944

Current Assets –			
Trade Receivables	1,818	(280)	1,538
Investments ·	3,763	-	3,763
Other Current Assets	104	(50)	54
Total	41,075	(110)	40,965
Shareholder's Funds			
Share Capital	7,953	-	7,953
Reserves & Surplus	16,597	-	16,597
Non-Current Liabilities			
Long Term Borrowings	1,000		1,000
Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	41,075	(110)	40,965

15. GG Ltd., a listed company, prepares its first Ind AS financial statements for the year ending 31st March, 20X3. The date of transition is 1st April, 20X1. The functional and presentation currency is Rupee. The financial statements as at and for the year ended 31st March, 20X3 contain an explicit and unreserved statement of compliance with Ind AS. Previously it was using Indian GAAP (AS) as base.

It has already published its first interim results of quarter 1, quarter 2 and quarter 3 of 20X2- 20X3 in accordance with Ind AS 34 and Ind AS 101. The interim financial report included the reconciliations both of total comprehensive income and of equity that are required by Ind AS 101.

Since issuing the interim financial report, its management has concluded that one of accounting policy choices applied at the interim should be changed for the full year. How should GG Ltd. deal with the change in accounting policy under Ind AS framework? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=5127]

Answer

The first annual Ind AS financial statements are prepared in accordance with the specific requirements of Ind AS 101. Subject to certain specified exemptions and exceptions, paragraph 7 of Ind AS 101 requires the entity to use the same accounting policies in its opening Ind AS balance sheet and throughout all periods presented. This override Ind AS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first Ind AS financial statements. GG Ltd. should include an explanation of the change in policy that it has made since the interim financial report, in the notes to the annual financial statements, in accordance with paragraph 27A of Ind AS 101. The disclosure note is likely to include information , similar to what Ind AS 8 would otherwise require, to help users of the financial statements to understand the changes that have been made. The entity should also ensure that the reconciliations of total comprehensive income and of equity, presented in the first Ind AS financial statements in accordance with paragraph 24 of Ind AS 101 are updated from those included in the interim financial report to reflect the amended accounting policy

2(c) G Ltd. operates oil exploration and production facilities. It is preparing its transition date opening balance sheet as per Ind AS.

(i) There· is a significant decommissioning obligation in connection with several oil wells, but it's previous GAAP did not require the obligation to be recognized.

Discuss the treatment of decommissioning obligation as per relevant Ind AS.

(ii) G Ltd. has four assets, each in a different class under property, plant & equipment.
Assets 1 and 2 are revalued under previous GAAP (AS). Assets 3 and 4 are not. Under previous GAAP, at 31st March 20X1, immediately prior to the entity's date of transition to Ind AS, it Balance Sheet (extract) is as follows:

	Asset 1	Asset 2	Asset 3	Asset 4	Total
	Valuation	Valuation	Cost	Cost	
Cost or revaluation	5,000	2,000	4,000	4,500	15,500
Accumulated deprecation	(1,000)	(500)	(2,000)	(1,700)	(5,200)
Net book value	4,000	1,500	2,000	2,800	10,300
Revaluation surplus	2,500	500	-	-	3,000

On adoption of Ind AS, its management decides that, under Ind AS, it will:

− Continue to revalue asset 1. The fair value of asset 1 at the date of transition is not materially different from its carrying value under previous GAAP;
− Use the previous valuation of asset 2 as deemed cost, and adopt a policy of cost less depreciation under Ind AS;

− Adopt a policy of revaluation for asset 3. The fair value of asset 3 at the entity's date of transition is ` 5,000;

− Continue to use a policy of cost less depreciation for asset 4.

All depreciation methods are already in accordance with those required by Ind AS 16.

Discuss the treatment under Ind AS of valuation of assets 1, 2, 3 & 4, being part of property, plant & equipment? (MTP May 2022)

[video link: https://youtu.be/H5VbXddxql4?t=1848]

Answer

(i) De-commissioning Obligation of G Ltd. and recognition of decommissioning cost:
Retrospective application of Ind AS 37 requires management to recognise the provision for decommissioning cost on the opening Ind AS Balance Sheet. The provision should reflect the net present value of the management's best estimate of the amount required to settle the obligation.

Accounting Treatment:

The obligation should be capitalised as a separate component of property, plant and equipment, together with the accumulated depreciation from the date when the obligation was incurred to the transition date. The amount to be capitalised as part of the c ost of the asset is calculated by discounting the liability back to the date when the obligation initially arose, using the best estimate of historical discount rate. The associated accumulated depreciation is calculated by applying the current estimate of the asset's useful life, using the entity's depreciation policy for the asset.

Any difference between the provision and the related component of the property, plant and equipment is adjusted against the retained earnings.
The entity could elect to apply the deemed cost exemption. Property, plant and equipment would be restated to fair value, with the corresponding adjustment to the retained earnings.

Management would need to ensure that the fair value obtained was the gross fair value and not net of the decommissioning obligation. Management would

recognise the provision for decommissioning costs in accordance with Ind AS 37. No cost in respect of provision should be added to property, plant and equipment but such cost should be recognised in the entity's opening retained earnings.

(ii) Measurement basis for valuation of PPE:

An entity has the following options with respect to measurement of its property, plant and equipment (Ind AS 16) in the opening Ind AS Balance Sheet:

♦ Measurement basis as per the respective standards applied retrospectively. This measurement option can be applied on an item-by-item basis. For example, Plant A can be measured applying Ind AS 16 retrospectively and Plant B can be measured applying the "fair value" or "revaluation" options mentioned below.

♦ Fair value at the date of transition to Ind AS. This measurement option can be applied on an item-by-item basis in similar fashion as explained above.

♦ Previous GAAP revaluation, if such revaluation was, at the date of revaluation, broadly comparable to (a) fair value or (b) cost or depreciated cost in accordance with other Ind AS adjusted to reflect changes in general or specific price index. This measurement option can be applied on an item-by-item basis in similar fashion as explained above.

Analysis of given case:

	Asset 1	Asset 2	Asset 3	Asset 4
Basis used in previous GAAP	Revaluation Model	Revaluation Model	Cost Model	Cost Model
Intent of G Ltd. on transition	To continue with Revaluation model	Use previous valuation as deemed cost	Adopt a policy of revaluation	Continue to use a policy of cost less depreciation
Treatment at the time of transition to Ind AS	Since fair value at the transition date is not materially different from its carrying value under previous GAAP, G Ltd. can carry forward with	An entity may elect to measure an item of property, plant and equipment at the date of transition to Ind AS at its fair value and use that fair value as its	Fair value at the date of transition to Ind AS is materially different from its carrying value under previous GAAP. The asset should be revalued	he entity is not availing any exemption given in Ind AS 101. The entity can measure applying Ind AS 16 retrospectively. It is assumed that measurement

	revalued carrying value ` 4,000 as per previous GAAP in Ind AS books and continue to disclose a revaluation surplus of ` 2,500.	deemed cost at that date. In Ind AS financial statements, asset will be carried forward at ` 1,500 and previously disclosed revaluation surplus is transferred to retained earnings or another component of equity.	and stated at its fair value of ` 5,000 on the date of transition to Ind AS. A revaluation surplus of ` 3,000 (5,000 – 2,000) will be transferred to revaluation reserve	bases for cost of asset as per previous GAAP and Ind AS are same so asset will be shown in the Ind AS financial statements at ` 2,800.

Ind AS 102

- An entity issues its own shares in exchange for goods/ service/ employee service then it applies Ind AS 102
- Shares issued maybe fixed or variable, either case they will be classified as Equity
- If they will be net settled then they are governed by Ind AS 109
- Two types of transaction covered

	ESOP	SAR
	Shares given in exchange for goods orservice	Cash equivalent to fair value of own shares or increase in price above a specified price given in exchange for goods or service
Valuation	Classified as equity	Classified as liability
Fair value	Determined on grant date	Determined on each reporting date

- ESOP with cash alternative
    - First determine fair value of both ESOP and SAR
    - SAR value is accounted as liability, i.e. each year end fair value is determined and liability accounted
    - If Fair value on grant date of ESOP > SAR, then diff is accounted as ESOP
    - If FV on grant date of SAR> ESOP, then completely accounted as SAR
- Conditions and accounting

	Service condition	Non-market performance condition	Market performance condition
Vesting period	Given	Estimated on each reporting date	Estimated on grant date
If estimate increase	NA	Increase VP and account for the same cumulatively	No change in accounting, continue with original estimated VP
If estimate decrease	NA	Decrease VP and account for the same cumulatively	Decrease VP and account for the same cumulatively
If estimated shares will not be given	Reverse expense already booked ESOP dr. To PL	Reverse expense already booked ESOP dr. To PL	Reversal will not take place, continue accounting If shares not issued at the end of estimated VP and lapsed, transfer ESOP balance to RE

- Modification

	Vesting period change	Change in exercise price	Change in no. of ESOP
Increase	No change in accounting	No change in accounting	• Additional options ffered deemed to be new ESOP • Fair value on such date is determined

			• Expensed over remaining VP • Estimated employees to receive ESOP same as old ESOP • Old ESOP to continue accounting as it is
Decrease	Change VP and account for the same cumulatively	• Continue accounting for old ESOP as it is • Determine FV of original Exercie price and revised exercise price on such date • Difference is accounted as new ESOP • No. of options and employees remain same as old • Expensed over remaining VP	No change in accounting

- Cancellation
  - Remianing exp relaed to ESOP expensed on accelerated basis in the year of cancellation
  - FV of such ESOP on such date determined
    - If amount paid to directors equal to above amount or less than the same, it is debited to ESOP and cash credited. Remaining ESOP balance transfer to RE
    - If amount aid more than such fair value, amount equivalent to such fair value is debited to ESOP and any aount above the same is debited to PL
- Group share based payment
  - Holding company issues its shares to employees of subsidiary
    - SFS of parent: Investment in Subs dr.
To ESOP o/s
    - SFS on subsi: P/L dr.
To Other Equity
    - CFS: P/L dr
To ESOP o/s
  - Subsidiary issues its shares to employees of holding
    - SFS of parent: P/L dr.
To Dividend income
    - SFS on subsi: Dividend exp dr.
To ESOP
    - CFS: P/L dr
To ESOP o/s

ESOP against Goods / Service

- If entity issues its own equity against delivery of goods / service (not the case of net settlement), then such goods and own equity shall be measured and accounted at fair value of such goods

SAR

3.(a)ABC Ltd.issued 11,000 share appreciation rights (SARs) that vest immediately to its employees on 1 April 2016. The SARs will be settled in cash. Using an option pricing model, at that date it is estimated that the fair value of a SAR is INR 100. SAR can be exercised any time until 31stMarch 2019. It is expected that out of the total employees,94% at the end of period on 31stMarch 2017, 91% at the end of next year will exercise the option. Finally,when these were vested i.e. at the end of the 3rd year, only 85% of the total employees exercised the option.

Fair value of SAR	INR
31-Mar-2017	132
31-Mar-2018	139
31-Mar-2019	141

Pass the Journal entries? (MTP Oct 2018) / (Exam May 18 similar) / (Exam nov 20) / (MTP Sept 22)

[video link: https://youtu.be/OIqCwQnnflo?t=928]

Answer

Period	Fair value	To be vested	Cumulative	Expense
1 April 2017 31 March 2018 31 March 2019 31 March 2020	100 132 139 141	100% 94% 91% 85%	10,00,000 12,40,800 12,64,900 11,98,500	10,00,000 240,800 24100 (66,400)
				11,98,500

1April 2017

Employee benefits expenses Dr. 10,00,000

To Share based payment liability 10,00,000

(Fair value of the SAR recognized)

31March 2018

Employee benefits expensesDr. 2,40,800

To Share based payment liability 2,40,800

(Fair value of the SAR re-measured)

31March 2019

Employee benefits expensesDr. 24,100

To Share based payment liability 24,100

(Fair value of the SAR re-measured)

31March2020

Share based payment liabilityDr. 66,400

To Employee benefits expenses 66,400

(Fair value of the SAR remeasured and reversed)

Share based payment liabilityDr. 11,98,500

To Cash/Bank 11,98,500

(Settlement of SAR)

(b)An entity which follows its financial year as per the calendar year grants 1,000 share appreciation rights (SARs) to each of its 40 management employees as on 1st January 20X5. The SARs provide the employees with the right to receive (at the date when the rights are exercised) cash equal to intrinsic value of the entity's share price. All of the rights vest on 31stDecember 20X6; and they can be exercised during 20X7 and 20X8. Management estimates that, at grant date, the fair value of each SAR is Rs. 11; and it estimates that 10% of the employees will leave evenly during the two-year period. The fair values of the SARs at each year end are shown below:

Year	Fair value at year end
31 December 20X5	12
31 December 20X6	8
31 December 20X7	13
31 December 20X8	12

10% of employees left before the end of 20X6. On 31stDecember 20X7 (when the intrinsic value of each SAR was Rs. 10), six employees exercised their options and remaining employees exercised their options at the end of 20X8 (when the intrinsic value of each SAR was equal to the fair value of Rs. 12). How much expense and liability is to be recognized at the end of each year? Also pass Journal entries. (MTP May 2020) / (RTP May 2020) / (MTP Oct 21)

[video link: https://youtu.be/PMpGCRSClQE?t=781]

Answer

Year	Expense Rs.	Liability Rs	Calculation of Liability
31 December 20X5	216000	216000	= 36 x 1,000 x 12 x ½
31 December 20X6	72000	288000	36 x 1,000 x 8
31 December 20X7	162000	390000	=30 x 1,000 x 13 Expense comprises an increase in the liability of Rs. 102,000 and cash paid to those exercising their SARs of Rs. 60,000(6 x 1,000 x 10).
31 December 20X8	(30000)	0	Liability extinguished. Excess liabilityreversed, because cash paid to those exercising their SARs Rs. 3,60,000 (30 x 1,000x 12) was less than the opening liability Rs.3,90,000.

Journal Entries

31 December 20X5

Employee benefits expensesDr. 2,16,000

To Share based payment liability 2,16,000

(Fair value of the SAR recognized)

31 December 20X6

Employee benefits expensesDr. 72,000

To Share based payment liability 72,000

(Fair value of the SAR re-measured)

31 December 20X7

Employee benefits expensesDr. 1,62,000

To Share based payment liability 1,62,000

(Fair value of the SAR recognized)

Share based payment liability Dr. 60,000

To Cash 60,000

(Settlement of SAR)

31 December 20X8

Share based payment liability Dr. 30,000

To Employee benefits expenses 30,000

Share based payment liability 360,000

To Cash(Settlement of SAR)Dr. 3,60,000

Determination of grant date

6. (a) New Age Technology Limited has entered into following Share Based payment transactions:

(i) On 1st April, 20X1, New Age Technology Limited decided to grant share options to its employees. The scheme was approved by the empl oyees on 30th June, 20X1. New Age Technology Limited determined the fair value of the share options to be the value of the equity shares on 1st April, 20X1.

(ii) On 1st April, 20X1, New Age Technology Limited entered into a contract to purchase IT equipment from Bombay Software Limited and agreed that the contract will be settled by issuing equity instruments of New Age Technology Limited. New Age Technology Limited received the IT equipment on 30th July, 20X1. The share-based payment transaction was measured based on the fair value of 'the equity instruments as on 1st April, 20X1.

(iii) On 1st April, 20X1, New Age Technology Limited decided to grant the share options to its employees. The scheme was approved by the employees on 30th June, 20X1. The issue of the share options was however subject to the same being approved by the shareholders in a general meeting. The scheme was approved in the general meeting held on 30th September, 20X1. The fair value of the equity instruments for measuring the share-based payment transaction was taken on 30th September, 20X1.

Identify the grant date and measurement date in all the 3 cases of Share based payment transactions entered into by New Age Technology Limited, supported by appropriate rationale for the determination? (MTP April 2021) / (RTP May 22)

[video link: https://youtu.be/PMpGCRSClQE?t=1610]

Answer

Ind AS 102 defines grant date and measurement dates as follows:

(a) Grant date: The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

(b) Measurement date: The date at which the fair value of the equity instruments granted is measured for the purposes of this Ind AS. For transactions wit h employees and others providing similar services, the measurement date is grant date. For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterp arty renders service. Applying the above definitions in the given scenarios following would be the conclusion based on the assumption that the approvals have been received prospectively:

Scenario	Grant date	Measurement date	Base for grant date	Base for measurement date
(i)	30thJune, 20X1	30thJune, 20X1	The date on which the scheme was approved by the employees	For employees, the measurement date is grant date
(ii)	1stApril, 20X1	30thJuly, 20X1	The date when the entity and the counterparty entered a contract and agreed for settlement by equity instruments	The date when the entity obtains the goods from the counterparty
(iii)	30thSeptember, 20X1	30thSeptember, 20X1	The date when the approval by shareholders was obtained	For employees, the measurement date is grant date

ESOP with service condition

4(a) Ankita Holding Inc. grants 100 shares to each of its 500 employees on 1stJanuary, 20X1. T he employees should remain in service during the vesting period. T he shares will vest at the end of the

First year if the company's earnings increase by 12%;

Second yearif the company's earnings increase by more than 20% over the two-yea r period;

Third year if the entity's earnings increase by more than 22% over the three-yea r period.

The fair value per share at the grant date is Rs.122. In 20X1, earnings increased by 10%, and 29 employees left the organisation. T he company expects that earnings will continue at a similar rate in 20X2 and expects that the shares will vest at the end of the year 20X2. T he company also expects that additional 31 employees will leave the organisation in the year 20X2 and that 440 employees will receive their shares at the end of the year 20X2. At the end of 20X2, company's earnings increased by 18%. Therefore, the shares did not vest. Only 29 employees left the organization during 20X2. Company believes that additional 23 employees will leave in 20X3 and earnings will further increase so that the performance target will be

achieved in 20X3. At the end of the year 20X3, only 21 employees have left the organization. Assume that the company's earnings increased to desired level and the performance target has been met. Determine the expense for each year and pa ss appropriate journal entries? (MTP April 2019) / (MTP March 2018) / (Exam Nov 18) / (Exam May 19)

[video link: https://youtu.be/OIqCwQnnflo?t=1183]

Answer

Since the earnings of the entity is non-market related, hence it will not be considered in fair value calculation of the shares given. However, the same will be considered while calculating number of shares to be vested.

Workings:

	20X1	20X2	20X3
T otal employees	500	500	500
Employees left (Actual)	(29)	(58)	(79)
Employees expected to leave in the next year	(31)	(23)	
Year end –No of employees	440	419	421
Shares per employee	100	100	100
Fair value of share at grant date	122	122	122
Vesting period	½	2/3	3/3
Expenses-20X1 (Note 1)	26,84,000		
Expenses-20X2 (Note 2)		723,867	
Expenses-20X3 (Note 3)			17,28,333

Note 1:

Expense for 20X1 =No. of employees x Shares per employee x Fair valu e of sharex Proportionate vesting period

= 440 x 100 x 122 X ½ = 26,84,000

Note 2:

Expense for 20X2 = (No of employees x Shares per employee x Fair value of share x Proportionate vesting period) –Expense recognized in year 20X1=

(419 x 100 x 122 x 2/3) –26,84,000= 7,23,867

Note 3:

Expense for 20X3 = (No of employees x Shares per employee x Fair valu eof share x Proportionate vesting period) –Expense recognized in year 20X1 and 20X2

= (421 x 100 x 122 x 3/3) –(26,84,000 + 7,23,867)= 17,28,333.

JournalEntries

31stDecember, 20X1

Employee benefits expensesDr.	26,84,000	
To Share based payment reserve (equity)		26,84,000
(Equity settled shared based payment expected vesting amount)		

31stDecember, 20X2

Employee benefits expensesDr.	7,23,867	
To Share based payment reserve (equity)		7,23,867
(Equity settled shared based payment expected vesting amount)		

31stDecember, 20X3

Employee benefits expensesDr.	17,28,333	
To Share based payment reserve (equity)		17,28,333
(Equity settled shared based payment expected vesting amount)		
Share based payment reserve (equity)Dr.	51,36,200	
To Share Capital		51,36,200
(Share capital Issued)		

ESOP with Cash Alternative

6.(a)At 1 January 2017, Ambani Limited grants its CEO an option to take either cash amount equivalent to 990 shares or 800 shares. The minimum service requirement is 2 years. There is a condition to keep the shares for 3 years if shares are opted.

Fair values of the shares	**INR**
Share alternative fair value (with restrictions)	**212**
Grant date fair value on 1stJanuary, 2016	**213**
Fair value on 31stDecember, 2016	**220**
Fair value on 31stDecember, 2017	**232**

The key management exercises his cash option at the end of 2018.Pass journal entries (MTP Aug 2018) / (Exam Dec 21) / Exam Nov 22

[Video link: https://youtu.be/OlqCwQnnflo?t=73]

Answer

	1stJan., 2017	31stDec., 2017	31stDec., 2018
Cashalternative (990 x 212) Equityalternative (800 x 213	209880 170400		

Equity option (2,09,880 – 1,70,400)	39480		
Cash Option (cumulative) (using period end fair value)		88000	185600
Equity Option (cumulative)		19740	39480
Expense for the period			
Equity option		19740	19740
Cash Option		88000	97600
		107740	117340

31st Dec., 2016

Employee benefits expensesDr. 1,07,740

To Share based payment reserve (equity) 19,740

To Share based payment liability 88,000

(Recognition of Equity option and cash settlement option)

31st Dec., 2017

Employee benefits expensesDr. 1,17,340

To Share based payment reserve (equity) 19,740

To Share based payment liability 97,600

(Recognition of Equity option and cash settlement option)

Share based payment liability Dr. 1,85,600

To Bank/ Cash 1,85,600

(Settlement in cash)

6 (a)Rely Industries issued share-based option to one of its key management personal which can be exercised either in cash or equity and it has following features:

Option I

No of cash settled shares 74,000

Service condition 3 years

Option II

No of equity settled shares 90,000

Conditions:Service 3 years

Restriction to sell 2 years

Fair values

Equity price with a restriction of sale for 2 years	115
Fair value grant date	135
Fair value as on 31St March2016	138
2017	140
2018	147

Pass the Journal entries? (MTP April 2018) / (MTP Oct 21)

[video link: https://youtu.be/PMpGCRSClQE?t=1882]

Answer

Fair value of Equity option components:

Fair value of a share with restrictive clause	Rs.115
No. of shares	90,000 shares
Fair value (90,000 X 115)A	Rs.1,03,50,000
Fair value of a share at the date of grant	Rs.135
No. of cash settled shares	74,000
Fair value (74,000 X 135)B	Rs.99,90,000
Fair value of equity component in compound instrument (A-B)	Rs.3,60,000

Journal Entries

31/3/2016

Employee benefit expensesDr.	35,24,000	
To Share based payment reserve (equity)(3,60,000/3)		1,20,000
To Share based payment liability (138 x 74,000) / 3		34,04,000
(Recognition of equity option and cash settlement option)		

31/3/2017

Employee benefits expensesDr.	36,22,667	
To Share based payment reserve (equity)(3,60,000/3)		1,20,000
To Share based payment liability (140 x 74,000) 2/3 -34,04,000		35,02,667
(Recognition of equity option and cash settlement option)		

31/3/2018

Employee benefits expensesDr. 40,91,333

To Share based payment reserve (equity)(3,60,000/3) 1,20,000

To Share based payment liability 39,71,333

(147 x 74,000) 3/3 -(34,04,000 + 35,02,667)

(Recognition of equity option and cash settlement option)

Upon cash alternative chosen

Share based payment liability (147 x 74,000)Dr. 1,08,78,000

To Bank/ Cash 1,08,78,000

(Being settlement made in cash)

Upon equity alternative chosen

Share based payment liability (147 x 74,000)Dr. 1,08,78,000

To Share capital 1,08,78,000

(Being settlement made in equity)

Graded Vesting

The following particulars in respect of stock options granted by a company are available:
No. of Employees covered 400

Nominal Value per share ` 100

No. of options per Employee 60

Exercise price per share ` 125

Shares offered were put in three groups.

Group 1 was for 20% of shares offered with vesting period one-year.

Group II was for 40% of shares offered with vesting period two - years.

Group III was for 40% of shares offered with vesting period three -years.

Fair value of option per share on grant date was ` 10 for Group I, ` 12.50 for Group II and ` 14 for Group III.

Position on 1st Year	Position on 2nd Year	Position on 3rd Year
- No. of employees left = 40 - Estimate of employees	- Employees left = 35 - Estimate of employees to leave in Year 3 = 30	- Employees left = 28 - Employees exercising Options in Group III = 295

to leave in Year 2 = 36 - Estimate of employees to leave in Year 3 = 34 - Employees exercising Options in Group I = 350	- Employees exercising Options in Group II = 319	

Options not exercised immediately on vesting, were forfeited. Compute expenses to recognise in each year and show important accounts in the books of the company (RTP Nov 22)

Answer

Total number of Options per employee = 60

Group I - 20% vesting in Year 1 = 12 options, Vesting period = 1 Yr.	Group II - 40% vesting in Year 2 = 24 options, Vesting period = 2 Yrs.	Group III - 40% vesting in Yr. 3 = 24 options, Vesting period = 3 Yrs.

Computation of Expenses for all the years

Group = No. of Options	Group I = 12 Options	Group II = 24 Options		Group III = 24 Options		
	Year 1	Year 1	Year 2	Year 1	Year 2	Year 3
(a) Employees at year end = [Opening No. of Employees - Forfeiture]	400 – 40 = 360	400 – 40 = 360	360 – 35 = 325	400 – 40 = 360	360 – 35 = 325	325 – 28 = 297
(b) Expected to leave in future	Na	36	NA	36 + 34 = 70	30	NA
(c) No. of employees eligible (a-b)	360	324	325	290	295	297
(d) Options expected to Vest = [(c) x No. of Shares]	360 * 12 = 4320	324 * 24 = 7776	325 * 24 = 7800	290 * 24 = 6960	295 * 24 = 7080	297 * 24 = 7128
e) FV per option =	10	12.5	12.5	14	14	14
(f) Value of Total Options = [d x e]	43200	97200	97500	97440	99120	99792
g) Total Cumulative	43200	F * ½ 48600	F * 2/2 97500	F * 1/3 32480	F * 2/3 66080	F * 3/3 99792

Cost of Options = [(f) x Completed Yrs/ Total Yrs)						
(h) Less: Recognized in last years	0	0	48600	0	32480	66080
(i) Expenses to be recognized	43200	48600	48900	32480	33600	33712
(j) Employees not exercising ESOP	10	325 – 319 = 6		297 – 295 = 2		
(k) Total Expenses for- Year 1 Year 2 Year 3	` 43,200 (Gr. 1) + ` 48,600 (Gr. 2) + ` 32,480 (Gr. 3) = ` 1,24,280 ` 48,900 (Gr. 2) + ` 33,600 (Gr. 3) = ` 82,500 ` 33,712 (Gr. 3 only)					

Employees Benefit Expenses A/c

	`		`
Year 1			
To Share-based Payment Reserve A/c	1,24,280	By Profit and Loss A/c	1,24,280
	1,24,280		1,24,280
Year 2			
To Share-based Payment Reserve A/c	82,500	By Profit and Loss A/c	82,500
	82,500		82,500
Year 3			
To Share-based Payment Reserve A/c	33,712	By Profit and Loss A/c	33,712
	33,712		33,712

Share-based Payment Reserve A/c

	`		`
Year 1			
To Retained Earnings [(360 - 350) Emp x 12 Options x ` 10]	1,200	By Employees Benefit Expenses A/c	1,24,280

To Share Capital		By Bank A/c (350 Emp x	
(350 Emp x 12 Options x ` 100)	4,20,000	12 Options x ` 125)	5,25,000
To Securities Premium			
(350 Emp x 12 Options x ` 35)	1,47,000		
To Balance c/d	81,080		
	6,49,280		6,49,280
Year 2			
To Retained Earnings	1,800	By Balance b/d	81,080
[(325 - 319) Emp x 24 Options x ` 12.50]		By Employees Benefit	
		Expenses A/c	82,500
To Share Capital (319 Emp x		By Bank A/c (319 Emp x	
24 Options x ` 100)	7,65,600	24 Options x ` 125)	9,57,000
To Securities Premium	2,87,100		
(319 Emp x 24 Options x ` 37.50)			
To Balance c/d	66,080		
	11,20,580		11,20,580
Year 3			
To Retained Earnings	672	By Balance b/d	66,080
[(297 - 295) Emp x 24 Options x ` 14]		By Employees Benefit	
		Expenses A/c	33,712
To Share Capital (295 Emp x		By Bank A/c (295 Emp x	
24 Options x ` 100)	7,08,000	24 Options x ` 125)	8,85,000
To Securities Premium (295			
Emp x 24 Options x ` 39)	2,76,120		
	9,84,792		9,84,792

Working Note:

Calculation of Securities Premium

	Group I	Group II	Group III
	Year 1	Year 2	Year 3
Exercise Price received per share	125	125	125
Value of service received per share, being the FV of the Options	10	12.5	14
Total Consideration received per share	135	137.5	139

Less: Nominal Value per share Securities Premium per share	100 35	100 37.5	100 39

ESOP modification

5(b)A Ltd. had on 1stApril, 2015 granted 1,000 share options each to 2,000 employees. T he options are due to vest on 31stMarch, 2018 provided the employee remains in employment till 31stMarch, 2018.

On 1stApril, 2015, the Directors of Company estimated that 1,800 employees would qualify for the option on 31stMarch, 2018. T his estimate was amended to 1,850 employees on 31stMarch, 2016 and further amended to 1,840 employees on 31stMarch, 2017.

On 1stApril, 2015, the fair value of an option was Rs.1.20. T he fair value increased to Rs.1.30 as on 31stMarch, 2016 but due to challenging business conditions, the fair value declined thereafter. In September 2016, when the fair value of an option was Rs.0.90, the Directors repriced the option and this caused the fair value to increase to Rs.1.05. T rading conditions improved in the second half of the year and by 31stMarch, 2017 the fair value of an option was Rs.1.25. QA Ltd. decided that additional cost incurred due to repricing of the options on 30thSeptember, 2016 should be spread over the remaining vesting period from 30thSeptember, 2016 to 31stMarch, 2018. T he Company has requested you to suggest the suitable accounting treatment for these tran saction a s on 31stMarch, 2017 (MTP March 2019) / (RTP Nov 19) / MTP Oct 2022

[video link: https://youtu.be/OIqCwQnnflo?t=1822]

Answer

Paragraph 27 of IndAS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted paragraph B43(a) of Appendix B requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instrumen ts granted. If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurementof the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in

addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.Accordingly, the amounts recognised in years 1 and 2 are as follows:

Year	Calculation	Compensation expense for period	Cumulative compensation expense
1	[1,850 employees× 1,000 options × Rs.1.20] × 1/3	740,000	740,000
2	(1,840 employees× 1,000 options × [(Rs.1.20× 2/3)+ {(Rs.1.05 -0.90) ×0.5/1.5}]–7,40,000	824,000	15,64,000

5 (a) On 1st April 2017, Kara Ltd. granted an award of 150 share options to each of its 1,000 employees, on condition of continuous employment with Kara Ltd. for three years and the benefits will then be settled in cash of an equivalent amount of share price. Fair value of each option on the grant date was ` 129.

Towards the end of 31st March 2018, Kara Ltd.'s share price dropped; so on 1st April 2018 management chose to reduce the exercise price of the options.

At the date of the re-pricing, the fair value of each of the original share options granted was ` 50 and the fair value of each re-priced option was ` 80. Thus, the incremental fair value of each modified option was ` 30.

At the date of the award, management estimated that 10% of employees would leave the entity before the end of three years (i.e., 900 awards would vest). During financial year 2018-2019, it became apparent that fewer employees than expected were leaving, so management revised its estimate of the number of leavers to only 5 % (i.e. 950 awards would vest). At the end of 31st March 2020, awards to 930 employees actually vested.

Determine the expense for each year and pass appropriate journal entries as per the relevant Ind AS. (Jan 21 Exam)

[video link: https://youtu.be/PMpGCRSCIQE?t=125]

Answer

Note: The first para of the question states that “benefits will then be settled in cash of an equivalent amount of share price.” This implies that the award is cash settled share-based payment. However, the second and third para talks about

repricing of the option which arises in case of equity settled share -based payment.

Hence, two alternative solutions have been provided based on the information taking certain assumptions .

1st Alternative based on the assumption that the award is cash settled share - based payment.

In such a situation, the services received against share-based payment plan to be settled in cash are measured at fair value of the liability and the liability continues to be re-measured at every reporting date until it is actually paid off.

There is a vesting condition attached to the share -based payment plans i.e. to remain in service for next 3 years. The recognition of such share-based payment plans should be done by recognizing fair value of the liability at the time of services received and not at the date of grant. The liability so recognized will be fair valued at each reporting date and difference in fair value will be charged to profit or loss for the period.

Calculation of expenses:

For the year ended 31st March 2018 = ` 50 x 150 awards x 900 employees x (1 year /3 years of service ) = ` 22,50,000

For the year ended 31st March 2019

Note: It is assumed that the fair value of ` 80 each of repriced option continues at the end of the remaining reporting period ie 31st March, 2019 and 31st March, 2020

= [` 80 x 150 awards x 950 employees x (2 year / 3 years of service)] –

` 22,50,000 =

` 7,60,00,000 –` 22,50,000 = ` 53,50,000

For the year ended 31st March 2020

= [` 80 x 150 awards x 930 employees] - ` 22,50,000 - ` 53,50,000

= ` 1,11,60,000 –` 22,50,000 - ` 53,50,000= ` 35,60,000

Journal Entries

31stMarch, 2018

Employee benefits expenses Dr.	22,50,000	
To Share based payment liability		22,50,000
(Fair value of the liability recognized)		

31st March, 2019

Employee benefits expenses Dr.	53,50,000	
To Share based payment liability		53,50,000
(Fair value of the liability re-measured)		

31st March, 2020

Employee benefits expenses Dr.	35,60,000	
To Share based payment liability		35,60,000
(Fair value of the liability recognized)		
Share based payment liability Dr.	1,11,60,000	
To Bank		1,11,60,000
(Being liability for awards settled in cash)		

2nd Alternative based on fair value at the grant date

(ignoring the fact that the award has to be settled in cash).

Calculation of expenses:

For the year ended 31st March 2018

= [` 129 x 150 awards x 900 employees x (1 year /3 years of service)]

= ` 58,05,000

For the year ended 31st March 2019

Ind AS 102 requires the entity to recognise the effects of repricing that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee.

If the repricing increases the fair value of the equity instruments granted standard requires the entity to include the incremental fair value granted (ie the difference between the fair value of the repriced equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted.

If the repricing occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the repricing date until the date when the repriced equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period. Accordingly, the amounts recognised are as follows:

Year ended	Calculation	Compensation expense for period	Cumulative compensation expense
31 March, 2018	[`129x 150 awards x 900 employees x (1 year /3 years ofservice)]	5805000	5805000
31 March, 2019	[`129x 150 awards x 950 employees x (2 year /3 years of service)] + (80-50) x 150 awards x 950 employees x (1 year / 2 years of service) -58,05,000	8587500	14392500
31 March, 2020	[(`129 + 30) x 150 awards x 930 employees]-1,43,92,500	7788000	22180500

Journal Entries

31stMarch, 2018

Employee benefits expensesDr.58,05,000

To Outstanding Share based payment option58,05,000

(Fair value of the liability recognized)

31stMarch, 2019

Employee benefits expensesDr.	85,87,500	
To Outstanding Share based payment option		85,87,500
(Fair value of the liability re-measured)		
31stMarch, 2020		
Employee benefits expensesDr.	77,88,000	
To Outstanding Share based payment option		77,88,000
(Fair value of the liability recognized)		
Outstanding Share based payment optionDr.	2,21,80,500	
To Equity share capital		2,21,80,500
(Being award settled)		

3(a) ABC Limited granted 500 stock appreciation rights (SAR) each to 80 employees on 1stApril, 2017 with a fair value `100 each. The terms of the award require the employee to provide service for four years to earn the award. The SARs are expected to be settled in cash and it is expected that 100% of the employees will exercise the option. The fair value of each SAR at each reporting date is as follows:

31stMarch, 2018	`110
31stMarch, 2019	`120
31stMarch, 2020	`115
31stMarch, 2021	`130

Please present the journal entries in the books of ABC Limited over the entire life of the grants.
What would be the difference if at the end of the second year of service (i.e. at 31st March, 2019), ABC Limited modifies the terms of the award to require only three years of total service? Please present with the revised journal entries. Answer on the basis of relevant Ind AS. (Exam Nov 19) / (MTP March 22)
[video link: https://youtu.be/PMpGCRSCIQE?t=2819]

Answer

Number of SARs = 80 Employees x 500 SARs = 40,000 SARs

1.When the term of the awards is 4 years of service

Period	Fair value	To be vested	Cumulative	Expense in proportion to the award earned	Cumulative expenses recognized
1.4.2017	100	100%	40,00,000	-	-
31.3.2018	110	100%	44,00,000	11,00,000	11,00,000
31.3.2019	120	100%	48,00,000	13,00,000	24,00,000
31.3.2020	115	100%	46,00,000	10,50,000	34,50,000
31.3.2021	130	100%	52,00,000	17,50,000	52,00,000

31st March, 2018
Employee benefits expenses/Profit and Loss A/cDr. 11,00,000
To Share based payment liability 11,00,000
(Fair value of SARs has been recognised)

31st March, 2019
Employee benefits expenses/Profit and Loss A/cDr. 13,00,000
To Share based payment liability 13,00,000
(Fair value of SARs has been re-measured)

31st March, 2020
Employee benefits expenses/Profit and Loss A/cDr. 10,50,000
To Share based payment liability 10,50,000
(Fair value of SARs has been recognized)

31st March, 2021
Employee benefits expenses A/c Dr. 17,50,000
To Share based payment liability 17,50,000
(Fair value of SARshas been recognized)

2.When the term of the awards is modified to 3 years of service instead of 4 years of service

Period	Fair value	To be vested	Cumulative	Expense in proportion to the award earned	Cumulative expenses recognized
1.4.2017	100	100%	40,00,000	-	-
31.3.2018	110	100%	44,00,000	11,00,000	11,00,000
31.3.2019	120	100%	48,00,000	21,00,000	32,00,000
31.3.2020	115	100%	46,00,000	14,00,000	46,00,000

31st March, 2018
Employee benefits expenses/Profit and Loss A/c Dr. 11,00,000
To Share based payment liability 11,00,000
(Fair value of SARs has been recognised)

31st March, 2019
Employee benefits expenses/Profit and Loss A/c Dr. 21,00,000
To Share based payment liability 21,00,000
(Fair value of SARs has been re-measured)

31st March, 2020
Employee benefits expenses/Profit and Loss A/c Dr. 14,00,000
To Share based payment liability 14,00,000
(Fair value of SARs has been recognized)

Cancellation of ESOP

6c. Voya Limited issued 1,000 share options to each of its 200 employees for an exercise price of ` 10. The employees are required to stay in employment for next 3 years. The fair value of the option is estimated at ` 18.
90% of the employees are expected to vest the option. The Company faced severe crisis during the 2nd year and it was decided to cancel the scheme with immediate effect. The market price of the share at the date of cancellation was ` 15.
The following information is available:
- **Fair value of the option at the date of cancellation is ` 12.**
- **The company paid compensation to the employees at the rate of ` 13.50. There were only 190 employees in the employment at that time.**

You are required to show how cancellation will be recorded in the books of the Company as per relevant Ind AS.
[similar question video link: https://youtu.be/ocZqNAjiOl0?t=84]
Answer

(A) Calculation of employee compensation expense

	Year 1	Year 2
Expected employees to remain in the employment during the vesting period	180	190
Fair value of option	18	18
Number of options	1,000	1,000
Total	32,40,000	34,20,000
Expense weightage	1/3	2/3 Balance 2/3rd in full, as it is cancelled
Expense for the year	10,80,000	23,40,000 Remaining amount since cancelled

(B) Cancellation compensation to be charged in the year 2

Cancellation compensation	
Number of employees (A)	190
Amount agreed to pay (B)	13.50
Number of options/ employee (C)	1,000
Compensation amount (A x B x C)	25,65,000
Less: Amount to be deducted from Equity	
Number of employees (D)	190
Fair value of option (at the date of cancellation) (E)	12
Number of options / employee (F)	1,000
Amount to be deducted from Equity (D x E x F)	(22,80,000)
Balance transferred to Profit and Loss	2,85,000

Group Share based payment

6. A parent grants 200 share options to each of 100 employees of its subsidiary, conditional upon the completion of two years' service with the subsidiary. The fair value of the share options on grant date is ` 30 each. At grant date, the subsidiary estimates that 80 percent of the employees will complete the two -year service period. This estimate does not change during the vesting period. At the end of the vesting period, 81 employees complete the required two years of service. The parent does not require the subsidiary to pay for the shares needed to settle the grant of share options. Pass the necessary journal entries for giving effect to the above arrangement. (RTP May 19)

[video link: https://youtu.be/PMpGCRSCIQE?t=2079]

Answer

As required by paragraph B53 of the Ind AS 102, over the two-year vesting period, the subsidiary measures the services received from the employees in accordance, the requirements applicable to equity-settled share-based payment transactions as given in paragraph 43B. Thus, the subsidiary measures the services received from the employees on the basis of the fair value of the share options at gran t date. An increase in equity is recognised as a contribution from the parent in the separate or individual financial statements of the subsidiary.

The journal entries recorded by the subsidiary for each of the two years are as follows:

Year 1

Remuneration expenseDr.(200 x 100 employees x `30x 80% x ½)	2,40,000	
To Equity (Contribution from the parent)	2,40,000	

Year 2

Remuneration expense Dr.[(200 x 81 employees x `30) –2,40,000]	2,46,000	
To Equity (Contribution from the parent)	2,46,000	

12.Company P is a holding company for company B. A group share-based payment is being organized in which Parent issues its own equity shares to the employees of company B. The details are as below –

Number of Employees of Company B	100
Grant date fair value of share	`87
Number of shares granted to each employee	25
Vesting conditions	Immediately
Face value per share	`10

Pass the journal entries in the books of company P & company B. (RTP May 2021)

[video link: https://youtu.be/PMpGCRSClQE?t=2785]

Answer

Journal Entries

Books of Company P

Investment in Company BDr.	2,17,500	
To Equity Share Capital A/c (2,500 shares x `10)		25,000
To Securities Premium A/c (2,500 shares x `77)		1,92,500

(Being allotment of 25 shares each to 100 employees of B at fair value of `87 per share)

Books of Company B

Employee Benefit Expense A/cDr.	2,17,500	
To Capital Contribution from Parent P		2,17,500

(Being issue of shares by Parent to Employees pursuant to Group Share-based Payment Plan)

Ind AS 103 & 110

Date of Acquisition	Subsequent years
Ind AS 103	Prepare 2 B/S SFS – Ind AS 28 CFS – Subsidiary – Ind AS 110 Associate – Ind AS 28 JO – Ind AS 111

Ind AS 103: PC + NCI – NA = G/(BP)

1. **PC**

Cash	Amount given
Future cash payment:	PV of such payment
Shares issued	Fair value on such date
Contingent consideration	At Fair value (given in question) **Subsequent recognition of such consideration** a. If payable in Cash: FL accounted as FVTPL b. If payable in variable no. of shares: FL accounted as FVTPL c. If payable in fixed no. of shares: Equity, no subsequent change in fair value
Shares already held	Fair value on such date
Unconditional payment to promoters	Amount given (If conditional then not part of PC, apply Ind AS 19)
Replacement of ESOP	FV of ESOP of subsidiary * Vesting period expired / Original VP or Revised accumulated VP weh
Transaction cost	Not part of PC a. If related to issue of shares then trf to RE b. If related to other reasons transfer to PL

2. **NA**

General rule	Account all assets and liabilities at fair value
Contingent liability	Account as liability at fair value given
Indemnification of CL above	Reduce liability above ny fair value of sch asset given (this can be maximum equal to CL above)
Employee benefit	As per Ind AS 19
Intangible Asset	Fair value even if not appearing in books of subsidiary
Asset held for sale	CA or FVLCTS wel
Deferred tax	Increase existing amount by • Asset side ○ If FV> CA = DTL ○ If FV < CA = DTA • Liability side ○ If FV > CA = DTA

	○ If FV < CA = DTL
Share based payment (not replaced)	

3. NCI
   a. Valued at either of the following as given in question
      i. Partial goodwill method/ Proportionate asset method: Proportionate to fair value of net assets given
      ii. Full goodwill method / Fair value method: Fair value fo equity shares of subsidiary
   b. ESOP not replaced also included in NCI at

$$\frac{\text{FV of ESOP of subsidiary * Vesting period expired}}{\text{Original VP or Revised accumulated VP weh}}$$

Adjustment to fair value of NA above

If certain assets determined above were not valued correctly or not accounted at all though existed on such date	
Correct value determined within 12months from such acquisition date, then correct the value of such asset and adjust goodwill / BP	Correct value determined after 12months from such acquisition date, then don't adjust goodwill / BP

Note: If value changes subsequently due to subsequent events, then don't adjust to Goodwill / BP

Ind AS 110

- Sale of goods by or from subsidiary to parent

	Upstream	Downstream
	Sale by subsi to parent	Sale by parent to subsi
Unrealized profit	$\frac{\text{Closing stock * profit on total sale}}{\text{Sale value}}$	
Debit	Conso PL and NCI as per respective share	Conso PL
Credit	Cl stock	Cl stock

- Exemption from CFS
  - Unlisted entity and not in process of listing (either debt or equity)
  - Some holding company above you preparing CFS
  - NCI has no objection
- Invetsment entity no need to prepare CFS unless its subsidiary is also investment entity or service provider to such investment entity
- Sale of subsidiary
  - Dr NCI

- Dr cash
- Dr shares held if any at fair value
- Cr net assets at carrying amount
- Cr goodwill if any
- Balancing figure PL
- FV reserve if any of subsidiary held to be transferred
  - If OCI – R to PL
  - If OCI – NR to RE

- Sale/ purchase of shares of subsidiary

	Purchase of further shares of subsidiary	Sale of shares of subsidiary without loosing control	Sale of shares of subsidiary loosing control
Entry in CFS	NCI dr To Cash To OE(bal figure)	Cash dr. To NCI To OE(Bal fig)	Cash dr. NCI dr To NA To Goodwill To PL (Bal fig)
Value of NCI	Proportionate reduction is carrying amount of NCI based on proportion of purchase	Value equivalent to carrying amount of NA of entity including goodwill / excluding BP in proportion of purchase	N.A.

Control

19. Solar Limited has an 80% interest in its subsidiary, Mars Limited. Solar Limited holds a direct interest of 25% in Venus Limited. Mars Limited also holds a 30% interest in Venus Limited. The decisions concerning relevant activities of Venus Limited require a simple majority of votes. How should Solar Limited account for its investment in Venus Limited in its consolidated financial statements? (RTP Nov 21)

[video link: https://youtu.be/QJdTojWQ3bw?t=2437]

Answer

In the present case, Solar Limited controls Mars Limited (since it holds 80% of its voting rights). Consequently, it also controls the voting rights associated with 30% equity interest held by Mars Limited in Venus Limited. Solar Limited also has 25% direct equity interest and related voting power in Venus Limited. Thus, Solar Limited controls 55% (30% + 25%) voting power of Venus Limited. As the decisions concerning relevant activities of Venus Limited require a simple majority of votes. Solar Limited controls Venus Limited and should therefore consolidate it in accordance with Ind AS 110.

Although, Solar Limited controls Venus Limited, its entitlement to the subsidiary's economic benefits is determined on the basis of its actual ownership interest. For

the purposes of the consolidated financial statements, Solar Limited's share in Venus Limited is determined as 49% [25% + (80% × 30%)]. As a result, 51% of profit or loss, other comprehensive income and net assets of Venus Limited shall be attributed to the non-controlling interests in the consolidated financial statements (this comprises 6% attributable to holders of non-controlling interests in Mars Limited [reflecting 20% interest of non-controlling shareholders of Mars Limited in 30% of Venus Limi ted] and 45% to holders of non-controlling interests in Venus Limited).

3cTee Limited is carrying on the business of developing light weight and medium weight guns for the Indian defence industry. Tee Limited acquired 48% of shares in Kay Limited, a company engaged in advanced research in weapons. Tee Limited acquired shares in Kay Limited to substantiate their position in the industry.
The remaining 52% of shares are held by the key management personnel of the Company Kay Limited. The Kay management consists of eleven people who are experts in the fields of advanced weapons and the core of the Company.
Tee Limited has the option to purchase remaining 52% at any time by paying 6 times the market price of the share. But on purchase of the shares it is highly possible that the key management personnel will leave the company.
(A) State whether Tee Limited has control over Kay Limited.
(B) What will be your answer if Tee Limited had 51% of shares in Kay Limited and Kay Limited can start the research, development and production of weapon only with the stringent approval process of the defence ministry of the Central Government.
[video link: https://youtu.be/Jv2xBLVq9A8?t=113]
Answer

As per para 7 of Ind AS110 / IFRS 10, an investor controls an investee if and only if the investor has all the following:

1.Power over the investee

Further, as per para 10 of the standard, an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevan t activities, ie the activities that significantly affect the investee’s returns.

2.Exposure, or rights, to variable returns from its involvement with the investee

As per para 15 of the standard, an investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor’s returns from its involvement have the potential to vary as aresult of the investee’s performance.

3.The ability to use its power over the investee to affect the amount of the investor's returns

An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Based on the above guidance, following can be concluded:

(a)T ee limited has acquired 48% in Kay Limited. T he purpose of acquiring the shares by T ee limited in it is to substantiate their position in the industry. Ka y Limited is a specialist entity that is engaged in advanced research in weapons. Acquiring Kay Limitedwill help T ee limited to gain access to their research which would complement Tee limited's operations and business of developing light weight and medium weight guns.

T he key management personnel who holds 52% shares of Kay Limited are ke y for running Kay Limited's business of advanced research and will help Tee limited to acquire the market through ground breaking advanced researches of Kay Limited. In case of acquisition of 52% stake of Kay Limited, the ke y management personnel may leave the organisation and in such a situation T ee limited will not enjoy any economic benefit or infact will lose the benefit of unique technical knowledge of those 11 experts.

Hence, T ee limited would not be able to use its power over Kay Limited to affect the amount of its returns which is one of the essential criteria to assess the control, so there is no control of T ee limited on Kay Limited.

(b)Even though T ee limited has acquired 51% stake in Kay Limited yet it does not have power over Kay Limited as it would not beable to exercise its existing rights that give it the current ability to direct the relevant activities, ie the activities that significantly affect the investee's returns. In other words, the relevant activity of Kay Limited is advance research in weapons which will help T ee limited to substantiate their position. However, the research, development and production will start only after stringent approval process of the defence ministry of the Central Government. T hus regulations prevent T ee limited to direct the relevant activity of Kay Limited which ultimately lead to prevent T ee Limited to have control.

1(b) High Speed Ltd. has entered into a Share Purchase Agreement ("SPA") with the shareholders of Fast Move Limited to purchase 30% stake in Fast Move Limited as at 1st June, 20X1 at a price of ` 30 per share. As per the terms of SPA, High Speed Ltd. has an option to purchase additional 25% stake in Fast Move Limited on or before 15th June, 20X1 at a price of ` 30 per share. Similarly, the

selling shareholder has an option to sell additional 25% stake in Fast Move Limited on or before 15.6.20X1 to High Speed Ltd. at a price of ` 30 per share.

The decisions on relevant activities of Fast Move Limited are made in Annual General Meeting / Extraordinary General Meeting (AGM / EGM). A resolution in AGM / EGM is passed when more than 50% votes are casted in favor of the resolution. An AGM / EGM can be called by giving atleast 21 days advance notice to all shareholders.

With respect to the SPA entered by High Speed Ltd., you are required to determine whether High Speed Ltd. has control over Fast Move Limited as at 1st June, 20X1. (MTP Oct 22)

Answer

Paragraph 10 of Ind AS 110 'Consolidated Financial Statements', states that an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns.

As per the facts given in the question, High Speed Ltd. has 15 days to exercise the option to purchase 25% additional stake in Fast Move Ltd. which will give it majority voting rights of 55% (30% + 25%). This is a substantive potential voting rights which is currently exercisable.

Further, the decisions on relevant activities of Fast Move Ltd. are made in AGM / EGM. An AGM/ EGM can be called by giving atleast 21 days advance notice. A resolution in AGM / EGM is passed when more than 50% votes are casted in favour of the resolution. Thus, the existing shareholders of Fast Move Ltd. are unable to change the existing policies over the relevant activities before the exercise of option by High Speed Ltd.

High Speed Ltd. can exercise the option and get voting rights of more than 50% at the date of AGM/ EGM. Accordingly, the option contract gives High Speed Ltd. the current ability to direct the relevant activities even before the option contract is settled. Therefore, High Speed Ltd. controls Fast Move Ltd. as at 1st June, 20X1.

Exemption from CFS

14.Gamma Limited, a parent company,is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

•Gamma Limited holds 100% Investment in G Limited and D Limited;

•G Limited and D Limited hold 60% and 40% in GD Limited respectively;

•Delta Limited is a 100% subsidiary of GD Limited

Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?

Secondly, if all other facts remain the same as aboveexcept thatG Limited and D Limited are both owned by an Individual (say, Mr.X) instead of Gamma Limited, thenexplain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements. (RTP May 20)

[video link: https://youtu.be/VVX7wS9ow2A?t=1174]

Answer

As per paragraph 4(a) of Ind AS 110, an entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

A parent need not present consolidated financial statements if it meets all the following conditions:

(i)it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitledto vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii)its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

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

(iv)its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

— wholly-owned subsidiary; or

—is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Although GD Limited is a partly-owned subsidiary of G Limited, it is the wholly-owned subsidiary of Gamma Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. G Limited and D Limited).

Thus, GDLimited being the wholly owned subsidiary fulfils the conditions as mentioned under paragraph 4(a)(i) and is not required to inform its other owner D Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, GD Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

In Alternative Scenario, whereboth G Limited and D Limited are owned by an individual Mr. X, then GD Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, GD Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, GD Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, D Limited should be informed about and do not object to GD Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of G Limited and D Limited, GD Limited will be required to provide relevant financial information as per Ind AS.

Deferred Tax

4.(a)In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of Rs. 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

Item	**Rs. in lakhs**
Assets	
Cash	**780**
Receivables (net)	**5,200**
Plant and equipment	**7,000**
Deferred tax asset	**360**

Liabilities

Payables	**1,050**
Borrowings	**4,900**
Employee entitlement liabilities	**900**
Deferred tax liability	**300**

The plant and equipment has a fair value of Rs. 8,000 lakhs and a tax written down value of Rs. 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of Rs. 300 lakhs.

Bad debts are deductible for tax purposes when written off against the allowance account by Dorman Ltd. Employee benefit liabilities are deductible for tax when paid.

Dorman Ltd. owns a popular brand name that meets the recognition criteria for intangible assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of Rs. 4.300 lakhs for the brand.However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

The tax rate of 30% can be considered for all items. Assume that unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to: (MTP Aug 2018)

(i) Calculate deferred tax assets and liabilities arising from the business combination (do not offset deferred tax assets and liabilities)

(ii)Calculate the goodwill that should be accounted on consolidation.

[video link: https://youtu.be/Jv2xBLVq9A8?t=554]

Answer

Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxesand goodwill.

Item	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax asset (liability) @ 30%
Cash	780	780	780	-	-
Receivable	5200	5200	5500	(300)	90
PPE	7000	8000	6000	2000	(600)
Brand		4300		4300	(1290)

Goodwill		2100			
DTA	360	360			
Total		20740			
Payables	1050	1050	1050		
Borrowings	4900	4900	4900		
Employee Benefit liabilities	900	900		(900)	270
DTL	300	1890			
Total		(8740)			
Consideration paid		12000			

Notes

(1) This amount has been derived from Dorman Ltd.'s Balance Sheetas it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in DormanLtd.'s Balance Sheetat the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheetat the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (Rs.5,200+Rs.300)lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is Rs. 360 lakhs, comprised of Rs.90 lakhs in relation to the receivables and Rs.270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is Rs. 1,890 lakhs calculated as follows:

Rs. In lakhs	DTL amount in Dorman Ltd.'s Balance Sheet	Deferred tax impact of fair value adjustments	Total DTL in Pharma Ltd's consolidated financial statements
Plant and equipment	300	300	600
Brand names	0	1290	1290
	300	1590	1890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements ofInd AS 103, para 32. The consideration transferred is Rs. 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is Rs. 9,900 lakhs

4.On 1 January 2020, entity H acquired 100%share capital of entity S for `15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

Figure in '000

Acquisitions	Book value	Tax base	Fair value
Land and buildings	600	500	700
Property, plant and equipment	250	200	270
Inventory	100	100	80
Accounts receivable	150	150	150
Cash and cash equivalents	130	130	130
Accounts payable	(160)	(160)	(160)
Retirement benefit obligations	(100)		(100)

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition. (RTP Nov 20) / (MTP Oct 21)

[video link: https://youtu.be/j1tQn2yRugg, time: 18:45]

Answer

Calculation of Net assets acquired (excluding the effect of deferred tax liability):

Net assets acquired	Tax base `'000	Fair values `'000
Land and buildings	500	700
Property, plantand equipment	200	270
Inventory	100	80
Accounts receivable	150	150
Cash and cash equivalents	130	130
Total assets	1,080	1,330
Accounts payable	(160)	(160)

Retirement benefit obligations	-	(100)
Net assets before deferred tax liability	920	1,070

Calculation of deferred tax arising on acquisition of entity S and goodwill

	Figure in thousand
Fair values of S's identifiable assets and liabilities (excluding deferred tax)	1,070
Less: Tax base	(920)
Temporary difference arising on acquisition	150
Net deferred tax liability arising on acquisition of entity S	
(`150,000 @ 40%)	60
Purchase consideration	1,500
Less: Fair values of entity S's identifiable assets and liabilities	
(excluding deferred tax)	1,070
Deferred taxliability	(60)
	(1,010)
Goodwill arising on acquisition	490

Note: Since, the tax base of the goodwill is nil, taxable temporary difference of `4,90,000 arises on goodwill. However, no deferred tax is recognised on the goodwill.The deferred tax on other temporary differences arising on acquisition is provided at 40% and not 30%, because taxes will be payable or recoverable in entity S's tax jurisdictions when the temporary differences will bereversed.

5 (b) C Ltd. acquired the following assets and liabilit ies of D Ltd. in a business combination: **` in '000s**

	Fair Value	Carrying Amount	Temporary Difference
Plant & equipment **Inventory** **Trade receivables** **Loans and advances**	**500** **130** **200** **80**	**510** **150** **210** **85**	**(10)** **(20)** **(10)** **(5)**
	910	**955**	**(45)**
10% Debentures	**200**	**200**	
	710	**755**	
Consideration Paid	**760**	**760**	
Goodwill	**50**	**5**	**45**

Goodwill is deductible as permissible expenses under the existing tax law. Calculate Deferred Tax Asset / liability as per relevant Ind AS and also pass related journal entry in books of C Ltd. and assume tax rate at 25 %. (Exam Jan 21)

[video link: https://youtu.be/VVX7wS9ow2A?t=1530]

Answer

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by ` 45,000. Deferred Tax Asset would be ` 11,250 (45,000 x 25%)

Journal entry

Plant and equipment Dr.	5,00,000	
Inventory Dr.	1,30,000	
Trade receivables Dr.	2,00,000	
Loans and advances Dr.	80,000	
Goodwill (50,000 - 11,250) Dr.	38,750	
Deferred Tax Asset Dr.	11,250	
To 10% Debentures		2,00,000
To Bank		7,60,000

(Assets and liabilities taken over, goodwill and defer red tax asset have been recognised)

Contingent Consideration

2. (a) How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

i) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

ϖan immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;

ϖa further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.

The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is Rs. 25 lakhs.

During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded Rs. 1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is Rs. 25 per share.

ii)Continuing with the fact pattern in (a) above except for:

ϖThe number of shares to be issued after one year is not fixed.

ϖRather, A Ltd. agreed to issue variable number of shares having a fair value equal to Rs. 40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds Rs. 1 crore. A Ltd. issued shares with Rs. 40 lakhs after an year. (MTP April 2018) / (MTP Oct 2019) / (RTP May 19) / (RTP May 2022 similar) / RTP Nov 22 similar

[video link: https://youtu.be/Jv2xBLVq9A8?t=2942]

Answer

Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of (a) the acquisition-date fair values of the assets transferred by the acquirer, (b) the liabilities incurred by the acquirer to former owners of the acquiree and (c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

i) In the given case the amount of purchase consideration to be recognised on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 xRs.20)	Rs.2,00,00,000
Fair value of contingent consideration	Rs.25,00,000
Total purchase consideration	Rs.2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

ϖThere is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).

ϖIf the instrument will or may be settled in the issuer's own equity instruments, then it is:

♣a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

♣a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to Rs. 25,00,000 is recognised as a part of equity and therefore not re-measured subsequently or on issuance of shares.

ii) The amount of purchase consideration to be recognised on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x Rs.20)	Rs.2,00,00,000
Fair value of contingent consideration	Rs.25,00,000
Total purchase consideration	Rs.2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognised in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of Rs. 15,00,000 (Rs. 40,00,000 - Rs. 25,00,000) should be recognised in the profit or loss for the period. A Ltd. would recognise issuance of 160,000 (Rs. 40,00,000/ 25) shares at a premium of Rs. 15 per share.

Intangible Asset accounitng

10.As part of its business expansion strategy, KK Ltd. is in process of setting up a pharma intermediates business which is at very initial stage. For this purpose, KK Ltd. has acquired on 1st April, 2018, 100% shares of ABR Ltd. that manufactures pharma intermediates. The purchase consideration for the same was by way of a share exchange valued at ` 35 crores. The fair value of ABR Ltd.' s net assets was ` 15 crores, but does not include:

(i) A patent owned by ABR Ltd. for an established successful intermediate drug that has a remaining life of 8 years. A consultant has estimated the value of this patent to be ` 10 crores. However, the outcome of clinical trials for the same are awaited. If the trials are successful, the value of the drug would fetch the estimated `15 crores.

(ii) ABR Ltd. has developed and patented a new drug which has been approved for clinical use. The cost of developing the drug was ` 12 crores. Based on early assessment of its sales success, the valuer has estimated its market value at `20 crores.

(iii) ABR Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the Company has been granted an exclusive five-year license to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is a valuable asset which assures guaranteed sales and the value for the same is estimated at ` 10 crores.

KK Ltd. has requested you to suggest the accounting treatment of the above transaction under applicable Ind AS. (RTP May 19) / (Exam Nov 19) / (Exam July 2021)

[video link: https://youtu.be/VVX7wS9ow2A?t=106]

Answer

As per para 13 of IndAS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense.Based on the above, the company can recognise following Intangible assets while determining Goodwill / Bargain Purchase for the transaction:

(i)Patent owned by ABR Ltd.: The patent owned will be recognised at fair value by KK Ltd. eventhough it was not recognised by ABR Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 8 years.

Since the company is awaiting the outcome of the trials, the value of the patent cannot be estimated at `15 crore and the extra `5 crore should only be disclosed as a Contingent Asset and not recognised.

(ii)Patent internally developed by ABR Ltd.:As per para 18 of Ind AS 103 'Business Combination', the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisitiondate fair values. Since the patent developed has been approved for clinical use, it is an identifiable asset, hence the same will be measured at fair value ie `20crore on the acquisition date.

(iii)Grant of Licence to ABR Ltd. by the Government:As regardsto the five-year license, applying para 18of Ind AS 103,grant asset will be recognised at fair valueon the acquisition date by KKLtd. On acquisition date, the fair value of the license is `10 crore. However, since the question does not mention about the fair value of the identifiable liability with respect to grant of license for the acquirer, it is assumed that no conditions with respect to compliance of grant (if any) have been passed to the acquirer. Hence, the fair value of the liability with respect to grant, for acquirer would be nil. Only, thegrantasset (license)would be recognised at `10crorein the books of acquirer KK Ltd.

Hence the revised working would be as follows:

Fair value of net assets of ABR Ltd.	`15 crore
Add: Patent (10 + 20)`30croreAdd: License	`10 crore
Less: Grant for License	(Nil)

	`55crores
Purchase Consideration	(`35 crores)
Bargain purchase	`20crore

3(b) 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 o rganize 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 (Jan 21 Exam) / (MTP Sept 22)

[video link: https://youtu.be/Ggs_6zXcj_Q?t=2272]

Answer

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 expenses2	16,25,000
Other expenses3	7,20,000
Total Expenses	

Notes to Accounts (Extract)

1. Intangible Assets

	Gross block			Accumulated Depreciation			Net block	
	Opening	Addition	Closing	Opening	Addition	Closing	Opening	closing
Goodwill	-	320000	320000	-	-	-	-	320000
Franchisee	-	8000000	8000000	-	1600000	1600000	-	6400000
Copyright	-	250000	250000	-	25000	25000	-	225000
		8570000	8570000		1625000	1625000		6945000

*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 x 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	2,25,00

Business Combination

13.Bima Ltd. acquired 65% of shares on 1 June, 20X1 in Nafa Ltd. which is engaged in production of components of machinery. Nafa Ltd. has 1,00,000 equity shares of `10 each. The quoted market price of shares of Nafa Ltd. was `12 on the date of acquisition. The fair value of Nafa Ltd.'s identifiable net assets as on 1 June, 20X1 was `80,00,000.

Bima Ltd. wired `50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of shares of Bima Ltd. on the date of issue was `25 per share.

Bima Ltd. also agrees to pay additional consideration of `15,00,000, if the cumulative profit earned by Nafa Ltd. exceeds `1 crore over the next three years. On the date of acquisition, Nafa Ltd. assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is `9,80,000. Nafa Ltd. incurred `1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of Nafa Ltd. be accounted by Bima Ltd., under Ind AS 103? Prepare detailed workings and pass the necessary journal entry (RTP May 2021)

[video link: https://youtu.be/VVX7wS9ow2A?t=2471]

Answer

Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	`
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition [B]	
(1,00,000 x 35% x 12)	4,20,000
Total [C] = [A] + [B]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] –[C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, `1,50,000 incurred by Nafa Ltd. in relation to acquisition, will be ignored by Bima Ltd.

Journal entry at the date of acquisition by Bima Limited as per Ind AS 103:

Identifiable net assetsDr.	80,00,000	
To Equity share capital (50,000 x 10)		5,00,000
To Securities Premium (50,000 x 15)		7,50,000
To Cash		50,00,000
To Provision for contingent consideration to Nafa Ltd.		9,80,000
To Non-controlling Interest4,20,000To Capital Reserve		3,50,000

4(c) P Limited and S Limited are in business of manufacturing garments. P Limited holds 30% of equity shares of S Limited for last several years. P Limited obtains control of S Limited when it acquires further65% stake of S Limited's shares, thereby resulting in a total holding of 95% on 31 December 2019. The acquisition had the following features:

(i)P Limited transfers cash of`50,00,000 and issues 90,000 shares on 31 December2019. The market price of P Limited's shares on the date of issue

was `10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition capital of P Limited.

(ii)P Limited agrees to pay additional consideration of`4,00,000, if the cumulative profits of S Limited exceeds `40,00,000 over the next two years. At the acquisition date, it is not considered probable that extra consideration will be paid. The fair value of contingent consideration is determined to be `2,00,000 at the acquisition date.

(iii) P Limited spent acquisition-related costs of`2,00,000.

(iv) Thefair value of theNCI is determined to be `5,00,000 at the acquisition date based on market price. P Limited decided to measure non-controlling interest at fair value for this transaction.

(v) P Limited has owned 30% of the shares in S Limited for several years. At 31 December 20.19, the investment is included in P Limited's consolidated balance sheet at `8,00,000. The fair value of previous holdings accounted for using the equity method is arrived at `18,00,000

The fair value of S Limited's net identifiable assets at 31 December2019 is`45,00,000, determined in accordance with Ind AS 103. Analyze the transaction and determine the accounting under acquisition method for the business combination by P Limited. (Exam nov 20)

[video link: https://youtu.be/Ggs_6zXcj_Q?t=468]

Answer

Identify the acquirer

In this case, P Limited has paid cash consideration to shareholders of S Limited. Further, the shares issued to S Limited pursuant to the acquisition do not transfer control of P Limited to erstwhile shareholders of S Limited. Therefore, P Limited is the acquirer and S Limited is the acquiree.

Determine acquisition date

As the control over the business of S Limited is transferred to P Limited on 31 December 2019, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise of the following:

Cash consideration	`50,00,000
Equity shares issued (90,000 x 10 i.e., at fair value)	`9,00,000
Contingent consideration (at fair value)	`2,00,000

Fair value of previously held interest	`18,00,000
Total purchase consideration	`79,00,000

Acquisition cost incurred by and on behalf of P Limited for acquisition of S Limited should be recognised in the Statement of Profit and Loss. As such, an amount of `2,00,000 should be recognised in the Statement of Profit and Loss.

Fair value of identifiable assets and liabilities

The fair value of identifiable net assets (as given in the question)`45,00,000.

Non-Controlling Interest

The management has decided to recognise NCI at its fair value, which is given in the question as `5,00,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, P Limited exercised significant influence over S Limited. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in the Statement of Profit and Loss. As such, an amount of `10,00,000(i.e. 18,00,000–8,00,000) will be recognised in the Statement of Profit and Loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:	(`)
Total consideration	79,00,000
Recognised amount of any non-controlling interest	5,00,000
Less: Fair value of net identifiable assets	(45,00,000)
Goodwill	39,00,000

Acquisition and Disposal of subsidiary

Q3a A parent purchased an 80% interest in a subsidiary for Rs.1,60,000 on 1 April 20X1 when the fair value of the subsidiary's net assets was Rs.1,75,000. Goodwill of Rs.20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs.8,000 was charged in the consolidated financial statements to 31 March 20X3. No other impairment charges have been recorded.T he parent sold its investment in the subsidiary on 31 March 20X4 for Rs.2,00,000. T he book value of the

subsidiary's net assets in the consolidated financial statements on the date of the sale was Rs.2,25,000 (not including goodwill of Rs.12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

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

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

(MTP April 2019)

[video link: https://youtu.be/Jv2xBLVq9A8?t=2073]

Answer

The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of Rs.40,000 calculated as follow:

	Rs.'000
Sale proceeds	200
Less:Cost of in vestment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of Rs.8,000 calculated as follows:

	Rs.'000
Sale proceeds	200
Less: share of net assets at date of disposal (Rs.2,25 ,000 X 80%)	(180)
Goodwill on consolidation at date of sale (W.N 1)	(12)
	(192)
Gain on sale in the group's account	8

Working Note

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:

	Rs.'000
Fair value of consideration at the date of acquisition	160
Non-controlling interest measured at proportionate share of	
The acquiree's identifiable net assets (1,75,000 X 20%)	35
Less: fair value of net assets of subsidiary at date of acquisition	(175)
	(140)

Goodwill arising on consolidation20Impairment at 31 March 20X3	(8)
Goodwill at 31 March 20X4	12

6(a)Shiv Ltd. purchased 70% stake in Shyam Ltd. for `21,22,400 on 01.04.2016. On the date of the acquisition, Shyam Ltd.'s assets & liabilities were`54,88,000 and`4,48,000 respectively. The net assets position of Shyam Ltd. as on 31.03.2017 and30.09.2017 were `78,40,000 and`1,10, 6 0, 0 0 0respectively,the increase resulting from profits earned during the period. On 01.10.2017, Shiv Ltd. retained 30% stake in Shyam Ltd. and sold balance for`50,00,000.

Discuss the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship as per relevant Accounting Standard. Also, calculate the profit arising on part sale of investment, carrying value of the portion unsold & Goodwill/Capital Reserve that arises on change in nature of the investment. (Exam May 19)

[video link: https://youtu.be/VVX7wS9ow2A?t=3504]

Common Control

19.Veera Limited and Zeera Limited are both in thebusiness of manufacturing and selling of Lubricant. Veera Limited and Zeera Limited shareholders agree to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited'sshareholders and 50 shares to Zeera Limited'sshareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders gets the voting rights in Meera Limited based on their respective shareholding. Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'. (RTP Nov 20)

[video link: https://youtu.be/VVX7wS9ow2A?t=1884]

Answer

As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree.

Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

The relative voting rights in the combinedentity after the business combination-

The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity.

Based on above mentioned para, acquirer shall be either of the combining entities (i.e. Veera Limited or Zeera Limited),whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence,in the above scenario Veera Limited'sshareholder gets 66.67% share (100/150x 100) and Zeera Limited'sshareholder gets 33.33% share in Meera Limited. Hence,Veera Limited is acquirer as per the principles of Ind AS 103.

6c Parent A holds 100% in its subsidiary B. Parent A had acquired B,10 years back and had decided to account for the acquisition under the purchase method using fair values of the subsidiary B in its consolidated financial statements.During the current year, A decides to merge B with itself.For the purpose of this proposed merger, what values of B should be used for accounting under the Ind AS? (Exam Nov 19)

[video link: https://youtu.be/Ggs_6zXcj_Q?t=129]

Answer

The acquisition of B Ltd. by A Ltd. is business combination under common control. In such a situation, pooling of interest method should be applied. However, B Ltd. is 100% subsidiary of A Ltd. and A Ltd. in its Consolidated financial statements use to give the carrying values of assets and liabilities of B Ltd. at fair value (as per acquisition under purchase method). Hence the carrying value for the purpose of pooling of interest method will be the values given in Consolidated financial statements and not in Separate financial statements.

In other words, since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.

NCI

6(a) XYZ Limited acquired 70% of equity shares of TUV Limited on 1st April, 2010 at cost of `20,00,000 when TUV Limited had an equity share capital of `20,00,000 and reserve and surplus of `1,60,000. In the four consecutive years, TUV Limited, fared badly and suffered losses of `5,00,000, `8,00,000, `10,00,000 and `2,40,000 respectively. Thereafter in 2014-15, TUV Limited, experienced turnaround and registered an annual profit of `1,00,000. In the next two years i.e. 2015-16 and 2016-17, TUV Limited recorded annual profits of `2,00,000 and `3,00,000 respectively. Calculate the non controlling interests at the end of each year for the purpose of consolidation, as per Ind AS 110 "Consolidated Financial Statements". (Exam May 18)

[video link: https://youtu.be/VVX7wS9ow2A?t=3114]

6(d) From the following data, determine in each case:
(i) Non-controlling interest at the date of acquisition (using proportionate share method) and at the date of consolidation.
(ii) Goodwill or gain on bargain purchase.

(iii) Amount of Holding Company's share of profit in the Consolidated Balance Sheet assuming Holding Company's own retained earnings to be ` 4,00,000 in each basis.

Case	Sub company	% of shares owned	Cost	Date of acq		Conso date	
				Share cap	Retained earning	Share cap	Retained earning
1	P	90%	280,000	200,000	100,000	200,000	140,000
2	Q	85%	208,000	200,000	60,000	200,000	40,000
3	R	80%	112,000	100,000	40,000	100,000	40,000
4	S	100%	200,000	100,000	80,000	100,000	112,000

The Company has adopted an accounting policy to measure non-controlling interest at NCI's proportionate share of the acquiree's Identifiable Net Assets. It may be assumed that the fair value of acquiree's net identifiable assets is equal to their book values. (Exam Dec 21)

[Video link: https://youtu.be/ngi-Dzq0Kis?t=3248]

Answer

Non-controlling Interest = the equity in a subsidiary not attributable, directly or indirectly, to a parent. Equity is the residual interest in the assets of an entity after deducting all its liabilities i.e. in this given case Share Capital + Balance in

Statement of Profit & Loss (Assuming it to be the net aggregate value of identifiable assets in accordance with Ind AS)

(1) Calculation of amount of NCI at the date of acquisition and consolidation

	% of shares owned by NCI [E]	Non-controlling interest as at the date of acquisition [E] x [A + B]	Non-controlling interest as at the date of consolidation [E] x [C + D]
1	10%	30,000	34,000
2	15%	39,000	36,000
3	20%	28,000	28,000
4	Nil	Nil	Nil

(2) Calculation of Goodwill or Gain on bargain purchase

Case	Consideration	NCI	Net Asset	Goodwill	BP
1	280,000	30,000	300,000	10,000	Nil
2	208,000	39,000	260,000	Nil	13,000
3	112,000	28,000	140,000	Nil	Nil
4	200,000	Nil	180,000	20,000	Nil

(3) In each case the following amount (shown in column No. O) shall be added or deducted from the balance of holding company's retained earnings of ` 4,00,000:

Case	% Share Holding	Retained earnings as on 1.4.2020	Retained earnings as on consolidation date 31.3.2021	Retained earnings post-acquisition	Amount to be added / (deducted) from holding's retained earnings
1	90%	100,000	140,000	40,000	36,000
2	85%	60,000	40,000	(20,000)	(17,000)
3	80%	40,000	40,000	Nil	Nil
4	100%	80,000	112,000	32,000	32,000

Ind AS 27, 28 and 111

Ind AS 27

- In SFS – Investment in Subsi / Associate / JV / JO are shown either at
  - Cost or
  - FV as per Ind AS 109 (FVTOCI)
- If at cost, at the time of held for sale it will be reclassified to Ind AS 105
- Single class rule, i.e. if one subsidiary measured at cost, all subsidiary measured at cost but associate can be measured at FV
- Exception rule – Investmemnt entity measures investment in subsi / asso / JV / JO at fair value
- Conversion of investment entity to non-investment entity
  - If wish to measure at fair value, continue accounting treatment
  - If wish to measure at cost, deem the FV on date of such conversion to be cost
- Conversion of non-investment entity to investment entity
  - If earlier measured at cos, determine fair value on such date and transfer diff to PL
  - If earlier measured at Fair value, continue measuring at fair value

Ind AS 28

- Accounting treatment

Particulars	SFS	CFS
Initial investment	Measure as per Ind aS 27 above	Determine your proportionate share in NA in associate at fair value, difference is **disclosed** as goodwill or BP in notes to accounts
Dividend received	Credit to PL	Deduct from investments (reverse what is credited to PL in SFS)
Profit share	NA	Proportionate profit share is added to investments and credited to PL
OCI share	NA	Proportionate OCI share is added to investments and credited to OCI
Loss	Impairment test	Proportionate loss share is deducted from investments and debited to PL. Maximum loss share is equal to investmemnt held in subsidiary (including pref and deb investments)

- Associate converted into subsidiary

SFS	CFS
Determine fair value of such investment held and transfer diff to PL (if cost method was applied)	Determine fair value of such investment held and transfer diff to PL If any OCI reserve of associate held by entity, If reclassifiable- trf to PL In non-reclassifiable – trf to RE

- **Sale or purchase from associate**

Particulars	Upstream	Downstream
	Sale by associate to investor	Sale by investor to associate
Year end closing stock	Use formula to determine unrealized profit Closing stock * Profit on sale Sale value	
Dr	PL	PL
Cr	Closing stock	Investment in associate

Ind AS 111

Joint operation	Joint Venture
Not a separate legal entity	Separate legal entity
Proportionate asset method of accounting	Equity method

- **Sale or purchase from JO**

Particulars	Upstream	Downstream
	Sale by JO to investor	Sale by investor to JO
Year end closing stock	Use formula to determine unrealized profit Closing stock * Profit on sale Sale value	
Dr	PL	PL
Cr	Closing stock	Closing stock

Ind AS 27

16.A company, AB Ltd. holds investments in subsidiaries and associates.In its separate financial statements, AB Ltd. wants to elect to account its investments in subsidiaries at cost and the investments in associates as financial assets at fair value through profit or loss (FVTPL) in accordance with Ind AS 109, Financial Instruments. Whether AB Limited can carry investments in subsidiaries at cost and investments in associates in accordance with Ind AS 109 in its separate financial statements? (RTP Nov 20) / (RTP Nov 21)

[video link: https://youtu.be/EXV2kaW0YOM?t=2338]

Answer

Paragraph 10 of Ind AS 27, Separate Financial Statements inter-alia provides that, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109, Financial Instruments in its separate financial statements. Further, the entity shall apply the same accounting for each category of investments.

It may be notedthat although the ‘category’ is used in number of Standards, it is not defined in any of the Ind AS.It seems that subsidiaries, associates and joint ventures would qualify as separate categories. Thus, the same accounting policies are applied for each category of investments -i.e. each of subsidiaries, associates and joint ventures.However, paragraph 10 of Ind AS 27 should not be read to mean that, in all circumstances, all investments in associates are one ‘category’ of investment and all investments in joint ventures or an associate are one ‘category’ of investment. These categories can be further divided into sub-categories provided the sub-category can be defined clearly and objectively and results in information that is relevant and reliable. For example, an investment entity parent can have investment entity subsidiary (at fair value through profit or loss) and non-investment entity subsidiary (whose main purpose is to provide services that relate to the investment entity's investment activities) as separate categories in its separate financial statements. In the present case, investment in subsidiaries and associates are considered to be different categories of investments.Further, Ind AS 27 requires to account for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, AB Limited can carry its investments in subsidiaries at cost and its investments in associates as financial assets in accordance with Ind AS 109 in its separate financial statements.

Change from IE to NIE

18. PP Ltd., a non-investment entity, is the parent of Praja Ltd. within the meaning of Ind AS 110 ‘Consolidated Financial Statements’. The investment in Praja Ltd. was carried in the separate financial statements of PP Ltd. at fair value with changes in fair value recognised in the other comprehensive income. On 1st April, 20X2, PP Ltd. qualifies as one that is an investment entity. Carrying amount of the investment on 1st April, 20X2 was ` 8,00,000. The fair value of its investment in Praja Ltd was ` 10,00,000 on that date. PP Ltd had recognised in OCI an amount of ` 1,00,000 as a previous fair value increase related to the investment in Praja Ltd.

How would PP Ltd account for the investment in Praja Ltd on the date of change of its classification/status as an investment entity, in its separate financial statements? (RTP Nov 21)

[video link: https://youtu.be/QJdTojWQ3bw?t=2044]

Answer

(i) As per paragraph 11B(b) of Ind AS 27, on the date of change, ie, 1st April, 20X2, PP Ltd (the parent) becoming an investment entity, its investment in Praja

Ltd (the subsidiary) shall be at fair value through profit and loss in accordance with Ind AS 109. Accordingly, the new carrying amount will be ` 10,00,000.

(ii) The difference between the new carrying amount and the carrying amount of the investment on the date of change will be recognised in the profit and loss. Hence, PP Ltd will recognise an amount of ` 2,00,000 (` 10,00,000 – ` 8,00,000) in profit and loss as gain.

(iii) Any fair value adjustments previously recognised in OCI in respect of subsidiary ie Praja Ltd. shall be treated as if the investment entity had disposed off the subsidiary at the date of change in status as per para 11B(b) of Ind AS 27.

Further, as per para B5.7.1 of Ind AS 109, a mounts presented in other comprehensive income shall not be subsequently transferred to profit or loss.

However, the entity may transfer the cumulative gain or loss within equity. Therefore, the company shall not reclassify the fair value gains or losses to profit or loss on change in classification from FVTOCI to FVTPL. However, the company may transfer the fair value gains or losses from one component to the other within equity.

Moreover, Paragraph 11A(e) of Ind AS 107, requires disclosure of any transfers of the cumulative gain or loss within equity during the period and the reason for such transfers. Accordingly, PP Ltd. shall provide the disclosures if it transfers the cumulative gain or loss from one component to the other within equity. Particulars `

Carrying amount of investment in Praja Ltd [as per (i) above]	10,00,000
Amounts recognised in profit and loss relating to investment in	
Praja Ltd [as per (ii) above]	2,00,000

Significant influence

3(c)X Ltd. owns 20% of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consist of five members. T he remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meeting at the short notice and make decisions in the absence of X Ltd's representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd's representative has attended board meetings, but suggestions for items to be included on the agenda have been ignored and the other directors oppose an y su ggestion s made b y X L td . Is Y L td an a ssocia te of X L td .? (MTP March 2019)

[video link: https://youtu.be/FUoYfOo-s08?t=46]

Answer

Despite the fact thatthe X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent X Ltd.from exerting significant influence. Whilst it appears the X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders preven t X Ltd's efforts and stop X Ltd from actually having any influence.In this situation, Y Ltd would not be an associate of X Ltd

8.Angel Ltd. has adopted Ind AS with a transition date of 1st April, 2017. Prior to Ind AS adoption, it followed Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as "IGAAP").

It has made investments in equity shares of Pharma Ltd., a listed company engaged in the business of pharmaceuticals. The shareholding pattern of Pharma Ltd. is given below:

Shareholders (refer Note 1)	Percentage shareholding as on 1st April, 2017
Angel Ltd.	21%
Little Angel Ltd. (refer Note 2)	24%
Wealth Master Mutual Fund (refer Note 3)	3%
Individual public shareholders (refer Note 4)	52%

Notes:

(1) None of the shareholders have entered into any shareholders' agreement.

(2) Little Angel Ltd. is a subsidiary of Angel Ltd. (under Ind AS) in which Angel Ltd. holds 51% voting power.

(3) Wealth Master Mutual Fund is not related party of either Little Angel Ltd. or Pharma Ltd.

(4) Individual public shareholders represent 17,455 individuals. None of the individual shareholders hold more than 1% of voting power in Pha rma Ltd.

All commercial decisions of Pharma Ltd. are taken by its directors who are appointed by a simple majority vote of the shareholders in the annual general meetings ("AGM"). The following table shows the voting pattern of past AGMs of Pharma Ltd.:

Shareholders	AGM for thefinancial year:

	2013-14	2014-15	2015-16
Angel Ltd.	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions
Little Angel Ltd	Attended and voted as per directions of Angel Ltd.	Attended and voted as per directions of Angel Ltd	Attended and voted as per directions of Angel Ltd
Wealth Master Mutual Fund	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors
Individuals	7% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors	8% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	6% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.

Pharma Ltd. has obtained substantial long term borrowings from a bank. The loan is payable in 20 years from 1st April, 2017. As per the terms of the borrowing, following actions by Pharma Ltd. will require prior approval of the bank:

- Payment of dividends to the shareholders in cash or kind;
- Buyback of its own equity shares;
- Issue of bonus equity shares;
- Amalgamation of Pharma Ltd. with any other entity; and
- Obtaining additional loans from any entity.

Recently, the Board of Directors of Pharma Ltd. proposed a dividend of `5 per share. However, when the CFO of Pharma Ltd. approached the ba nk for obtaining their approval, the bank rejected the proposal citing concerns over the

short -term cash liquidity of Pharma Ltd. Having learned about the developments, the Directors of Angel Ltd. along with the Directors of Little Angel Ltd. approached t he bank with a request to re-consider its decision. The Directors of Angel Ltd. and Little Angel Ltd. urged the bank to approve a reduced dividend of at least `2 per share. However, the bank categorically refused to approve any payout of dividend.

Under IGAAP, Angel Ltd. has classified Pharma Ltd. as its associate. As the CFO of Angel Ltd., you are required to comment on the correct classification of Pharma Ltd. on transition to Ind AS (RTP May 19)

[video link: https://youtu.be/FUoYfOo-s08?t=1592]

Answer

To determine whether Pharma Limited can be continued to be classified as an associate on transition to IndAS, we will have to determine whether Angel Limited controls Pharma Limited as defined under Ind AS 110.

An investor controls an investee if and only if the investor has all the following:

(a)Power over investee

(b)Exposure, or rights, to variable returns from its involvement with the investee

(c)Ability to use power over the investee to affect the amount of the investor's returns.

Since Angel Ltd. does not have majority voting rights in Pharma Ltd. we will have to determine whether the existing voting rights of Angel Ltd. are sufficient to provide it power over Pharma Ltd.

Analysis of each of the three elements of the definition of control:

Power over investee

Angel Limited along with its subsidiary Little Angel Limited (hereinafter referred to as "the Angel group") does not have majority voting rights in Pharma Limited. Therefore, in order to determine whether Angel group have power over Pharma Limited. we will need to analyse whether Angel group, by virtue of its non-majority voting power, have practical ability to unilaterally direct the relevant activitiesof Pharma Limited. In other words, we will need to analyse whether Angel group has de facto powerover Pharma Limited. Following is the analysis of de facto power of Angel over Pharma Limited:

-The public shareholding of Pharma Limited (that is, 52% represents thousands of shareholders none individually holding material shareholding,

-The actual participation of Individual public shareholders in the general meetings is minimal (that is, in the range of 6% to 8%).

-Even the public shareholders who attend the meeting do not consult with each other to vote.

-Therefore, as per guidance of Ind AS 110, the public shareholders will not be able to outvote Angel group (who is the largest shareholder group) in any general meeting.

Based on the above-mentioned analysis, we can conclude that Angel group has de facto power over Pharma Limited.

Exposure, or rights, to variable returns from its involvement with the investee

Angel group has exposure to variable returns from its involvement with Pharma Limited by virtue of its equity stake.

Ability to use power over the investee to affect the amount of the investor's returns

Angel group has ability to use its power (in the capacity of a principal and not an agent) to affect the amount of returns from Pharma Limited because it is in the position to appoint directors of Pharma Limited who would take all the decisions regarding relevant activities of Pharma Limited.

Here, it is worthwhile to evaluate whether certain rights held by the bank would prevent Angel Limited's ability to use the power over Pharma Limited to affect its returns. It is to be noted that, all the rights held by the bank in relation to Pharma Limited are protective in nature as they do not relate to the relevant activities (that is, activities that significantly affect he Pharma Limited's returns) of Pharma Limited.

As per Ind AS 110, protective rights are the rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

Therefore, the protective rights held by the bank should not be considered while evaluating whether or not Angel Group has control over Pharma Limited.

Conclusion: Since all the three elements of definition of control is present, it can be concluded that Angel Limited has control over Pharma Limited.Since it has been established that Angel Limited has control over Pharma Limited, upon transition to Ind AS, Angel Limited shall classify Pharma Limited as its subsidiary

Accounting for associate

Q3a Bright Ltd. acquired 30% of East India Ltd. shares for Rs.2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits Rs.80,000 and declared a dividend of Rs.50,000 on 12-08-20X1. East India reported earnings of Rs.3,00,000 for the financial year ending on 31-03-20X2 and declared dividends of Rs.60,000 on 12-06-20X2.Calculate the carrying amount of investment in:

(i)Separate financial statements of Bright Ltd. as on 31-03-20X2;

(ii)Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

(iii)What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?(MTP April 2019) (MTP April 2018 Similar)

[video link: https://youtu.be/Ggs_6zXcj_Q?t=2963]

Answer

(i)Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2	Rs.
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (Rs.50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2	1,85,000

(ii)Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2	Rs.
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of profit of investee as per equity method	
(30% of Rs.3,00,000 for 10 months)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii)Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2	Rs.
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (Rs.60,000 x 30% x 10/12)	(15,000)
Carrying amount as on 30.6.20X2	2,45,000

2.On 1st April 2019, Investor Ltd. acquires 35% interest in another entity, XYZ Ltd. Investor Ltd. determines that it is able to exercise significant influence over XYZ Ltd. Investor Ltd. has paid total consideration of `47,50,000 for acquisition of its interest in XYZ Ltd. At the date of acquisition, the book value of XYZ Ltd.'s net assets was `90,00,000 and their fair value was `1,10,00,000.InvestorLtd.has determined that the difference of `20,00,000 pertains to an item of property, plant and equipment (PPE) which has remaining useful life of 10 years.

During the year, XYZ Ltd. made a profit of `8,00,000. XYZLtd.paid a dividend of `12,00,000 on 31stMarch,2020.XYZLtd.also holds a long-term investment in equity securities. Under Ind AS, investment is classified as at FVTOCI in accordance with Ind AS 109 and XYZ Ltd. recognized an increase in value of investment by `2,00,000 in OCI during the year. Ignore deferred tax implications, if any.

Calculate the closing balance of Investor Ltd.'s investment in XYZ Ltd. as at 31stMarch,2020as per the relevant Ind AS. (RTP Nov 2020) / (Exam Jan 2021) / (MTP Nov 2021) / MTP Oct 2022 / Exam Nov 22

[video link: https://youtu.be/EXV2kaW0YOM?t=1132]

Answer

Calculation of Investor Ltd.'sinvestment in XYZ Ltd. under equity method:

Acquisition of investment in XYZLtd.	
Share in book value of XYZLtd.'s net assets (35% of `90,00,000)	31,50,000
Share in fair valuation of XYZLtd.'s net assets	
[35% of (`1,10,00,000–`90,00,000)]	7,00,000
Goodwill on investment in XYZ Ltd. (balancing figure)	9,00,000
Cost of investment	47,50,000
Profit during the year	
Share in the profit reported by XYZ Ltd. (35% of `8,00,000)	2,80,000
Adjustment to reflect effect of fair valuation	
[35% of (`20,00,000/10 years)]	(70,000)
Share of profit in XYZ Ltd. recognised in income by InvestorLtd.	2,10,000
Long term equity investment	
FVTOCI gain recognised in OCI (35% of `2,00,000)	70,000
Dividend received by Investor Ltd. during the year	

[35% of `12,00,000]	(4,20,000)
Closing balance of InvestorLtd.'s investment in XYZLtd.	46,10,000

Associate to subsidiary

3.(a)Deepak Ltd., an automobile group acquires 25% of the voting ordinary shares of Shaun Ltd., another automobile business, by paying, ` 4,320 crore on 01.04.2019. Deepak Ltd. accounts its investment in Shaun Ltd. using equity method as prescribed under I nd AS 28. At 31.03.2020, Deepak Ltd. recognised its share of the net asset changes of Shaun Ltd. using equity accounting as follows: (` in crore)

Share of Profit or Loss	**378**
Share of Exchange difference in OCI	**54**
Share of Revaluation Reserve of PPE in OCI	**27**

On 01.04.2020, Deepak Ltd. acquired remaining 75% of Shaun Ltd. for cash ` 13,500 crore. Fair value of the 25% interest already owned was `4,860 crore and fair value of Shaun Ltd.'s identifiable net assets was ` 16,200 crore as on 01.04.2020. How should such business combination be accounted for in accordance with the applicable Ind AS? (MTP Oct 2020) / (Exam May 19)

[video link: https://youtu.be/FUoYfOo-s08?t=209]

Answer

Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquireeat its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interestin the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed of directly the previously held equity interest.

Applying the above, Deepak Ltd. records the following entry in its consolidated financial statements: (`in crore)

Identifiable net assets of Shaun Ltd. Dr.	16,200	
Goodwill (W.N.1) Dr.	2,160	
Foreign currency translation reserve Dr.		54

PPE revaluation reserve Dr.	27
To Cash	13,500
To Investment in associate -Shaun Ltd.	4,779
To Retained earnings (W.N.2)	27
To Gain on previously held interest in	
Shaun Ltd. recognised in Profit or loss (W.N.3)	135

(Recognition of acquisition of Shaun Ltd.)

Working Notes:

1. Calculation of Goodwill	`in crore
Cash consideration	13,500
Add:Fair value of previously held equity interest in Shaun Ltd.	4,860
Total consideration	18,360
Less:Fair value of identifiable net assets acquired	(16,200)
Goodwill	2,160

2. T he credit to retained earnings represents the reversal of the unrealized gain of `27 crore in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in Shaun Ltd. is calculated as follows:

	`in crore
Fair Value of 30% interest in Shaun Ltd. at 1st April, 2018	4,860
Carrying amount of interest in Shaun Ltd. at 1st April, 2018	(4,779)
	81
Unrealised gain previously recognised in OCI	54
Gain on previously held interest in Shaun Ltd. recognised	
in profit or loss	135

Inter company sale of goods

1bSumeru Limited holds 35% of total equity shares of Meru Limited, an associate company. The value of Investments in Meru Limited on March 31, 20X1 is Rs. 3 crores in the consolidated financial statements of Sumeru Limited.
Sumeru Limited sold goods worth Rs. 3,50,000 to Meru Limited. The cost of goods sold. is Rs. 3,00,000. Out of these, goods costing Rs. 1,00,000 to Meru Limited were in the closing stock of Meru Limited.
During the year ended March 31, 20X2 the profit and loss statement of Meru Limited showed a loss of Rs. 1 crore.
(A) What is the value of investment in Meru Limited as on March 31, 20X2 in the consolidated financial statements of Sumeru Limited, if equity method is adopted for valuing the investments in associates?
(B) Will your answer be different if Meru Limited had earned a profit of Rs. 1.50 crores and declared a dividend of Rs. 75 lacs to the equity shareholders of the Company? (MTP Oct 2019)
[video link: https://youtu.be/FUoYfOo-s08?t=765]

Answer

(a) Value of investment in Meru Ltd. as on 31st March, 20X2as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Less:Share in Post-acquisition Loss (1,00,00,000 x 35%)	(35,00,000)
Less:Unrealised gain on inventory left unsold with Meru Ltd.	
[{(50,000/3,00,000) x 1,00,000} x 35%]	(5,833)
Carrying value as per Equity method	2,64,94,167

(b)Value of investment in Meru Ltd. as on 31st March, 20X2as per equity method in the consolidated financial statements of Sumeru Ltd.

	Rs.
Cost of Investment	3,00,00,000
Add: Share in Post-Acquisition Profit (1,50,00,000x 35%)	52,50,000
Less:Unrealised gain on inventory left unsold with Meru Ltd.	
[{(50,000/3,00,000) x 1,00,000} x 35%]	(5,833)
Less:Dividend (75,00,000 x 35%)	(26,25,000)
Carrying value as per Equity method	3,26,19,167

Indirect associate

5.An entity P (parent) has two wholly-owned subsidiaries -X and Y, each of which has an ownership interest in an 'associate', entity Z. Subsidiary X is a venture capital organisation. Neither of the investments held in associate Z by subsidiaries X and Y is held for trading. Subsidiary X and Y account for their investment in associate Z at fair value through profit or loss in accordance with Ind AS 109 and using the equity method in accordance with Ind AS 28 respectively.

How should P account for the investment in associate Z in the following scenarios:

Scenario 1:Where both investments in the associate result in significant influence on a stand-alone basis -Subsidiary X and Y ownership interest in associate Z is 25% and 20% respectively.

Scenario 2:When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis -Subsidiary X and Y ownership interest in associate Z is 10% each.

Scenario 3:When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis -Subsidiary X and Y ownership interest in associate Z is 30% and 10% respectively.

Assume there is significant influence if the entity has 20% or more voting rights (RTP May 20)

[video link: https://youtu.be/FUoYfOo-s08?t=2122 &

https://youtu.be/EXV2kaW0YOM?t=79]

Answer

Paragraph 18 of Ind AS 28 states that, "when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit orloss in accordance with Ind AS 109. An entity shall make this election separately for each associate or joint venture, at initial recognition of theassociate or joint venture."

Paragraph 19 of Ind AS 28 provides that, "'when an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with

Ind AS 109 regardless of whether the venture capital organisation has significant influence over that portion of the investment.

If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation".

Therefore, fair value exemption can be applied partially in such cases.

Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis.

In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 20% interest held by Y.

Under the partial use of fair value exemption, P may elect to measure the 25% interest held by X at fair value through profit or loss.

Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis.

In the present case in accordance with the paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, P may elect to measure the 10% interest held by X at fair value through profit or loss.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis

In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, the P may elect to measure the 30% interest held by X at fair value through profit or loss.

Indirect subsidiary

5 (c) Entity H holds a 20% equity interest in Entity S (an associate) that in turnhas a 100% equity interest in Entity T. Entity S recognised net assets relating to Entity T of `10,000 in its consolidated financial statements. Entity S sells 20% of its interest in Entity T to a third party (a non-controlling shareholder) for `3,000 and recognises this transaction as an equity transaction in accordance with the provisions of Ind AS110, resulting in a credit in Entity S's equity of`1,000.The

financial statements of Entity H and Entity S are summarised as follows before and after the transaction:

Before

H's consolidated financial statements

Assets(`)		Liabilities(`)	
Investment in S	2,000	Equity	2,000
Total	2,000	Total	2,000

S's consolidated financial statements

Assets(`)		Liabilities(`)	
Assets (from T)	10,000	Equity	10,000
Total	10,000	Total	10,000

The financial statements of S after the transaction are summarised below:

After

S's consolidated financial statements

Assets(`)		Liabilities(`)	
Assets (from T)	10,000	Equity	10,000
Cash	3,000	Equity transaction Impact with non-controlling Interest	1,000
		Equity attributableto owners	11,000
		Non-controlling interest	2,000
Total	13,000	Total	13,000

Although Entity H did not participate in the transaction, Entity H's share of net assets in Entity S increased as a result of the sale of S's20% interest in T. Effectively, H's share in S's net assets is now `2,200 (20% of`11,000) i.e., `200 in addition to its previous share.

How this equity transaction that is recognised in the financial statements of Entity S reflected in the consolidated financial statements of Entity H that uses the equity method to account for its investment in Entity S? (Exam nov 20)

[video link: https://youtu.be/EXV2kaW0YOM?t=2444]

Answer

Ind AS 28 defines the equity method as “a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor’s share of the investee’s net assets. The investor’s profit or loss includes its share of the investee’s profit or loss and the investor’s other comprehensive income includes its share of the investee’s other comprehensive income.”

Ind AS 28, states, inter alia, that when an associate or joint venture has subsidiaries,associates or joint ventures, the profit or loss, other comprehensive income, and net assets taken into account in applying the equity method are those recognised in the associate’s or joint venture’s financial statements (including the associate’s or joint venture’s share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures),after any adjustments necessary to give effect to uniform accounting policies.

The change of interest in the net assets / equity of the associate as a result of the investee’s equity transaction is reflected in the investor’s financial statements as ‘share of other changes in equity of investee’ (in the statement of changes in equity) instead of gain in Statement of profit and loss,since it reflects the post-acquisition change in the net assets of the investee as per the provisions ofInd AS 28 and also faithfully reflects the investor’s share of the associate’s transaction as presented in the associate’s consolidated financial statements.

Thus, in the given case, Entity Hrecognises `200 as change in other equityinstead of in statement of profit and loss and maintains the same classification as of its associate, Entity S, i.e., a direct credit to equity as in its consolidated financial statements.

Joint Operation

8.AB Limited and BC Limited establish a joint arrangement through a separate vehicle PQR, but the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Limited has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owed by PQR to a lender XYZ. AB Limited and BC Limited have rights to all other assets in PQR, and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each).

PQR's summarized balance sheet is as follows:	(Rs. in crore)
Building 1	240
Building 2	200
Cash	40
Total Assets	480
Equity	140
Debt owed to XYZ	240
Employee benefit plan obligation	100
Total Liabilities	480

How would AB Limited present its interest in PQR in its financial statements? (RTP May 20)

[video link: https://youtu.be/EXV2kaW0YOM?t=826]

Answer

Paragraph 20 of Ind AS 111 states that "a joint operator shall recognise in relation to its interest in a joint operation:

(a)its assets, including its share of any assets held jointly;

(b)its liabilities, including its share of any liabilities incurred jointly;

(c)its revenue from the sale of its share of the output arising from the joint operation;

(d)its share of the revenue from the sale of the output by the joint operation; and

(e)its expenses, including its share of any expenses incurred jointly."

The rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenue and expensesrelating to a joint operation might differ from its ownership interest in the joint operation.

Thus a joint operator needs to recognise its interest in the assets, liabilities, revenue and expenses of the joint operation on the basis (bases) specified in the contractual arrangement, rather than in proportion of its ownership interest in the joint operation.

Thus, AB Limited would record the following in its financial statements, to account for its rights to the assets of PQR and its obligations for the liabilities of PQR.

Rs.in crore

Assets

Cash	20
Building 1*	240
Building 2	100
Liabilities	
Debt owned to XYZ (third party)**	240
Employees benefit plan obligation	50

*Since AB Limited has the rights to all of Building No. 1, it records the amount in its entirety.

**AB Limited has obligation for the debt owed by PQR to XYZ in its entirety.

6 (d)EntityK is owned by three institutional investors -M Limited, N Limited and C Limited -holding 40%, 40% and 20% equity interest respectively. A contractual arrangement between M Limited and N Limited gives them joint control over the relevant activities of Entity K. It is determined that Entity K is a joint operation (and not a joint venture). C Limited is not a party to the arrangement between M Limited and N Limited. However, like M Limited and N Limited, C Limited also has rights to the assets, and obligations for the liabilities, relating to the joint operation in proportion of its equity interest in Entity K.

Would the manner of accounting to be followed by M Limited and N Limited on the one hand and C Limited on the other in respect of their respective interests in Entity K be the same or different?

You are required to explain in light of the relevant provisions in the relevant standard in this regard. (Exam Nov 20)

[video link: https://youtu.be/EXV2kaW0YOM?t=3037]

Answer

Ind AS 111 states that a joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d)its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Ind AS applicable to the particular assets, liabilities, revenues and expenses.

Further, Ind AS 111 states that a party that participates in, but does not have joint control of a joint operation shall also account for its interest in the arrangement in accordance with above provisions of the standard, if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation

In the given case, all three investors (M Limited, N Limited and C Limited) share in the assets and liabilities of the joint operation in proportion of their respective equity interest. Accordingly, both M Limited and N Limited (which have joint control) and C Limited (which does not have joint control but participates) shall recognise their interest in joint operation as per above guidance while accounting for their respective interests in Entity K in their respective separate financial statements as well as in the consolidated financial statements.

12. Identify the type of joint arrangements in each of the following scenarios:
(i) X Ltd and Y Ltd, manufacturing similar type of mobile phones, form a joint arrangement to manufacture and sell mobile phones. Under the terms of the arrangement, both X Ltd and Y Ltd are to use their own assets to manufacture the mobile phones and both are responsible for liabilities related to their resp ective manufacture. The arrangement also lays down the distribution revenues from the sale of the mobile phones and expenses incurred thereof. X Ltd however has exclusive control over the marketing and distribution functions and does not require the consent of Y Ltd in this aspect. No separate entity is created for the arrangement.

(ii) Continuing with (i) above, what would be the classification of the joint arrangement if X Ltd and Y Ltd both jointly control all the relevant activities of the Joint arrangement including the marketing and the distribution functions?
(iii) What would be the classification of the joint arrangement if under the terms of the arrangement, a separate entity is created to manufacture the mobile phones.

(iv) Continuing with (iii) above, the joint arrangement is a means of manufacturing mobile phones on a common platform but the output of the joint arrangement is purchased by both X Ltd and Y Ltd in the ratio of 50:50.

The joint arrangement cannot sell output to third parties. The price of the output sold to X Ltd and Y Ltd is set by both the parties to the arrangement to cover the production costs and other administrative costs of the joint arrangement entity.

(v) Would your answer in (iv) above be different if X Ltd and Y Ltd sold their respective share of output to third parties?

(vi) Assume that in (iv) above, the contractual terms of the arrangement were modified so that the joint arrangement entity is not obliged to sell the output to X Ltd and Y Ltd but was able to sell the output to third parties. (RTP May 2022) / (MTP April 22)

[video link: https://youtu.be/zHYIGfZ1Djo?t=1741]

Answer

For a joint arrangement to be either a joint operation or joint venture, it depends on whether the parties to the joint arrangement have rights to the assets and obligations for liabilities (will be a joint operation) OR whether the parties to the joint arrangement have rights to the net assets of the arrangement (will be joint venture).
(i) In order to fit into the definition of a joint arrangement, the parties to the joint arrangement should have joint control over the arrangement. In the given case, decisions relating to relevant activities, ie, marketing and distribution, are solely controlled by X Ltd and such decisions do not require the consent of Y Ltd. Hence, the joint control test is not satisfied in this arrangement and the arrangement does not fit into the definition of a joint arrangement in accordance with the Standard.

(ii) Where X Ltd and Y Ltd both jointly control all the relevant activities of the arrangement and since no separate entity is formed for the arrangement, the joint arrangement is in the nature of a joint operation.

(iii) Where under a joint arrangement, a separate vehicle is formed to give effect to the joint arrangement, then the joint arrangement can either be a joint operation or a joint venture.

Hence in the given case, if:

(a) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd rights to the assets and obligations for the liabilities relating to the arrangement, and the rights to the corresponding revenues and obligations for the corresponding expenses, then the joint arrangement will be in the nature of a joint operation.
(b) The contractual terms of the joint arrangement, give both X Ltd and Y Ltd.

rights to the net assets of the arrangement, then the joint arrangement will be in the nature of a joint venture.

(iv) Where the rights to assets and liabilities to obligations are not clear from the contractual arrangement, then other facts and circumstances also need to be considered to determine whether the joint arrangement is a joint operation or a joint venture.

When the provision of the activities of the joint venture is primarily to produce output and the output is available / distributed only to the parties to the joint arrangement in some pre-determined ratio, then this indicates that the parties have substantially all the economic benefits of the assets of the arrangement. The only source of cash flows to the joint arrangement is receipts from parties through their purchases of the output and the parties also have a liability to fund the settlement of liabilities of the separate entity. Such an arrangement indicates that the joint arrangement is in the nature of a joint operation. In the given case, the output of the joint arrangement is exclusively used by X Ltd. and Y Ltd. and the joint arrangement is not allowed to sell the output to outside parties. Hence, the joint arrangement between X Ltd. and Y Ltd. is in the nature of a joint operation.

(v) It makes no difference whether the output of the joint arrangement is exclusively for use by the parties to the joint arrangement or the parties to the arrangement sold their share of the output to third parties.

Hence, even if X Ltd. and Y Ltd. sold their respective share of output to third parties, the fact still remains that the joint arrangement cannot sell output directly to third parties. Hence, the joint arrangement will still be deemed to be in the nature of a joint operation.

(vi) Where the terms of the contractual arrangement enable the separate entity to sell the output to third parties, this would result in the separate entity assuming demand, inventory and credit risks. Such facts and circumstances would indicate that the arrangement is a joint venture.

Ind AS 105

Note:

To be classified under Ind AS 105, asset must be available for immediate sale in its present condition and sale must be highly probable

Conditions to be satisfied

1. Mgmt. committed to plan to sell the asset
2. Actively search a buyer
3. SP = FV
4. Sale is expected to be completed within 12 months
5. Insignificant chances to withdraw from the plan to sell the asset

Criteria for classification under Ind AS 105

A Ltd. is to sell a non-current asset, being a piece of land. The piece of land has been contaminated and will require the entity to carry out Rs. 100,000 of work in order to rectify the contamination. If the land was not contaminated, it could be sold for Rs. 300,000. With the contamination, it is worth only Rs. 200,000. The work that is needed to rectify the contamination will extend the period of sale by one year from the date the land is first marketed for sale.Required:In the following situations, examine with suitable reasons whether land can be classified as held for sale in accordance with Ind AS 105: Non-current assets held for sale and discontinued operations

Situation 1 The land is marketed for Rs. 300,000 and A Ltd. was not aware of the contamination till the time a firm purchase commitment was signed with a purchaser. The purchaser found the contamination through a survey. The purchaser signed the firm purchase commitment on condition that the contamination damage will be rectified.

Situation 2 A Ltd. marketed the land for Rs. 300,000, knowing about the contamination when the proposal to sale the land went in the market. However, A Ltd. marketed it with an agreement that it would carry out the rectification work within few months from signing the firm purchase commitment.

Situation 3A Ltd. knew about the contamination prior to float the proposal to sell the land and markets it for Rs. 200,000 with no obligation on itself to rectify or fix the contamination. (MTP April 2018)

[video link: https://youtu.be/LDz94zJwX_8?t=132]

Answer

Situation 1

As far as the entity was aware, the land was marketed and available for immediate sale in its present condition at a reasonable price. The event extending the one-year period was imposed by the buyer after the firm purchase commitment was received and the entity is taking steps to address it. The land qualifies as held for sale and continues to do so after it is required to carry out the rectification work.

Situation 2

The land is not available for immediate sale in its present condition when it is first marketed. It is being marketed at a price that involves further work to the land. It cannot be classified as held for sale when it is first marketed. It also cannot be classified as held for sale when a purchase commitment is received, because even then it is not for sale in its present condition and no conditions have been unexpectedly imposed. The land will not be classified as held for sale until the rectification work is actually carried out.

Situation 3

The land in this case is available for immediate sale in its present condition and it would qualify to be classified as held for sales since it is being marketed at reasonable price.

13. On February 28, 20X1, Entity X is committed to the following plans:

(a) To sell a property after completion of certain renovations to increase its value prior to selling it. The renovations are expected to be completed within a short span of time i.e., 2 months.

(b) To sell a commercial building to a buyer after the occupant vacates the building.
The time required for vacating the building is usual and customary for sale of such commercial property. The entity considers the sale to be highly probable.

Can the above-mentioned property and commercial building be classified as non-current assets held for sale at the reporting date i.e. 31 st March, 20X1? (RTP Nov 21)

[video link: https://youtu.be/QJdTojWQ3bw?t=619]

Answer

Ind AS 105 provides guidance on classification of a non -current asset held for sale in paragraph 7 which states that, the asset (or disposal group) must be

available for immediate sale in its present condition subject only to terms that are usual and custo mary for sales of such assets (or disposal groups) and its sale must be highly probable.

(a) In respect of Entity X's plan to sell property which is being renovated and such renovation is incomplete as at the reporting date. Although, the renovations are expected to be completed within 2 months from the reporting date i.e., March 31, 20X1, the property cannot be classified as held for sale at the reporting date as it is not available for sale immediately in its present condition.

(b) In case of Entity X's plan to sell commercial building, it intends to transfer the commercial building to a buyer after the occupant vacates the building and the time required for vacating such building is usual and customary for sale of such non -current asset. Accordingly, the criterion of the asset being available for immediate sale would be met and hence, the commercial building can be classified as held for sale at the reporting date

6a. Identify which of the following is a disposal group at 31st March, 20X1:

(1) On 21st March, 20X1, XYZ Ltd. announced the Board's intention to sell its shares in a subsidiary company, Alpha Ltd., contingent upon the approval of Alpha Ltd.'s shareholders.

It seems unlikely that approval will be granted in the near future and no specific potential buyer has been identified.

(2) PQR Ltd. has entered into a contract to sell the entire delivery fleet of vehicles operated from its warehouse to a competitor, ABC Ltd., on 14th March, 20X1. The assets will be transferred on 28th April, 20X1 from which date the Group will outsource its delivery activities to another company, LMN Ltd.

(3) On 16th January, 20X1, DEF's management and shareholders approved a plan to sell its retail business in Mumbai and a consultant is hired to manage the sale. As at 31 st March, 20X1 heads of agreement had been signed although due diligence and the negotiation of final terms are still in process. The transaction is expected to be completed in April, 20X1. (MTP April 22)

[video link: https://youtu.be/zHYIGfZ1Djo?t=4223]

Answer

Presented as disposal group held for sale

(2) PQR Ltd.'s fleet of vehicles is classified as held for sale because it constitutes a group of assets to be sold in their present condition and the sale is highly probable at the reporting date (as a contract has been entered into).

(3) DEF Ltd.'s sale of its retail business will not be completed until the final terms (e.g. of purchase price) are agreed. However, the business is ready for immediate sale and the sale is highly probable to be completed by April, 20X1. This implies that the retail business is a disposal group held for sale, unless other evidence after the reporting date but before the financial statements are approved for issue, comes to light to indicate the contrary.

Not presented as disposal group held for sale

(1) XYZ Ltd.'s shares in Alpha Ltd. are not available for an immediate sale as shareholders' approval is required. Also, no specific potential buyer has been identified. Taking these facts into consideration, it is clear that the sale is not highly probable.

14. Company A has financial year ending 31st March, 20X0. On 1st June, 20X0, the Company has classified its Division B as held for sale in accordance with Ind AS 105. How property, plant and equipment (PPE) for which the company has adopted cost model shall be measured immediately before the classification as held for sale on 1st June, 20X0?(RTP Nov 22)

Answer

Paragraph 18 of Ind AS 105 provides that immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS.

In the instant case, Company A should measure the property, plant and equipment (for which it has adopted cost model), in accordance with Ind AS 16, Property, Plant and Equipment. Hence, depreciation should be provided upto 31st May, 20X0

Measurement under Ind AS 105

12.CK Ltd. prepares the financial statement under Ind AS for the quarter year ended 30th June, 2018. During the 3 months ended 30th June, 2018 following events occurred:

On 1st April, 2018, the Company has decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with the Company collecting any outstanding trade receivables relating to the divisi on and settling any current liabilities.

On 1st April, 2018, the carrying amount of the assets of the division were as follows:

- Purchased Goodwill

–` 60,000 - Property, Plant & Equipment (average remaining estimated useful life two years) - `20,00,000

- Inventories - ` 10,00,000

From 1st April, 2018, the Company has started to actively market the division and has received number of serious enquiries. On 1st April, 2018 the directors estimated that they would receive ` 32,00,000 from the sale of the division. Since 1st April, 2018, market condition has improved and as on 1st August, 2018 the Company received and accepted a firm offer to purchase the division for ` 33,00,000.

The sale is expected to be completed on 30th September, 2018 and ` 33,00,000 can be assumed to be a reasonable estimate of the value of the division as on 30th June, 2018. During the period from 1st April to 30th June inventories of the division costing ` 8,00,000 were sold for ` 12,00,000. At 30th June, 2018, the total cost of the inventories of the division was ` 9,00,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

The Company has approached you to suggest how the proposed sale will be reported in the interim financial statements for the quarter ended 30th June, 2018 giving relevant explanations. (RTP May 19)

[video link: https://youtu.be/LDz94zJwX_8?t=648]

Answer

The decision to offer the division for sale on 1st April, 2018 means that from that date the division has been classified as held for sale. The division available for immediate sale, is being actively marketed at a reasonable price and the sale is expected to be completed within one year.

The consequence of this classification is that the assets of the division w ill be measured at the lower of their existing carrying amounts and their fair value less cost to sell. Here the division shall be measured at their existing carrying amount ie ` 30,60,000 since it is less than the fair value less cost to sell ` 32,00,000.

The increase in expected selling price will not be accounted for since earlier there was no impairment to division held for sale.

The assets of the division need to be presented separately from other assets in the balance sheet. Their major classes should be separately disclosed either on the face of the balance sheet or in the notes.

The Property, Plant and Equipment shall not be depreciated after 1st April, 2018 so its carrying value at 30th June, 2018 will be ` 20,00,000 only. The inventories of the division will be shown at ` 9,00,000.

The division will be regarded as discontinued operation for the quarter ended 30th June, 2018. It represents a separate line of business and is held for sale at the year end.

The Statement of Profit and Loss should disclose, as a single amount, the post-tax profit or loss of the division on classification as held for sale. Further, as per Ind AS 33, EPS will also be disclosed separately for the discontinued operation.

2. (b)On June 1, 2018, entity D Limited plans to sell a group of assets and liabilities, which is classified as a disposal group. On July 31, 2018, the Board of Directors approved and committed to the plan to sell the manufacturing unit by entering into a firm purchase commitment with entity G Limited.However, since the manufacturing unit is regulated, the approval from the regulator is needed for sale. The approval from the regulator is customary and highly probable to be received by November 30, 2018 and the sale is expected to be completed by 31stMarch, 2019. Entity D Limited follows December year end. The assets and liabilities attributable to this manufacturing unit are as under: (`in lakh)

Particulars	Carrying value as on 31stDecember, 2017	Carrying value as on 31stJuly, 2018
Goodwill	1000	1000
Plant and Machinery	2000	1800
Building	4000	3700
Debtors	1700	2100
Inventory	1400	800
Creditors	(600)	(500)
Loans	(4000)	(3700)
Net	5500	5200

The fair value of the manufacturing unit as on December 31, 2017 is `4,000 lakh and as on July 31, 2018 is`3,700lakh. The cost to sell is ` 200lakhon both these dates. The disposal group is not sold at, the period end i.e., December 31, 2018. The fair value as on 31stDecember, 2018 is lower than the carrying value of the disposal group as on that date.

Required:

(i)Assess whether the manufacturing unit can be classified as held for sale and reasons thereof. If yes, then at which date?

(ii) The measurement of the manufacturing unit as on the date of classification as held for sale.

(iii)The measurement of the manufacturing unit as at the end of the year. (Exam Nov 19) / (MTP Nov 21) / (Exam May 22 similar)

[video link: https://youtu.be/LDz94zJwX_8?t=1791]

Answer

(i)Assessment of manufacturing unit whether to be classified as held for sale

The manufacturing unit can be classified as held for sale due to the following reasons:

(a)The disposal group is available for immediate sale and in its present condition. The regulatory approval is customary and it is expected to be received in one year. The date at which the disposal group is classified as held for sale will be 31stJuly, 2018, i.e.the date at which management becomes committed to the plan.

(b)The sale is highly probable as the appropriate level of management i.e., board of directors in this case have approved the plan.

(c) A firm purchase agreement has been entered with the buyer.

(d)The sale is expected to be complete by 31stMarch, 2019, i.e., within one year from the date of classification.

(ii) Measurement of the manufacturing unit as on the date of classification as held for sale

Following steps need to be followed:

Step 1: Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable Ind AS. This has been done and the carrying value of the disposal group as on 31stJuly, 2018 is determined at `5,200lakh. The difference between the carrying value as on 31stDecember, 2017 and 31stJuly, 2018 is accounted for as per Ind AS 36.

Step 2: An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. The fair value less cost to sell of the disposal group as on 31stJuly, 2018 is `3,500 lakh (i.e.`3,700lakh-`200lakh). This is lower than the carrying value of `5,200lakh.Thus, an impairment loss needs to be recognised and allocated first towards goodwill and thereafter pro-rata between assets of the disposal group which are within the scope of Ind AS 105 based on their carrying value. Thus, the assets will be measured as under: (`in lakh)

Particulars	Carrying value –	Impairment	Carrying value as

	31st July, 2018		per Ind AS 105 – 31st July, 2018
Goodwill	1000	(1000)	-
Plant and Machinery	1800	(229)	1571
Building	3700	(471)	3229
Debtors	2100		2100
Inventory	800		800
Creditors	(500)		(500)
Loans	(3700)		(3700)
	5200	(1700)	3500

Working Note:

Allocation of impairment loss to Plant and Machinery and Building

After adjustment of impairment loss of `1,000lakhfrom the full value of goodwill, the balance `700lakh(`1,700lakh–`1,000lakh) is allocated to plant and machinery and Building on proportionate basis.

Plant and machinery –`700lakhx `1,800lakh/`5,500lakh= `230lakh(rounded off)Building –`700lakhx `3,700lakh/`5,500lakh= `470lakh(rounded off

(iii)Measurement of the manufacturing unit as on the date of classification as at the year end

The measurement as at the year-end shall be on similar lines as done above.

The assets and liabilities in the disposal group not within the scope of this Standard are measured as per the respective standards.

The fair value less cost to sell of the disposal group as a whole is calculated. This fair value less cost tosell as at the year-end shall be compared with the carrying value as at the date of classification as held for sale.It is provided that the fair value as on the year end is less than the carrying amount as on that date –thus the impairment loss shall be allocated in the same way between the assets of the disposal group falling within the scope of this standard as shown above.

Measurement of the manufacturing unit as on the date of classification as at the year-end shall be on similar lines as done above.

10. X Ltd. acquires B Ltd. exclusively with a view to sale and it meets the criteria to be classified as discontinued operation as per Ind AS 105. Further, following information is available about B Ltd.:
Fair value of total assets excluding liabilities on acquisition – ` 360
Costs to sell as on acquisition and on reporting date – ` 10
Fair value of liabilities on acquisition and reporting date – ` 80
Fair value of total assets excluding liabilities on the reporting date – ` 340

How discontinued operation pertaining to B Ltd. should be measured in consolidated financial statements of X Ltd. on acquisition date and reporting date? (RTP May 2022)
[video link: https://youtu.be/rxTiMeT0IDU?t=3737]

Answer

Ind AS 105 defines a disposal group as a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80 –87 of Ind AS 36, Impairment of Assets, or if it is an operation within such a cash- generating unit.

In the given case, B Ltd. is acquired exclusively with a view to sell and meets the criteria to be classified as discontinued operation.

The discontinued operation would be measured in accordance with paragraphs 15 and 16 of Ind AS 105

As per para 15, an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

As per para 16, if a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell.

Hence, if the asset (or disposal group) is acquired as part of a business combination, it shall be measured at fair value less costs to sell. Therefore, on acquisition date, in line with paragraph 16, X Ltd. will measure B Ltd. as a disposal group at fair value less costs to sell which will be calculated as

Fair value of total assets excluding liabilities on acquisition – Costs to sell = ` 360 – ` 10 = ` 350.

Fair value of liabilities on acquisition = ` 80.

At the reporting date, in line with paragraph 15, X Ltd. will remeasure the disposal group at the lower of its cost and fair value less costs to sell which will be calculated as:

Fair value of total assets excluding liabilities on subsequent reporting d ate – Costs to sell
= ` 340 – ` 10 = ` 330

Fair value of liabilities on reporting date = ` 80.

At the reporting date, X Ltd. shall present these assets and liabilities separately from other assets and liabilities in its consolidated financial statements.

In the statement of profit and loss, X Ltd. shall recognise loss on subsequent measurement (of net assets at fair value) of B Ltd. which equals to ` 20 (` 270 – ` 250).

Temporary shut down

6(a)PB Limited purchased a plastic bottle manufacturing plant for `24 lakhon 1st April, 2015. The useful life of the plant is 8 years. On 30th September, 2017,PB Limited temporarily stops using the manufacturing plant because demand has declined. However,the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of PB Limited decided to treat the plant as held for sale until the demand picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell. The accountant has also stopped charging depreciation for rest of the period considering the plant as held for sale. The fair value less cost to sell on 30thSeptember, 2017 and 31stMarch, 2018 was `13.5 lakhand `12 lakh respectively.

The accountant has made the following working:

Carrying amount on initial classification as held for sale

Purchase price of Plant	24,00,000
Less: Accumulated Depreciation [(`24,00,000/8)x2.5 years]	7,50,000
	16,50,000
Fair value less cost to sell as on 31st March, 2017	12,00,000
The value lower of the above two	12,00,000

Balance Sheet extracts as on 31stMarch, 2018

Particulars	`
Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	12,00,000

Required:

Analyze whether the above accounting treatment is in compliance with the Ind AS. If not, advise the co rrect trea tmen t showing necessary workings. (Exam Nov 18)

[video link: https://youtu.be/LDz94zJwX_8?t=1259]

Answer

As per Ind AS 105‘Non-current Assets Held for Sale and Discontinued Operations’, an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For asset tobe classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable. In such a situation, an asset cannot be classified as a non-current asset held for sale, if the entity intends to sell it in a distant future.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
Further Ind AS 105 also states thatan entity shall not classify as held for sale a non-current asset that is to be abandoned. T his is because its carrying amount will be recovered principally through continuing use.
An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.
In addition to Ind AS 105, Ind AS 16 states that depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.
T he Accountant of PB Ltd. has treated the plant as held for saleand measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.
Accordingly, the manufacturing plant should neither be treated as abandoned asset nor as held for sale because its carrying amount will be principally recovered through continuous use. PB Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.
The working of the same for presenting in the balance sheet will be as follows:
Calculation of carrying amount as on 31st March, 2018`

Purchase Price of Plant	24,00,000
Less: Accumulated depreciation (24,00,000/ 8 years) x 3 years	(9,00,000)
Carrying amount before impairment	15,00,000
Less:Impairment loss (Refer Working Note)	(3,00,000)
Revised carrying amount after impairment	12,00,000

Balance Sheet extracts as on 31st March 2018
Assets
Non-Current Assets

Property, Plant and Equipment	12,00,000

Working Note:
Fair value less cost to sell of the Plant = `12,00,000

Value in Use (not given) or= Nil (since plant has temporarily not been used for manufacturing due to decline in demand)

Recoverable amount = higher of above i.e. `12,00,000

Impairment loss = Carrying amount –Recoverable amountImpairment loss = `15,00,000 -`12,00,000= `3,00,000.

Ind AS 108

Six conditions to be presented as a segment

1. 10% or more of internal + external sales
2. 10% or more of assets
3. 10% or more of [∑Profit segments or ∑loss segments] whichever is higher
4. Reported in PY because of any of above three points
5. Management discretion
6. Minimum 75% of external sales

6 (b)XLtd. Has identified 4 operating segments for which revenue datais given below

	External sale	Internal sale	Total
Segment A	30,00,000	Nil	30,00,000
Segment B	650,000	Nil	650,000
Segment C	850,000	100,000	950,000
Segment D	500,000	49,00,000	54,00,000
	50,00,000	50,00,000	100,00,000

Additional information:

Segment C is a new business unit and management expectthis segment to make a significant contribution to external revenue in coming years. Which of the segments would be reportable under the criteria identified in Ind AS 108? (MTP March 2018) / (Exam nov 20) / (MTP Oct 19)

[video link: https://youtu.be/w8LWbDcWNm0?t=91]

Answer

Threshold amount is `10,00,000 (`1,00,00,000 × 10%).

Segment A exceeds the quantitative threshold (`30,00,000 > `10,00,000) and hence reportable segment.

Segment D exceeds the quantitative threshold (`54,00,000 > `10,00,000) and hence reportable segment.

Segment B & C do not meet the quantitative threshold amount and may not be classified as reportable segment.

However, the total external revenue generated by these two segments A & D represent only 70% (`35,000/50,000 x 100) of the entity's total external revenue. If the total external revenue reported by operating segments constitutes less than 75% of the entity total external revenue, additional operating segments should be identified as reportable segments until at least 75% of the revenue is included in reportable segments.

In case of X Ltd., it is given that Segment C is a new business unit and management expect this segment to make a significant contribution to external revenue in coming years. In accordance with the requirement of Ind AS 108, X Ltd. designates this start-up segment C as a reportable segment, making the total external revenue attributable to reportable segments 87% (`43,50,000/ 50,00,000 x 100) of total entity revenues.

3 (c) Heavy Goods Ltd. has 6 operating segments namely L-Q (below). The total revenues (internal and external), profits or losses and assets are set out below :

Segment	Inter segment sales	External sales	Profit / loss	Total assets
L	4200	12300	3000	37500
M	3500	7750	1500	23250
N	1000	3500	(1500)	15750
O	0	5250	(750)	10500
P	500	5500	900	10500
Q	1200	1050	600	5250
	10400	35350	3750	102750

Heavy Goods Ltd. needs to determine how many reportable segments it has. You are required to advice Heavy Goods Ltd. as per the criteria defined in Ind AS 108 (Exam Jan 21)

[video link: https://youtu.be/w8LWbDcWNm0?t=533]

Answers

As per paragraph 13 of Ind AS 108, an entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and inter - segment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

Combined total sales of all the segment = ` 10,400 + ` 35,350 = ` 45,750.

10% thresholds = 45,750 x 10% = 4,575.

(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of

(i) the combined reported profit of all operating segments that did not report a loss and

(ii) the combined reported loss of all operating segments that reported a loss.

In the given situation, combined reported profit = ` 6,000 and combined reported loss (` 2,250). Hence, for 10% thresholds ` 6,000 will be considered .

10% thresholds = ` 6,000 x 10% = ` 600

(c) Its assets are 10 per cent or more of the combined assets of all operating segments.

Combined total assets of all the segment = ` 1,02,750

10% thresholds = ` 1,02,750 x 10% = 10,275

Accordingly, quantitative thresholds are calculated below:

Segments	L	M	N	O	P	Q	Reportable segments
% segment sales to total sales	36.66	24.59	9.84	11.48	13.11	4.92	L,M, O,P
% segment profit to total profits	50	25	25	12.5	15	10	LMNOPQ
% segment assets to total assets	36.5	22.63	15.33	10.22	10.22	5.11	LMNOP

Segments L, M, O and P clearly satisfy the revenue and assets test s and they are separate reportable segments.

Segments N does not satisfy the revenue test, but it does satisfy the asset test and it is a reportable segment.

Segment Q does not satisfy the revenue or the assets test but is does satisfy the profits test. Therefore, Segment Q is also a reportable segment.

Hence, all segments i.e; L, M, N, O, P and Q are reportable segments.

17. XYZ Ltd. has eight segments namely A, B, C, D, E, F, G and H. The information regarding respective segments for the year ended 31st March, 20X1 is as follows:

Segments	A	B	C	D	E	F	G	H
External sales	0	255	15	10	15	50	25	35
Inter-segment sales	100	60	30	5				
Total	100	315	45	15	15	50	25	35
Segment result Profit/(Loss)	5	(90)	15	(5)	8	(5)	5	7
Segment assets	15	47	5	11	3	5	5	9

Identify which of the above segments out of A to H would be considered as reportable segments of XYZ Ltd. for the year ending 31st March, 20X1? (RTP May 22)

[video link: https://youtu.be/rxTiMeT0IDU?t=5537]

Answer

An entity has eight segments and the relevant information is as follows: Criterial 1: Segment revenue is 10% or more of total external + intersegment sales

Segments	A	B	C	D	E	F	G	H	Total
Total sales	100	315	45	15	15	50	25	35	600
% to total sales	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8	
Reportable segments	A	B							

Criteria 2: 10% or more of segment result Consider segment profit and loss separately in absolute terms

Segments	A	B	C	D	E	F	G	H	Total
Profit	**5**		**15**		**8**		**5**	**7**	40
(Loss)		**(90)**		**(5)**		**(5)**			100
% to total sales	16.7	52.5	7.5	2.5	2.5	8.3	4.2	5.8	
Reportable segments	A	B							

Since segment loss is greater, we select 100 as evaluating the segment percentage

Segments	A	B	C	D	E	F	G	H	Total
% to segment loss	5	90	15	5	8	5	5	7	
Reportable segments		B	C						

Criteria 2: 10% or more of segment assets

Segments	A	B	C	D	E	F	G	H	Total
Segment assets	15	47	5	11	3	5	5	9	100
%	15	47	5	11	3	5	5	9	
Reportable segments	A	B		D					

Based on the above 3 criteria, the Reportable Segments are A, B, C & D

However, 75% test for external sales should also be checked

Reportable Segments	A	B	C	D	TOTAL
External sales	0	255	15	10	280
Total entity's sales (external)					405
% of reportable segments external sales to entity's sales					69.14%
Required percentage					75%

Hence, in the above scenario, additional operating segments need to be identified as reportable segments, till the 75% test is satisfied, even if those segments do not satisfy the quantitative threshold limits.

3 (b)T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:

- Segment 1: Local Route

- Segment 2: Inter-city Route

- Segment 3: Contract Hiring

The characteristics of each segment are as under:

Segment 1: The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.

Segment 2: T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).

Segment 3: T Ltd also leases buses to schools under a long-term arrangement.

While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under 'Operating Segment'

Required:

Whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108 'Operating Segments'? and Discuss, in the above context, whether disclosure of segment information is relevant to an investor's appraisal of financial statements? (MTP March 2021)

[video link: https://youtu.be/w8LWbDcWNm0?t=934]

Answer

Ind AS 108 'Operating Segments' requires operating segments to be aggregated to present a reportable segment if the segments have similar economic

characteristics, and the segments are similar in each of the following aggregation criteria:

(a)The nature of the products and services

(b)The nature of the production process

(c)The type or class of customer for their products and services

(d)The methods used to distribute their products or provide their services

(e)If applicable, the nature of the regulatory environment

While the products and services are similar, the customers for those products and services are different.

In Segment 1, the decision to award the contract is in the hands of the local authority, which also sets prices and pays for the services. The company is not exposed to passenger revenue risk, since a contract is awarded by competitive tender.

On the other hand, in the inter-city segment, the customer determines whether a bus route is economically viable by choosing whether or not to buy tickets. T Ltd sets the ticket prices but will be affected by customer behavior or feedback. T Ltd is exposed to passenger revenue-risk, as it sets prices which customers may or may not choose to pay.

Operating Segment provides information that makes the financial statements more useful to investors. In making the investment decisions, investors and creditors consider the returns they are likely to make on their investment. This requires assessment of the amount, timing and uncertainty of the future cash flows of T Ltd as well as of management's stewardship of T Ltd's resources. How management derives profit is therefore relevant information to an investor.

Inappropriately aggregating segments reduces the usefulness of segment disclosures to investors. Ind AS 108 requires information to be disclosed that is not readily available elsewhere in the financial statements, therefore it provides additional information which aids an investor's understanding of how the business operates and is managed.

In T Ltd.'s case,if the segments are aggregated, then the increased profits in segment 2 will hide the decreased profits in segment 1. However, the fact that profits have sharply declined in segment 1 would be of interest to investors as it may suggest that future cash flows from this segment are at risk.

20.An entity uses the weighted average cost formula to assign costs to inventories and cost of goods sold for financial reporting purposes, but the reports provided to the chief operating decision maker use the First-In, First-Out (FIFO) method for evaluating the performance of segment

operations. Which cost formula should be used for Ind AS 108 disclosure purposes? (RTP May 19)

[video link: https://youtu.be/w8LWbDcWNm0?t=1306]

Answer

The entity should use F irst-In, First-Out (FIFO) method for its Ind AS 108 disclosures, even though it uses the weighted average cost formula for measuring inventories for inclusion in its financial statements. Where chief operating decision maker uses only one measure of segment asset, same measure should be used to report segment information. Accordingly, in the given case, the method used in preparing the financial information for the chief operating decision maker should be used for reporting under Ind AS 108. However, reconciliation between the segment results and results as per financial statements needs to be given by the entity in its segment report.

7.ABC Limited has 5 operating segments namely A, B, C, D and E. The profit/ loss of respective segments for the year ended March 31, 20X1 are as follows:

Segment	Profit/(Loss) (`in crore)
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	1,480

Based on the quantitative thresholds, which of the above segments A to E would be considered as reportable segments for the year ending March 31,20X1? (RTP May 20) / Exam Nov 22

[video link: https://youtu.be/w8LWbDcWNm0?t=842]

Answer

With regard to quantitative thresholds to determine reportable segment relevant in context of instant case, paragraph 13(b) of Ind AS 108 may be noted which provides as follows:

"The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating

segments that did not report a loss and (ii) the combined reportedloss of all operating segments that reported a loss."

In compliance with Ind AS 108, the segment profit/loss of respective segment will be compared with the greater of the following:

(i) All segments in profit, i.e., A, B and E –Total profit `8,280 crores.

(ii) All segments in loss, i.e., C and D –Total loss `6,800 crores.

Greater of the above –`8,280 crores.

Based on the above, reportable segments will be determined as follows:

Segment	Profit/(Loss)(`in crore)	As absolute % of `8,280 crore	Reportable segment
A	780	9%	No
B	1500	18%	Yes
C	(2300)	28%	Yes
D	(4500)	54%	Yes
E	6000	72%	Yes

Hence B, C, D, E are reportable segments.

2 (b) Seeds Ltd. is operating in oil industry. Its business segments comprise crushing and refining. Certain information for financial year 2017-18 is given below: (` in lakh)

Segments	External Sale	Tax	Other Operating Income	Result	Assets	Liabilities
Crushing	**100,000**	**2500**	**20,000**	**5,000**	**25,000**	**15,000**
Refining	**35,000**	**1500**	**7,500**	**2,000**	**15,000**	**5,000**

Additional Information: (` in lakh)

– **Unallocated revenue net of expenses is ` 1,500.**

– **Interest and bank charges is ` 1,000**

– **Income-tax expense is ` 1,000 (current tax ` 975 and deferred tax ` 25)**

– **Investments ` 5,000 and unallocated assets ` 5,000**

– **Unallocated liabilities, Reserves & Surplus and Share capital are ` 10,000; ` 15,000 and ` 5,000 respectively.**

– **Depreciation amounts for crushing and refining are ` 500 and ` 150 respectively.**

– Capital expenditure for crushing and refining are ` 2,500 and ` 1,000 respectively.

– Revenue from outside India is ` 15,000 and segment assets outside India ` 5,000.

Based on the above information, how Seeds Ltd. would disclose information about reportable segment revenue, profit or loss, assets and liabilities for financial year 2017-18? (Exam may 18) / (MTP April 22)

[video link: https://youtu.be/w6z701hVUFI?t=855]

Answer

(1) Segment revenues, results and other information (` in lakh)

Revenue	Coating	Others	Total
1. External sales (gross)	1,00,000	35,000	1,35,000
Tax	(2,500)	(1,500)	(4,000)
External sales (net)	97,500	33,500	1,31,000
Other operating income	20,000	7,500	27,500
Total Revenue	1,17,500	41,000	1,58,500
2. Results			
Segment results	5,000	2,000	7,000
Unallocated income (net of unallocated expenses)			1,500
Profit from operation before interest, taxation and exceptional items			8,500
Interest and bank charges			(1,000)
Profit before exceptional items			7,500
Exceptional items			Nil
Profit before taxation			7,500
Less: Income Taxes			
Current taxes			(975)
Deferred taxes			(25)
Profit after taxation			6,500

3. Other Information

(a) Assets			
Segment Assets	25,000	15,000	40,000
Investments			5,000
Unallocated assets			5,000
Total Assets			50,000
(b) Liabilities/Shareholder's funds			
Segment liabilities	15,000	5,000	20,000
Unallocated liabilities			10,000
Share capital			5,000
Reserves and surplus			15,000
Total liabilities / shareholder's funds			50,000
(c) Others			
Capital Expenditure	2,500	1,000	3,500
Depreciation	500	150	650

(2) Geographical Information (` in lakh)

	India	Outside India	Total
Revenue	1,43,500	15,000	1,58,500
Segment assets	35,000	5,000	40,000
Capital expenditure	3,500	-	3,500

Note: Segment revenue, results, assets and liabilities include the respective amounts identifiable to each of the segments.

Ind AS 113

3(b) EitherAn asset is sold in 2 different active markets (a market in which transaction for the asset or liability takes place with sufficient frequency and volume to provide pricing information on an ongoing basis) at different prices.

An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:The sale price of the asset is Rs. 26, transaction cost is Rs.3 and the cost to transport the asset to MarketA is Rs.2 (i.e., the net amount that would be received is Rs. 21).

In Market B:The sale priceof the asset is Rs. 25, transaction costis Re.1 and the cost to transport the asset to MarketB is Rs.2 (i.e., the net amount that would be received is Rs. 22).

Determine the fair value of the asset by supporting your answer with proper reason. (Aug 2018 MTP) / (Exam Nov 18) / (Exam Nov 19)

[video link: https://youtu.be/w8LWbDcWNm0?t=1512]

Answer

If Market A is the principal market for the sale of asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costof Rs. 24.The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.

If neither market is the principal market for the sale of asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received bysellingthe asset, after taking into account transport cost (i.e., the net amount that would be received in the respective markets).

Since the entity would maximise the net amount that would be received for the asset in Market B, the fair value of the asset would be measuredusing the price in that market ie. sale of asset Rs. 25less transport costRs. 2, resulting in a fair value measurement of Rs. 23.

13.Comment on the following by quoting references from appropriate Ind AS.

(i)DS Limited holds some vacant land for which the use is not yet determined.the land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

On what basis will the land be fair valued under Ind AS?

(ii)DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares,the company used discounted cash flow method as there were no similar shares available in the market.

Under which level of fair value hierarchy will the above inputs be classified?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares? (RTP Nov 19)

[video link: https://youtu.be/w8LWbDcWNm0?t=1893]

Answer

(i)As per Ind AS 113, a fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The highest and best use of a non-financial asset takes intoaccount the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a)A use that is physically possible takes into account the physical characteristics of the asset that market participants would take intoaccount when pricing the asset (eg the location or size of a property).

(b)A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg thezoning regulations applicable to a property).

(c)A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or

cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

Highest and best use is determined from the perspective of market participants, even if the entityintends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. Nevertheless, the entity shall measure the fair valueof a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the land is to develop a commercial complex. Although developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as Ind AS 113does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

(ii)As per Ind AS 113, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, DS Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Level 2 inputs include the following:
(a)quoted prices for similar assets or liabilities in active markets.
(b)quoted prices for identical or similar assets or liabilities in markets that are not active.
(c)inputs other than quoted prices that are observable for the asset or liability.

If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

15. (i) Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of ` 10. Entity XYZ's after-tax maintainable profits are estimated at ` 70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20%. Entity A values its holding in company XYZ's shares based on earnings. Determine the fair value of Entity A's investment in XYZ's shares.

(ii) Based on the facts given in the aforementioned part (i), assume that, Entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net assets including those recognised in its balance sheet and those that are not recognised is ` 8,50,000.

Determine the fair value of Entity A's investment in XYZ's shares. (RTP Nov 21) / (Exam May 22)

[video link: https://youtu.be/QJdTojWQ3bw?t=1319]

Answer

(i) An earnings-based valuation of Entity A's holding of shares in company XYZ could be calculated as follows:

Particulars	Unit
Entity XYZ's after-tax maintainable profits (A)	` 70,000
Price/Earnings ratio (B)	15
Adjusted discount factor (C) (1- 0.20)	0.80
Value of Company XYZ (A) x (B) x (C)	` 8,40,000
Value of a share of XYZ = ` 8,40,000 ÷ 5,000 shares =	` 168

The fair value of Entity A's investment in XYZ's shares is estimated at ` 42,000 (that is, 250 shares × ` 168 per share).

(ii) Share price = ` 8,50,000 ÷ 5,000 shares = ` 170 per share.

The fair value of Entity A's investment in XYZ shares is estimated to be ` 42,500 (250 shares × ` 170 per share).

Ind AS 115

Determination of Performance Obligation

6d A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all asp ects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components. Determine whether the company has a single or multiple performance obligations under the contract? (MTP April 2021)

[video link: https://youtu.be/w12BdM5lDsU?t=1650]

Answer

Determining whether a good or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition. While the customer may be able to benefit from each promised good or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation. This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

10.A property sale contract includes the following:

(a) Common areas

(b) Construction services and building material

(c) Property management services

(d) Golf membership

(e) Car park

(f) Land entitlement

Analyse whether the above items can be considered as separate performance obligations as per the requirements of Ind AS 115? (RTP May 2021)

[video link: https://youtu.be/w12BdM5IDsU?t=4442]

Answer

Paragraph 22 of Ind AS 115 provides that at contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute a performance obligation.

A performance obligation is a promise in a contract to transfer to the customer either:

•a good or service (or a bundle of goods or services) that is distinct; and

•series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

As per paragraph 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (i.e. the good or service is capable of being distinct); and

(b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (i.e. the promise to transfer the good or service is distinct within the context of the contract).

Each performance obligation is required to be accounted for separately.

Based on the above guidance, the following table discusses whether the common goods and services in property sale contract should be considered as separate performance obligation or not:

Goods/Service	**Whether a separate Performance obligation (PO) or not**	**Reason**
Common areas	Unlikely to be separate PO	Common areas are unlikely to be a separate performance obligation because the interests received in common areas are typically undivided interests that are not separable from the property itself. However, if the common areas were sold separately by the developer, then they could be considered as a separate performance obligation provided that it is distinct in the context of the contract.
Construction	Unlikely to be separate PO	Construction services and building materials can meet the first criterion as they

services and building material		are items that can be used in conjunction with other readily available goods or services. However, the developer would be considered to be providing a significant integration service as it is bringing together all the separate elements to deliver a complete building.
Property manage ment services and Golf member ship	Likely to be separate PO	Property management services and golf membership are likely to be separate performance obligations as they may be used in isolation or with the property already acquired, i.e., management services can be used with the property. These types of services are not significantly customised, integrated with, or dependent on the property. This is because there is no change in their function with or without the property. Also, a property management service could be undertaken by a third party
Car park and Land entitleme nt	Analysis required	Items such as car parks and land entitlements generally meet the first criterion –i.e., capable of being distinct –as the buyer benefits from them on their own.Whether the second criterion is met depends on the facts and circumstances. For example, if the land entitlement can be sold separately or pledged as security as a separate item, it may indicate that it is not highly dependent on, or integrated with, other rights received in the contract. In an apartment scenario, the customer can receive an undivided interest in the land on which the apartment block sits. This type of right is generally considered as highly inter-related with the apartment itself.*

* However, if title to the land is transferred to the buyer separately –for example in a single party development –then the separately identifiable criterion may be met.

PS: Other facts and circumstances of each contract should also be carefully examined to determine performance obligations.

6c. Telco T Ltd. enters into a two-year contract for internet services with Customer C. C also buys a modem and a router from T Ltd. and obtains title to the equipment. T Ltd. does not require customers to purchase its

modems and routers and will provide internet services to customers using other equipment that is compatible with T Ltd.'s network. There is a secondary market in which modems and routers can be bought or sold for amounts greater than scrap value.

Determine how many performance obligations does the entity T Ltd. have? (MTP Oct 21) / (MTP April 22)

[video link: https://youtu.be/zNXsu2FRgBo?t=1711]

Answer

T Ltd. concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation:

Criterion 1: Capable of being distinct

- C can benefit from the modem and router on their own because they can be resold for more than scrap value.
- C can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set- up, they could be bought from alternative retail vendors or the internet service could be used with different equipment.

Criterion 2: Distinct within the context of the contract

- T Ltd. does not provide a significant integration service.
- The modem, router and internet services do not modify or customise one another.
- C could benefit from the internet services using routers and modems that are not sold by T Ltd. Therefore, the modem, router and internet services are not highly dependent on or highly inter-related with each other.

Allocation of discount

4.(a)The Company has sold certain items to a customer with after sale service for a period of two years from the date of such sale i.e. 1stOctober, 2017 without any additional charges. The total amount payable by the customer is agreed as follows:

•Rs.8,00,000, if paid by 31stJanuary, 2018;

•Rs.8,10,000, if paid by 28thFebruary, 2018;

•Rs.8,20,000, if paid by 31stMarch, 2018.

Based on past experience it is highly probable that the customer makes the payment before 28thFebruary, 2018. The standalone selling price of the product is Rs.7,00,000 and two years' services are offered to the customer at Rs.1,40,000.

Answer the following:

(1) How many transactions are included in the above arrangement as per applicable Ind AS

(2) What is the amount of revenue to be considere1,000d for revenue recognition as per the applicable Ind AS?

(3) What is the amount of revenue to be recognised under Ind AS towards sale of product as per the terms of the contract with the customer?

(4) What is the amount of revenue to be recognised under Ind AS towards sale of service as per the terms of the contract with the customer?

(5) What is the portion of current and non-current liabilities to be presented in the financial statements as per Ind AS? (MTP Oct 2018)

[video link: https://youtu.be/WUXRwsjv-W4?t=483]

Answer

Two transactions are included in the above arrangement as per applicable Ind AS ie. sale of item includes following transactions:

(i)Selling price of item

(ii)Two-years' after sale service

Revenue attributable to both the components is calculated as follows:

Total fair value of item and two years' service period	
(7,00,000 + 1,40,000)	8,40,000
Less: Sale price of the item and two years' service period	(8,10,000)
Discount	30,000

Discount and revenue attributable to each component of the transaction:

Proportionate discount attributable to sale of item	25,000
(30,000 x 7,00,000 / 8,40,000)	
Revenue from sale of item (7,00,000 –25,000)	6,75,000
Proportionate discount attributable to two years' service period	5,000
(30,000 x 1,40,000 / 8,40,000)	

Revenue from two years' service period (1,40,000 –5,000) 1,35,000

Revenue in respect of sale of item should be recognised immediately and revenue from two years' service period should be recognised over the 2 year period on monthly basis ie on 31stMarch, 2017 revenue for two years' service period will be Rs. 5,625 (Rs. 1,35,000/24 months)

Amount of two years' service period due within 12 months from the reporting date =(1,35,000 / 24 months) x 12 months = Rs. 67,500 (Current).

Amount of two years' service period due after 12 months from the reporting date =(1,35,000 / 24 months) x 11 months = Rs. 61,875 (Non-current).

6(b) KK Ltd. runs a departmental store which awards 10 points for every purchase of ` 500 which can be discounted by the customers for further shopping with the same merchant. Unutilised points will lapse on expiry of two years from the date of credit. Value of each point is ` 0.50. During the accounting period 201 9-2020, the entity awarded 1,00,00,000 points to various customers of which 18,00,000 points remained undiscounted. The management expects only 80% will be discounted in future of which normally 60 -70% are redeemed during the next year. The Company has approached your firm with the following queries and has asked you to suggest the accounting treatment (Journal Entries) under the applicable Ind AS for these award points:

(a)How should the recognition be done for the sale of goods worth `10,00,000 on a particular day?

(b)How should the redemption transaction be recorded in the year 2019-2020? The Company has requested you to present the sale of goods and redemption as independent transaction. Total sales of the entity is`5,000 lakhs.

(c)How much of the deferred revenue should be recognizedat the year-end (2019-2020) because of the estimation that only 80% of the outstanding points will be redeemed?

(d)In the next year 2020-2021, 60% of the outstanding points were discounted.Balance 40% of the outstanding points of 2019-2020still remained outstanding. How much of the deferred revenue should the merchant recognize in the year 2020-2021and what will be the amount of balance deferred revenue?

(e)How much revenue will the merchant recognized in the year 2021-2022, if 3,00,000 points are redeemed in the year 2021-2022? (MTP Oct 2020) / (RTP May 19)

[video link: https://youtu.be/WUXRwsjv-W4?t=2154]

Answer

(a)Points earned on Rs.10,00,000 @ 10 points on every Rs.500 = [(10,00,000/500) x10] = 20,000 points.

Value of points = 20,000 points x Rs.0.5 each point = Rs.10,000

Revenue recognized for sale of goods Rs.9,90,099

[10,00,000 x(10,00,000/10,10,000)]

Revenue for points deferred Rs.9,901

[10,00,000 x (10,000/10,10,000)]

Journal Entry

Bank A/c Dr.	10,00,000	
T o Sales A/c		9,90,099
T o Liability under Customer Loyalty programme		9,901

(b)Points earned on Rs.50,00,00,000 @ 10 points on every Rs.500 = [(50,00,00,000/500) x 10] = 1,00,00,000 points.

Value of points = 1,00,00,000 points x Rs.0.5 each point = Rs.50,00,000

Revenue recognized for sale of goods = Rs.49,50,49,505 [50,00,00,000x (50,00,00,000 / 50,50,00,000)]

Revenue for points = Rs.49,50,495 [50,00,00,000x (50,00,000 / 50,50,00,000)]

Journal Entry in the year 20X1

Bank A/c Dr.	50,00,00,000	
T o Sales A/c		49,50,49,505
T o Liability under Customer Loyal ty programme		49,50,495
(On sale of Goods)		
Liability under Customer Loyal ty programmeDr.	42,11,002	
T o Sales A/c		42,11,002
(On redemption of (100 lakhs -18 lakhs) points)		

Revenue for points to be recognized

Undiscounted points estimated to be recognized next year 18,00,000 x 80% = 14,40,000 points

T otal points to be redeemed within 2 years = [(1,00,00,000-18,00,000) + 14,40,000]

= 96,40,000

Revenue to be recognised with respect to discounted point = 49,50,495 x (82,00,000/96,40,000) = 42,11,002

(c) Revenue to be deferred with respect to undiscounted point in 20X1-20X2= 49,50,495 –42,11,002 = 7,39,493

(d)In 20X2-20X3,KK Ltd. would recognize revenue for discounting of 60% of outstanding points as follows:

Outstanding points = 18,00,000 x 60% = 10,80,000 points

T otal points discounted till date = 82,00,000 + 10,80,000 = 92,80,000 points

Revenue to be recognized in the year 20X2-20X3

= [{49,50,495 x (92,80,000 / 96,40,000)} -42,11,002]

= Rs.5,54,620.

Liability under Customer Loyalty programmeDr.	5,54,620	
T o Sales A/c		5,54,620

(On redemption of further 10,80,000 points)

T he Liability under Customer Loyalty programme at the end of the year 20X2-20X3will be Rs. 7,39,493 –5,54,620 = 1,84,873.

(e)In the year 20X3-20X4, the merchant will recognized the balance revenue of Rs. 1,84,873 irrespective of the points redeemed as this is the last year for redeeming the points. Journal entry will be as follows:

Liability under Customer Loyalty programmeDr.	1,84,873	
T o Sales A/c		1,84,873

(On redemption of remaining points)

6(c) Royal Silks, a textile chain operates a customer loyalty programme. It grants programme members loyalty points when they purchase textiles for a specified amount. Programme members can redeem the points for further

purchase of textiles. The points have no expiry date. In one period, the entity grants 10,000 points. Management estimates the fair value of textiles for which each loyalty point can be redeemed as `125.This amount takes into account an estimate of the discount that management expects would otherwise be offered to customers who have not earned award credits from an initial sale. In addition, management expects only 8,000 of these points to be redeemed.At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e. half of those expected to be redeemed. In the second year, management revises its expectations.It now expects 9,000 points to be redeemed altogether.During the second year, 4,100 points are redeemed.In the third year, a further 900 points are redeemed, i.e. that no more points will be redeemed after the third year. How would the Royal Silks account for the customer loyalty programme? (Exam May 18)

[video link: https://youtu.be/w12BdM5IDsU?t=4694]

Answer

The fair value of textiles for which each loyalty point can be redeemed as `125. Since management expects that only 8,000 points to be reimbursed, the revenue that should be deferred is of `10,00,000 (8,000 x 125).

Year 1

At the end of the first year, 4,000 of the points have been redeemed in exchange for textiles, i.e., half of those expected to be redeemed. The entity recognises revenue of (4,000 points/8,000 points) x `10,00,000 = `5,00,000.

Year 2

During the second year, 4,100points are redeemed, bringing the total number redeemed to 4,000 + 4,100= 8,100points. The cumulative revenue that the entity recognises is (8,100points/9,000 points) × `10,00,000 = `9,00,000. The entity has recognised revenue of `5,00,000 in the first year, so it recognises `4,00,000 in the second year

Year 3

In the third year, a further nine hundred points are redeemed, taking the total number of points redeemed to 8,100+ 900= 9,000. Management continues to expect that only 9,000 points will ever be redeemed, i.e., that no more points will be redeemed after the third year. So the cumulative revenue to date is (9,000 points/9,000 points) × `10,00,000 = `10,00,000.The entity has already recognised

`9,00,000 of revenue (`5,00,000 in the first year and `4,00,000 in the second year). So it recognises the remaining `1,00,000 in the third year. All of the revenue initially deferred has now been recognised.

13. A Ltd. owns 20 resorts across India. Every customer who stays in any of the resorts owned by A Ltd. is entitled to get points on the basis of total amount paid by him. Under this scheme, 1 point is granted for every ` 100 spent for stay in the resort. As per the past experience of A Ltd., the likelihood of exercise of the points is 100% and the standalone price of each such point is ` 5. Customer X spends ` 10,000 in one of the resorts of A Ltd. What is the accounting treatment for the points granted b y A Ltd.? (RTP Nov 22)

Answer

Paragraph B40 of Ind AS 115, inter alia, states that, "if in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract".
Further, paragraph B41 states that if a customer has the option to acquire an additional good or service at a price that would reflect the stand-alone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only by entering into a previous contract.

In those cases, the entity has made a marketing offer that it shall account for in accordance with this Standard only when the customer exercises the option to purchase the additional goods or services .

In the given case, the customer does get a material right by way of a discount of ` 500 for every 100 points that he would not receive without the previous stay in that resort.

Thus, the customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred.

According to paragraph B42, paragraph 74 requires an entity to allocate the transaction price to performance obligations on a relative stand-alone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity shall estimate it on the basis of percentage discount the customer may obtain upon exercising the option and the likelihood of the option getting exercised.

In accordance with above, an entity shall account for award credit as a separate performance obligation of the sales transactions in which they are initially granted.

The value of the consideration the entity expects to be entitled in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

In the current case, the standalone selling price of the 100 points is ` 500. A Ltd. Should allocate the fair value of the consideration (i.e. ` 10,000) between the points and the other components of the sale as ` 476 (500/10,500 x 10,000) and ` 9,524 (10,000/10,500 x 10,000) respectively in proportion of their standalone selling price.

Since A Ltd. supplies the awards itself (i.e. it acts as a principal), it should recognize` 476 as revenue when points are redeemed.

Point of Recognition of Revenue

3(c)An entity enters into 1,000 contracts with customers. Each contract includes the sale of one product for Rs.50 (1,000 total products × Rs.50 = Rs.50,000 total consideration). Cash is received when control of a product transfers. T he entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. T he entity's cost of each product is Rs.30.

The entity applies the requirements in Ind AS 115 to the portfolio of 1,000 contracts because it reasonably expects that, in accordance with paragraph 4, the effects on the financial statements from applying these requirements to the portfolio would not differ materially from applying the requirements to the individual contracts within the portfolio. Since the contract allows a customer to return the products, the consideration received from the customer is variable. T o estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (seeparagraph 53(a) of Ind AS 115) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.

T he entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.Determine the amount of revenue, refund liability and the asset to be recognised by the entity for the saidcontracts. (MTP April 2019) / (MTP May 2020)

[video link: https://youtu.be/WUXRwsjv-W4]

Answer

T he entity also considers the requirements in paragraphs 56–58 of Ind AS 115 on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of Rs.48,500 (Rs.50 × 970 products not expected to be returned) can be included in the transaction price. T he entity considers the factors in paragraph57 of Ind AS 115 and determines that although the returns are outside the entity's influence, it has significant experience in estimating returns for this product and customer class. In addition, the uncertainty will be resolved within a short time frame (iethe 30-day return period). Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognised (i.e. Rs.48,500) will not occur as the uncertainty is resolved (i.e.over the return period).

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

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

(a)revenue of Rs.48,500 (Rs.50 × 970 products not expected to be returned);

(b)a refund liability of Rs.1,500 (Rs.50 refund × 30 products expected to be returned); and

(c)an asset of Rs.900 (Rs.30 × 30 products for its right to recover products from customers on settling the refund liability).

6(b)An entity enters into a contract for the sale of Product A for Rs.1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to Rs.1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs.500 of additional products.Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price? (MTP May 2020) / Exam Nov 22

[video link: https://youtu.be/WUXRwsjv-W4?t=4220]

Answer

Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right

is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.

The entity believes there is 80% likelihood that a customer will redeem the voucher and on an average, a customer will purchase Rs.500 of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is Rs.120 (Rs.500 average purchase price of additional products x 30% incremental discount x 80% likelihood of exercising the option). The stand-alone selling prices of Product A and the discount voucher and theresulting allocation of the Rs.1,000 transaction price are as follows:

Performance obligations	Stand-alone selling price
Product A	Rs.1,000
Discount voucher	Rs.120
Total	Rs.1,120

Performance obligations	Allocated transaction price(to nearest Rs.10)
Product A(Rs.1000 ÷ Rs.1120 × Rs.1000)	Rs.890
Discount voucher(Rs.120 ÷ Rs.1120 × Rs.1000)	Rs.110
Total	Rs.1000

The entity allocates Rs.890 to Product A and recognises revenue for Product A when control transfers. The entity allocates Rs.110 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods or services or when it expires.

6.An entity G Ltd. enters into a contract with a customer P Ltd. for the sale of a machinery for `20,00,000. P Ltd. intends to use the said machinery to start a food processing unit. The food processing industry is highly competitive and P Ltd. has very little experience in the said industry.

P Ltd. pays a non-refundable deposit of `1,00,000 at inception of the contract and enters into a long-term financing agreement with G Ltd. for the remaining 95 per cent of the agreed consideration which it intends to pay primarily from income derived from its food processing unit as it lacks any other major source of income. The financing arrangement is provided on a non-recourse basis, which means that if P Ltd. defaults then G Ltd. can repossess the machinery but cannot seek further compensation from P Ltd., even if the full value of the amount owed is not recovered from the

machinery. The cost of the machinery for G Ltd. is `12,00,000. P Ltd. obtains control of the machinery at contract inception.

When should G Ltd. recognise revenue from sale of machinery to P Ltd. in accordance with Ind AS 115? (RTP Nov 19)

[video link: https://youtu.be/w12BdM5IDsU?t=2901]

Answer

As per paragraph 9 of Ind AS 115, "An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a)theparties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b)the entity can identify each party's rights regarding the goods or services to be transferred;

(c)the entity can identify the payment terms for the goods or services to be transferred;

(d)the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e)it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession".

Paragraph 9(e) above, requires that for revenue to be recognised, it should be probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In the given case, it is not probable that G Ltd. will collect the consideration to which it is entitled in exchange for the transfer of the machinery. P Ltd.'s ability to pay may be uncertain due to the following reasons:

(a)P Ltd. intends to pay the remaining consideration (which has a significant balance) primarily from income derived from its food processing unit (which is a business involving significant risk because of high competition in the said industry and P Ltd.'s little experience);

(b)P Ltd. lacks sources of other income or assets that could be used to repay the balance consideration; and

(c)P Ltd.'s liability is limited because the financing arrangement is provided on a non-recourse basis.

In accordance with the above, the criteria in paragraph 9 of Ind AS 115 are not met.

Further, para15 states that when a contract with a customer does not meet the criteria in paragraph 9 and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

(a)the entity has no remaining obligations to transfer goods or services to the customerand all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b)the contract has been terminated and the consideration received from the customer is non-refundable.

Para 16 statesthat an entity shall recognise the consideration received from a customer as a liability until one of the events in paragraph 15 occurs or until the criteria in paragraph 9 are subsequently met. Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received. In either case, the liability shall be measured at the amount of consideration received from the customer.

In accordance with the above, in the given case G Ltd. should account for the non-refundable deposit of `1,00,000 payment as a deposit liability as none of the events described in paragraph 15 have occurred—that is, neither the entity has receivedsubstantially all of the consideration nor it has terminated the contract. Consequently, in accordance with paragraph 16, G Ltd. Will continue to account for the initial deposit as well as any future payments of principal and interest as a deposit liability until the criteria in paragraph 9 are met (i.e. the entity is able to conclude that it is probable that the entity will collect the consideration) or one of the events in paragraph 15 has occurred. Further, G Ltd. will continue to assess the contract inaccordance with paragraph 14 to determine whether the criteria in paragraph 9 are subsequently met or whether the events in paragraph 15 of Ind AS 115 have occurred.

Determination of Transaction Price

18.(a)Entity I sells a piece of machinery to the customer for `2 million, payable in 90 days.Entity I is aware at contract inception that the customer might not pay the full contract price. Entity I estimates that the customer will pay atleast `1.75 million, which is sufficient to cover entity I's cost of sales (`1.5million) and which entity I is willing to accept because it wants to grow its presence in this market. Entity I has granted similar price concessions in comparable contracts. Entity I concludes that it is highly probable that it will collect `1.75 million, and such amount is not constrained under the variable consideration guidance. What is the transaction price in this arrangement? (RTP May 2020)

[video link: https://youtu.be/w12BdM5IDsU?t=3555]

Answer

Entity I is likely to provide a price concession and accept an amount less than Rs. 2 million in exchange for the machinery. The consideration is therefore variable. The transaction price in this arrangement is Rs. 1.75 million, as this is the amount which entity I expects to receive after providing the concession and it is not constrained under the variable consideration guidance. Entity I can also conclude that the collectability threshold is met for Rs. 1.75 million and therefore contract exists.

(b) Buildings Limited with a financial year end of 31st March, entered into a contract with its customer, Radar Limited, to build a manufacturing facility. Buildings Limited determines that the contract contains one performance obliga tion satisfied over time. Construction is scheduled to be completed by the end of the 36th month for an agreed upon price of Rs. 25 crores. Buildings Limited has the opportunity to earn a performance bonus for early completion as follows:

•15% bonus of the contract price if completed by the 30th months (25% likelihood).

•10% bonus of the contract price if completed by the 32nd months (40% likelihood).

•5% bonus of the contract price if completed by the 34th months (15% likelihood).

In addition to the potential performance bonus for early completion, Buildings Limited is entitled to a quality bonus of Rs. 2 crores if a health and safety inspector assigns the facility a gold star rating as defined by

Radar Limited in terms of the contract. Buildings Limite d concludes that it is 60% likely that it will receive the quality bonus.

Analyze and determine the amount of variable consideration Building Limited should recognize in its contract with Radar Company Limited to build a manufacturing facility. (MTP April 2021) / (MTP April 22 similar)

[video link: https://youtu.be/w12BdM5lDsU?t=73]

Answer

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

Buildings Limited decides to use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes and the entity has experience with a large number of similar contracts that provide a reasonable basis to predict future outcomes. Therefore, the entity expects this method to best predict the amount of variable consideration associated with the early completion bonus. Buildings Ltd.'s best estimate of the early completion bonus is Rs. 2.125 crore, calculated as shown in the following table:

Bonus %	Amount of bonus (Rs.in crore)	Probability	Probability-weighted amount (Rs.in crore)
15% 10% 5% 0%	3.75 2.5 1.25 0	25% 40% 15% 20%	0.9375 1 0.1875 0
			2.125

Buildings Limited decides to use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (Rs. 2 crore or Rs. Nil) and this method would best predict the amount of conside ration associated with the quality bonus. Buildings Limited believes the most likely amount of the quality bonus is Rs. 2 crore. Total variable consideration = 4.125 crore (2.125 crore + 2 crore)

2(b)On 1 January 20X8, entity J enters into a one-year contract with a customer to deliver water treatment chemicals. The contract stipulates that the price per container will be adjusted retroactively once the customer reaches certain sales volume, defined, as follows:

Price per container **Cumulative sales volume**

Rs. 100	**1 - 1,000,000 containers**
Rs. 90	**1,000,001 - 3,000,000 containers**
Rs. 85	**3,000,001 containers and above**

Volume is determined based on sales during the calendar year. There are no minimum purchase requirements. Entity J estimates that the total sales volume for the year will be 2.8 million containers, based on its experience with similar contracts and forecasted sales to the customer. Entity J sells 700,000 containers to the customer during the first quarter ended 31 March 20X8 for a contract price of Rs. 100 per container. How should entity J determine the transaction price? (MTP March 2021) / (RTP May 20) / (Exam May 22)

[video link: https://youtu.be/w12BdM5IDsU?t=2147]

Answer

The transaction price is Rs. 90 per container based on entity J's estimate of total sales volume for the year, since the estimated cumulative sales volume of 2.8 million containers would result in a price per container of Rs. 90. Entity J concludes that based on a transaction price of Rs. 90 per container, it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved. Revenue is therefore recognised at a selling price of Rs. 90 per container as each container is sold. Entity J will recognise a liability for cash received in excess of the transaction price for the first 1 million containers sold at Rs. 100 per container (that is, Rs. 10 per container) until the cumulative sales volume is reached for the next pricing tier and the price is retroactively reduced.For the quarter ended 31stMarch, 20X8, entity J recognizes revenue of Rs. 63 million (700,000 containers x Rs. 90) and a liability of Rs. 7 million [700,000 containers x (Rs. 100 -Rs. 90)].Entity J will update its estimate of the total sales volume at each reporting date until the uncertainty is resolved.

2 (a) ABC Limited supplies plastic buckets to wholesaler customers.As per the contract entered into between ABC Limited and a customer for the financial year 2019-2020, the price per plastic bucket will decrease retrospectively as sales volume increases within the stipulatedtime of one year.

The price applicable for theentire sale will be based, on sales volume bracket during the year.

Price per unit (INR)	**Salesvolume**

90	**0 -10,000 units**
80	**10,001 -35,000 units**
70	**35,001 units & above**

All transactions are made in cash.

(i) Suggest how revenue is to be recognised in the books of accounts of ABC Limited as per expected value method, considering a probability of 15%, 75% and 10% for sales volumes of 9,000 units, 28,000 units and 36,000 units respectively. For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under expected value method for the financial year 2019-2020.

(ii) In case ABC Limited decides to measure revenue, based on most likely method instead of expected value method, how will be the revenue recognised in the books of accounts of ABC Limited based on above available information? For workings, assume that ABC Limited achieved the same number of units of sales to the customer during the year as initially estimated under most likely value method for the financial year 2019-2020

(iii) You are required to pass Journal entries in the books of ABC Limited if the revenue is accounted for as per expected value method for financial year 2019-2020. (Exam Nov 20)

[video link: https://youtu.be/w12BdM5lDsU?t=2411]

Answer

(i)Determination of how revenue is to be recognisedin the books of ABC Ltd. as per expected value method

Calculation of probability weighted sales volume

Sales volume (units)	Probability	Probability-weighted sales volume (units)
9,000	15%	1,350
28,000	75%	21,000
36,000	10%	3,600
		25,950

Transaction price will be : 25,950 units x `80 per unit = `20,76,000

Average unit price applicable = `80.

First 10,000 units sold will be booked at `90 per unit and liability is accrued for the difference price of `10 per unit (`90 –`80), which will be reversed upon subsequent sales of 15,950 units.

(ii)Determination of how revenue is to be recognised in the books of ABC Ltd. as per most likely method

Note:It is assumed that the sales volume of 28,000 units given under the expected value method, with highest probability is the sales estimated under most likely method too.

Transaction price will be:

28,000 units x `80 per unit = `22,40,000

Average unit price applicable = `80

First 10,000 units sold will be booked at `90 per unit and liability of `1,00,000 is accrued for the difference price of `10 per unit (`90 –`80), which will be reversed upon subsequent sales of 18,000 units (as question states that ABC Ltd. achieved the same number of units of sales to the customer during the year as initially estimated under the most likely method for the financial year 2019-2020).

(iii)Journal Entries in the books of ABC Ltd. (when revenue is accounted for as per expected value method for financial year 2019-2020)

1.Bank A/c (10,000 x `90)Dr.	9,00,000	
To Revenue A/c (10,000 x `80)		8,00,000
To Liability (10,000 x `10)		1,00,000
(Revenue recognised on sale of first 10,000 units)		

2.Bank A/c [(25,950 x `80)-9,00,000]Dr.	11,76,000	
Liability Dr.	100,000	
To Revenue A/c (15,950 x `80)		12,76,000

(Revenue recognised on sale of remaining 15,950 units (25,950 -10,000).

Amount paid by the customer will be the balance amount after adjusting the excess paid earlier since, the customer falls now in second slab)

6.A contractor enters into a contract with a customer to build an asset for `1,00,000, with a performance bonus of `50,000 that will be paid based on the timing of completion. The amount of the performance bonus decreases by 10% per week for every week beyond the agreed-upon completion date.The contract requirements are similar to those of contracts that the contractor has performed previously, and management believes that such

experience is predictive for this contract. The contractor concludes that the expected value method is most predictive in this case.

The contractor estimates that there is a 60% probability that the contract will be completed by the agreed-upon completion date, a 30% probability that it will be completed one week late, and a 10% probability that it will be completed two weeks late. Determine the transaction price. (RTP Nov 20)

[video link: https://youtu.be/w12BdM5IDsU?t=3710]

Answer

The transaction price should include management's estimate of the amount of consideration to which the entity will be entitled for the work performed.

Probability-weighted	Consideration
`1,50,000(fixed fee plus full performance bonus) x 60%	`90,000
`1,45,000 (fixed fee plus 90% of performance bonus) x 30%	`43,500
`1,40,000 (fixed fee plus 80% of performance bonus) x 10%	`14,000
Total probability-weighted consideration	`1,47,500

The total transaction price is `1,47,500, based on the probability-weighted estimate. The contractor will update its estimate at each reporting date

6.(a)An entity enters into a contract with a customer for two intellectual property licences (Licences A and B), which the entity determines to represent two performance obligations each satisfied at a point in time. T he stand-alone selling prices of Licences A and B are Rs.1,600,000 and Rs.2,000,000, respectively. T he entity transfers Licence B at inception of the contract and transfers Licence A one month later.

Case A—Variable consideration allocated entirely to one performance obligation

The price stated in the contract for Licence A is a fixed amount of Rs.1,600,000 and for Licence B the consideration is three per cent of the customer's future sales of products that use Licence B. For purposes of allocation, the entity estimates its sales-based royalties (ie the variabl e consideration) to be Rs.2,000,000. Allocate the transaction price.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

The price stated in the contract for Licence A is a fixed amount of Rs.600,000and for Licence B the consideration is five per cent of the

customer's future sales of products that use Licence B. T he entity's estimate of the sales-based royalties (ie the variable consideration) is Rs.3,000,000. Allocate the transaction price anddetermine the revenue to be recognised for each licence and the contract liabili ty, i f an y. (MTP March 2019)

[video link: https://youtu.be/WUXRwsjv-W4?t=1522]

Answer

Case A—Variable consideration allocated entirely to one performance obligation

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

(a)the variable payment relates specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B).

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

T he entity transfers Licence B at inception of the contract and transfers Licence A one month later. Upon the transfer of Licence B, the entity does not recognise revenue because the consideration allocated to Licence B is in the form of a sales-based royalty. T herefore , the entity recognises revenue for the sales-based royalty when those subsequent sales occur.When Licence A is transferred, the entity recognises as revenue the Rs.1,600,00 0 allocated to Licence A.

Case B—Variable consideration allocated on the basis of stand-alone selling prices

T o allocate the transaction price, the entity applies the criteria in paragraph 85 of Ind AS 115 to determine whether to allocate the variable consideration (ie the sales-based royalties) entirel y to Licence B.

In applying the criteria, the entity concludes that even though the variable payments relate specifically to an outcome from the performance obligation to transfer Licence B (ie the customer's subsequent sales of products that use Licence B), allocating the variabl e consideration entirely to Licence B would be inconsistent with the principle for allocating the transaction price. Allocating Rs.600,000 to Licence A and Rs.3,000,000 to Licence B does not reflect a reasonable allocation of the transaction price on the basis of the stand-alone selling prices of Licences A and B of Rs.1,600,000 and Rs.2,000,000, respectively. Consequentl y, the entity applies the general allocation requirements of Ind AS 115.

T he entity allocates the transaction price of Rs.600,000 to Licences A and B on the basis of relative stand-alone selling prices of Rs.1,600,000 and Rs.2,000,000, respectively. T he enti ty also allocates the consideration related to the sales-based royalty on a relative stand-alon e selling price basis. However, when an entity licenses intellectual property in which the consideration is in the form of a sales-based royalty, the entity cannot recognise revenue until the later of the following events: the subsequent sales occur or the performance obligation is satisfied (or partially satisfied).

Licence B is transferred to the customer at the inception of the contract and Licence A is transferred three months later. When Licence B is transferred, the entity recognises as revenu e Rs.333,333 [(Rs.2,000,000 ÷ Rs.3,600,000) × Rs.600,000] allocated to Licence B. When Licence A is transferred, the entity recognises as revenue Rs.266,667 [(Rs.1,600,000 ÷ Rs.3,600,000) × Rs.600,000] allocated to Licence A.

In the first month, the royalty due from the customer's first month of sales is Rs.400,000. Consequently, the entity recognises as revenue Rs.222,222 (Rs.2,000,000 ÷ Rs.3,600,000 × Rs.400,000) allocated to Licence B(which has been transferred to the customer and is therefore a satisfied performance obligation). T he entity recognises a contract liability for the Rs.177,778 (Rs.1,600,000 ÷ Rs.3,600,000 × Rs.400,000) allocated to Licence A. T his is because although the subsequent sale by the entity's customer has occurred, the performance obligation to which the royalty has been allocated has not been satisfied.

2(b) GTM Limited has provided the following 4 independent scenarios. You are advised to respond to the queries mentioned at the end of each scenario. Support your answer with the relevant extracts of the applicable Ind AS.

Scenario 1

GTM Limited enters into a contract with a customer to sell product G, T and M in exchange for ` 1,90,000. GTM Limited will satisfy the performance obligations for each of the product at different points in time. GTM Limited regularly sells product G separately and therefore the stand -alone selling price is directly observable. The stand-alone selling prices of product T and M are not directly observable.

Because the stand-alone selling prices for Product T and M are not directly observable, the Company has to estimate them. To estimate the stand-alone selling prices, the Company uses the adjusted market assessment approach for product T and the expected cost plus a margin approach for product M. In making these estimates, the Company maximizes the use of observable inputs.
The entity estimated the stand -alone selling prices as follows:

Product	Stand-alone selling price (`)
Product G	90,000
Product T	44,000
Product M	66,000
Total	2,00,000

Determine the transaction price allocated to each Product.

Scenario 2

GTM Limited regularly sells Products G, T and M individually. The standalone selling prices are as under:

Product	Stand-alone selling price (`)
Product G	90,000
Product T	44,000
Product M	66,000
Total	2,00,000

In addition, the Company regularly sells Products T and M together for ` 1,00,000.
The Company enters into a contract with another customer to sell Products G, T and M in exchange for ` 1,90,000. GTM Limited will satisfy the performance obligations for each of the products at different points in time; or Product T and M at same point in time.

Determine the allocation of transaction price to Product T and M.
Scenario 3

GTM Limited enters into a contract with a custo mer to sell products G, T and M as described in scenario 2. The contract also includes a promise to transfer product 'Hope'. Total consideration in the contract is ` 2,40,000. The stand-alone selling price for product 'Hope' is highly variable because the company sells Product 'Hope' to different customers for a broad range of amounts (` 40,000 to ` 65,000).

Determine the selling price of Products G, T, M and Hope using the residual approach.
Scenario 4

The same facts as in scenario 3 applies to scenario 4 except that the transaction price is ` 2,25,000 instead of ` 2,40,000. Discuss how the transaction price should be allocated. (Exam July 2021) / (RTP Nov 21)

[video link: https://youtu.be/tZSGT1KBYBI?t=1254]

Answer

(b) Scenario 1

The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (` 2,00,000) exceeds the promised consideration (` 1,90,000). The entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across Products G, T and M. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price `
Product G	85,500 (` 90,000 ÷ ` 2,00,000 × ` 1,90,000)
Product T	41,800 (` 44,000 ÷ ` 2,00,000 × ` 1,90,000)
Product M	62,700 (` 66,000 ÷ ` 2,00,000 × ` 1,90,000)
Total	1,90,000

Scenario 2

The contract includes a discount of ` 10,000 on the overall transaction, which would be allocated proportionately to all three performance obligations when allocating the transaction price using the relative stand -alone selling price method.
However, because the entity regularly sells Products T and M together for ` 1,00,000 and Product G for ` 90,000, it has evidence that the entire discount of ` 10,000 should be allocated to the promises to transfer Products T and M in accordance with paragraph 82 of Ind AS 115.

If the entity transfers control of Products T and M at the same point in time, then the entity could, as a practical matter, account for the transfer of those products as a single performance obligation. That is, the entity could allocate ` 90,000 of the transaction prices to the single performance obligation of G and recognize revenue of ` 1,00,000 when Products T and M simultaneously transfer to the customer.

If the contract requires the entity to transfer control of Product s T and M at different points in time, then the allocated amount of ` 1,00,000 is individually allocated to the promises to transfer Product T (stand-alone selling price of ` 44,000) and Product M (stand-alone selling price of ` 66,000) as follows:

Product	Allocated transaction price `
Product T	40,000 (` 44,000 ÷ ` 1,10,000 total stand-alone selling price × `1,00,000)
Product M	60,000 (` 66,000 ÷ ` 1,10,000 total stand-alone selling price × ` 1,00,000)
Total	1,00,000

Scenario 3

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

As in Scenario 2, because the entity regularly sells Products T and M together for ` 1,00,000 and Product G for ` 90,000, it has observable evidence that ` 1,90,000 should be allocated to those three products and ` 10,000 discount should be allocated to the promises to transfer Products T and M in accordance with paragraph 82 of Ind AS 115 .

Using the residual approach, the entity estimates the stand -alone selling price of Product Hope to be ` 50,000 as follows:

Product	Stand-alone selling price	Method `
Product G	90,000	Directly observable
Products T and M	1,00,000	Directly observable with discount
Product Hope	50,000	Residual approach
Total	2,40,000	

The entity observes that the resulting ` 50,000 allocated to Product Hope is within the range of its observable selling prices (` 40,000 to ` 65,000).

Scenario 4

The same facts as in Scenario 3 apply to Scenario 4 except the transaction price is ` 2,25,000 instead of ` 2,40,000. Consequently, the application of the residual approach would result in a stand-alone selling price of ` 35,000 for Product Hope (` 2,25,000 transaction price less ` 1,90,000 allocated to Products G, T and M). The entity concludes that ` 35,000 would not faithfully depict the amount of consideration to which the entity expects to be entitl ed in exchange for satisfying its performance obligation to transfer Product Hope, because ` 35,000 does not approximate the stand-alone selling price of Product Hope, which ranges from ` 40,000 to ` 65,000.

Consequently, the entity reviews its observable data, including sales and margin reports, to estimate the stand-alone selling price of Product Hope using another suitable method. The entity allocates the transaction price of ` 2,25,000 to Products G, T, M and Hope using the relative stand-alone selling prices of those products in accordance with paragraphs 73–80 of Ind AS 115.

4. On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy -duty equipment for a promised consideration of rupees with a bonus of rupees if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be rupees and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur.

Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 20X2, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115.

However, on 4 June 20X2, the contract is modified with the result that the fixed consideration and expected costs increase by ` 1,50,000 and ` 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is

highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of Ind AS 115, for the year 20X1-20X2 and 20X2-20X3. (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=1388]

Answer

For the year 20X1-20X2

S Limited accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with Ind AS 115. At the inception of the contract, S Limited expects the following: Transaction price – ` 20,00,000

Expected costs – ` 11,00,000

Expected profit (45%) – ` 9,00,000

At contract inception, S Limited excludes the ` 2,50,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the heavy –duty equipment is highly susceptible to factors outside the entity's influence.

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore ` 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 31st March, 20X2, the following would be recognised:

Revenue (A) – ` 13,00,000 (` 20,00,000 x 65%)

Costs (B) – ` 7,15,000 (` 11,00,000 x 65%)

Gross profit (C) i.e.(A-B) – ` 5,85,000

For the year 20X2-20X3

On 4th June, 20X2, the contract is modified. As a result, the fixed consideration and expected costs increase by ` 1,50,000 and ` 80,000, respectively.

The total potential consideration after the modification is ` 24,00,000 which is ` 21,50,000 fixed consideration + ` 2,50,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative

revenue recognised in accordance with Ind AS 115. Therefore, the bonus of ` 2,50,000 can be included in the transaction price.

S Limited also concludes that the contract remains a single performance obligation.
Thus, S Limited accounts for the contract modification as if it were part of the original contract. Therefore, S Limited updates its estimates of costs and revenue as follows:

S Limited has satisfied 60.60% of its performance obligation (` 7,15,000 actual costs incurred compared to ` 11,80,000 total expected costs). The entity recognises additional revenue of ` 1,54,400 [(60.60% of ` 24,00,000) – ` 13,00,000 revenue recognised to date] at the date of modification i.e. on 4th June, 20X2 as a cumulative catch-up adjustment.

5(c) Entity sells gym memberships for ` 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at ` 6,000 per year. Entity estimates an annual attrition rate of 50% each year.

Determine the amount of revenue to be recognised in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount. (MTP April 22)

[video link: https://youtu.be/zHYIGfZ1Djo?t=3422]

Answer

Allocated price per unit (year) is calculated as follows:

Total estimated memberships is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175

Total consideration is ` 12,00,000 {(100 x 7,500) + (50 x 6,000) + (25 x 6,000)}

Allocated price per membership is ` 6,857 approx. (12,00,000 / 175)

Basis on above, it is to be noted that although entity has collected ` 7,500 but revenue can be recognised at ` 6,857 approx. per membership and remaining ` 643 should be recorded as contract liability against option given to customer for renewing their membership at discount.

Significant Financing Component

6(c)ST Limited enters into a contract with a customer to sell an asset. Control of the asset will transfer to the customer in two years (i.e. the

performance obligation will be satisfied at a point in time). The contract includes two alternative payment options:

(1)Payment of Rs.5,000 in two years when the customer obtains control of the asset or

(2)Payment of Rs.4,000 when the contract is signed. The customer elects to pay Rs.4,000 when the contract is signed.

ST Limited concludes that the contract contains a significant financing component because of the length of time between when the customer pays for the asset and when the entity transfers the asset to the customer, as well as the prevailing interest rates in the market.

The interest rate implicit in the transaction is 11.8 per cent, which is the interest rate necessary to make the two alternative payment options economically equivalent. However, the entity determines that, the rate that should be used in adjusting the promised consideration is 6%, which is the entity's incremental borrowing rate.Pass journal entries showing how the entity would account for the significant financing component. (MTP May 2020)

[video link: https://youtu.be/WUXRwsjv-W4?t=4780]

Answer

Journal Entries showing accounting for the significant financing component:

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

CashDr.	Rs.4,000	
To Contract liability		Rs.4,000

(b) During the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration and accretes the contract liability by recognising interest on Rs.4,000 at 6% for two years:

Interest expenseDr.	Rs.494*	
To Contract liability		Rs.494

* Rs.494 = Rs.4,000 contract liability × (6% interest per year for two years).

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

Contract liabilityDr.	Rs.4,494	
To Revenue		Rs.4,494

3b. X Ltd. is engaged in manufacturing and selling of designer furniture. It sells goods on extended credit. X Ltd. sold furniture for `40,00,000 to a customer, the payment against which was receivable after 12 months with interest at the rate of 3% per annum. The market interest rate on the date of transaction was 8% per annum. Calculate the revenue to be recognised by X Ltd. for the above transactions. (MTP March 2018)

[Video link: https://youtu.be/w12BdM5IDsU?t=1883]

Answer

X Ltd. should determine the fair value of revenue by calculating the present value of the cash flows receivable.

Total amount receivable= `40,00,000 x 1.03 = `41,20,000.

Present Value of receivable (Revenue)= `41,20,000/1.08 = `38,14,815.

Interest income= `41,20,000 -`38,14,815 = `3,05,185.

Therefore, on transaction date,`38,14,815 will be recognised as revenue from sale of goods and `3,05,185 will be recognised as interest income receivable forthe period in accordance with Ind AS 109.

6(b) Mercury Ltd. has sold goods to Mars Ltd. at a consideration of Rs. 10 lakhs, the receipt of which receivable in three equal installments of Rs. 3,33,333 over a two year period (receipts on 1st April, 20X1, 31st March, 20X2 and 31st March, 20X3).

The company is offering a discount of 5 % (i.e. Rs. 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at Rs. 10 Lakhs and hence, the management has recognised the revenue from sale of goods for Rs. 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same. Also show its presentation in the company's profit & loss and balance sheet. (MTP March 2021) / (MTP Oct 2021) / (MTP Oct 18) / Exam Nov 22

[video link: https://youtu.be/WUXRwsjv-W4?t=60]

Answer

The revenue from sale of goods shall be recognised at the fair value of the consideration received or receivable. The fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest where the receipt is deferred beyond normal credit terms. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue.

The fair value of consideration (cash price equivalent) of the sale of goods is calculated as follows:

Year	Consideration (Installment)	PVF	Present value of consideration
0	3,33,333	-	3,33,333
1st year	3,33,333	0.949	3,16,333
2nd year	3,33,334	0.901	3,00,334
	10,00,000		9,50,000

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods

	Dr.	Cr.
CashDr.	3,33,333	
Trade ReceivableDr.	6,16,667	
To Sale		9,50,000

Recognition of interest expense and receipt of second installment

	Dr.	Cr.
CashDr.	3,33,333	
To Interest Income		33,053
To Trade Receivable		3,00,280

Recognition of interest expense and payment of final installment

	Dr.	Cr.
CashDr.	3,33,334	
To Interest Income (Balancing figure)		16,947
To Trade Receivable		3,16,387

Statement of Profit and Loss (extracts)for the year ended 31st March, 20X2 and 31st March, 20X3

	As at 31st March, 20X2	As at 31st March, 20X3
Income		

Sale of Goods	9,50,000	-
Other Income (Finance income)	33,053	16,947

Balance Sheet (extracts) as at 31st March, 20X2 and 31st March, 20X3

	As at 31st March, 20X2	As at 31st March, 20X3
Assets		
Current Assets		
Financial Assets		
Trade Receivables	3,16,387	-

2(b) A Ltd. is a company which is in the business of manufacturing engineering machines and providing after sales services. The company entered into a contract with Mr. Anik to supply and install a machine, namely 'model pi' on 1st April 2018 and to service this machine on 30th September 2018 and 1st April 2019. The cost of manufacturing the machine to A Ltd. was ` 1,60,000.

It is possible for a customer to purchase both the machine 'model pi' and the maintenance services separately. Mr. Anik is contractually obliged to pay A Ltd ` 4,00,000 on 1st April, 2019.

The prevailing rate for one-year credit granted to trade customers in the industry is 5 percent per six-month period.

As per the experience, the servicing of the machine 'model pi' sold to Mr. Anik is expected to cost A Ltd.` 30,000 to perform the first service and ` 50,000 to perform the second service. Assume actual costs equal expected costs. When A Ltd. provides machine services to customers in a separate transaction it earns a margin of 50 % on cost. On 1st April, 2018, the cash selling price of the machine 'model pi' sold to Mr. Anik is ` 2,51,927

The promised supply of machine 'model pi' and maintenance service obligations are satisfactorily carried out in time by the company. You are required to:

(i) Segregate the components of the transaction that A Ltd. shall apply to the revenue recognition criteria separately as per Ind AS 115;

(ii) Calculate the amount of revenue which A Ltd. must allocate to each component of the transaction;

(iii) Prepare journal entries to record the information set out above in the books of accounts of A Ltd. for the years ended 31st March-2019 and 31st March 2020; and

(iv) Draft an extract showing how revenue could be presented and disclosed in the financial statements of A Ltd. for the year ended 31st March 2019 and 31st March 2020. (Exam Jan 21) / (MTP March 22 similar) / (MTP Sep 22)

[video link: https://youtu.be/w12BdM5IDsU?t=6711]

Answer

(i) As per para 27 of Ind AS 115, a good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the m. A readily available resource is a good or service that is sold separately (by the entity or another entity) or that the customer has already obtained from the entity or from other transactions or events; and

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

Factors that indicate that two or more promises to transfer goods or services to a customer are separately identifiable include, but are not limited to, the following:

(a) significant integration services are not provided (i.e. the entity is not using the goods or services as inputs to produce or deliver the combined output called for in the contract)

(b) the goods or services does not significantly modify or customize other promised goods or services in the contract.

(c) the goods or services are not highly inter-dependent or highly interrelated with other promised goods or services in the contract

Accordingly, on 1st April, 2018, entity A entered into a single transaction with three identifiable separate components:

1. Sale of a good (i.e. engineering machine);

2. Rendering of services (i.e. engineering machine maintenance services on 30th September, 2018 and 1st April, 2019); and

3. Providing finance (i.e. sale of engineering machine and rendering of services on extended period credit).

(ii) Calculation and allocation of revenue to each component of the transaction

Date	Opening	Finance income	Goods	Services	Payment recd	Closing
1.4.2018 30.09.2018	- 251927	- 12596	251927 -	- 45000	- -	251927 309523

31.3.2019	309523	15477	-	-	-	325000
1.4.2019	325000	-	-	75000	400000	

Notes:

1. Calculation of finance income as on 30th September, 2018

= 5% x 2,51,927 = ` 12,596

2. Calculation of finance income as on 31st March, 2019

= 5% x 3,09,523 = ` 15,477

(iii) Journal Entries

1stApril, 2018

Mr. AnikDr. 2,51,927

To Revenue -sale of goods (Profit or loss A/c) 2,51,927

(Being revenue recognised from the sale of the machine on credit)

Cost of goods sold (Profit or loss) Dr. 1,60,000

To Inventories 1,60,000

(Being cost of goods sold recognised)

30thSeptember 2018

Mr. AnikDr. 12,596

To Finance Income (Profit or loss) 12,596

(Being finance income recognised)

Mr. AnikDr. 45,000

To Revenue-rendering of services (Profit or loss) 45,000

(Being revenue from the rendering of maintenance services recognised)

Cost of services (Profit or loss)Dr. 30,000

To Cash/Bank or payables 30,000

(Being the cost of performing maintenance services recognised)

31stMarch 2019

Mr. AnikDr. 15,477

To Finance Income (Profit or loss) 15,477

(Being finance income recognised)

1stApril, 2019

Mr. Anik Dr. 75,000

To Revenue -rendering of services (Profit or loss) 75,000

(Being revenue from the rendering of maintenance services recognised)

Cost of services (Profit or loss)Dr. 50,000

To Cash/Bank or payables 50,000

(Being the cost of performing maintenance services recognised)

Cash/BankDr. 4,00,000

To Mr. Anik 4,00,000

(Being the receipt of cash from the customer recognised)

(iv) Extract of Notes to the financial statements for the year ended 31st March, 2019 and 31st March, 2020

Note on Revenue

	2019-2020	2018-2019
Sale of goods	–	2,51,927
Rendering of machine-maintenance services	75,000	45,000
Finance income–		28,073
	75,000	3,25,000

3 (c) An entity has a fixed fee contract for ` 22,00,000 to develop a product that meets specified performance criteria. Estimated cost to complete the contract is ` 20,00,000.

The entity will transfer control of the product over five years and the entity uses the cost - to-cost input method to measure progress on the contract. An incentive award is available if the product meets the following weight criteria:

Weight (Kg)	Award % of Fixed Fee	Incentive Fee (`)
951 or greater	0%	Nil
701 - 950	10%	2,20,000
700 or less	25%	5,50,000

The entity has extensive experience creating products that meet the specific

performance criteria. Based on its experience, the entity has identified five engineering alternatives that will achieve the 10% incentive and two that will achieve the 25% incentive. In this case, the entity determined that it has 90% confidence that it will achieve the 10% incentive and 10% confidence that it will achieve 25% incentive. Based on this analysis, the entity believes 10% to be the most likely amount when estimatin g the transaction price. Therefore, the entity includes only the 10% award in the transaction price when calculating revenue because the entity has concluded it is probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved due to its 90% confidence in achieving the 10% award.

The entity reassesses its production status quarterly to determine whether it is on track to meet the criteria for the incentive award. At the end of the year four, it becomes apparent that this contract will fully achieve the weight-based criteria. Therefore, the entity revises its estimate of variable consideration to include the entire 25% incentive fee in the year four because, at this point, it is probable that a significant reversal in the amount of cumulative revenue recognised will not occur when including the entire variable consideration in the transaction price. Analyse the impact of changes in variable consideration when cost incurred is as follows:

Year	
1	**1,20,000**
2	**3,70,000**
3	**8,20,000**
4	**5,70,000**
5	**1,20,000**

Calculate yearly Revenue, Operating Profit and Margin (%). For simplification purposes, calculate revenue for the year independently based on costs incurred during the year divided by total expected costs, with the assumption that total expected costs do not change. (Exam Dec 21)

[video link: https://youtu.be/ngi-Dzq0Kis?t=2102]

Answer

Fixed consideration	A	22,00,000				
Estimated costs to complete	B	20,00,000				
		Year 1	Year 2	Year 3	Year 4	Year 5
Total estimated variable consideration	C	2,20,000	220,000	220,000	550,000	550,000
Fixed revenue	D=A * H/B	132,000	407,000	902,000	627,000	132,000
Variable revenue	E=C*H/B	13,200	40,700	90,200	156,750	33,000

Cumulative revenue adjustment	F	-	-		216,150	
Total revenue	G=D+E+F	145,200	447,700	992,200	999,900	165,000
Costs	H	120,000	370,000	820,000	570,000	120,000
Operating profit	I=G-H	25,200	77,700	172,200	429,900	45,000
Margin (rounded off)	J=I/G	17.36%	17.36%	17.36%	42.99%	27.27%

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

Calculation of cumulative catch-up adjustment:

Updated variable consideration	L	5,50,000
Cumulative costs through Year 4	M	18,80,000
Estimated costs to complete	N	20,00,000
Percent complete in Year 4: (rounded off)	O=M/N	94%
Cumulative variable revenue through Year 4:	P	3,00,850
Cumulative catch-up adjustment	F=[(LxO)–P]	2,16,150

Contract Modification

5(c) Entity AB Ltd. enters into a three-year service contract with a customer CD Ltd. for Rs. 4,50,000 (Rs.1,50,000 per year). The standalone selling price for one year of service at inception of the contract is Rs.1,50,000 per year. AB Ltd. accounts for the contract as a series of distinct services.

At the beginning of the third year, the parties agree to modify the contract as follows:

(i) the fee for the third year is reduced to Rs.1,20,000; and

(ii) CD Ltd. agrees to extend the contract for another three years for Rs.3,00,000 (Rs.1,00,000 per year).

The standalone selling price for one year of service at the time of modification is Rs. 1,20,000. How should AB Ltd. account for the modification?Analyze. (MTP April 2021)

[video link: https://youtu.be/w12BdM5IDsU?t=484]

Answer

Paragraph 20 of Ind AS 115, inter alia, states that, “An entity shall account for a contract modification as a separate contract if both of the following conditions are present:

(a) the scope of the contract increases because of the addition of promised goods or services that are distinct (in accordance with paragraphs 26–30); and

(b) the price of the contract increases by an amount of consideration that reflects the entity’s stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the ci rcumstances of the particular contract.

In accordance with the above, it may be noted that a contract modification should be accounted for prospectively if the additional promised goods or services are distinct and the pricing for those goods or services reflects their stand-alone selling price.

In the given case, even though the remaining services to be provided are distinct, the modification should not be accounted for as a separate contract because the price of the contract did not increase by an amount of consideration that reflects the standalone selling price of the additional services. The modification would be accounted for, from the date of the modification, as if the existing arrangement was terminated and a new contract created (i.e. on a prospective basis) because the remaining services to be provided are distinct.

AB Ltd. should reallocate the remaining consideration to all of the remaining services to be provided (i.e. the obligations remaining from the original contract and the new obligations). AB Ltd. will recognise a total of Rs.4,20,000 (Rs.1,20,000 + Rs.3,00,000) over the remaining four-year service period (one year remaining under the original contract plus three additional years) or Rs.1,05,000 per year.

2c. Growth Ltd. enters into an arrangement with a customer for infrastructure outsourcing deal.

Based on its experience, Growth Ltd. determines that customising the infrastructure will take approximately 200 hours in total to complete the project and charges ` 150 per hour.

After incurring 100 hours of time, Growth Ltd . and the customer agree to change an aspect of the project and increases the estimate of labour hours by 50 hours at the rate of ` 100 per hour. (MTP Oct 21)

[video link: https://youtu.be/sjJB6IjiZGM?t=2491]

Answer

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

Particulars	Hours	Rate (`)	Amount (`)
Initial contract amount	200	150	30,000
Modification in contract	50	100	5,000
Contract amount after modification	250	140*	35,000
Revenue to be recognised	100	140	14,000
Revenue already booked	100	150	15,000
Adjustment in revenue			(1,000)

*` 35,000 / 250 hours = ` 140.

4. (a) On 1st April, 20X1, S Limited enters into a contract with Corp Limited to construct heavy –duty equipment for a promised consideration of ` 20,00,000 with a bonus of ` 2,50,000 if the equipment is completed within 24 months. At the inception of the contract, S Limited correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with Ind AS 115. At the inception of the contract, the Company expects the costs to be ` 11,00,000 and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will occur. Completion of the heavy-duty equipment is highly susceptible to factors outside of the Company's influence, mainly due to difficulties with the supply of components.

At 31st March, 20X2, S Limited has satisfied 65% of its performance obligation on the basis of costs incurred to date and concludes that the variable consideration is still constrained in accordance with Ind AS 115. However, on 4th June, 20X2, the contract is modified with the result that the fixed consideration and expected costs increase by ` 1,50,000 and ` 80,000 respectively. The time allowable for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that the bonus will be achieved and that the contract remains a single performance obligation.

S Limited wants your opinion on the accounting treatment of contract with Corp Limited in light of Ind AS 115, for the year 20X1-20X2 and 20X2-20X3. (MTP Oct 22)

Answer

For the year 20X1-20X2

S Limited accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with Ind AS 115. At the inception of the contract, S Limited expects the following:

Transaction price – ` 20,00,000

Expected costs – ` 11,00,000

Expected profit (45%) – ` 9,00,000

At contract inception, S Limited excludes the ` 2,50,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the heavy -duty equipment is highly susceptible to factors outside the entity's influence.

By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are therefore ` 7,15,000 and S Limited reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 31st March, 20X2, the following would be recognised:

Revenue (A) – ` 13,00,000 (` 20,00,000 x 65%)

Costs (B) – ` 7,15,000 (` 11,00,000 x 65%)

Gross profit (C) i.e.(A-B) – ` 5,85,000

For the year 20X2-20X3

On 4th June, 20X2, the contract is modified. As a result, the fixed consideration and expected costs increase by ` 1,50,000 and ` 80,000, respectively.

The total potential consideration after the modification is ` 24,00,000 which is ` 21,50,000 fixed consideration + ` 2,50,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that S Limited concludes that it is highly probable that including the bonus in the transaction price will not result i n a significant reversal in the amount of cumulative revenue recognised in accordance with Ind AS 115. Therefore, the bonus of ` 2,50,000 can be included in the transaction price.

S Limited also concludes that the contract remains a single performance obligation. Thus, S Limited accounts for the contract modification as if it were part of the original contract.

Therefore, S Limited updates its estimates of costs and revenue as follows:

S Limited has satisfied 60.60% of its performance obligation (` 7,15,000 actual costs incurred compared to ` 11,80,000 total expected costs). The entity recognises additional revenue of ` 1,54,400 [(60.60% of ` 24,00,000) – ` 13,00,000 revenue recognised to date] at the date of modification i.e. on 4th June, 20X2 as a cumulative catch-up adjustment.

Cnsideration paid to customer

2 (c)Entity K sells electric razors to retailers for Rs. 50 per unit. A rebate coupon is included inside theelectric razor package that can be redeemed by the end consumers for Rs. 10 per unit

Entity K estimates that 20% to 25% of eligible rebates will be redeemed, based on its experience with similar programmes and rebate redemption rates available in the market for similar programmes. Entity K concludes that the transaction price should incorporate an assumption of 25% rebate redemption, as this is the amount for which it is highly probable that a significant reversal of cumulative revenue will not occur if estimates of the rebates change. How should entity K determine the transaction price? (MTP March 2021) / (RTP May 2020)

[video link: https://youtu.be/w12BdM5IDsU?t=2594]

Answer

Entity K records sales to the retailer at a transaction price of Rs. 47.50 (Rs. 50 less 25% of Rs. 10). The difference between the per unit cash selling price to the retailers and the transaction price is recorded as a liability for cash consideration expected to be paid to the end customer. Entity K will update its estimate of the rebate and the transaction price at each reporting date if estimates of redemption rates change.

2. (d)A manufacturer enters into a contract to sell goods to a retailer for Rs. 1,000. The manufacturer also offers price protection, whereby it will reimburse the retailer for any difference between the sale price and the lowest price offered to any customer during the following six months. This clause is consistent with other price protection clauses offered in the past, and the manufacturer believes that it has experience which is predictive for this contract. Management expects that it will offer a price decrease of 5% during the price protection period. Management concludes that it is highly probable that a significant reversal of cumulative revenue will not occur if estimates change.How should the manufacturer determine the transaction price? (MTP March 2021) / (RTP May 2020)

[video link: https://youtu.be/w12BdM5IDsU?t=2759]

Answer

The transaction price is Rs. 950, because the expected reimbursement is Rs. 50. The expected payment to the retailer is reflected in the transaction price at contract inception, as that is the amount of consideration to which the

manufacturer expects to be entitled after the price protection. The manufacturer will recognise a liability for the difference between the invoice price and the transaction price, as this represents the cash that it expects to refund to the retailer. The manufacturer will update its estimate of expected reimbursement at each reporting date until the uncertainty is resolved

Events after balance sheet date

5.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)

[video link: https://youtu.be/w12BdM5IDsU?t=3934]

Answer

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 havea 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.

19. 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, 20X1 and 31st March, 20X1. ABC Ltd. paid the dues by 15th April, 20X1 with respect to sales made between 17th March, 20X1 and 31st March, 20X1. Financial statements were approved for issue by Board of Directors on 31st May, 20X1.

State whether discount will be adjusted from the sales at the end of the reporting period. (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=5859]

Answer

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 within 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.

Warranty

2(c)Deluxe bike manufactured by Zed Limited is sold with an extended warranty of 2 years for `87,300 while an identical Deluxe bike without the extended warranty is sold in the market for `80,000 and equivalent warranty is given in the market for `10,000. How should Zed Limited recognize and measure revenue in the books on the sale of the bikes and warranty? (Exam Nov 18)

[video link: https://youtu.be/w12BdM5IDsU?t=5084]

Answer

Zed Ltd. has sold two products viz Deluxe bike and the extended warranty. Revenue earned on sale of each product should be recognised separately.

Calculation of Revenue attributable to both the components:

Total fair value of Deluxe bike and extended warranty	
(80,000+10,000)	`90,000
Less:Sale price of the Deluxe bike with extended warranty	(`87,300)
Discount	`2,700

Discount and revenue attributable to each component of the transaction:

Proportionate discount attributable to sale of Deluxe bike	`2,400
(2,700 x 80,000/90,000)	

Revenue from sale of Deluxe bike (80,000 –2,400)	`77,600
Proportionate discount attributable to extended warranty (2,700 x 10,000/90,000)	`300
Revenue from extended warranty (10,000-300)	`9,700

Revenue in respect of sale of Deluxe bike of `77,600 should be recognised immediately and revenue from warranty of `9,700 should be recognised over the period of warrantyie.2 years.

Contract Cost

3 (a)Orange Ltd. contracts to renovate a five star hotel including theinstallation of new elevators on 01.10.2017. Orange Ltd. estimates thetransaction price of `480 lakh. The expected cost of elevators is `144lakh and expected other costs is `240 lakh. Orange Ltd. purchaseselevators and they are delivered to the site six months before they willbe installed. Orange Ltd. uses an input method based on cost tomeasure progress toward s completion. The entity has incurred actualother costs of `48 lakh by 31.03.2018.How much revenue will be recognised as per relevant Ind AS115for the year ended 31stMa rch, 2018, i f performance obliga tion is me t o ver a period of time? (Exam May 19)

[video link: https://youtu.be/w12BdM5IDsU?t=5176]

Answer

Cost to be incurred comprises two major components –cost for elevators and cost of construction service.

(a)T he elevators are part of the overall construction project and are not a distinct performance obligation

(b)T he cost of elevators is substantial to the overall project and are incurred well in advance.

(c)Upon delivery at site, customer acquires control of such elevators.

(d)There is no modification done to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

-T he measure of progress should be based on percentage of costs incurred relative to the total budgeted costs.

-T he cost of elevators should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred

The revenue to be recognized is measured as follows:

Particulars	Amount (`in lakh)
Transaction price	480
Costs incurred:	
(a)Cost of elevators	144
(b)Other costs	48
Measure of progress	48 / 240 = 20%

Revenue to be recognised:	(`in lakh)
(a)For costs incurred (other than elevators)	
Total attributable revenue = 480-144	=336
% of work completed	= 20%
Revenue to be recognised =	67.20
(b)Revenue for elevators (equal to costs incurred)	144
Total revenue to be recognised144 + 67.2	= 211.20

Therefore, for the year ended 31st March, 2018, the company shall recognize revenue of `211.20 lakhs on the project

4(a)Nivaan Limited commenced work on two long-term contracts during the financial year ended on 31st March, 2019.

The first contract with A & Co. commences on 1st June, 2018 and had a total salesvalue of `40 lakh. It was envisaged that the contract would run for two years and that the total expected costs would be `32 lakh. On 31st March, 2019,Nivaan Limited revised its estimate of the total expected cost to `34 lakh on the basis of the additional rectification cost of ` 2 lakh incurred on the contract during the current financial year. An independent surveyor has estimated at 31st March, 2019 that the contract is 30% complete. Nivaan

Limited has incurred costs up to 31stMarch, 2019 of `16 lakh and has received payments on account of `13 lakh.

The second contract with B & Co. commenced on 1stSeptember, 2018 and was for 18 months. The total sales value of contract was `30 lakh and the total expected cost is `24 lakh. Payments on account already received were `9.50 lakh and total costs incurred to date were `8 lakh. Nivaan Limited has insisted on a large deposit from B & Co. because the companies had not traded together prior to the contract. The independent surveyor estimated that on 31stMarch, 2019 the contract was 20% complete.

The two contracts meet the requirement of Ind AS115 'Revenue from Contracts with Customers' to recognize revenue over time as the performance obligations are satisfied over time.

The company also has several other contracts of between twelve and eighteen months in duration. Some of these contracts fall into two accounting periods and were not completed as at 31stMarch, 2019. In absence of any financial date relating to the other contracts, you are advised to ignore these other contracts while preparing the financial statements of the company for the year ended 31stMarch, 2019.Prepare financial statement extracts for Nivaan Limited in respect of the two construction contracts for the year ending 31stMarch, 2019. (Exam Nov 19) / (MTP Nov 21)

[video link: https://youtu.be/w12BdM5IDsU?t=5770]

Answer

(a)Extracts of Balance Sheet of Nivaan Ltd. as on 31stMarch, 2019 `in lakh

Current Assets	
Contract Assets-Work-in-progress(Refer W.N. 3)	9.0
Current Liabilities	
Contract Liabilities (Advance from customers) (Refer W.N. 2)	4.5

Extracts of Statement of Profit and Loss of Nivaan Ltd. as on 31stMarch, 2019

	`in lakh
Revenue from contracts (Refer W.N. 1)	18
Cost of Revenue (Refer W.N. 1)	(15)
Net Profit on Contracts (Refer W.N. 1)	3

Working Notes:

1.Table showing calculation of total revenue, expenses and profit or loss on contract for the year `in lakh

	A & Co.	B & Co.	Total
Revenue from contracts	(40 x 30%) = 12	(30 x 20%) = 6	18
Expenses due for the year	(34*x 30%) = 10.2	(24 x 20%) = 4.8	15
Profit or loss on contract	1.8	1.2	3

*Note:Additional rectification cost of `2 lakh has been treated as normal cost. Hence total expected cost has been considered as `34 lakh. Alternatively, in case this `2 lakh is treated as abnormal cost then expense due for the year would be `11.6 lakh (ie 30% of `32 lakhplus `2 lakh).Accordingly,with respect to A & Co., the profit for the year would be `0.4 lakhand work-in-progress recognised at the end of the yearwould be `4.4 lakh.

2.Calculation of amount due from / (to) customers `in lakh

	A &Co	B & Co	Total
Billing based on revenue recognised in the books	12	6	18
Payments received from the customers	(13)	(9.5)	(22.5)
Advance received from the customers	1	3.5	4.5

3.Work in Progress recognisedas part of contract asset at the end of the year`in lakh

	A &Co	B & Co	Total
Total actual cost incurred during the year	16	8	24
Less: Cost recognised in the books for the year 31.3.2019	(10.2)	(4.8)	(15)
Work-in-progress recognised at the end of the year	5.8	3.2	9

Agent vs. Principal

6 An entity negotiates with major airlines to purchase tickets at reduced rates compared with the price of tickets sold directly by the airlines to the public.The entity agrees to buy a specific number of tickets and will pay for those tickets even if it is not able to resell them. The reduced rate paid by the entity for each ticketpurchased is negotiated and agreed in advance. The entity determines the prices at which the airline tickets will be sold to its customers.

The entity sells the tickets and collects the consideration from customers when the tickets are sold; therefore, there is no credit risk to the entity. The

entity also assists the customers in resolving complaints with the service provided by airlines.

However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

Determine whether the entity is a principal or an agent with suitable explanation in light with the provisions given in the relevant standard (Exam nov 20)

[video link: https://youtu.be/w12BdM5lDsU?t=6607]

Answer

To determine whether the entity's performance obligation is to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for another party to provide those goods or services (i.e. the entity is an agent), the entity considers the nature of its promise as per Ind AS 115.

The entity determines that its promise is to provide the customer with a ticket, which provides the right to fly on the specified flight or another flight if the specified flight is changed or cancelled. The entity considers the following indicators for assessment as principal or agent under the contract with the customers:

(a)the entity is primarily responsible for fulfilling the contract, which is providing the right to fly. However, the entity is not responsible for providing the flight itself, which will be provided by the airline.

(b)the entity has inventory risk for the tickets because they are purchased before they are sold to the entity's customers and the entity is exposed to any loss as a result of not being able to sell the tickets formore than the entity's cost.

(c)the entity has discretion in setting the sales prices for tickets to its customers.

The entity concludes that its promise is to provide a ticket (i.e. a right to fly) to the customer. On the basis of the indicators, the entity concludes that it controls the ticket before it is transferred to the customer. Thus, the entity concludes that it is a principal in the transaction and recognises revenue in the gross amount of consideration to which it is entitled in exchange forthe tickets transferred.

3.(b) As a part of its sales promotion activities, MIL distributes office utility articles along with its product catalogues to medical practitioners to familiarize & encourage them to prescribe medicines manufactured by it. No conditions are attached with the items distributed.

Whether the distribution of office utility articles to medical practitioners is covered by Ind AS 115 'Revenue from Contracts with Customers'? If not, how should the same be accounted by MIL? Give reasons. (MTP May 2022)

[video link: https://youtu.be/H5VbXddxql4?t=2882]

Answer

The term 'contract' is defined in Ind AS 115 as an agreement between two or more parties that creates enforceable rights and obligations. In the given case:

• Gifts are distributed by MIL to doctors as a part of its sales promotion activities without there being an agreement between MIL and the doctors creating enforceable rights and obligations.

• The doctors to whom gifts are distributed are not 'customers' of MIL as they have not contracted with it to obtain goods or services in exchange for considera tion.

• The items distributed as gifts are not an output of MIL ordinary activities. In view of the above, the distribution of gifts to doctors does not fall under the scope of Ind AS 115.

As per Ind AS 38, sometimes expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods. Examples of expenditure that is recognised as an expense when it is incurred include expenditure on advertising and promotional activities (including mail order catalogues).
Items acquired by MIL to be distributed as gifts as a part of sales promotion activities have no other purpose than to undertake those activities. In other words, the only benefit of those items for MIL is to develop or create brands or customer relationships, which in turn generate revenue.

Ind AS 38 requires an entity to recognise expenditure on such items as an expense when the entity has a right to access those goods. Ind AS 38 states that an entity has a right to access goods when it owns them, or otherwise has a right to access them regardless of when it distributes the goods.

In view of the above, MIL should recognise the cost of the items to be distributed as gifts as an expense when it owns those items, or otherwise has a right to access them, regardless of when it distributes the items to doctors.

Ind AS 116

Lease term includes

1. Rent free period
2. Non cancellable period
3. Optional renewal period if renewal at the option of lessee
4. Less period lessee does expect to continue lease (termination period)

Leace liability includes present value of

1. Fixed rental payment
2. Variable rent if based on fixed percentage or index based like MIBOR / CPI
3. Guaranteed residual value
4. Purchase option at end of lease term if expected to be exercised
5. Termination penalty if expected to terminate early
6. Less Lease incentive post commencement of lease

RTUA includes

1. Lease liability
2. Transaction cost if any
3. All expenses incurred between inception to commencement including rent and deducting lease incentive

Change in estimates

1. Redertmine the value of lease liability
2. Use original discount rate if estimates change related to residual value guarantee or payment related to index or rate unless floating interest rates
3. Use revised discount rate if estimates change related to reassessment of lease term or reassessment of purchase option
4. Difference is adjusted to RTUA

Modification

Increase or decrease in consideration only	• Recalculate lease liability for remaining period using revised discount rate • Adjust the same to RTUA
Increase in lease term or leased area	• Recalculate lease liability for remaining period using revised discount rate • Adjust the same to RTUA
Decrease in leased area	• Reduce proportionately lease liability and RTUA in proportion of area reduced

	• Difference of both to be adjusted to PL • Recalculate lease liability using revised discount rate • Adjust difference to RTUA
Decrease in lease term	• Reduce proportionaltely RTUA as new lease term remaining / old lease term remaining • Determine PV of LL at original rate for remining period, this will be new LL • Difference of reduction of both above is adjusted to PL • Again recalculate LL at revised rate • Adjust this difference to RTUA

Sale and Lease back steps

1. Determine present value of rent
2. FV of asset less SP of asset
3. Determine difference of above 2
4. Apportion carrying amount of PPE in ratio of CA * S3/FV
5. Journal entry will be
   Cash dr. (amount received)
   RTUA dr. (S4)
   To PPE (CA)
   To Lease liability (S1)
   Balance transfer to PL

Identify Lease

Case I

Scenario 1: The 'last mile' is a dedicated cable that connects Entity Y's network with the end customer's device. The use of this cable is at the discretion of the customer. Entity Y decides the location of end points and has right to replace the lines (dedicated c able), however it is not practical to replace the lines, since replacement would require additional costs to be incurred without any corresponding benefit. Whether the arrangement would be within the scope of Ind AS 116?

Scenario 2: If it is practical for the Entity Y to replace the lines and Entity Y would benefit from this replacement, would the answer be different?
Case II

Customer X enters into a 10-year contract with a utility company, Entity Y, for the right to use three specified, physically distinct fibers within a larger cable connecting Mumbai to Delhi. Customer makes the decisions about the use of the fibers by connecting each end of the fibers to its electronic

equipment. Entity Y owns extra fibers but can substitute those for Customer's fibers only for reasons of repairs, maintenance or malfunction. The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116?

Case III

Customer X enters into a 10-year contract with Entity Y for the right to use a specified amount of capacity within a cable connecting Mumbai to Delhi. The specified amount is equivalent to Customer X having the use of the full capacity of three fiber strands within the cable (the cable contains multiple fibers with similar capacities). Entity Y makes decisions about the transmission of data (i.e., Entity Y lights the fibers, makes decisions about which fibers are used to transmit Customer's traffic). The useful life of the fiber is 15 years. Whether this arrangement is covered under Ind AS 116? (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=3199]

Answer

Paragraph 9, B9, B13 and B14 of Ind AS 116 state the following: "9 At inception of a contract, an entity shall assess whether the contract is, or contains,a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration."

"B9 To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

(a) the right to obtain substantially all of the economic benefits from use of the identified asset; and

(b) the right to direct the use of the identified asset."

"B13 An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer."

"B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

(a) the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from

substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and

(b) the supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset)."

Paragraph B20 of Ind AS 116 which provides guidance regarding identified asset in case of portion of assets states that a capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

Paragraph B21 of Ind AS 116, inter alia, states that to control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or subleasing the asset.

Further, paragraph B24 of Ind AS 116 provides that a customer has the right to direct the use of an identified asset throughout the period of use if the customer has the right to direct how and for what purpose the asset is used throughout the period of use Paragraph B25 of Ind AS 116 states that a customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

Case I

Scenario 1:

(i) As per paragraph B13 of Ind AS 116, 'Last mile' which is a dedicated cable is an identified asset since it is physically distinct.

(ii) There are no substantive substitution rights with Entity Y, as it does not have the practical ability to substitute alternative assets throughout the period of use. Thus, this arrangement is within the scope of Ind AS 116.

Scenario 2:

If Entity Y has the practical ability to replace the lines and it would benefit from such replacement, Entity Y has substantive substitution rights. In such case, this arrangement for the 'last mile cable' will not be within the scope of Ind AS 116.

Case II

The fibers are specified in the contract and are physically distinct. Hence, in accordance with paragraph B13 and B20, the said three fibers are identified asset. Paragraph B18, inter alia, states that the supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.

Further, paragraph B27 provides that although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for what purpose the asset is used and can actually be dependent on the decisions about how and for what purpose the asset is used.

In accordance with the above, as Entity Y can substitute these three distinct fibers only for reasons of repairs, maintenance or malfunction, it does not preclude them from being an identified asset.

Further, the Customer X has right to control the use of the identified fibers for 10 year since it has –

(a) the right to obtain substantially all of the economic benefits from use of the identified fibers throughout the period of use, i.e., 10 years; and
(b) the right to direct the use of the fibers as it makes the decisions about the use of the fibers, i.e., it has right to direct how and for what purpose the fibers are used throughout the period of use.

Hence, this arrangement is within the scope of Ind AS 116.

Case III

Paragraph B20 specifically provides that a capacity or other portion of a n asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset. In the given case, the capacity portion that will be provided to Customer X is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the

capacity of the cable, thus, it is not an identified asset. Further, Entity Y makes all decisions about the transmission of data, (i.e., supplier lights the fibers, makes decisions about which fibers are used to transmit customer's traffic). Thus, the contract does not contain a lease and is therefore not within the scope of Ind AS 116.

1. (a) Feel Fresh Limited (the Company) is into manufacturing and retailing of FMCG products listed on stock exchanges in India. One of its products is bathing soap which the Company sells under the brand name 'Feel Fresh'. The Company does not have its own man ufacturing facilities for soap and therefore it enters into arrangements with a third party to procure the soaps. The Company entered into a long term purchase contract of 10 years with M/s. Radhey. Following are the relevant terms of the contract with M/s. Radhey.

(i) M/s. Radhey has to purchase a machine costing ` 10,00,000 from the supplier as specified by the Company. The machine will be customized to produce the soaps as designed by the Company. This machine cannot be used by M/s. Radhey to produce the soaps for buyers other than the Company due to the design specifications. The machine has a useful life of 10 years and the straight line method of depreciation is best suited considering the use of the machine.

(ii) The Company will pay ` 4.75 per soap for the first year of contract. This is calculated based on the budgeted annual purchase of 7,00,000 soaps as follows:

Particulars	Per soap price
Variable cost of manufacturing	4.00
Cost of machine (` 1,74,015 / 7,00,000 soaps)	0.25
M/s. Radhey's margin	0.50
Per soap cost to the Company	4.75

In case the Company purchases more than 7,00,000 (i.e. budgeted number of soaps) soaps in the first year then the cost of the machine (i.e. 0.25 per soap) will not be paid for soaps procured in excess of 7,00,000 units. However, in case Company procures less than budgeted number of soaps, then the Company will pay the differential unabsorbed cost of the machine, at the end of the year. For example, if the Company purchases only 6,00,000 soaps in first year then the differential amount of ` 24,015 (1,74,015 - (6,00,000 x 0.25)) will be paid by the Company to M/s. Radhey at the end of the year. Variable cost will be actualized at the end of the year.

(iii) The cost per soap will be calculated for each year in advance based on the budgeted number of soaps to be produced each year. An amount of ` 1,74,015

shall be considered each year for the cost of machine for year 1 to year 8 while calculating the cost per soap. Any differential under absorbed amount shall be paid by the Company to M/s. Radhey at the end of that year. A charge of ` 1,74,015 per annum for the machine is derived using borrowing cost of 8% p.a. For year 9 and year 10, only variable cost and margins will be paid.

(iv) M/s. Radhey does not have any right to terminate the contract but the Company has the right to terminate the contract at the end of each year. However, if the Company terminates the contract, it has to compensate M/s. Radhey for any unabsorbed cost of Machine. For example, if the Company terminates the contract at the end of second year then it has to pay ` 10,44,090 (i.e. 1,74,015 per year x 6 remaining years). If it terminates the contract after the 8th year then the Company does not have to pay the compensation since the cost of the machine would have been absorbed.

(v) In the first year, the Company purchases 5,50,000 soaps at ` 4.75 per soap.

Evaluate the contract of the Company with M/s. Radhey and provide necessary accounting entries for first year in accordance with Ind AS with working notes. Assume all cash flows occur at the end of the year. (MTP Oct 22)

Answer

Identification of the contract (by applying para 9 of Ind AS 116)

(a) Identified asset

Feel Fresh Ltd. (a customer company) enters into a long-term purchase contract with M/s Radhey (a manufacturer) to purchase a particular type and quality of soaps for 10 year period.

Since for the purpose of the contract M/s Radhey has to buy a customized machine as per the directions of Feel Fresh Ltd. and also the machine cannot be used for any other type of soap, the machine is an identified asset.

(b) Right to obtain substantially all of the economic benefits from use of the asset throughout the period of use

Since the machine cannot be used for manufacture of soap for any other buyer, Feel Fresh Ltd. will obtain substantially all the economic benefits from the use of the asset throughout the period of use.

(c) Right to direct the use

Feel Fresh Ltd. controls the use of machine and directs the terms and conditions of the contract with respect to recovery of fixed expenses related to machine. Hence the contract contains a lease.

Lease term

The lease term shall be 10 years assuming reasonable certainty. Though the lessee is not contractually bound till 10th year, i.e., the lessee can refuse to make payment anytime without lessor's permission but, it is assumed that the lessee is reasonably certain that it will not exercise this option to terminate.

Identification of lease payment

Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:
(a) fixed payments (including in-substance fixed payments), less any lease incentives
(b) variable lease payments that depend on an index or a rate

(c) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option

(d) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

Here in-substance fixed payments in the given lease contract are ` 1,74,015 p.a.

The present value of lease payment which would be recovered in 8 years @ 8% would be ` 10,00,000 (approx.)

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Hence, lease liability will be recognized by ` 10,00,000 in the books of Feel Fresh Ltd.
Since there are no payments made to lessor before commencement date less lease incentives received from lessor or initial direct costs incurred by lessee or estimate of costs for restoration / dismantling of underlying asset, the right of use asset is equal to lease liability.

Journal Entries

On initial recognition

ROU Asset Dr. 10,00,000

To Lease Liability 10,00,000

To initially recognise the Lease Liability and the corresponding ROU Asset

At the end of the first year

Interest Expense Dr. 80,000

To Lease Liability 80,000

To record interest expense and accrete the lease liability using the effective interest method (` 10,00,000 x 8%)

Depreciation Expense (10,00,000 / 10 years) Dr. 1,00,000

To ROU Asset 1,00,000

To record depreciation on ROU using the straight-line method (` 10,00,000 / 10 years)

Lease Liability Dr. 1,74,015

To Bank / M/s. Radhey 1,74,015

To record lease payment

Cost of soap Dr. 24,75,000

To Bank / M/s. Radhey {5,50,000 x (4 + 0.5)} 24,75,000

To record variable expenses paid as cost of the goods purchased

Land lease

12.Jeevan India Limited is in the business of development of smart city. For development of smart city, Jeevan India Limited allots its land to customer on 99 years of lease. The customer is required to pay lease premium at the time of execution of lease deed and lease rent on annual basis over a period of 99 years.

The lease premium amount is the market value of land and lease rent is nominal amount say `1 per square metre per year. The lease premium is non-refundable. As per the lease terms, on completion of 99 years, the lease is renewable at mutual consent of lessor and lessee.

How would income in respect of lease premium collected by Jeevan India Limited (which is the market value of land and is notrefundable) at the time of execution of lease deed be recognised as per Ind AS, if for subsequent years, only nominal lease rent is collected. (RTP Nov 19)

[video link: https://youtu.be/hLJ47ta0MK4, time: 24:03]

Answer

Paragraph 5 of IndAS 115 scopes out revenue arising from lease agreements. Principles enunciated under Ind AS 116, Leases would be applicable for revenue arising from leasing agreements.

Recognition of income in respect of lease would depend on its classification as per IndAS 116, Leases.

If the lease of land is an operating lease, then it will be accounted for as given below:

•Lessors shall present assets subject to operating leases in their balance sheet according to the nature of the asset.

•Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless either:

(a) another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished, even if the payments tothe lessors are not on that basis; or

(b) the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to factors other than inflation, then this condition is not met.

The long lease term may be an indication that the lease is classified as a finance lease. If it is a finance leasethen lessor Jeevan India Ltd. shall recogniseassets held under a finance lease in their balance sheets and present them as a receivable at an amount equal to the net investment in the lease. The recognition of finance income shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease. Nominal lease rent collected every year will also be accounted every year on accrual basis.

2.(a)On 1stApril, 2017, JLtd.began to lease a property on a 20-year lease. JLtd.paid a lease premium of Rs.30,00,000 on 1stApril, 2017.T he termsof the lease required JLtd.to make annual payments of Rs.500,000 in arrears, the first of which was made on 31stMarch, 2018.

On 1stApril, 2017 the fair values of the leasehold interests in the leased property were as follows:–

Land Rs.30,00,000.

–Buildings Rs.45,00,000.

T here is no opportunity to extend the lease term beyond 31stMarch, 2037. On 1stApril, 2017, the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9.2%. The present value of 20 payments of Re.1 in arrears at a discount rate of 9.2% is Rs.9.

Required:

Explain the accounting treatment for the above property lease and produce appropriate extracts from the financial statements of JLtd. for the year ended 31stMarch, 2018. (MTP April 2019)

[video link: https://youtu.be/a4i6InPKEeE?t=75]

Lessee accounitng

4.(a)Company EFG enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5-year renewal option. The economic life of the property is 40 years and the fair value of the leased property is Rs.50 Lacs. Company EFG has an option to purchase the property at the end of the lease term for Rs.30 lacs. Lease is paid at the beginning of the year. The first annual payment is Rs.5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H givesCompany EFG an incentive of Rs.2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement. Company EFG is reasonably certain to exercise that purchase option. How would EFG measure the right-of-use asset and lease liability over the lease term? (MTP May 2020)

[video link: https://youtu.be/a4i6InPKEeE?t=1875]

Answer

As per Ind AS 116, Company EFG would first calculate the lease liability as the present value of the annual lease payments, less the lease incentive paid in year 2, plus the exercise price of the purchase option using the rate implicit in the lease of approximately 9.04%.

PV of lease payments, less lease incentive (W.N. 1)Rs.37,39,648

PV of purchase option at end of lease term (W.N. 2)Rs.12,60,000

Total lease liabilityRs.49,99,648 or Rs.50,00,000 (approx.)

The right-of-use asset is equal to the lease liability because there is no adjustment required for initial direct costs incurred by Company EFG, lease payments made at or before the lease commencement date, or lease incentives

received prior to the lease commencement date.Entity EFG wouldpassthe following journal entry on the lease commencement date.

Right-of-use AssetDr.Rs.50,00,000

To Lease LiabilityRs.50,00,000

To record ROU asset and lease liability atthe commencement date.

Since the purchase option is reasonably certain to be exercised, EFG would amortize the right-of-use asset over the economic life of the underlying asset (40 years). Annual amortization expense would be Rs.1,25,000 (Rs.50,00,000 / 40 years)

Interest expense on the lease liability would be calculated as shown in the following table. This table includes all expected cash flows during the lease term, including the lease incentive paid by Entity H and Company EFG's purchase option.

Year	Payment	Principal beginning	Interest paid	Int expense	Closing
0					50,00,000
1	500,000	500,000	-	406,800	49,06,800
2	315,000	(91,800)	406,800	415,099	50,06,899
3	530,450	115,351	415,099	404,671	48,81,120
4	546,364	141,693	404,671	391,862	47,26,618
5	562,754	170,892	391,862	376,413	45,40,277
6	579,637	203,224	376,413	358,042	43,18,682
7	597,026	238,984	358,042	336,438	40,58,094
8	614,937	278,499	336,438	311,261	37,54,418
9	633,385	322,124	311,261	282,141	34,03,174
10	652,387	370,246	282,141	249,213	30,00,000
10	30,00,000	27,50,787	249,213		-
	85,31,940	50,00,000	35,31,940	35,31,940	

*(5,00,000 + increased by 3% -lease incentive paid amounting to 2,00,000)

**Difference of Rs. 542 (Rs. 2,48,671 and Rs. 2,49,213) is due to rounding of interest expense calculated @ 9.04%.

Although the lease was for 10 years, the asset had an economic life of 40 years. When Company EFG exercises its purchase option at the end of the 10-year lease, it would have fully extinguished its lease liability but continue depreciating the asset over the remaining useful life

Working Notes:

1.Calculating PV of lease payments, less lease incentive:

Year Lease Payment (A) PVF@ 9.04% (B) PV (Ax B=C)

Year 1	5,00,000	1	5,00,000
Year 2	3,15,000	0.92	2,89,800
Year 3	5,30,450	0.84	4,45,578
Year 4	5,46,364	0.77	4,20,700
Year 5	5,62,754	0.71	3,99,555
Year 6	5,79,637	0.65	3,76,764
Year 7	5,97,026	0.59	3,52,245
Year 8	6,14,937	0.55	3,38,215
Year 9	6,33,385	0.50	3,16,693
Year 10	6,52,387	0.46	3,00,098
Total			37,39,648

2.Calculating PV of purchase option at end of lease term:

Year 10 30,00,000 * 0.42 = 12,60,000

The discount rate for year 10 is different in the above calculations because in the earlier one its beginning of year 10 and in the later one its end of the year 10.

Lease and non lease component

17.Entity X (lessee) entered into a lease agreement (‘lease agreement’) with Entity Y (lessor) to lease an entire floor of a shopping mall for a period of 9 years. The annual lease rentof`70,000is payable at year end. To carry out its operations smoothly, Entity X simultaneously entered into another agreement (‘facilities agreement’) with Entity Y for using certain other facilities owned by Entity Y such as passenger lifts, DG sets, power supply infrastructure, parking space etc., which are specifically mentioned in the agreement, for annual service charges amounting to `1,00,000. As per the agreement, the ownership of the facilities shall remain with Entity Y. Lessee's incremental borrowing rate is 10%.

The facilities agreement clearly specifies that it shall be co-existent and coterminous with ‘lease agreement’. The facility agreement shall stand terminated automatically on termination or expiry of ‘lease agreement’. Entity X has assessed that the stand-alone price of ‘lease agreement’ is `1,20,000 per year and stand-alone price of the ‘facilities agreement’ is `80,000 per year.

Entity X has not elected to apply the practical expedient in paragraph 15 of Ind AS 116 of not to separate non-lease component (s) from lease component(s) and accordingly it separates non-lease components from lease components. How will Entity X account for lease liability as at the commencement date? (RTP Nov 20)

[Video link: https://youtu.be/a4i6InPKEeE?t=4010]

Answer

Entity X identifies that the contract contains lease of premises and non-lease component of facilities availed. As Entity X has not elected to apply the practical expedient as provided in paragraph 15, it will separate the lease and non-lease components and allocate the total consideration of `1,70,000 to the lease and non-lease components in the ratio of their relative stand-alone selling prices as follows

Particulars	Stand-alone Prices	% of total Stand-alone Price	Allocation of consideration
Building rent Service charge	120,000 80,000	60% 40%	102000 68000
	200000		170000

As Entity X's incremental borrowing rate is 10%, it discounts lease payments using this rate and the lease liability at the commencement date is calculated as follows:

Year	Lease Payment	Present value factor@ 10%	Present value of lease payments
1	102000	0.909	92718
2	102000	0.826	84252
3	102000	0.751	76602
4	102000	0.683	69666
5	102000	0.621	63342
6	102000	0.564	57528
7	102000	0.513	52326
8	102000	0.467	47634
9	102000	0.424	43248
			587316

Further, `68,000 allocated to the non-lease component of facility used will be recognised in profit or loss as and when incurred

Estimate change

The Company has entered into a lease agreemen t for its retail store as on 1st April, 20X1 for a period of 10 years. A lease rental of ` 56,000 per annum

is payable in arrears. The Company recognized a lease liability of ` 3,51,613 at inception using an incremental borrowing rate of 9.5% p.a. as at 1st April 20X1. As per the terms of lease agreement, the lease rental shall be adjusted every 2 years to give effect of inflation. Inflation cost index as notified by the Income tax department shall be used to derive the lease payments. Inflation cost index was 280 for financial year 20X1-20X2 and 301 for financial year 20X3-20X4. The current incremental borrowing rate is 8% p.a. Show the Journal entry at the beginning of year 3, to account for change in lease. (RTP Nov 21) / (MTP Sept 22)

[video link: https://youtu.be/4BBd21zl_hM?t=3241]

Answer

As per para 27 (b) of Ind AS 116, variable lease payments that depend on an index or a rate, are initially measured using the index or rate as at the commencement date.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of ` 60,200 discounted at an original discount rate of 9.5% per annum as per para 43 of Ind AS 116.

Year	Revised lease rental	Discount factor @ 9.5%	Present value
3	[(56,000 / 280) x 301] = 60,200	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
			3,27,127

Table showing amortised cost of lease liability

Year	Opening balance	Interest @ 9.5%	Rental paid	Closing balance
1	3,51,613	33,403	56,000	3,29,016
2	3,29,016	31,257	56,000	3,04,273

Difference of ` 22,854 (3,27,127 – 3,04,273) will increase the lease liability with corresponding increase in ROU Asset as per para 39 of Ind AS 116.

Journal entry at the beginning of year 3 would be:

Right-of-use asset Dr. ` 22,854

To Lease liability ` 22,854

4(a) • Jakob Ltd. entered into a contract for lease of machinery with Jason Ltd. On 1.1.2018. The initial term of the lease is 6 years with a renewal option of further 2 years.
• The annual payments for initial term and renewal term are ` 2,80,000 and ` 3,50,000 respectively

• The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year. For example, the payment due on 1.1.2019 will be based on the CPI available at 31.12.2018.

• Jakob Ltd.'s incremental borrowing rate at the lease inception date and as at
1.1.2021 is 8% and 10% respectively and the CPI at lease commencement date and as at 1.1.2021 is 250 and 260 respectively.

• At the lease commencement date, Jakob Ltd. did not think that it will be a viable
option to renew the lease but in the first quarter of 2021, Jakob Ltd. made some
major changes in the retail store which increases its economic life by five years.

• Jakob Ltd. determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.
Jakob Ltd. asked your opinion whether remeasurement of lease is required in the first quarter of 2021. (Exam Dec 21)

[video link: https://youtu.be/ngi-Dzq0Kis?t=2328]

Answer

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.

The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	5 years (3 years remaining in the initial

	term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 7,79,417 (Refer note 2)

Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% [{(260-250)/250} x 100]. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

Year	4	5	6	7	8	Total
Lease payment	291,200	291,200	291,200	364,000	364,000	16,01,600
Discount @ 10%	1	0.909	0.826	0.751	0.683	
Present value	291,200	264,701	240,531	273,364	248,612	13,18,408

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	13,18,408
Original lease liability	(7,79,417)
Adjustment to the lease liability on re-measurement	5,38,991

Based on above calculations, it is clear that re-measurement of lease is required and accordingly adjustment to lease liability and ROU asset is required in the first quarter of 2021.

Journal entry to adjust the lease liability

ROU Asset Dr. 5,38,991

To Lease liability 5,38,991

(Being lease liability and ROU asset adjusted on account of re-measurement)

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year	Lease Payment	PVF @ 8%	PV of lease payments
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680

Lease liability as at the commencement date 13,98,040

Or
(2,80,000 x Sum of PV (4.993) @ 8% for 5 years = 13,98,040)

2. Calculation of Lease Liability and ROU asset at each year end

Year	LL				RTUA		
	Op	Lease payment	Int @ 8%	Closing	Op	Dep	Cl
1	13,98,040	280,000	89,443	12,07,483	13,98,040	233,007	11,65,033
2	12,07,483	280,000	74,199	10,01,682	11,65,033	233,007	932,026
3	10,01,682	280,000	57,735	7,79,417	932,026	233,007	699,019
4	7,79,417				699,019		

As per the information given in the third bullet point at page 10, it is inferred that annual lease payments are due at the beginning of the year. Hence, it can be inferred that the annual lease payment of 2021 had been paid on 1.1.2021.

Accordingly lease liability considered for the purpose of remeasurement would be of 5 th, 6th, 7th and 8th year only i.e. for 4 years. However, since remeasurement has been decided in the first quarter of 2021, ROU asset balance before remeasurement will be after depreciation of 3 years i.e. till 2020.

Based on the above contention, following alternative solution is also possible:

Since in the first quarter of 2021, Jakob Ltd. is reasonably certain that it will exercise its renewal option, it is required to re-measure the lease in the first quarter of 2021.

The following table summarizes information pertinent to the lease re-measurement:

Re-measured lease term	4 years (2 years remaining in the initial term plus 2 years in the renewal period)
Jakob Ltd.'s incremental borrowing rate on the re-measurement date	10%
CPI available on the re-measurement date	260
Right-of-use asset immediately before the re-measurement	` 6,99,019 (Refer note 2)
Lease liability immediately before the re-measurement	` 5,39,370 (Refer note 2)

Procedure to re-measure the lease liability:

To re-measure the lease liability, Jakob Ltd. would first calculate the present value of the future lease payments for the new lease term (using the updated discount rate of 10%).

Since the initial lease payments were based on a CPI of 250, the CPI has increased by 4% [{(260-250)/250} x 100]. As a result, Jakob Ltd. would increase the future lease payments by 4%.

Computation of present value of the future lease payments based on an updated CPI of 260:

Year	5	6	7	8	Total
Lease payment	291,200	291,200	291,200	364,000	13,10,400
Discount @ 10%	1	0.909	0.826	0.751	
Present value	291,200	264,701	240,531	273,364	11,30,329

Calculation of the adjustment to the lease liability on re-measurement by comparing the recalculated and original lease liability balances on the re-measurement date:

Revised lease liability	11,30,329
Original lease liability	(5,39,370)
Adjustment to the lease liability on re-measurement	5,90,959

Based on above calculations, it is clear that re-measurement of lease is required and accordingly adjustment to lease liability and ROU asset is required in the first quarter of 2022.

Journal entry to adjust the lease liability

ROU Asset Dr. 5,90,959

To Lease liability 5,90,959

(Being lease liability and ROU asset adjusted on account of re-measurement)

Working Notes:

1. Calculation of ROU asset before the date of re-measurement

Year	Lease Payment	PVF @ 8%	Present value of lease payments
1	2,80,000	1.000	2,80,000
2	2,80,000	0.926	2,59,280
3	2,80,000	0.857	2,39,960
4	2,80,000	0.794	2,22,320
5	2,80,000	0.735	2,05,800
6	2,80,000	0.681	1,90,680

Lease liability as at commencement date 13,98,040

Or (2,80,000 x sum of PV (4.993) @ 8% for 5 years = 13,98,040)

2. Calculation of Lease Liability and ROU asset at each year end

Year	LL				RTUA		
	Op	Lease payment	Int @ 8%	Closing	Op	Dep	Cl
1 2 3 4	13,98,040 12,07,483 10,01,682 7,79,417 539,370	280,000 280,000 280,000 280,000	89,443 74,199 57,735 39,953	12,07,483 10,01,682 7,79,417 539,370	13,98,040 11,65,033 932,026 699,019	233,007 233,007 233,007	11,65,033 932,026 699,019

Lease Modification

2(b) Buildings Limited entered into a 10-year lease for 6,000 square meter of office space. The annual lease payments are Rs. 60,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Buildings Limited's incremental borrowing rate at the commencement date is 8% p.a. At the beginning of 6th year, Buildings Limited and lessor agree to amend the original lease to reduce the space to

only 3,000 square meters of the original space starting from the end of the first quarter of year 6. The annual fixed lease payments (from year 6 to year 10) are Rs. 35,000. Buildings Limited's incremental borrowing rate at the beginnin g of year 6 is 6% p.a.

The CFO of the Company has requested your suggestion on how to account for the modification in the lease of office space? Prepare the detailed working for the modification. (MTP April 2021) / (MTP April 22 similar) / Exam Nov 22

[video link: https://youtu.be/a4i6InPKEeE?t=2539]

Answer

In the given case, Lessee calculates the ROU asset and the lease liabilities before modification as follows:

Year	Lease Liability				ROU asset		
	Initial value	Lease payments	Interest expense @ 8%	Closing balance	Initial Value	Depreciation	Closing balance
1	402600	60000	32208	374808	402600	40260	362340
2	374808	60000	29985	344793	362340	40260	322080
3	344793	60000	27583	312376	322080	40260	281820
4	312376	60000	24990	277366	281820	40260	241560
5	277366	60000	22189	239555	241560	40260	201300
6	239555				201300		

* Initial value of ROU asset and lease liability = Annual lease payment x annuity factor @ 8% = 60,000 x 6.71 = Rs. 4,02,600

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

(a) a five-year remaining lease term,

(b) annual payments of Rs. 35,000 and

(c) Lessee's incremental borrowing rate of 6% p.a.

Present value of modified lease = Annual lease payment x annuity factor @ 6% = 35,000 x 4.212 = 1,47,420

Lessee determines the proportiona te decrease in the carrying amount of the ROU Asset on the basis of the remaining ROU Asset (i.e., 3,000 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (Rs. 2,01,300) is Rs. 1,00,650

50% of the pre-modification lease liability (Rs. 2,39,555) is Rs. 1,19,777.50.

Consequently, Lessee reduces the carrying amount of the ROU Asset by Rs. 1,00,650 and the carrying amount of the lease liability by Rs. 1,19,777.50. Lessee recognises the difference between the decrease in the lease liability and the decrease in the ROU Asset (Rs. 1,19,777.50 – Rs. 1,00,650 = Rs. 19,127.50) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognises the difference between the remaining lease liability of Rs. 1,19,777.50 and the modified lease liability of Rs. 1,47,420 (which equals Rs. 27,642.50) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and t he revised discount rate.

Lessor accounting

2. A company manufactures specialised machinery. The company offers customers the choice of either buying or leasing the machinery. A customer chooses to lease the machinery. Details of the arrangement are as follows:

(i) The lease commences on 1st April, 20X1 and lasts for three years.

(ii) The lessee is required to make three annual rentals payable in arrears of ` 57,500.

(iii) The leased machinery is returned to the lessor at the end of the lease.

(iv) The fair value of the machinery is ` 1,50,000, which is equivalent to the selling price of the machinery

(v) The machinery cost ` 1,00,000 to manufacture. The lessor incurred costs of ` 2,500 to negotiate and arrange the lease.

(vi) The expected useful life of the machinery is 3 years. The machinery has an expected residual value of ` 10,000 at the end of year three. The estimated residual value does not change over the term of the lease.

(vii) The interest rate implicit in the lease is 10.19%.

The lessor classifies the lease as a finance lease.

How should the Lessor account for the same in its books of accounts? Pass necessary journal entries. (RTP Nov 22)

Answer

The cost to the lessor for providing the machinery on lease consists of the book value of the machinery (` 1,00,000), plus the initial direct costs associated with entering into the lease (` 2,500), less the future income expected from disposing of the machinery at the end of the lease (the present value of the unguaranteed

residual value of ` 10,000 discounted @ 10.19%, being ` 7,470). This gives a cost of sale of ` 95,030.

The lessor records the following entries at the commencement of the lease: Lease receivable Dr. 1,50,000

Cost of sales Dr. 95,030

To Inventory 1,00,000

To Revenue 1,42,530

To Creditors/Cash 2,500

The sales profit recognised by the lessor at the commencement of the lease is therefore ` 47,500 (` 1,42,530 - ` 95,030). This is equal to the fair value of the machinery of ` 1,50,000, less the book value of the machinery (` 1,00,000) and the initial direct costs of entering into the lease (` 2,500). Revenue is equal to the lease receivable (` 1,50,000), less the present value of the unguaranteed residual value (` 7,470)

Year	Opening	Payments	Int income 10.19%	Net decrease	Closing
1	150,000	57,500	15,285	42,215	107,785
2	107,785	57,500	10,983	46,517	61,268
3	61,268	57,500	6232	51,268	10,000

The lessor will record the following entries:

Year 1 Cash/Bank Dr. 57,500

To Lease receivable 42,215

To Interest income 15,285

Year 2 Cash/Bank Dr. 57,500

To Lease receivable 46,517

To Interest income 10,983

Year 3 Cash/Bank Dr. 57,500

To Lease receivable 51,268

To Interest income 6,232

At the end of the three-year lease term, the leased machinery will be returned to the lessor, who will record the following entries:

Inventory Dr. 10,000

To Lease receivable 10,000

3(a) Coups Limited availed a machine on lease from Ferrari Limited. The terms and conditions of the Lease are as under:

Lease period is 3 years, machine costing ` 8,00,000.

- Machine has expected useful life of 5 years.

- Machine reverts back to Ferrari Limited on termination of lease.

- The unguaranteed residual value is estimated at ` 50,000 at the end of 3rd year.

- 3 equal annual installments are made at the end of each year.

- Implicit Interest Rate (IRR) = 10%.

- Present value of ` 1 due at the end of 3rd year at 10% rate of interest is 0.7513.

- Present value of annuity of ` 1 due at the end of 3rd year at 10% IRR is 2.4868.

You are required to ascertain whether it is a Finance Lease or Operating Lease and also calculate Unearned Finance Income with the relevant context to relevant Ind AS (exam Jan 21)

[video link: https://youtu.be/a4i6InPKEeE?t=6677]

Answer

It is assumed that the fair value of the machine on lease is equivalent t o the cost of the machine.

(i) A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

(ii) Computation of annual lease payment to the lessor `

Cost of equipment/ fair value	8,00,000
Unguaranteed residual value	50,000
Present value of residual value after third year @ 10%	
(50,000 x 0.7513)	37,565

Fair value to be recovered from lease payments	
(8,00,000 –37,565)	7,62,435
Present value of annuity for three years is	2.4868
Annual lease payment = 7,62,435 / 2.4868	3,06,593

The present value of lease payment i.e., ` 7,62,435 is more than 95% of the fair market value i.e., ` 8,00,000. The present value of minimum lease payments substantially covers the initial fair value of the leased asset and lease term (i.e. 3 years) covers the major part of the life of asset (i.e. 5 years). Therefore, it constitutes a finance lease.

(ii) Computation of Unearned Finance Income	`
Total lease payments (`3,06,593 x 3)	9,19,779
Add:Unguaranteed residual value	50,000
Gross investment in the lease	9,69,779
Less: Present value of investment	
(lease payments and residual value)	
(37,565 + 7,62,435)	(8,00,000)
Unearned finance income	1,69,779

5c. Ted entered into a lease contract with lessor to lease 2,000 sqm of retail space for 5 years.

The rentals are payable monthly in advance. The lease commenced on 1st April 2019. In the year 2020, as a direct consequence of Covid 19 pandemic, Ted has negotiated with the lessor which may results in the following situations:

- **Lessor agrees a rent concession under which the monthly rent will be reduced by 30% per month for the 12 months commencing 1st October 2020.**
- **Ted is granted a rent concession by the lessor whereby the lease payments for the period October 2020 to December 2020 are deferred. Three months are added to the end of the lease term at same monthly rent.**
- **Lessor offers to reduce monthly rent by 50% for the months October 2020 to March 2021 on the condition that its space is reduced from 2,000 sq m to 1,500 sq m.**

Analyze the given situations in the light of Ind AS 116 and comment on whether rent concession/deferral is eligible for practical expedient? (Exam July 21)

[video link: https://youtu.be/tZSGT1KBYBI?t=2803]

Answer

As per para 27 (b) of Ind AS 116, variable lease payments that depend on an index or a rate, are initially measured using the index or rate as at the commencement date.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of ` 60,200 discounted at an original discount rate of 9.5% per annum as per para 43 of Ind AS 116.

Year	Revised lease rental	Discount factor @ 9.5%	Present value
3	[(56,000 / 280) x 301] = 60,200	0.913	54,963
4	60,200	0.834	50,207
5	60,200	0.762	45,872
6	60,200	0.696	41,899
7	60,200	0.635	38,277
8	60,200	0.580	34,916
9	60,200	0.530	31,906
10	60,200	0.484	29,137
			3,27,127

Table showing amortised cost of lease liability

Year	Opening balance	Interest @ 9.5%	Rental paid	Closing balance
1	3,51,613	33,403	56,000	3,29,016
2	3,29,016	31,257	56,000	3,04,273

Difference of ` 22,854 (3,27,127 – 3,04,273) will increase the lease liability with corresponding increase in ROU Asset as per para 39 of Ind AS 116.

Journal entry at the beginning of year 3 would be:

	Dr.	Cr.
Right-of-use asset Dr.	` 22,854	
To Lease liability		` 22,854

Foreign currency lease

11.Entity X is an Indian entity whose functional currency is Indian Rupee. It has taken a plant on lease from Entity Y for 5 years to use in its manufacturing process for which it has to pay annual rentals in arrears of USD 10,000 every year. On the commencement date, exchange rate was USD = `68. The average rate for Year 1 was `69 and at the end of year 1, the exchange rate was `70. The incremental borrowing rate of Entity X on commencement of the lease for a USD borrowing was 5% p.a.

How will entity X measure the right of use (ROU) asset and lease liability initially and at the end of Year 1? (RTP May 2021)

[video link: https://youtu.be/a4i6InPKEeE?t=4396]

Answer

On initial measurement, Entity X will measure the lease liability and ROU asset as under:

Year	Lease Payments (USD)	PVF@5%	PV	Conversion rate	INR value
1	10,000	0.952	9520	68	647,360
2	10,000	0.907	9070	68	616.760
3	10,000	0.864	8640	68	587,520
4	10,000	0.823	8230	68	559,640
5	10,000	0.784	7840	68	533,120
			43,300		29,44,400

As per Ind AS 21, The Effects of Changes in Foreign Exchange Rates, monetary assets and liabilities are restated at each reporting date at the closing rate and the difference due to foreign exchange movement is recognised in profit and loss whereas non-monetary assets and liabilities carried measured in terms of historical cost in foreign currency are not restated.

Accordingly, the ROU asset in the given case being a non-monetary asset measured in terms of historical cost in foreign currency will not be restated but the lease liability being a monetary liability will be restated at each reporting date with the resultant difference being taken to profit and loss.At the end of Year 1,the lease liability will be measured in terms of USD as under:

Lease Liability

Year	Initial Value(USD)	Lease Payment	Interest @5%	Closing Value(USD)
1	43,300	10,000	2165	35,465

Interest at the rate of 5% will be accounted for in profit and loss at average rate of `69 (i.e., USD 2,165 x 69) = `1,49,385.

Interest ExpenseDr. 1,49,385

To Lease liability 1,49,385

Lease payment would be accounted for at the reporting date exchange rate, i.e. `70 at the end of year 1

Lease liabilityDr. 7,00,000

To Cash 7,00,000

As per the guidance above under Ind AS 21, the lease liability will be restated using the reporting date exchange rate i.e., `70 at the end of Year 1. Accordingly, the lease liability will be measured at `24,82,550(35,465 x `70) with the corresponding impact due to exchange rate movement of `88,765(24,82,550–(29,44,400+ 1,49,385 –700,000) taken to profit and loss.

At the end of year 1, the ROU asset will be measuredas under

Year	Opening Balance	Depreciation	Closing Balance
1	29,44,400	588,880	23,55,520

Sale and lease back

3.(a)QA Ltd. sold a property on 1stApril, 2016 for Rs.48 crores to raise cash for the future expansion of its business. T he carrying value of the property on 1stApril, 2016 was Rs.50 crores and as per the independent valuation report the market value of the property is Rs.55 crores and the distress sale value is Rs.52 crores. T he estimated future life of the property as on 1stApril, 2016 was 40 years.

However, since the administrative office of the Company was in the same premises and to avoid and logistic inconvenience, the Company on the same day has taken the same premises on the lease and the annual rental for 10 years is as follows:

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Rent in Cr	**1**	**1.2**	**1.3**	**1.4**	**1.5**	**1.6**	**1.7**	**1.8**	**1.9**	**2**

T he lease agreement is for the period of 10 years, however the same is cancellable after initial period of 5 years. T he Company as on date is expected to utilise the premises for entire period of 10 years. As per market survey, rentals for a similar property for a similar period is expected to be Rs.8.00 crores for the first five years and Rs.11 crores for the next five years. T he Company wants you to suggest the accounting treatment of the above lease transaction as per a pplicable Ind AS. (MTP March 2019)

[video link: https://youtu.be/ebOb76K0d5c?t=1940]

3 (a)Venus Ltd.(Seller-lessee) sells a building to Mars Ltd.(Buyer-lessor) for cash of `28,00,000. Immediately before the transaction, the building is carried at a cost of`13,00,000.At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 20 years, with an annual payment of `2,00,000 payable at the end of each year.The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements for determining when a performance obligation is satisfied in accordance with Ind AS 115 "Revenue from Contracts with Customers".

The fair value of the building at the date of sale is `25,00,000.Initial direct costs, if any, are to be ignored. The interest rate implicit in the lease is 12% p.a., which is readily determinable by Seller-lessee. Present Value (PV) of annual payments (20 payments of`2,00,000 each discounted@ 12%) is`14,94,000.Buyer-lessor classifies the lease of the building as an operating lease.How should the said transaction be accounted by Venus Ltd.? (Exam nov 20)

[video link: https://youtu.be/a4i6InPKEeE?t=5041]

Answer

Considering facts of the case, Venus Ltd. (seller-lessee) and Mars Ltd. (buyer-lessor) account for the transaction as a sale and lease back.

Firstly, since the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer -lessor make adjustments to measure the sale proceeds at fair value. Thus, the amount of the excess sale price of `3,00,000 (as calculated below) is recognised as additional financing provided by Buyer-lessor to Seller-lessee.

Sale Price:	28,00,000
Less: Fair Value (at the date of sale):	(25,00,000)
Additional financing provided by Buyer-lessor to Seller-lessee	3,00,000

The present value of the annual payments is `14,94,000 (as given in the question).

Out of this `14,94,000, `3,00,000 relates to the additional financing (as calculated above) and balance `11,94,000 relates to the lease.

Accounting by Venus Ltd. (seller-lessee):

At the commencement date, Seller-lessee measures the ROU asset arising from the leaseback of the building at the proportion of the previous carrying amount of

the building that relates to the right-of-use retained by Seller-lessee, calculated as follows:

Carrying Amount (A)	13,00,000
Fair Value (at the date of sale) (B)	25,00,000
Discounted lease payments for the 20 year ROU asset (C)	11,94,000
ROU Asset [(A / B) x C]	6,20,880

Seller-lessee recognises only the amount of the gain that relates to the rights transferredto Buyer-lessor, calculated as follows:

Fair Value (at the date of sale) (A)	25,00,000
Carrying Amount (B)	13,00,000
Discounted lease payments for the 20-year ROU asset (C)	11,94,000
Gain on sale of building (D) = (A -B)	12,00,000
Relating to the right to use the building retained by	
Seller-lessee (E)=[(D/A)xC]	5,73,120
Relating to the rights transferred to Buyer-lessor (D -E)	6,26,880

At the commencement date, Seller-lessee accounts for the transaction, as follows:

Bank / Cash A/cDr.	28,00,000	
ROU Asset A/cDr.	6,20,880	
To Building		13,00,000
To Financial Liability		14,94,000
To Gain on rights transferred		6,26,880

Transition

1. (a) A retailer (lessee) entered into 3-year lease of retail space beginning at 1 st April 20X1 with three annual lease payments of ` 2,00,000 due on 31st March 20X2, 20X3 and 20X4, respectively. The lease is classified as an operating lease under the erstwhile, accounting standard . The retailer initially applies Ind AS 116 for the first time in t he annual period beginning at 1st April 20X3. The incremental borrowing rate at the date of the initial application (i.e., 1st April 20X3) is 10% p.a. and at the commencement of the lease (i.e., 1 st April 20X1) was 12% p.a. The ROU asset is subject to straight

-line depreciation over the lease term. Assume that no practical expedients are elected, the lessee did not incur initial direct costs, there were no lease incentives and there were no requirements for the les see to dismantle and remove the underlying asset, restore the site on which it is located or restore the underlying asset to the condition under the terms and conditions of the lease.

What would be the impact for the lessee as per Ind AS 116 using the following transition approaches:

(i) Full Retrospective Approach

(ii) Modified Retrospective Approach (when ROU asset is not equal to lease liability)
Show the impact of adjustments through journal entries, consequent to transition for the year 20X2-20X3 and 20X3-20X4. (MTP Oct 2021)

Answer

Full Retrospective Approach:

Under the full retrospective approach, the lease liability and the ROU asset are measured on the commencement date (i.e., 1st April, 20X1 in this case) using the incremental borrowing rate at lease commencement date (i.e., 12% p.a. in this case). The lease liability is accounted for by the interest method subsequently and the ROU asset is subject to depreciation on the straight-line basis over the lease term of three years. The Lease Liability and ROU Asset are as follows:

Year	Payments (Cash flows)	Present Value Factor @ 12%	Discounted Cash flows / Present Value
31 Mar 20X2	2,00,000	0.8929	1,78,580
31 Mar 20X3	2,00,000	0.7972	1,59,440
31 Mar 20X4	2,00,000	0.7118	1,42,360
	6,00,000		4,80,380

Lease Liability Schedule:

Year	Opening	Interest Expense @ 12%	Payments	Closing
31 Mar 20X2	4,80,380	57,646	(2,00,000)	3,38,026
31 Mar 20X3	3,38,026	40,563	(2,00,000)	1,78,589
31 Mar 20X4	1,78,589	21,411*	(2,00,000)	–

*Difference is due to approximation

ROU Asset Schedule:

Year	Opening	Depreciation	Closing
31 Mar 20X2	4,80,380	(1,60,126)	3,20,254
31 Mar 20X3	3,20,254	(1,60,127)	1,60,127
31 Mar 20X4	1,60,127	(1,60,127)	–

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
1 Apr 20X1	4,80,380	4,80,380	-	-	-
31 Mar 20X2	3,20,254	3,38,026	-	-	-
1 Apr 20X2	3,20,254	3,38,026			(17,772)
31 Mar 20X3	1,60,127	1,78,589	40,563	1,60,127	–
1 Apr 20X3	1,60,127	1,78,589	-	-	-
31 Mar 20X4	-	-	21,411	1,60,127	–

Ind AS 116 is applicable for the financial year beginning from 1st April, 20X3. Hence, 20X3-20X4 is the first year of adoption and using Full retrospective method the comparative for 20 X2-20X3 needs to be restated and 1st April, 20X2 (i.e the opening of the comparative) is taken as transition date for adoption of this standard. At adoption, the lessee would record the ROU asset and lease liability at the 1st April, 20X2 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as of 1st April, 20X2 (assuming that only the 20X2-20X3 financial information is included as comparatives).

ROU Asset Dr.	3,20,254	
Retained Earnings Dr.	17,772	
To Lease Liability		3,38,026

To initially recognise the lease-related asset and liability as of 1 April 20 X2.

The following journal entries would be recorded during 20 X2-20X3:

Interest expense Dr.	40,563	
To Lease Liability		40,563

To record interest expense and accrete the lease liability using the interest method.

Depreciation expense Dr. 1,60,127

To ROU Asset 1,60,127

To record depreciation expense on the ROU asset.

Lease Liability Dr. 2,00,000

To Cash 2,00,000

To record lease payment.

The following journal entries would be recorded during 20X3-20X4:

Interest expense Dr. 21,411

To Lease Liability 21,411

To record interest expense and accrete the lease liability using the interest method.

Depreciation expense Dr. 1,60,127

To ROU Asset 1,60,127

To record depreciation expense on the ROU asset.

Lease Liability Dr. 2,00,000

To Cash 2,00,000

To record lease payment.

Modified Retrospective Approach (When ROU asset is not equal to lease liability):

Under the modified retrospective approach (Alternative 1), the lease liability is measured based on the remaining lease payments (i.e., from the date of transition to the lease end date, viz., 1st April, 20X3 to 31st March, 20X4 in this case) discounted using the incremental borrowing rate as of the date of initial application being 1st April, 20X3 (i.e. 10% p.a. in this case). The ROU asset is at its carrying amount as if Ind AS 116 had been applied since the commencement date (i.e., 1st April 20X1 in this case) by using incremental borrowing rate as at transition date. The Lease Liability and ROU Asset are as follows:

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows / Present Value
31 Mar 20X4	2,00,000	0.9091	1,81,820
	2,00,000		1,81,820

Lease Liability Schedule:

Year	Opening Balance	Interest Expense @ 10%	Payments	Closing Balance
31 Mar 20X4	1,81,820	18,180*	(2,00,000)	–

*Difference is due to approximation

ROU Asset Schedule:

Year	Opening Balance	Depreciation	Closing Balance
31 Mar 20X4	1,65,787***	(1,65,787)	–

***(Refer W.N.3)

The following table shows account balances under this method beginning at lease commencement:

Date	ROU Asset	Lease Liability	Interest Expense	Depreciation Expense	Retained Earnings
1 Apr 20X1	4,97,360*	4,97,360**	-	-	-
31 Mar 20X2	3,31,574	3,47,096	49,736	1,65,786	–
31 Mar 20X3	1,65,787	1,81,806	34,710	1,65,787	(16,019)
1 Apr 20X3	1,65,787	1,81,806	-	-	-
31 Mar 20X4	-	-	18,194	1,65,787	–

*(Refer W.N.1)

**(Refer W.N.2)

At adoption, the lessee would record the ROU asset and lease liability at 1 st April 20X3 by taking values from the above table, with the difference between the ROU asset and lease liability going to retained earnings as 1st April 20X3.

ROU Asset Dr.	1,65,787	
Retained Earnings Dr.	16,019	
To Lease Liability		1,81,806

To initially recognise the lease-related asset and liability as of 1st April 20X3.

The following journal entries would be recorded during 20 X3-20X4:

Interest expense Dr.	18,194	
To Lease Liability		18,194

To record interest expense and accrete the lease liability using the interest method.

Depreciation expense Dr.	1,65,787	
To ROU Asset		1,65,787

To record depreciation expense on the ROU asset.

Lease Liability Dr.	2,00,000	
To Cash		2,00,000

To record lease payment.

Working Notes

1. Calculation of Present value of lease payments as at commencement date i.e., 1st April, 20X1

Year	Payments (Cash flows)	Discounting Factor @10%	Discounted Cash flows / Present Value
31 Mar 20X2	2,00,000	0.9091	1,81,820
31 Mar 20X3	2,00,000	0.8264	1,65,280
31 Mar 20X4	2,00,000	0.7513	1,50,260
	6,00,000		4,97,360

2. Lease Liability Schedule:

Year	Opening	Interest Expense @ 10%	Payments	Closing
31 Mar 20X2	4,97,360	49,736	(2,00,000)	3,47,096
31 Mar 20X3	3,47,096	34,710	(2,00,000)	1,81,806
31 Mar 20X4	1,81,806	18,194*	(2,00,000)	–

*Difference is due to approximation

3. Calculation of ROU asset as at transition date i.e., 1st April, 20X3

Year	Opening	Depreciation	Closing
31 Mar 20X2	4,97,360	(1,65,786)	3,31,574
31 Mar 20X3	3,31,574	(1,65,787)	1,65,787
31 Mar 20X4	1,65,787	(1,65,787)	-

Analysis of F.S.

1. (a) Following is the financial statements of Arish Ltd. prepared on the basis of Accounting Standards: (Note all figures are in INR million)

Balance Sheet

Particulars	Note	As at 31st March, 2018
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital (shares of Rs. 10 each)		1,000
Reserves and surplus	1	2,000
Non-current liabilities		
Long-term borrowings	2	5,555
Deferred tax liabilities	3	200
Current liabilities		
Trade payables		300
Short-term provisions		250
Other current liabilities	4	150
TOTAL		9,455
ASSETS		
Non - current assets		
Fixed Assets		5,655
Deferred Tax Assets	3	500
Current assets		
Inventories		1,000
Trade receivables	5	1,100
Cash and bank balances		1,200
TOTAL		9,455

Note 1: The Company has achieved a major breakthrough in its consultancy services in Middle East following which it has entered into a contract of

rendering services with Finland Inc for INR 6 billion during the year. The termination clause of the contract is equivalent to INR 7 Million and is payable in case transition time schedule is missed from 15th December 2022. The management however is of the view that the liability cannot be treated as onerous.

Note 2: The Company is not able to assess the final liability for a particular tax assessment pertaining to assessment year 2018-2019 wherein it has received a demand notice of INR 6 Million. However, the company is contesting the same with CIT (Appeals) as on the reporting date.

Statement of Profit & Loss

Particulars	Note	Year ended March 31, 2018
Revenue from operations		5,500
Expenses		
Employee Benefit Expense		1,200
Operating Costs		2,200
Depreciation		999
Total Expenses		4,399
Profit before tax		1,101
Tax Expense		(150)
Profit after tax		951

Notes to Accounts:

Note 1: Reserves and surplus		(INR in millions)
Capital Reserve		500
Surplus from P & L		
Opening Balance	49	
Additions	951	1,000
Reserve for foreseeable loss		500
Total		2,000

Note 2:

Long Term Borrowings	
Term Loan from Bank	5,555

Total	**5,555**
Note 3: Deferred Tax	
Deferred Tax Asset	**500**
Deferred Tax Liability	**(200)**
Total	**300**
Note 4: Other Current Liabilities	
Unclaimed dividends	**3**
Billing in Advance	**147**
Total	**150**
Note 5: Trade Receivables	
Considered good (outstanding within 6 months)	**1,065**
Considered doubtful (due from past 1 year)	**40**
Provision for doubtful debts	**(5)**
Total	**1,100**

Additional Information:

(a) Share capital comprises of 100 million shares of INR 10 each

(b) Term Loan from bank for INR 5555 million also includes interest accrued and due of INR 555 million as on the reporting date.

(c) Reserve for foreseeable loss is created against a service contract due within 6 months.

Required:

(i) Evaluate and report the errors and misstatements in the above extracts; and

(ii) Prepare the corrected Balance Sheet & Statement of Profit and Loss . (MTP Aug 2018) / (Exam May 19) / (Exam Nov 19)

Answer

(a) On evaluation of the financial statements, following was observed:

1. Reserve for foreseeable loss for INR 500 million, due within 6 months, should be a part of provisions. Hence it needs to be regrouped, and if it was a part of previous year's comparatives, a Note should be added in the notes to account on the regrouping do ne this year.

2. Interest accrued and due of INR 555 million on term loan will be a part of current liabilities since it is supposed to be paid within 12 months from the reporting date. Hence, it should be shown under the heading “Other Current Liabilities”.

3. It can be inferred from Note 3, that the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, hence these shall be set off, in accordance with Ind AS 12. The net DTA of INR 300 million shall be shown in the balance sheet.

4. The notes to trade receivables is incorrectly presented. The recommended notes would be as below:

Trade receivables (Unsecured) consist of the following:		INR in million
a) Over six months from the date they were due for payment		
i. Considered good		0
ii. Considered doubtful		40
Less: Provision for doubtful debts		(5)
	(A)	35
(b) Others		
i. Considered good		1,065
ii. Considered doubtful		0
Less: Provision for doubtful debts		0
	(B)	1,065
Total		1,100

5. It is common to have a termination clause in service contracts and having a termination clause per se will not create a liability on the company. Ind AS 37 states that a provision will be recognized when:

(a) An enterprise has a present obligation 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 should be recognized

In the above case, there is nothing to show that there is a present obligation, and hence there is no provision to be made.

As per Ind AS 37, a contingent liability is recognized only where the possibility of an outflow of resources embodying economic benefits is not remote. Since there is no onerous liability as of date, the possibility of an outflow being remote, no contingent liability arises. In fact, the management has wrongly worded 'onerous liability' in its notes to accounts. Onerous liability arises only if the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it, which doesn't seem to be the case as far as Arish Ltd. is concerned. Hence, this note shall be eliminated.

6. The demand notice from the tax department that is under litigation is a clear instance of a 'contingent liability'. Accordingly, the note should be revised as – 'Contingent Liability- Demand notice from income tax department pertaining to INR 6 Million, under contest with CIT (Appeals) as on the reporting date.

7. The Statement to Profit and Loss needs to represent earnings per share, to be compliant with Ind AS 33.

Revised extracts of the financial statements

Balance Sheet (INR in Million)

	Note No.	As at 31st March, 2018
ASSETS		
Non - current assets		
Fixed Assets		5,655
Deferred Tax Assets	3	300
Current assets		
Inventories		1,000
Trade receivables	5	1,100
Cash and Cash Equivalents		1,200
TOTAL		9,255
EQUITY AND LIABILITIES		
Shareholders' funds		
Share capital		1,000
Reserves and surplus	1	1,500
Non-current liabilities		
Long-term borrowings	2	5,000

Current liabilities		
Trade payables		300
Short-term provisions		750
Other current liabilities	4	705
TOTAL		9,255

Statement of Profit and Loss (INR in Million)

	Note No.	Year ended 31st March, 2018
Revenue from operations		5,500
Expenses		
Operating Costs		2,200
Employee Benefit Expense		1,200
Depreciation		999
Total Expenses		4,399
Profit Before Tax		1,101
Tax Expense		150
Profit for the period		951
Earnings Per Equity Share		
Basic		9.51
Diluted		9.51

Number of equity shares (face value of Rs. 10 each) 100 million

Revised Notes (wherever applicable):

Note on Reserves and Surplus (INR in Million)

Capital Reserve		500
Surplus from P & L		
Opening Balance	49	
Additions	951	1,000
Total		1,500

Note on Long Term Borrowings

Term Loan from Bank	5,000

Total	5,000
Note on Other Current Liabilities	
Unclaimed dividend	3
Interest on Term Loan	555
Billing in Advance	147
Total	705

1. Defense Innovators Limited is a public sector undertaking and is engaged in the construction of warships and submarines. XYZ Private Limited approached Defense Innovators Limited for construction of "specially designed" ships for it, which will be usedby XYZ Private Limited for transportation of specific goods. The offer was accepted bythe Defense Innovators Limited and both the companies entered into an agreement forthe construction and delivery of 3 specially designed ships on 'Fixed Price' basis with variable component in respect to certain items. Base and depot (B & D) spares for all three ships shall be procured by Defense Innovators Limited and will be paid on the cost of the item with certain percentage.

The contract states that "certain equipment" out of variable cost items, will be supplied by XYZ Private Limited at 'free of cost' for installation on board of ship. It is, therefore,to be noted as under:

(i) Some equipment are procured by Defense Innovators Limited in the presence of the XYZ Private Limited's representative for technical scrutiny as well as negotiating the prices. The vendors of these equipment are paid by Defense Innovators Limited. The cost of the equipment along with the cost of installation and profit thereon is claimed and reimbursed by XYZ Private Limited to Defense Innovators Limited.

(ii) There are certain other equipment for which orders are directly placed and also paid by the XYZ Private Limited. These equipment are known as 'Buyer Furnished Equipment (BFE)' and are delivered to the company 'free of cost' for installing in the ship. The labour cost of Installation of these are already included in the price component of the contract. BFEs are returned to the buyer after completion of the ship.

The period required for construction of one ship was approximately four years.
Whether the cost of Buyer Furnished Equipment's (BFE's) supplied by XYZ Private Limited to Defense Innovators Limited for-installing the same in the

ships can be considered as 'inventory' by Defense Innovators Limited and then on delivery of ship will be recognised as revenue in its books of account? Elaborate. (RTP May 2022)

[video link: https://youtu.be/rxTiMeT0IDU?t=98]

Answers

Before any item can be recognised as an inventory, it should meet the definition of 'asset' as given in the Conceptual Framework for Financial Reporting under Ind AS, issued by the Institute of Chartered Accountants of India as follows:

"An asset is a present economic resource controlled by the entity as a result of past events and economic resource is a right that has the potential to produce economic benefits".

The orders in respect of Buyer Furnished Equipment's (BFEs) are directly placed by the buyer and payment in respect of them is made by the buyer. These are then supplied to the company for installing in the ship and the buyer pays installation charges which are included in the contract price. Thus, the company has neither incurred any cost on BFE s nor any amount is recoverable on account of such equipment except installation charges.

Accordingly, such equipment are not 'assets' that may be considered as a part of its contract work-in progress.

In fact, after installation in the ship, BFEs are returned to the buyer after completion of the ship. Thus, these are only held by the company in the capacity of a bailee. Since, it cannot be considered as an 'asset', therefore, it can neither be considered as 'inventory' nor as 'work-in-progress'. Further, it can also not be considered as a part of sale value or revenue of the company as no consideration would be receivable with respect to the cost of such equipment.
On the basis of the above, it can be concluded that:

(i) The BFEs cannot be considered as inventories / Work-in-progress for Defense Innovators Limited.

(ii) The BFE's cost cannot be considered as part of sales value / contract revenue to Defense Innovators Limited.

1. (a) A Limited has prepared the following draft balance sheet as on 31st March 20X1:

(` in crore)

Particulars	31st March,20X1	31st March,20X0
ASSETS		
Cash	250	170
Cash equivalents	70	30
Non-controlling interest's share of profit for the year	160	150
Dividend declared and paid by A Limited	90	70
Accounts receivable	2300	1800
Inventory at cost	1500	1650
Inventory at fair value less cost to complete and sell	180	130
Investment property	3100	3100
Property, plant and equipment (PPE) at cost	5200	4700
Total	12,850	11,800
CLAIMS AGAINST ASSETS		
Long term debt (` 500 crore due on 1st January each year)	3300	3885
Interest accrued on long term debt (due in less than 12 months)	260	290
Share Capital	1130	1050
Retained earnings at the beginning of the year	1875	1740
Profit for the year	1200	830
Non-controlling interest	830	540
Accumulated depreciation on PPE	1610	1240
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 consolidated balance sheet using current and non-current classification in accordance with Ind AS 1. Operating cycle of the entity is 12 months. (MTP April 2022)

[video link: https://youtu.be/zHYIGfZ1Djo?t=107]

Answer

A Limited

Consolidated Balance Sheet as at 31st March 20X1 (` in crore)

Particulars	Note	31st March, 20X1	31st March,20X0
ASSETS			
Non-current assets			
(a) Property, plant and equipment	1	3590	3460
(b) Investment property		3100	3100
Total non-current assets		6690	6560
Current assets			
(a) Inventory	2	1680	1780
(b) Financial assets			
(i) Trade and other receivables	3	2100	1735
(ii) Cash and cash equivalents	4	320	200
Total current assets		4100	3715
Total assets		10,790	10,275
EQUITY & LIABILITIES			
Equity attributable to owners of the parent			
Share capital		1130	1050
Other Equity	5	2825	2350
Non-controlling interests		830	540
Total equity		4,785	3,940

LIABILITIES			
Non-current liabilities			
(a) Financial Liabilities			
(i) Borrowings - Long-term debt	6	2800	3385
(b) Provisions			
(i) Long-term provisions		765	640
(environmental restoration)			
Total non-current liabilities		3,565	4,025
Current liabilities			
(a) Financial Liabilities			
(i) Trade and other payables (Other than micro enterprises and small enterprises)	7	895	820
(ii) Current portion of long-term debt	8	500	500
(iii) Interest accrued on long-term debt		260	290
(iv) Dividend payable		150	230
(b) Provisions			
(i) Warranty provision		600	445
(ii) Provisions for accrued leave		35	25
Total current liabilities		2440	2310
Total liabilities		6005	6335
Total equity and liabilities		10,790	10,275

Working Notes:

Notes	Particulars	Basis	Calculation ` in crore	Amount ` in crore
1	Property, plant and equipment	Property, plant and equipment (PPE) at cost less Accumulated (depreciation on PPE	5,200 – 1,610 (4,700 – 1,240)	3,590 (3,460)
2	Inventory	Inventory at cost add Inventory at fair value less cost to complete and sell	1,500 + 180 (1,650 + 130)	1,680 (1,780)

3	Trade and other receivables	Accounts receivable less Provision for doubtful receivables	2,300 – 200 (1,800 – 65)	2,100 (1,735)
4	Cash and cash equivalents	Cash and Cash equivalents	250 + 70 (170 + 30)	320 (200)
5	Other Equity	Retained earnings at the beginning of the year add Profit for the year less Non-controlling interest's share of profit for the year less Dividend declared by A Limited	1,875 + 1,200– 160 – 90 (1,740 + 830 – 150 – 70)	2,825 (2,350)
6	Long-term debt	Long-term debt less Due on 1st January each year	3,300 – 500 (3,885 – 500)	2,800 (3,385)
7	Trade & other payables	Trade payables add Accrued expenses	880 + 15 (790 + 30)	895 (820)
8	Current portion of long- term debt	Due on 1st January each year		500 (500)

Note: Figures in brackets represent the figures for the comparative year.

Consolidation Full questions

3(b) On 1st April 20X1, A Limited acquired 80% of the share capital of S Limited.

On acquisition date the share capital and reserves of S Ltd. stood at ` 5,00,000 and ` 1,25,000 respectively.

A Limited paid initial cash consideration of ` 10,00,000. Additionally, A Limited issued 2,00,000 equity shares with a nominal value of ` 1 per share at current market value of ` 1.80 per share.

It was also agreed that A Limited would pay a further sum of ` 5,00,000 after three years.
A Limited's cost of capital is 10%. The appropriate discount factor for ` 1 @ 10% receivable at the end of

1st year: 0.91

2nd year: 0.83

3rd year: 0.75

The shares and deferred consideration have not yet been recor ded by A limited.

Below are the Balance Sheet of A Limited and S Limited as at 31 st March, 20X3:

	A Limited (` 000)	S Limited (` 000)
Non-current assets:		
Property, plant & equipment	5,500	1,500
Investment in S Limited at cost	1,000	
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Equity:		
Share capital	2,000	500

Retained earnings	**1,400**	**300**
	3,400	**800**
Non-current liabilities	**3,000**	**400**
Current liabilities	**1,250**	**650**
	7,650	**1,850**

Further information:

(i) On the date of acquisition the fair values of S Limited's plant exceeded its book value by ` 2,00,000. The plant had a remaining useful life of five years at this date;

(ii) The consolidated goodwill has been impaired by ` 2,58,000; and

(iii) The A Limited Group, values the non-controlling interest using the fair value method. At the date of acquisition, the fair value of the 20% non controlling interest was ` 3,80,000.

You are required to prepare Consolidated Balance Sheet of A Limited as at 31st March, 20X3.

(Notes to Account on Consolidated Balance Sheet is not required). (MTP Oct 21) / (Exam Jan 21) / (MTP March 22)

[video link: https://youtu.be/H5VbXddxql4?t=3957]

Answer

Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd.

as at 31st March, 20X3

Particulars	` in 000s
I. Assets	
(1) Non-current assets	
(i) Property Plant & Equipment (W.N.4)	7,120.00
(ii) Intangible asset – Goodwill (W.N.3)	1,032.00
(2) Current Assets	
(i) Inventories (550 + 100)	650.00
(ii) Financial Assets	
(a) Trade Receivables (400 + 200)	600.00

(b) Cash & Cash equivalents (200 + 50)	250.00
Total Assets	9,652.00
II. Equity and Liabilities	
(1) Equity	
(i) Equity Share Capital (2,000 + 200)	2,200.00
(ii) Other Equity	
(a) Retained Earnings (W.N.6)	1190.85
(b) Securities Premium	160.00
(2) Non-Controlling Interest (W.N.5)	347.40
(3) Non-Current Liabilities (3,000 + 400)	3,400.00
(4) Current Liabilities (W.N.8)	2,353.75
Total Equity & Liabilities	9,652.00

Working Notes:

1. Calculation of purchase consideration at the acquisition date i.e. 1 st April, 20X1

	` in 000s
Payment made by A Ltd. to S Ltd.	
Cash	1,000.00
Equity shares (2,00,000 shares x ` 1.80)	360.00
Present value of deferred consideration (` 5,00,000 x 0.75)	375.00
Total consideration	1,735.00

2. Calculation of net assets i.e. net worth at the acquisition date i.e. 1 st April, 20X1

	` in 000s
Share capital of S Ltd.	500.00
Reserves of S Ltd.	125.00
Fair value increase on Property, Plant and Equipment	200.00
Net worth on acquisition date	825.00

3. Calculation of Goodwill at the acquisition date i.e. 1 st April, 20X1 and 31st March, 20X3

	` in 000s
Purchase consideration (W.N.1)	1,735.00

Non-controlling interest at fair value (as given in the question)	380.00
	2,115.00
Less: Net worth (W.N.2)	(825.00)
Goodwill as on 1st April 20X1	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31st March 20X3	1,032.00

4. Calculation of Property, Plant and Equipment as on 31 st March 20X3

		` in 000s
A Ltd.		5,500.00
S Ltd.	1,500.00	
Add: Net fair value gain not recorded yet	200.00	
Less: Depreciation [(200/5) x 2] (80.00)	120.00	1,620.00
		7,120.00

5. Calculation of Post-acquisition gain (after adjustment of impairment on goodwill) and value of NCI as on 31st March 20X3

		` in 000s	` in 000s
		NCI	A Ltd.
		(20%)	(80%)
Acquisition date balance		380.00	Nil
Closing balance of Retained Earnings	300.00		
Less: Pre-acquisition balance	(125.00)		
Post-acquisition gain	175.00		
Less: Additional Depreciation on PPE			
[(200/5) x 2]	(80.00)		
Share in post-acquisition gain	95.00	19.00	76.00
Less: Impairment on goodwill	258.00	(51.60)	(206.40)
		347.40	(130.40)

6. Consolidated Retained Earnings as on 31 st March 20X3	` in 000s
A Ltd.	1,400.00

Add: Share of post-acquisition loss of S Ltd. (W.N.5)	(130.40)
Less: Finance cost on deferred consideration	
(37.5 + 41.25) (W.N.7)	(78.75)
Retained Earnings as on 31st March 20X3	1,190.85

7. Calculation of value of deferred consideration as on 31 st March 20X3

	` in 000s
Value of deferred consideration as on 1 st April 20X1 (W.N.1)	375.00
Add: Finance cost for the year 20X1-20X2 (375 x 10%)	37.50
	412.50
Add: Finance cost for the year 20X2-20X3 (412.50 x 10%)	41.25
Deferred consideration as on 31st March 20X3	453.75

8. Calculation of current Liability as on 31 st March 20X3	` in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31st March 20X3 (W.N.7)	453.75
Current Liability as on 31st March 20X3	2,353.75

1. T he balance sheet of P Ltd. and D Ltd. as of 31st March, 20X2 is given below:

Assets	**P Ltd.**	**D Ltd.**
Non-Current Assets:		
Property, plant and equipment	**300**	**500**
Investment	**400**	**100**
Current assets:		
Inventories	**250**	**150**
Financial assets		
T rade receivables	**450**	**300**
Cash and cash equivalents	**200**	**100**
Others	**400**	**230**

Total	**2,000**	**1,380**
Equity and Liabilities		
Equity		
Share capital- Equity shares of Rs. 100 each	**500**	**400**
Other Equity	**810**	**225**
Non-Current liabilities:		
Long term borrowings	**250**	**200**
Long term provisions	**50**	**70**
Deferred tax	**40**	**35**
Current Liabilities:		
Short term borrowings	**100**	**150**
T rade payables	**250**	**300**
Total	**2,000**	**1,380**

Other information

(a) P Ltd. acquired 70% shares of D Ltd. on 1st April, 20X2 by issuing its own shares in the ratio of 1 share of P Ltd. for every 2 shares of D Ltd. T he fair value of the shares of P Ltd. was Rs. 40 per share.

(b) T he fair value exercise resulted in the following: (all nos in Lakh)

a. Fair value of PPE on 1st April, 20X2 was Rs. 350 lakhs.

b. P Ltd. also agreed to pay an additional payment as consideration that is higher of 35 lakh and 25% of any excess profits in the first year, after acquisition, over its profits in the preceding 12 months made by D Ltd. T his additional amount will be due after 2 years. D Ltd. has earned Rs. 10 lakh profit in the prec eding year and expects to earn another Rs. 20 Lakh.

c. In addition to above, P Ltd. also had agreed to pay one of the founder shareholder a payment of Rs. 20 lakh provided he stays with the Company for two year after the acquisition.

d. D Ltd. had certain equity settled share based payment award (original award) which got replaced by the new awards issued by P Ltd. As per the original term the vestin g period was 4 years and as of the acquisition date the employees of D Ltd. have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year

from the acquisition date). The fair value of the award on the acquisition date was as follows:

i. Original award- Rs. 5 lakh

ii. Replacement award- Rs. 8 lakh.

e. D Ltd had a lawsuit pending with a customer who had made a claim of Rs. 50 lakh. Management reliably estimated the fair value of the liability to be Rs. 5 lakh.

f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of P Ltd. as on 1st April, 20X2. Assume 10% discount rate (MTP April 2019) / (Exam Nov 19) / (Exam May 22)

[similar question video link: https://youtu.be/KJBEhbsmUYs?t=1151]

Answer

Consolidated Balance Sheet of P Ltd as on 1st April, 20X2 (Rs. in Lakhs)

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	
Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	3,230
Equity and Liabilities	
Equity	
Share capital- Equity shares of Rs. 100 each	514
Other Equity	1128.62

NCI	154.95
Non-Current liabilities:	
Long term borrowings	450
Long term provisions (50+70+28.93)	148.93
Deferred tax	28.5
Current Liabilities:	
Short term borrowings	250
T rade payables	550
Provision for Law suit damages	5
Total	3230

Notes:

a. Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at Rs. 350 lakhs.

b. T he value of replacement award is allocated between consideration transferred and post combination expense. T he portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, 2.5 (5 x 2/4) is considered as a part of purchase consideration and is credited to P Ltd equity as this will be settled in its own equity. The balance of 2.5 will be recorded as employee expense in the books of D Ltd. over the remaining life, which is 1 year in this scenario.

c. T here is a difference between contingent consideration and deferred consideration. In the given case 35 is the minimum payment to be paid after 2 years and accordingly will be considered as deferred consideration. T he other element is if company meet certain target then they will get 25% of that or 35 whichever is higher. In the given case since the minimum what is expected to be paid the fair value of the contingent consideration has been considered as zero. T he impact of time value on deferred consideration has been given @ 10%.

d. T he additional consideration of Rs. 20 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as employee compensation and will be recorded as post combination expenses in the income statement of D Ltd.

Working for Purchase consideration Rs. in lakhs

Particulars Amount		
Share capital of D Ltd		400
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value per share		40
PC (2,00,000 x 70% x Rs. 40 per share) (A)		56.00
Deferred consideration after discounting Rs. 35 lakhs for 2 years @ 10% (B)		28.93
Replacement award Market based measure of the acquiree award (5) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award ie (5 x 2 / 4) (C)		2.50
PC in lakhs (A+B+C)		87.43

Purchase price allocation workings

Particulars	Book value (A)	Fair value (B)	FV adjustment (A-B)
Property, plant and equipment	500	350	(150)
Investment	100	100	–
Inventories	150	150	–
Financial assets:			-
T rade receivables	300	300	–
Cash and cash equivalents	100	100	–
Others	230	230	
Less: Long term borrowings	(200)	(200)	–
Long term provisions	(70)	(70)	–
Deferred tax	(35)	(35)	–
Short term borrowings	(150)	(150)	–

T rade payables	(300)	(300)	–
Contingent liability	-	(5)	(5)
Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment			
(155 x 30%) (Y)		46.50	155
Net assets (X+Y)		516.5	
Non-controlling interest (516.50 x 30%)			
rounded off		154.95	
Capital Reserve			
(Net assets – NCI – PC)		274.12	
Purchase consideration (PC)		87.43	

Consolidation workings

	P Ltd.	D Ltd. (pre-acquisition)	PPA Allocation	Total
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500
Current assets:				
Inventories	250	150		400
Financial assets:				
T rade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2000	1380	(150)	3230
Equity and Liabilities				
Equity				
Share capital- Equity shares of Rs. 100 each	500			
Shares allotted to D Ltd. (2,00,000 x 70% x Rs. 10 per share)			14	514
Other Equity	810		318.62	1128.62
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93

Deferred tax Current Liabilities: Short term borrowings T rade payable Liability for lawsuit damages	40 100 250	35 150 300	(46.5) 0 5	28.5 250 550 5
Total	2000	755	475	3230
Other Equity Other Equity Replacement award Security Premium Reserve (2,00,000 shares x 70% x Rs.30) Capital Reserve	 810		 2.5 42 274.12	 810 2.5 42 274.12
	810		318.62	1128.62

4. (a) Ram Ltd. acquired 60% ordinary shares of ` 100 each of Krishan Ltd. on 1st October 20X1. On 31st March, 20X2, the summarised Balance Sheets of the two companies were as given below:

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

Bank Overdraft	**1,60,000**	**–**
Trade Payable	**94,200**	**34,800**
Total	**19,68,600**	**7,98,800**

The Retained earnings of Krishan Ltd. showed a credit balance of ` 60,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November.

Ram Ltd. has credited the dividend received to its Retained earnings. Fair value of plant and machinery as on 1st October 20X1 was ` 4,00,000. The rate of depreciation on plant & machinery is 10%.

Following are the increases on comparison of Fair value as per respective Ind AS with book value as on 1st October 20X1 which are to be considered while consolidating the Balance Sheets:

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

Notes:
I. It may be assumed that the inventory is still unsold on balance sheet date and the Trade Payables are also not yet settled.

II. Also assume that the Other Reserves as on 31st March 20X2 are the same as was on 1st April, 20X1.

Prepare consolidated Balance Sheet as on 31st March, 20X2. (MTP Nov 21) / (Exam May 18) / (Exam May 19)

[similar question video link: https://youtu.be/BuBqP0m6N5U?t=3976]

Answer

Consolidated Balance Sheet of Ram Ltd. and its subsidiary, Krishan Ltd. as on 31st March, 20X2

Particulars	Note No.	`
I. Assets		
(1) Non-current assets		
(i) Property, Plant & Equipment	1	17,20,000
(ii) Goodwill	2	165,800
(2) Current Assets		
(i) Inventories	3	342,800

Particulars	Note	Amount
(ii) Financial Assets		
(a) Trade Receivables	4	199,600
(b) Cash & Cash equivalents	5	45,000
Total Assets		24,73,200
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	6	10,00,000
(ii) Other Equity	7	730,600
(2) Non-controlling Interest (WN 4)		433,600
(3) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	8	149,000
(b) Short term borrowings	9	160,000
Total Equity & Liabilities		24,73,200

Notes to accounts	`
1. Property Plant & Equipment	
Land & Building (3,00,000 + (3,60,000 + 2,00,000))	8,60,000
Plant & Machinery (W.N.6)	8,60,000
	17,20,000
2. Goodwill	1,65,800
3. Inventories	
Ram Ltd.	2,40,000
Krishan Ltd. (72,800 + 30,000)	1,02,800
	3,42,800
4. Trade Receivables	
Ram Ltd.	1,19,600
Krishan Ltd.	80,000
	1,99,600

5. Cash & Cash equivalents

Ram Ltd.	29,000
Krishan Ltd.	16,000
	45,000

8. Trade Payables

Ram Ltd.	94,200
Krishan Ltd. (34,800 + 20,000)	54,800
	1,49,000

9. Short-term borrowings

Bank overdraft	1,60,000

Statement of Changes in Equity:

6. Equity share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
10,00,000	0	10,00,000

7. Other Equity

	Reserves & Surplus			Total
	Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning of the reporting period		0	600,000	600,000
Total comprehensive income for the year	0	114,400		114,400
Dividends	0	(24,000)		(24,000)
Total comprehensive income attributable to parent	0	40,200		40,200
Balance at the end of reporting period		130,600	600,000	730,600

Working Notes:

1. Adjustments of Fair Value

The Plant & Machinery of Krishan Ltd. would stand in the books at ` 2,85,000 on 1st October, 20X1, considering only six months' depreciation on ` 3,00,000 total depreciation being ` 30,000. The value put on the assets being ` 4,00,000 there is an appreciation to the extent of ` 1,15,000.

2. Acquisition date profits of Krishan Ltd.

Reserves on 1.4.20X1	200,000
Profit & Loss Account Balance on 1.4.20X1	60,000
Profit for 20X1-20X2:	
Total (` 1,64,000 less depreciation ` 20,000) x 6/12	
i.e. ` 72,000; upto 1.10. 20X1	72,000
Total Appreciation (1,15,000 + 2,00,000 + 30,000 – 20,000)	325,000
	657,000
Holding Co. Share (60%)	394,200

3. Post-acquisition profits of Krishan Ltd.

Profit after 1.10.20X1 [1,64,000-20,000]x 6/12	72,000
Less: 10% depreciation on ` 4,00,000 for 6 months less	
depreciation already charged for 2nd half of 20X1-20X2 on	
` 3,00,000 (20,000-15,000)	(5000)
	67,000
Total Share of holding Co. (60%)	40,200

4. Non-controlling Interest

Par value of 1600 shares	160,000
Add: 2/5 Acquisition date profits (6,57,000 – 40,000)	246,800
Add: 2/5 Post-acquisition profits [WN 3] (67,000 x 40%)	26,800
	433,600

5. Goodwill

Amount paid for 2,400 shares	800,000

Par value of shares	240,000	
Acquisition date profits share of Ram Ltd. 394,200		(634,200)
Goodwill		165,800

6. Value of Plant & Machinery

Ram Ltd.	480,000
Krishan Ltd.	270,000
Add: Appreciation on 1.10.20X1	115,000
Add: Depreciation for 2nd half charged on pre-revalued value	15,000
Less: Depreciation on ` 4,00,000 for 6 months	(20,000)
	860,000

7. Profit & Loss account consolidated

Ram Ltd. (as given)	114,400
Less: Dividend	(24000)
Share of Ram Ltd. in post-acquisition profits (W.N. 3)	40,200
	130,600

Common Control

1. X Ltd. and Y Ltd. amalgamated on and from 1st April, 2017. A new company XY Ltd. with shares of Rs. 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31st March, 2018 INR in '000

ASSETS	Note No.	X Ltd	Y Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets Investment		1,050	550
Current assets			
Inventories		1,250	2,750
Trade receivables		1,800	4,000

Cash and Cash equivalents		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of INR 10 each)		6,000	7,000
Other equity	1	3,050	2,700
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings (12% Debentures)		3,000	4,000
Current liabilities			
Trade payables		1,000	1,500
		13,050	15,200

Notes to Accounts:

1. Other equity	X Ltd	Y Ltd
General Reserve	1,500	2,000
Profit & Loss	1,000	500
Investment Allowance Reserve	500	100
Export Profit Reserve	50	100
	3,050	2,700

XY Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of XY Ltd:

(i) Assuming that both the entities are under common control

(ii) Assuming Y Ltd is a larger entity and their management will take the control of the entity XY Ltd. The fair value of net assets of X and Y limited are as follows:

Assets	X Ltd. ('000)	Y Ltd. ('000)
Property, Plant and Equipment	9,500	1,000

Inventories	1,300	2,900
Fair value of the business	11,000	14,000

(MTP Oct 18) / (Exam Dec 21)

[similar question video link: https://youtu.be/ngi-Dzq0Kis?t=1036]

Answer

1. Calculation of Purchase Consideration		X Ltd.		Y Ltd. Rs. '000
Assets taken over:				
Property, Plant and Equipment		85,00		75,00
Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Cash equivalent		4,50		4,00
Gross Assets		130,50		152,00
Less: Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Reserves and Surplus:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		60,00		70,00

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

No. of shares to be issued to X Ltd = Net Assets taken over of X Ltd. x Purchase Consideration / Net Assets taken over of X Ltd. and Y Ltd.

No. of shares to be issued to Y Ltd = Net Assets taken over of Y Ltd. x Purchase Consideration / Net Assets taken over of X Ltd. and Y Ltd.

X Ltd. Y Ltd. Rs. ’000

130,00 * 90,50 / 187,50 =6 27,500 × ∗ Equity shares of Rs. 10 each = 62,75

130,00 * 97,00 / 187,50 672,500 × Equity shares of Rs. 10 each = 67,25

(3) Balance Sheet of XY Ltd. as on 1st April, 2018 INR in '000

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets Investment		1,600
Current assets		
Inventories		4,000
Trade receivables		5,800
Cash and Cash equivalents		850
		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of INR 10 each)	1	13,000
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payables		2,500
		28,250

Notes to Accounts	(Rs. 000)	(Rs. 000)
1. Share Capital		
13,00,000 Equity Shares of Rs. 10 each		130,00
2. Reserves and surplus		
General Reserve (15,00 + 20,00)	35,00	

Profit & Loss (10,00 + 5,00)	15,00	
Investment Allowance Reserve (5,00 + 1,00)	6,00	
Export Profit Reserve (50 + 1,00)	1,50	57,50
3. Long Term Borrowings		
12% Debentures		70,00

(ii) Assuming Y Ltd is a larger entity and their management will take the control of the entity XY Ltd.

In this case Y Ltd. and X Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. A question arises here is who is the accounting acquirer XY Ltd which is issuing the shares or X Ltd. or Y Ltd. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although XY Ltd. is issuing the shares but Y Ltd. post-merger will have control and is bigger in size which is a clear indicator that Y Ltd. will be an accounting acquirer. This can be justified by the following table:

(In '000s)	X Ltd.	Y Ltd.
Fair Value	11,000	14,000
Value per share	10	10
No. of shares	1,100	1,400

i.e. Total No. of shares in XY Ltd. = 2,500 thousand shares

Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.

Accordingly, Y Ltd.'s assets will be recorded at historical cost in the merged financial statements.

(1) Calculation and discharge of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by Y Ltd. to X Ltd. to maintain the same percentage i.e. 56%:

Thus, 700 thousand shares of Y Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares ie 700 thousand shares / 56%.

This implies Y Ltd. would need to issue 550 thousand shares (1,250 - 700) to X Ltd.

Purchase Consideration = 550 thousand shares x Rs. 20 per share (ie. 14,000 thousand / 700 thousand shares) = Rs. 11,000 thousand.

(2) Balance Sheet of XY Ltd. as on 1st April, 2018 INR in '000

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment (9500+7500)		17,000
Goodwill (Refer Working Note)		900
Financial assets		
Investment (1050+550)		1,600
Current assets		
Inventories (1300+2750)		4,050
Trade receivables (1800+4000)		5,800
Cash and Cash equivalents (450+400)		850
		30,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of INR 10 each)	1	12,500
Other equity	2	8,200
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures)	3	7,000
Current liabilities		
Trade payables		2,500
		30,200

Notes to Accounts	(Rs. 000)	(Rs. 000)
1. Share Capital		
1,250,000 Equity Shares of Rs. 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00

2. Reserves and Surplus		
General reserve of BX Ltd	20,00	
P&L of BX Ltd	5,00	
Export Profit Reserve of BX Ltd	1,00	
Investment Allowance Reserve of BX Ltd	1,00	
Security Premium (550 shares x Rs. 10)	5,500	8,200
3. Long Term Borrowings		
12% Debentures (Assumed that new debentures were issued in exchange of the old series)		70,00

Working Note:

Computation of Goodwill:

Assets:	Rs. in 000s
Property, Plant and Equipment	9,500
Investment	1,050
Inventories	1,300
Trade Receivables	1,800
Cash & Cash Equivalents	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payables	1,000
Net Assets	10,100
Purchase Consideration	11,000
Goodwill	900

2(a) Notorola Limited has two divisions A and B. Division A has been making constant profits while Division B has been invariably suffering losses.

On 31st March 2018, the division-wise draft extract of the Balance Sheet was as follows: (` in crore)

	A	B	Total
Fixed Assets Cost	500	1000	1500
Depreciation	(450)	(800)	(1250)
Net Fixed Assets (A)	50	200	250
Current Assets	400	1000	1400
Less: Current Liabilities	(50)	(800)	(850)
Net Current Assets (B)	350	200	550
Total (A) + (B)	400	400	800
Financed by :			
Loan Funds	-	600	600
Capital : Equity ` 10 each	50	-	50
Surplus	350	(200)	150
Total	400	400	800

Division B along with its assets and liabilities was sold for ` 50 crore to Senovo Limited a new company, who allotted 2 crore equity shares of ` 10 each at a premium of ` 15 per share to the members of Notorola Limited in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Notorola Limited was holding 52% shares of the company.

Assuming that, there are no other transactions, you are required to:

(i) Pass journal entries in the books of Notorola Limited.

(ii) Prepare the Balance Sheet of Notor ola Limited after the entries in (i).

(iii) Prepare the Balance Sheet of Senovo Limited.

Balance Sheet prepared for (ii) and (iii) above should comply with the relevant Ind ASand Schedule III of the Companies Act, 2013. Provide Notes to Accounts, for 'Other Equity' in case of (ii) and 'Share Capital' in case of (iii), only. (Exam May 18)

Answer

(i) Journal of Notorola Ltd. (` in crore)

Loan Funds Dr. 600

Current Liabilities Dr.	800	
Provision for Depreciation Dr.	800	
To Fixed Assets		1,000
To Current Assets		1,000
To Capital Reserve		200

(Being division B along with its assets and liabilities sold to Senovo Ltd. for ` 50 crore)
In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded as capital reserve in the books of demerged entity (Notorola Ltd).

Notes: Any other alternative set of entries, with the same net effect on various accounts, may also be given.

(ii) Notorola Ltd. Balance Sheet after demerger (` in crore)

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		50
Current assets		400
		450
EQUITY AND LIABILITIES		
Equity Equity share capital (of face value of `10 each)	1	50
Other equity	2	350
Liabilities Current liabilities		50
		450

Notes to Accounts (` in crore)

1. Equity Share Capital

5 crore equity shares of face value of ` 10 each 50

Consequent to transfer of Division B to newly incorporated company Senovo Ltd., the members of the company have been allotted 2 crore equity shares of ` 10 each at a premium of ` 15 per share of Senovo Ltd., in full settlement of the

consideration in proportion to their shareholding in the company

2. Other Equity

Surplus (350 - 200)	150
Add: Capital Reserve on reconstruction	200
	350

(iii) Balance Sheet of Senovo Ltd. (` in crore)

	Note No.	Amount
ASSETS		
Non-current assets		
Property, Plant and Equipment		200
Current assets		1,000
		1,200
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of INR 10 each)	1	20
Other equity	2	(220)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		600
Current liabilities		800
		1,200

Notes to Accounts (` in crore)

1. Share Capital

Issued and Paid-up capital

2 crore Equity shares of ` 10 each fully paid up 20

(All the above shares have been allotted to the members of Notorola Ltd. on takeover of Division B from Notorola Ltd. as fully paid-up pursuant to contract without payment being received in cash)

2. Other Equity

Securities Premium	30

Capital reserve [50 - (1,200 – 1,400)]	(250)
	(220)

Disposal of Subsidiary

6. (a) Trust Ltd. has a number of wholly-owned subsidiaries including Trust Infocomm Ltd. at 31st March 2018.

Trust Ltd. consolidated statement of financial position and the group carrying amount of Trust Infocomm Ltd. assets and liabilities (ie the amount included in that consolidated statement of financial position in respect of Trust Infocomm Ltd. assets and liabilities) at 31st March 2018 are as follows:

Particulars	Consolidated (Rs. In '000)	Carrying amount of Trust Infocomm Ltd. asset and liabilities Ltd. in the Group (Rs. In '000)
Assets		
Non-current Assets		
Goodwill	190	90
Buildings	1620	670
Current Assets		
Inventories	70	20
Trade Receivables	850	450
Cash	1550	500
Total Assets	4280	1730
Equity & Liabilities		
Equity		
Share Capital	800	
Other Equity		
Retained Earnings	2130	
Current liabilities		
Trade Payables	1350	450
Total Equity & Liabilities	4280	450

Prepare Consolidated Balance Sheet after disposal as on 31st March, 2018 when Trust Ltd. group sold 90% shares of Trust Infocomm Ltd. to independent party for Rs. 1000 ('000). (MTP Oct 18) / (MTP Aug 2018)

[video link: https://youtu.be/BuBqP0m6N5U?t=2090]

Answer

When 90% shares sold to independent party

Consolidated Balance Sheet of Trust Ltd. and its remaining subsidiaries

as on 31st March, 2018

Particulars	Note No.	(Rs. In '000)
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	950
(ii) Goodwill	2	100
(iii) Financial Assets		
(a) Investments	3	128
(2) Current Assets		
(i) Inventories	4	50
(ii) Financial Assets		
(b) Trade Receivables	5	400
(c) Cash & Cash equivalents	6	2050
Total Assets		3678
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	7	800
(ii) Other Equity	8	1978
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	9	900
Total Equity & Liabilities		3,678

Notes to accounts: (Rs. In '000)

1. Property Plant & Equipment		
Land & Building	1620	
Less: Trust Infocomm Ltd.	(670)	950
2. Goodwill	190	
Less: Trust Infocomm Ltd.	(90)	100
3. Investments		
Investment in Trust Infocomm Ltd. (WN 2)	128	128
4. Inventories		
Group	70	
Less: Trust Infocomm Ltd.	(20)	50
5. Trade Receivables		
Group	70	
Less: Trust Infocomm Ltd.	(20)	50
8. Cash & Cash equivalents		
Group (WN 3)	20500	2050
Trade Payables		
Group	1350	
Less: Trust Infocomm Ltd.	(450)	900

Working Notes:

1. When 90% being sold, the carrying amount of all assets and liabilities attributable to Trust Infocomm Ltd. were eliminated from the consolidated statement of financial position and further financial asset is recognized for remaining 10%.

2. Fair value of remaining investment (in '000):

Net Assets of Trust Ltd.	1280
Less: 90% disposal	(1152)
Financial Asset	128

3. Cash on hand (in '000):

Cash before disposal of Trust Infocomm Ltd.	1550
Less: Trust Infocomm Ltd. Cash	(500)
Add: Cash realized from disposal	1,000
Cash on Hand	2,050

4. Gain/ Loss on disposal of entity (in '000):

Proceeds from disposal	1000
Less: Proportionate (90%) Net assets of Trust Infocomm Ltd. (90% of 1,280) 1,000	(1,152)
Loss on disposal	(152)

5. Retained Earnings (in '000):

Retained Earnings before disposal	2130
Less: Loss on disposal	(152)
Retained earnings after disposal	1,978

Associate and JO

2. (a) The following information relates to the results of the parent and subsidiary (jointly) and the investment in associate and joint Operation: (All figures are in rupees)

Summarised Balance Sheet as at 31.3.20X1

	Holding and subsidiary	Associate	Joint Operation
Equity and Liabilities			
Called up equity shares of ` 1 each	**1,00,000**	**40,000**	**10,000**
General reserve	**40,000**	**–**	
Profit and loss account	**37,000**	**27,000**	**83,000**
NCI	**20,000**	**-**	**-**

Current Liabilities			
Trade payables –			
Creditors	**20,000**	**32,000**	**6,000**
Provision for tax	**19,000**	**11,000**	**11,000**
	2,36,000	**1,10,000**	**1,10,000**
Assets			
Non-current assets			
Fixed assets-			
Tangible assets	**1,95,000**	**74,000**	**41,000**
Investments:			
8,000 shares in Associate	**15,000**	**-**	**-**
5,000 shares in Joint Venture	**5,000**	**-**	**-**
Current assets	**21,000**	**36,000**	**69,000**
	2,36,000	**1,10,000**	**1,10,000**

Details of Profit and Loss account for the year ended 31.3.20X1

	Holding and subsidiary	**Associate**	**Joint Operation**
Retained profit for the year	**15,000**	**11,000**	**23,000**
Add: Retained profit brought forward	**22,000**	**16,000**	**60,000**
Retained profit carried forward	**37,000**	**27,000**	**83,000**

You are given the following additional information:

(a) The parent company purchased its investment in the associate two years ago when the balance on the profit and loss account was ` 17,000. There are no signs of impairment of the goodwill.

(b) The parent company entered into a joint venture to access a luc rative market in the former East Germany. It set up a company two years ago and has 50 per cent of the voting rights of the company set up for this joint venture.

Prepare the consolidated balance sheet for the Group as per relevant Accounting Standards for the year ended 31.3.20X1. (MTP March 2018)

Answer

(a) Consolidated Balance Sheet as on 31.3.20X1

Particulars	Note No.	`
I. Assets		
(1) Non-current assets		
(a) Fixed assets		
Tangible assets	5	2,15,500
(b) Non-current investment	6	17,200
(2) Current assets	7	55,500
Total		2,88,200
II. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,00,000
(b) Reserves and Surplus	2	1,20,700
(2) Minority Interest		20,000
(3) Current Liabilities		
(a) Trade Payables	3	23,000
(b) Short Term Provisions	4	24,500
Total		2,88,200

Notes to Accounts	`
1. Share Capital Called up equity shares of ` 1 each	1,00,000
2. Reserves and Surplus	
General Reserve	40,000
Profit and Loss A/c (W.N.3)	80,700
	1,20,700
3. Trade Payables	
Holding & Subsidiary	20,000
Joint Operation (50%)	3,000
	23,000
4. Short term provisions	
Provisions for Tax	

Holding & Subsidiary	19,000
Joint Operation (50%)	5,500
	24,500

5. Tangibles Assets

Holding & Subsidiary	1,95,000
Joint Venture (50%)	20,500
	2,15,500

6. Non-current investment

Investment in Associate (W.N.4)	17,200
7. Current Asset Holding & Subsidiary	21,000
Joint Venture (50%)	34,500
	55,500

Working Notes:

1. Analysis of Profit & Loss of Associate / Joint Venture

		Pre-acquisition	Post-acquisition
Profit as on 31.3.20X1	27,000	16,000	11,000
Share of Associate company (20%)		3,200	2,200
Analysis of Profit and Loss of Joint Operation		Nil	83,000
Share of Joint Operation (50%)			41,500

2. Calculation of Goodwill/Capital Reserve

		Associate		Joint Operation
Investment		15,000		5,000
Less: Nominal Value	8,000		5,000	
Capital Profit	3,200	(11,200)	-	(5,000)
Goodwill		3,800		Nil

3. Calculation of Consolidated Profit and Loss Account `

Profit and Loss Account of Holding & Subsidiary	37,000
Add: Share of Associate (W.N.1)	2,200
Joint Operation (W.N.1)	41,500

	80,700
4. Calculation of Investment in Associate `	
Goodwill (W.N.2)	3,800
Net worth	11,200
Cost	15,000
Add: Share of Revenue Profit	2,200
	17,200

Note: Out of ` 17,000 existed at the time of acquisition, only ` 16,000 (Opening Balance) is continuing in the books of the associate. Therefore, ` 16,000 is taken as capital profit assuming that it is a part of that ` 17,000 existed at the time of acquisition.

1. Company X is engaged in the business of exploration & development of Oil & Gas Blocks.

Company X currently holds participating interest (PI) in below mentioned producing Block as follows:

Block Name	Company X	Company Y	Company Z	Total
AWM/01	30%	60%	10%	100%

For the above Block, Company X, Y & Z has entered into unincorporated Joint Venture.
Company Y is the Operator of the Block AWM/01. Company X & Company Z are the Joint Operators. Company Y incurs all the expenditure on behalf of Joint Venture and raise cash call to Company X & Company Z at each month end in respect of their share of expenditure incurred in Joint Venture. All the manpower and requisite facilities / machineries owned by the Joint venture and thereby owned by all the Joint Operators.

For past few months, due to liquidity issues, Company Z defaulted in payment of cash calls to operators. Therefore, company Y (Operator) has issued notice to company Z for withdrawal of their participating right from on 01.04.20 X1. However, company Z has filed the appeal with arbitrator on 30.04.20 X1.

Financial performance of company Z has not been improved in subsequent months and therefore company Z has decided to withdraw participating interest rights from Block AWM/01 and entered into sale agreement with Company X & Company Y. As per the terms of the agreement, dated 31.5.20X1, Company X will

receive 33.33% share & Company Y will receive 66.67% share of PI rights owned by Company Z.

Company X is required to pay `1 Lacs against 33.33% share of PI rights owned by Company Z.

After signing of sale agreement, Operator (company Y) approach government of India for modification in PSC (Production Sharing Contract) i.e. removal of Company Z from PSC of AWM/01 and government has approved this transaction on 30.6.20 X1. Government approval for the modification in PSC is essential given the industry in which the joint-operators operate.

Balance sheet of Company X & Company Z are as follows:

Particulars	Company X		Company Z	
	31.5.20X1	30.6.20X1	31.5.20X1	30.6.20X1
Assets Non-Current Assets Property, Plant & Equipment Right of Use Asset Development CWIP Financial Assets Loan receivable	 500,000 100,000 50,000 25,000	 10,00,000 200,000 100,000 50,000	 150,000 10,000 50,000 25,000	 300,000 20,000 100,000 50,000
Total Non-Current Assets	675,000	1350,000	235,000	470,000
Current assets Inventories Financial Assets Trade receivables Cash and cash equivalents Other Current Assets	 100,000 150,000 200,000 225,000	 200,000 300,000 400,000 50,000	 15,000 50,000 100,000 25,000	 30,000 100,000 200,000 50,000
Total Current Assets	675,000	950,000	190,000	380,000
Total Assets	1350,000	23,00,000	425,000	850,000
Equity and Liabilities Equity Equity share capital Other equity	 300,000 150,000	 300,000 300,000	 100,000 75,000	 100,000 250,000
Total Equity	500,000	600,000	175,000	350,000
Liabilities Non-Current Liabilities Provisions Other Liabilities	 400,000 150,000	 800,000 300,000	 100,000 50,000	 200,000 100,000
Total Non-Current Liabilities	550,000	11,00,000	150,000	300,000
Current Liabilities Financial Liabilities Trade Payables	 300,000	 600,000	 100,000	 200,000
Total Current Liabilities	300,000	600,000	100,000	200,000

Total Liabilities	13,50,000	23,00,000	425,000	850,000

Additional Information:

1. Fair Value of PPE & Development CWIP owned by Company Z as per Market participant approach is ` 5,00,000 & ` 2,00,000 respectively.

2. Fair Value of all the other assets and liabilities acquired are assumed to be at their carrying values (except cash & cash equivalents). Cash and cash equivalents of Company Z are not to be acquired by Company X as per the terms of agreement.

3. Tax rate is assumed to be 30%.

4. As per Ind AS 28, all the joint operators are joint ventures whereby each parties that have joint control of the arrangement have rights to the net assets of the arrangement and therefore every operator records their share of assets and liabilities in their books.

You need to determine the following:

1. Whether the above acquisition falls under business or asset acquisition as defined under business combination standard Ind AS 103?

2. Determine the acquisition date in the above transaction.

3. Prepare Journal entries for the above -mentioned transaction.

4. Draft the Balance Sheet for Company X based on your analysis in Part 1 above as at acquisition date. (RTP Nov 21) / (MTP Sep 22)

[video link: https://youtu.be/4BBd21zl_hM?t=98]

Answer

Ind AS 103 defines business as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

For a transaction to meet the definition of a business combination (and for the acquisition method of accounting to apply), the entity must gain control of an integrated set of assets and activities that is more than a collection of assets or a combination of assets and liabilities.

To be capable of being conducted and managed for the purpose identified in the definition of a business, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs.

Therefore, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output.

In the aforesaid transaction, Company X acquired share of part icipating rights owned by Company Z for the producing Block (AWM/01). The output exist in this transaction (Considering AWM/01) is a producing block. Also all the manpower and requisite facilities / machineries are owned by Joint venture and thereby all the Joint Operators. Hence, acquiring participating rights tantamount to acquire inputs (Expertise Manpower & Machinery) and it is critical to the ability to continue producing outputs. Thus, the said acquisition will fall under the Business Acquisition and hence standard Ind AS 103 is to be applied for the same.

(2) As per paragraph 8 of Ind AS 103, acquisition date is the date on which the acquirer obtains control of the acquiree. Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree —the closing date.

However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date. Since government of India (GOI) approval is a substantive approval for Company X to acquire control of Company Z's operations, the date of acquisition cannot be earlier than the date on which a pproval is obtained from GOI.
This is pertinent given that the approval from GOI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval. Hence acquisition date in the above scenario is 30.6.20X1.

Journal entry for acquisition

Particulars	Amount
Property Plant & Equipment Dr.	1,66,650
Right-of-use Asset Dr.	6,666
Development CWIP Dr.	66,660
Financial Assets - Loan Receivables Dr.	16,665
Inventories Dr.	9,999
Trade Receivables Dr.	33,330

Other Current Assets Dr. 16,665

To Provisions 66,660

To Other Liabilities 33,330

To Trade Payables 66,660

To Deferred Tax Liability 29,997

To Cash & Cash Equivalent (Purchase consideration) 1,00,000

To Gain on bargain purchase (Other Comprehensive Income) 19,988

(Being assets acquired and liabilities assumed from Company Z recorded at fair value along gain on bargain purchase)

(4) Balance Sheet of Company X as at 30.6.20X1

(Pre & Post Acquisition of PI rights pertaining to Company Z)

Particulars	Pre-Acquisition	Adjustments	Post-Acquisition
	30.6.20X1		30.6.20X1
Assets Non - Current Assets Property Plant & Equipment Right of Use Asset Development CWIP Financial Assets Loan receivable	 10,00,000 200,000 100,000 50,000	 166,650 6,666 66,660 16,665	 11,66,650 206,666 166,660 66,665
Total Non-Current Assets	13,50,000		16,06,641
Current assets Inventories Financial Assets Trade receivables Cash and cash equivalents Other Current Assets	 200,000 300,000 400,000 50,000	 9,999 33,330 (100,000) 16,665	 209,999 333,330 300,000 66,665
Total Current Assets	950,000		909,994
Total Assets	23,00,000		25,16,635
Equity and Liabilities Equity Equity share capital Other equity Capital Reserve (OCI)	 300,000 300,000 	 19,988	 300,000 300,000 19,988
Total Equity	600,000		619,988
Liabilities Non-Current Liabilities			

Provisions Other Liabilities Deferred Tax Liability	800,000 300,000	66,660 33,330 29,997	86,660 333,330 29,997
Total Non-Current Liabilities	11,00,000		12,29,987
Current Liabilities Financial liabilities Trade Payables	600,000	66,660	666,660
Total Current Liabilities	600,000		666,660
Total Equity and Liabilities	23,00,000		21,16,635

Working Notes

1. Determination of Company Z's balance acquired by Company X on 30.6.20X1 (Acquisition Date)

Particulars	As per Company Z Books	Carrying Value 33.33% Share	Acquisition Date Value	Remarks
	30.6.20X1			
Assets Non-Current Assets Property Plant & Equipment Right of Use Asset Development CWIP Financial Assets Loan receivable	 300,000 200,000 100,000 50,000	 99,990 6,666 33,330 16,665	 166,650 6,666 66,660 16,665	 Note 1 Note 2
Total Non-Current Assets	470,000	156,651	256,641	
Current assets Inventories Financial Assets Trade receivables Cash and cash equivalents Other Current Assets	 30,000 100,000 200,000 50,000	 9,999 33,330 66,660 16,665	 9,999 33,330 66,660 16,665	
Total Current Assets	380,000	126,654	126,654	
Liabilities Non-Current Liabilities Provisions Other Liabilities	 200,000 100,000	 66,660 33,330	 66,660 33,330	
Total Non-Current Liabilities	300,000	99,990	99,990	
Current Liabilities Financial liabilities Trade Payables	 200,000	 66,660	 66,660	
Total Current Liabilities	200,000	66,660	66,660	

Note 1: Fair Value of PPE:

Fair Value of PPE in Company Z Books ` 5,00,000

33.33% Share acquired by Company X ` 1,66,650

Note 2: Fair Value of Development CWIP:

Fair Value of PPE in Company Z Books	` 2,00,000
33.33% Share acquired by Company X	` 66,660

2. Computation Goodwill/Bargain Purchase Gain

Particulars	As at 30.6.20X1 (`)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ` 66,660) (1,26,654 – 66,660)	59,994
Total Non-Current Liabilities	(99,990)
Total Current Liabilities	(66,660)
Total Deferred Tax Liability (Refer Working note 3)	(29,997)
Net Assets Acquired	1,19,988
Less: Consideration Paid	(1,00,000)
Gain on Bargain Purchase (To be transferred to OCI)	19,988

*In extremely rare circumstances, an acquirer will make a bargain purchase in a business combination in which the value of net assets acquired in a business combination exceeds the purchase consideration. The acquirer shall recognise the resulting gain in other comprehensive income on the acquisition date and accumulate the same in equity as capital reserve, if the reason for bargain purchase gain is clear and evidence exist. If there does not exist clear evidence of the underlying reasons for classifying the business combination as a bargain purchase, then the gain shall be recognised directly in equity as capital reserve. Since in above scenario it is clearly evident that due to liquidity issues, Company Z has to withdraw their participating right from AWM/01. The said bargain purchase gain should be transferred to other comprehensive income on the acquisition date.

3. Computation of Deferred Tax Liability arising on Business Combination

Particulars	Acquisition Date Value (`)
Total Non - Current Assets	2,56,641
Total Current Assets (Except Cash & Cash Equivalent of ` 66,660)	59,994
Total Non-Current Liabilities	(99,990)

Total Current Liabilities	(66,660)
Net Assets Acquired at Fair Value	1,49,985
Book value of Net Assets Acquired	49,995
Temporary Difference	99,990
DTL @ 30% on Temporary Difference	29,997

Note: As per Ind AS 103, in case an entity acquires another entity step by step through series of purchase then the acquisition date will be the date on which the acquirer obtains control. Till the time the control is obtained the investment will be accounted as per the requirements of other Ind AS 109, if the in vestments are covered under that standard or as per Ind AS 28, if the investments are in Associates or Joint Ventures.

If a business combination is achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

Since in the above transaction, company X does not hold any prior interest in Company Z & company holds only 30% PI rights in Block AWM/01 through unincorporated joint venture, this is not a case of step acquisition.

Reverse Acquisition

4. (a) On September 30, 20X1, Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

The fair value of each ordinary share of Entity B at September 30, 20X1 is ` 40. The quoted market price of Entity A's ordinary shares at that date is ` 16.

The fair values of Entity A's identifiable assets and liabilities at September 30, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at September 30, 20X1 is 1,500.

The draft statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A	**Entity B**
	(legal parent,	**(legal subsidiary,**
	accounting acquiree)	**accounting acquirer)**

Current assets	**500**	**700**
Non-current assets	**1,300**	**3,000**
Total assets	**1,800**	**3,700**
Current liabilities	**300**	**600**
Non-current liabilities	**400**	**1,100**
Total liabilities	**700**	**1,700**
Shareholders' equity		
Retained earnings	**800**	**1,400**
Issued equity 100 ordinary shares	**300**	
60 ordinary shares		**600**
Total shareholders' equity	**1,100**	**2,000**
Total liabilities and shareholders' equity	**1,800**	**3,700**

Entity B's earnings for the annual period ended December 31, 20X0 were 600 and that the consolidated earnings for the annual period ended December 31, 20X1 were 800. Also there was no change in the number of ordinary shares issued by Entity B during the a nnual period ended December 31, 20X0 and during the period from January 1, 20X1 to the date of the reverse acquisition on September 30, 20X1.

Required:

Calculate the fair value of the consideration transferred, measure goodwill and prepare the consolidated balance sheet as on September 30, 20X1 as per Ind AS. Also compute Earnings per share as on December 31, 20X1 (MTP March 2018)

[video link: https://youtu.be/3JCNBdLcMZ8?t=128]

Answer

(a) Identifying the acquirer

As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer while Entity A is the legal acquirer.

Calculating the fair value of the consideration transferred

If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. Here, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500

Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1, 20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition) = 150

Number of shares outstanding from the acquisition date to December 31, 20X1 = 250

Weighted average number of ordinary shares outstanding [(150 × 9/12) + (250 × 3/12)] = 175

Earnings per share [800 / 175] = 4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)]

Consolidated Cash flow statement

3. (a) 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 (Rs.)

Revenue	**3,80,000**

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

Consolidated balance sheet	**20X2**	**20X1**
	Amount (Rs.)	**Amount (Rs.)**
Assets		
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 Rs. 74,000 in cash. The fair values of assets acquired and liabilities assumed were:

Particulars	**Amount (Rs.)**
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 statement of cash flows of Entity A. (MTP May 20) / (RTP May 20) / (Exam Nov 20)

[video lin: https://youtu.be/5eZJgfaSfo0, time: 42:13]

Answer

This information will be incorporated into the consolidated statement of cash flows as follows:

Statement of cash flows for 20X2 (extract)	Amount (Rs.)
Cash flows from opening activities	
Profit before taxation	70,000
Adjustments for non-cash items:	
Depreciation	30,000
Decrease in inventories (Note 1)	9,000
Decrease in trade receivables (Note 2)	4,000
Decrease in trade payables (Note 3)	(24,000)
Interest paid to be included in financing activities	4,000
Taxation (11,000 + 15,000 – 12,000)	(14,000)
Net cash inflow 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	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. Inventories

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

2. Trade Receivables

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

3. Trade Payables

Trade payables at the end of the year	Rs. 68,000
Trade payables of the subsidiary assumed during the year	(Rs.32,000)
	Rs. 36,000
Opening Trade payable	(Rs.60,000)
Decrease in Trade payables	Rs. 24,000

Chain Holding

1. Given below are the balance sheets of a group of companies comprising LX Limited, MX Limited and NX Limited as on 31st March 2021: ` in lakh

Particulars	LX Limited	MX Limited	NX Limited
Assets Non-current Assets Property, Plant and Equipment Investment	 1500	 1600	 1400

17.0 lakh share in MX Limited	2620		
9.6 lakh shares in NX Limited		1350	
Current Assets			
Inventories	1230	750	1180
Financial Assets			
Trade Receivables	1415	270	620
Bills Receivables	650	60	
Cash in hand and at Bank	1085	90	150
	8500	4100	3350
Equity and Liabilities			
Shareholders' Equity			
Share Capital (` 100 per share)	3400	2000	1600
Other Equity			
Reserves	1150	810	580
Retained earnings	1030	600	310
Current Liabilities			
Financial Liabilities			
Trade Payables	2920	690	805
Bills Payable			
MX Limited			55
	8500	4100	3350

LX Limited holds 85% shares in MX Limited, which were acquired on 1st April 2020 and MX Limited holds 60% shares in NX Limited, which were acquired on 30th September 2020.

The following balances stood in the books of MX Limited and NX Limited as on 1st April 2020:

	MX Limited	NX Limited
	` in lakh	` in lakh
Reserves	760	520
Retained earnings	480	150

The business activities of NX Limited are not seasonal in nature. The parent company has adopted an accounting policy to measure non - controlling interest at fair value applying Ind AS 103. The fair value is to be determined at quoted market price. The given market price of MX Limited is ` 120 per share and NX Limited is ` 125 per share.

Prepare the consolidated Balance Sheet as on 3 1st March 2021 of the group of companies LX Limited, MX Limited and NX Limited. (Exam July 2021) / (MTP May 20) / (Exam Nov 18) / (MTP April 22) / MTP Oct 22 / Exam Nov 22

[video link: https://youtu.be/3JCNBdLcMZ8?t=1096]

Answer

Consolidated Balance Sheet of the Group as at 31st March, 2021

Particulars	Note No.	` in lakh
ASSETS		
Non-current assets		
Property, plant and equipment	1	4,500.00
Current assets		
(a) Inventories	2	3,140.00
(b) Financial assets		
Trade receivables	3	2,305.00
Bills receivables	4	655.00
Cash and cash equivalents	5	1,325.00
Total assets		11,925.00
EQUITY & LIABILITIES		
Equity attributable to owners of parent		
Share Capital		3,400.00
Other Equity	6	2,893.10
Non-controlling interests (W.N.4)		1,216.90
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
Trade payables	7	4,415.00
Total equity and liabilities		11,925.00

Notes to Accounts (` in lakh)

1. Property Plant & Equipment		
LX Ltd.	1,500	
MX Ltd.	1,600	
NX Ltd.	1,400	4,500

2. Inventories		
LX Ltd.	1,230	
MX Ltd.	730	
NX Ltd.	1,180	3,140
3. Trade Receivables		
LX Ltd.	1,415	
MX Ltd.	270	
NX Ltd.	620	2,305
4. Bills Receivables		
LX Ltd.	650	
MX Ltd. (60-55)	5	655
5. Cash & Cash equivalents		
LX Ltd.	1,085	
MX Ltd.	90	
NX Ltd.	150	1,325
6. Other Equity		
Reserve (W.N.5)	1207.80	
Retained earnings (W.N.5)	1172.80	
Capital Reserve (W.N.3)	512.50	2893.10
7. Trade Payables		
LX Ltd.	2,920	
MX Ltd.	690	
NX Ltd.	805	4,415

Working Notes:

1. Analysis of Reserves and Surplus (` in lakh)

	MX Ltd.	NX Ltd.
Reserves as on 1.4.2020	760	520
Increase during the year 2020-2021 (580 - 520)	60	

Increase for the half year till 30.9.2020		30
Balance on acquisition date (A)	760	550
Total balance as on 31.3.2021	810	580
Post-acquisition balance	50	30
Retained Earnings as on 1.4.2020	480	150
Increase during the year 2020-2021 (310 - 150) 160		
Increase for the half year till 30.9.2020		80
Balance on acquisition date (B)	480	230
Total balance as on 31.3.2021	600	310
Post-acquisition balance	120	80
Total balance on the acquisition date (A+B)	1,240	780

2. Calculation of Effective Interest of LX Ltd. in NX Ltd.

Acquisition by LX Ltd. in MX Ltd. = 85%

Acquisition by MX Ltd. in NX Ltd. = 60%

Acquisition by Group in NX Ltd. (85% x 60%) = 51%

Non-controlling Interest = 49%

3. Calculation of Goodwill / Capital Reserve on the acquisition

	MX Ltd.	NX Ltd.
Investment or consideration	2,620.00	(1,350 x 85%)
		1,147.50
Add: NCI at Fair value		
[(2,000 / 100) x 120 x 15%]	360.00	
[(1,600 / 100) x 125 x 49%]	-	980.00
	2,980.00	2,127.50
Less: Identifiable net assets (Share Capital + Increase in the Reserves and Surplus till acquisition date)	(2,000+760+480)	(1600 + 550 + 230)

	(3,240.00)	(2,380.00)
Capital Reserve	260.00	252.50
Total Capital Reserve (260 + 252.50)	512.50	

4. Calculation of Non-controlling Interest

	MX Ltd.	NX Ltd.
At Fair Value (See Note 3)	360.00	980.00
Add: Post Acquisition Reserves (W.N.1)	(50 x 15%) 7.50	(30 x 49%) 14.70
Add: Post Acquisition Retained Earnings (W.N.1)	(120 x 15%) 18.00	(80 x 49%) 39.20
Less: NCI share of investment in NX Ltd.	(1,350 x 15%) (202.50)*	
	183.00	1,033.90
Total (183.00 + 1,033.90)		1,216.90

*Note: The non-controlling interest in MX Ltd. will take its proportion in NX Ltd. Therefore, they have to bear their proportion in the investment by MX Ltd. (in NX Ltd.)
also.

5. Calculation of Consolidated Other Equity

	Reserves	Retained Earnings
LX Ltd.	1,150.00	1,030.00
Add: Share in MX Ltd.	(50 x 85%) 42.50	(120 x 85%) 102.00
Add: Share in NX Ltd.	(30 x 51%) 15.30	(80 x 51%) 40.80
	1,207.80	1,172.80